

# THE REDWOOD REVIEW

## THIRD QUARTER 2017



REDWOOD TRUST

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## CAUTIONARY STATEMENT

This Redwood Review contains 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, goals, 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 and our Quarterly Reports on Form 10-Q 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 forward-looking statements, whether as a result of new information, future events, or otherwise.

Statements regarding the following subjects, among others, are forward-looking by their nature: (i) statements we make regarding Redwood’s business strategy and strategic focus, including statements relating to our overall market position, strategy and long-term prospects; (ii) statements related to our financial outlook and expectations for 2017, including with respect to: 2017 GAAP earnings, our investment portfolio, net interest income on our portfolio of residential loans held for investment, residential securities, and multifamily securities, our MSR portfolio, deployment of capital available for investment, residential mortgage banking activities, operating expenses, our effective tax rate and tax provision, and investment return targets for our investment portfolio and mortgage banking operations; (iii) statements regarding our long-term debt and upcoming maturity of convertible notes in 2018; (iv) statements regarding our investment portfolio, including the potential impact of changes to the capital requirement under our FHLB borrowing facility; (v) statements regarding our mortgage banking activities, including expectations relating to residential mortgage banking margins, securitization execution, loan purchase volume, and our expanded-prime Redwood Choice loan program; (vi) statements relating to acquiring residential mortgage loans in the future that we have identified for purchase or plan to purchase, including the amount of such loans that we identified for purchase during the third quarter of 2017 and at September 30, 2017, and expected fallout and the corresponding volume of residential mortgage loans expected to be available for purchase; (vii) statements relating to our estimate of our available capital (including that we estimate our available capital at September 30, 2017 was approximately \$330 million, expectations relating to our upcoming \$250 million convertible debt maturity, and that we believe we can source incremental capital on an as-needed basis for redeployment through continued optimization of our investment portfolio); (viii) statements we make regarding our dividend policy, including our intention to pay a regular dividend of \$0.28 per share per quarter in 2017; and (ix) statements regarding our expectations and estimates relating to the characterization for income tax purposes of our dividend distributions, our expectations and

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estimates relating to tax accounting, tax liabilities and tax savings, and GAAP tax provisions, and our estimates of REIT taxable income and TRS taxable income.

Important factors, among others, that may affect our actual results include:

- the pace at which we redeploy our available capital into new investments;
- interest rate volatility, changes in credit spreads, and changes in liquidity in the market for real estate securities and loans;
- changes in the demand from investors for residential mortgages and investments, and our ability to distribute residential mortgages through our whole-loan distribution channel;
- our ability to finance our investments in securities and our acquisition of residential mortgages with short-term debt;
- changes in the values of assets we own;
- general economic trends, the performance of the housing, real estate, mortgage, credit, and broader financial markets, and their effects on the prices of earning assets and the credit status of borrowers;
- federal and state legislative and regulatory developments, and the actions of governmental authorities, including the new U.S. presidential administration, and in particular those affecting the mortgage industry or our business (including, but not limited to, the Federal Housing Finance Agency's rules relating to FHLB membership requirements and the implications for our captive insurance subsidiary's membership in the FHLB);
- strategic business and capital deployment decisions we make;
- developments related to the fixed income and mortgage finance markets and the Federal Reserve's statements regarding its future open market activity and monetary policy;
- our exposure to credit risk and the timing of credit losses within our portfolio;
- the concentration of the credit risks we are exposed to, including due to the structure of assets we hold and the geographical concentration of real estate underlying assets we own;
- our exposure to adjustable-rate mortgage loans;
- the efficacy and expense of our efforts to manage or hedge credit risk, interest rate risk, and other financial and operational risks;
- changes in credit ratings on assets we own and changes in the rating agencies' credit rating methodologies;
- changes in interest rates;
- changes in mortgage prepayment rates;
- changes in liquidity in the market for real estate securities and loans;
- our ability to finance the acquisition of real estate-related assets with short-term debt;
- the ability of counterparties to satisfy their obligations to us;
- our involvement in securitization transactions, the profitability of those transactions, and the risks we are exposed to in engaging in securitization transactions;
- exposure to claims and litigation, including litigation arising from our involvement in securitization transactions;

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- ongoing litigation against various trustees of RMBS transactions;
- whether we have sufficient liquid assets to meet short-term needs;
- our ability to successfully compete and retain or attract key personnel;
- our ability to adapt our business model and strategies to changing circumstances;
- changes in our investment, financing, and hedging strategies and new risks we may be exposed to if we expand our business activities;
- our exposure to a disruption or breach of the security of our technology infrastructure and systems;
- exposure to environmental liabilities;
- our failure to comply with applicable laws and regulations;
- our failure to maintain appropriate internal controls over financial reporting and disclosure controls and procedures;
- the impact on our reputation that could result from our actions or omissions or from those of others; changes in accounting principles and tax rules;
- our ability to maintain our status as a REIT for tax purposes;
- limitations imposed on our business due to our REIT status and our status as exempt from registration under the Investment Company Act of 1940;
- decisions about raising, managing, and distributing capital; and
- other factors not presently identified.

This Redwood Review 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.

## INTRODUCTION

### Note to Readers:

We file annual reports (on Form 10-K) and quarterly reports (on Form 10-Q) with the Securities and Exchange Commission. These filings and our earnings press releases provide information about Redwood and our financial results in accordance with generally accepted accounting principles (GAAP). We urge you to review these documents, which are available through our website, [www.redwoodtrust.com](http://www.redwoodtrust.com).

This document, called The Redwood Review, is an additional format for providing information about Redwood through a discussion of our GAAP financial results, as well as other metrics, such as taxable income. Supplemental information is also provided in the Financial Tables in this Review to facilitate more detailed understanding and analysis of Redwood. We also provide non-GAAP financial measures in this Review. When we use non-GAAP financial measures it is because we believe that these figures provide additional insight into Redwood's business. In each case in which we discuss a non-GAAP financial measure we provide an explanation of how it has been calculated, why we think the figure is important, and a reconciliation between the GAAP and non-GAAP figures.

References herein to "Redwood," the "company," "we," "us," and "our" include Redwood Trust, Inc. and its consolidated subsidiaries. Note that because we round numbers in the tables to millions, except per share amounts, some numbers may not foot due to rounding. References to the "third quarter" refer to the quarter ended September 30, 2017, and references to the "second quarter" refer to the quarter ended June 30, 2017, unless otherwise specified.

We hope you find this Review helpful to your understanding of our business. We thank you for your input and suggestions, which have resulted in our changing the form and content of The Redwood Review over time.

Selected Financial Highlights					
Quarter:Year	GAAP Income per Share	REIT Taxable Income per Share <sup>(1)</sup>	Annualized GAAP Return on Equity	GAAP Book Value per Share	Dividends per Share
Q317	\$0.41	\$0.26	12%	\$15.67	\$0.28
Q217	\$0.43	\$0.25	12%	\$15.29	\$0.28
Q117	\$0.43	\$0.22	13%	\$15.13	\$0.28
Q416	\$0.31	\$0.34	9%	\$14.96	\$0.28
Q316	\$0.58	\$0.34	19%	\$14.74	\$0.28
Q216	\$0.48	\$0.36	15%	\$14.20	\$0.28
Q116	\$0.15	\$0.23	4%	\$14.17	\$0.28
Q415	\$0.46	\$0.37	14%	\$14.67	\$0.28
Q315	\$0.22	\$0.29	6%	\$14.69	\$0.28

(1) REIT taxable income per share for 2017 is an estimate until we file our tax return.

**Dear Fellow Shareholders:**

Recent events have laid bare the competitive imbalance between mankind and Mother Nature, and our thoughts remain with those impacted by the hurricanes and, closer to home, the recent Bay Area wildfires.

We made strong tactical and financial progress in the third quarter, positioning ourselves to achieve the operating metrics we set out for the year and build momentum as we head towards 2018. Perhaps most importantly, we completed our executive search process with the hiring of Dash Robinson, who started with us in late September in his capacity as Executive Vice President. We also completed three highly successful securitization issuances, including our first expanded-prime Choice transaction, and issued convertible debt at an attractive level. We put \$119 million of capital to work in new investments, much of it after the event-driven spread widening in early September. We timed our capital deployment well, as market technicals re-asserted themselves and credit spreads largely retraced their widening, in most cases finishing the quarter at or above June 30th levels.

In this letter, we'll touch on our financial results for the quarter, then go through our recent mortgage banking activities and our thoughts on capital and investing. We'll conclude with our outlook for the balance of 2017.

**Financial Results**

Our quarterly financial metrics continue to reflect strength in both our Mortgage Banking and Investment Portfolio segments. Our GAAP book value per share increased to \$15.67 at September 30th, from \$15.29 at June 30th. We generated GAAP earnings per share of \$0.41, as compared with \$0.43 in the second quarter of 2017, and non-GAAP core earnings of \$0.35 per share, consistent with the second quarter of 2017. Further details on, and a reconciliation of, these metrics can be found in the Quarterly Overview section of this Redwood Review.

**Residential Mortgage Banking**

Our mortgage banking team had a very strong third quarter, with our expanded product rollout continuing to drive outperformance. Our initial Choice securitization, backed by \$318 million of loans, was received favorably by the market, and attracted a good number of both new and existing investors. The issuance created \$31 million of investments for our portfolio, utilizing approximately \$13 million of capital - more than double what is produced through a traditional Sequoia transaction. Given the current pace and expected growth of Choice purchases, we expect to issue Choice transactions on a regular basis.

We also completed our fifth and sixth traditional Sequoia securitizations of the year during the third quarter, backed by loans totaling \$839 million; this was followed closely by another Sequoia issuance in early October. In addition, we sold \$212 million of whole loans to portfolio buyers during the third quarter.

As spreads for loans and RMBS have tightened, we have become more competitive with bank retail and correspondent mortgage channels and our loan purchase volumes have risen. Loan purchase commitments, adjusted for fallout, increased to \$1.6 billion in the third quarter of 2017, up from \$1.4 billion and \$1.1 billion in the second and first quarters of 2017, respectively. We had strong growth during the third quarter with our Choice program, which accounted for approximately 30% of our total third quarter loan purchase commitments, adjusted for fallout, versus approximately 20% in the second quarter of 2017. Overall margins remained at or above our long-term expectations of 75-100 bps during the third quarter.

### **Capital and Investing**

We aggressively pursued new investments in September when volatility due to hurricane activity drove spreads wider. The bulk of the quarter's \$119 million of capital deployment occurred during this period, and included \$63 million in GSE residential credit risk transfer (CRT) securities, \$39 million in Sequoia and third-party RMBS, and \$17 million in multifamily securities. Year-to-date, we deployed \$393 million of capital towards new investments (including \$37 million of debt repurchases).

We also sold \$49 million of mostly lower-yielding securities in the third quarter, freeing up \$20 million of capital for reinvestment, after the repayment of associated debt. Additionally, we issued \$245 million of six-year, 4.75% convertible debt in August.

As of September 30, 2017, we estimate that our available capital was approximately \$330 million, versus \$180 million at June 30, 2017. Although we continue to evaluate our options with regard to our upcoming \$250 million convertible debt maturity, at current market prices the excess cost to retire this debt prior to maturity is unattractive relative to alternative short-term uses of cash. In addition, we believe we can source incremental capital on an as-needed basis for redeployment through the continued optimization of our investment portfolio.

We continue to evaluate the potential impact of hurricane activity in Houston and Florida on our investment portfolio, although it is still very early in the process. The vast majority of our non-Agency loans and securities were not impacted by the storms and, to date, we have not incurred any realized losses related to properties in the affected areas. Although we did see some impact to pricing from the hurricanes, most of our investments had positive net market valuation adjustments as the benefit from overall spread tightening exceeded any negative impact from the hurricanes.

## Outlook

As we progress through the fourth quarter, our year-to-date operating metrics are validating the full-year guidance we provided in the Q4 2016 Redwood Review. While investment portfolio returns have been bolstered by persistent spread tightening, we have also maintained consistent levels of net interest income and have refined our portfolio mix by selling lower-yielding securities when appropriate. Mortgage banking margins continue to be robust and we are encouraged by the relative mix of Select and Choice loans in our pipeline.

We remain cognizant of forces outside of our control (both financial and otherwise) and their potential impact on our business. With this backdrop, a fully-seated executive team is an important milestone as we continue to think critically about our business assumptions and look ahead to next year and beyond.

As we have done in the past, we plan to provide our outlook for next year with our year-end letter in February 2018. We thank you for your continued support.



Marty Hughes  
Chief Executive Officer



Christopher J. Abate  
President

### Third Quarter Highlights

- ▶ Our GAAP earnings were \$0.41 per share for the third quarter of 2017, as compared with \$0.43 per share for the second quarter of 2017. Higher mortgage banking income and interest income were offset by higher interest costs and less benefit from spread tightening on the fair value of our trading securities portfolio relative to the second quarter.
- ▶ Our non-GAAP core earnings were \$0.35 per share for the third quarter of 2017, consistent with \$0.35 per share for the second quarter of 2017. For details on GAAP and core earnings, please see the *GAAP Net Income and Reconciliation to Non-GAAP Core Earnings* section that follows on page 10.
- ▶ Our GAAP book value was \$15.67 per share at September 30, 2017, as compared with \$15.29 per share at June 30, 2017. This increase was driven primarily by our quarterly earnings exceeding our dividend, and higher fair values on our available-for-sale securities.
- ▶ We deployed \$119 million of capital in the third quarter of 2017 toward new investments, including \$63 million in Agency residential CRT securities, \$39 million in Sequoia and third-party RMBS, and \$17 million in Agency multifamily securities. Year-to-date, we have deployed \$393 million of capital into new investments (including \$37 million of debt repurchases).
- ▶ We sold \$49 million of securities during the third quarter of 2017, freeing up \$20 million of capital for reinvestment after the repayment of associated debt. Year-to-date, we have sold \$148 million of mostly lower-yielding securities and \$53 million of conforming MSRs, freeing up \$131 million of capital for reinvestment after the repayment of associated debt.
- ▶ We purchased \$1.5 billion of residential jumbo loans during the third quarter of 2017, and \$3.8 billion year-to-date. At September 30, 2017, our pipeline of jumbo residential loans identified for purchase was \$1.5 billion.
- ▶ Residential loan sales totaled \$1.4 billion during the third quarter of 2017 and included \$0.2 billion of whole loan sales to third parties and \$1.2 billion of loans that were securitized. Year-to-date, residential loan sales have totaled \$3.5 billion, and included \$0.9 billion of whole loan sales to third parties and \$2.6 billion of loans that were securitized in seven separate transactions, including our first expanded-prime Choice securitization.
- ▶ We issued \$245 million of six-year, 4.75% convertible debt during the third quarter of 2017.
- ▶ For an updated discussion of our key business drivers in 2017, please see the 2017 Financial Outlook section of this Redwood Review.

## GAAP Net Income and Reconciliation to Non-GAAP Core Earnings

Below we present GAAP net income and a reconciliation to non-GAAP core earnings for the third and second quarters of 2017. Further information about Redwood's core earnings measure is included in the *Core Earnings Definition* section of the *Appendix*.

<b>GAAP Net Income and Reconciliation to Non-GAAP Core Earnings</b>			
(\$ in millions, except per share data)			
	Three Months Ended		
	9/30/2017	6/30/2017	
Interest income	\$ 63	\$ 59	
Interest expense	(27)	(24)	
<b>Net interest income</b>	<b>35</b>	<b>35</b>	
Non-interest income			
Mortgage banking activities, net	21	12	
MSR income, net	2	3	
Investment fair value changes, net	—	8	
Other income	1	1	
Realized gains, net	2	1	
<b>Total non-interest income, net</b>	<b>26</b>	<b>25</b>	
Operating expenses	(20)	(19)	
Provision for income taxes	(5)	(5)	
<b>GAAP net income</b>	<b>\$ 36</b>	<b>\$ 36</b>	
<b>Core earnings adjustments</b>			
Eliminate mark-to-market changes on long-term investments and associated derivatives <sup>(1)</sup>	(6)	(14)	
Include cumulative gain (loss) on long-term investments sold, net <sup>(2)</sup>	1	4	
Income tax adjustments associated with core earnings adjustments <sup>(3)</sup>	(1)	2	
<b>Non-GAAP core earnings</b>	<b>\$ 30</b>	<b>\$ 29</b>	
<b>GAAP net income per diluted common share</b>	<b>\$ 0.41</b>	<b>\$ 0.43</b>	
<b>Non-GAAP core earnings per diluted common share <sup>(4)</sup></b>	<b>\$ 0.35</b>	<b>\$ 0.35</b>	

(1) Adjustments eliminate the mark-to-market changes on the fair value of loans held-for-investment, trading securities, other investments, and associated derivatives that are primarily related to changes in benchmark interest rates and credit spreads. Details on the components of investment fair value changes, net, are included in the *Financial Insights* section of this Redwood Review.

(2) Adjustment includes the cumulative net gains or losses on long-term investments accounted for as trading securities under GAAP that were sold during the period presented, net of any realized gains or losses from derivatives associated with the investments sold. Cumulative gains and losses are calculated by multiplying the difference between the sales price and original purchase price by the face value of the securities sold.

(3) We apply estimated effective tax rates to core earnings adjustments occurring within Redwood's taxable REIT subsidiaries to estimate the hypothetical income tax expense or benefit associated with those adjustments.

(4) Consistent with the calculation of net income per diluted common share for GAAP purposes, non-GAAP core earnings per diluted common share is calculated following the "two-class" method. Additional information on the calculation of core earnings using the "two-class" method can be found in Table 2 in the *Financial Tables* section of the *Appendix* to this Redwood Review.

### *Analysis of Earnings*

- ▶ Net interest income of \$35 million for the third quarter was consistent with the second quarter of 2017. Higher interest income from capital deployment and a higher average balance of loans held-for-sale relative to the second quarter was offset by higher interest costs as a result of our convertible debt offering in August and higher interest costs on our portfolio investments.
- ▶ Mortgage banking activities, net, increased to \$21 million for the third quarter, from \$12 million for the second quarter of 2017, driven by higher loan purchase volume and higher gross margins primarily due to improved securitization execution.
- ▶ MSR income, net, was \$2 million for the third quarter, as compared with \$3 million for the second quarter of 2017, reflecting the sale of substantially all of our remaining conforming MSRs during the second quarter.
- ▶ Investment fair value changes, net, on a GAAP basis were less than \$1 million for the third quarter, as compared with \$8 million for the second quarter of 2017, reflecting a decline in benefit from spread tightening in the third quarter relative to the second quarter. On a non-GAAP core earnings basis, after eliminating certain mark-to-market changes on long-term investments (and associated derivatives), investment fair value changes, net, were negative \$6 million for the third quarter of 2017, consistent with the second quarter of 2017.
- ▶ For GAAP purposes, we realized gains of \$2 million during the third quarter, which were primarily related to the sale of \$23 million of available-for-sale securities, as compared with realized gains of \$1 million during the second quarter of 2017, which included \$2 million of gains from the sale of \$19 million of available-for-sale securities and a \$1 million loss from the repurchase of \$37 million of convertible debt. For non-GAAP core earnings, we include the cumulative net gains or losses on trading securities sold. This adjustment increased realized gains, net to \$3 million for the third quarter, as compared with \$5 million for the second quarter.
- ▶ Operating expenses were \$20 million for the third quarter, as compared with \$19 million for the second quarter of 2017. Third quarter operating expenses included upfront costs associated with hiring a new executive officer and variable compensation commensurate with our year-to-date results.
- ▶ We recorded a tax provision of \$5 million during the third quarter, consistent with the second quarter, as a decrease in fair value changes on first-loss CRT securities held at the taxable REIT subsidiary (TRS) level offset higher mortgage banking income. A reconciliation of GAAP and taxable income is set forth in Table 4 in the *Financial Tables* section of the *Appendix* to this Redwood Review.
- ▶ Additional details on our earnings are included in the *GAAP Results by Business Segment* portion of the *Financial Insights* section that follows.

## GAAP Book Value

Our GAAP book value at September 30, 2017 was \$15.67 per share, as compared with \$15.29 per share at June 30, 2017. The following table sets forth the changes in Redwood's GAAP book value per share for the third and second quarters of 2017.

	Three Months Ended	
	9/30/2017	6/30/2017
Beginning book value per share	\$ 15.29	\$ 15.13
Earnings	0.41	0.43
Changes in unrealized gains on securities, net from:		
Realized gains recognized in earnings	(0.03)	(0.02)
Amortization income recognized in earnings	(0.05)	(0.05)
Mark-to-market adjustments, net	0.27	0.09
Total change in unrealized gains on securities, net	0.19	0.02
Dividends	(0.28)	(0.28)
Equity compensation, net	0.02	—
Changes in unrealized losses on derivatives hedging long-term debt	—	(0.03)
Other, net	0.04	0.02
<b>Ending book value per share</b>	<b>\$ 15.67</b>	<b>\$ 15.29</b>

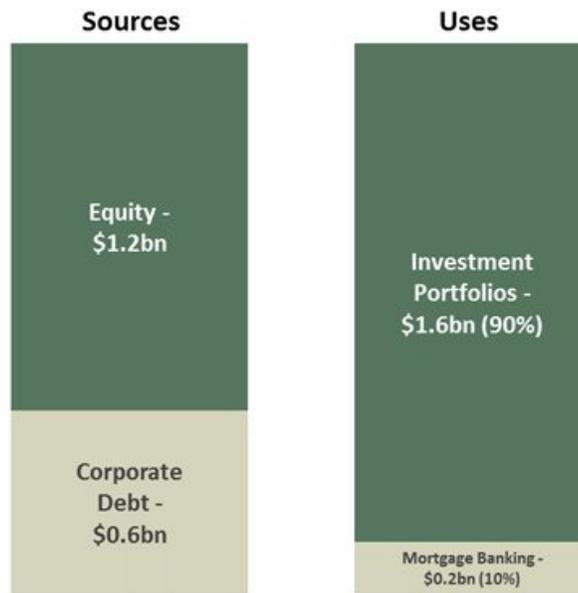
- ▶ Our GAAP book value per share increased \$0.38 per share to \$15.67 per share during the third quarter of 2017. This increase was driven primarily by positive mark-to-market adjustments on our available-for-sale securities and our quarterly earnings exceeding our dividend.
- ▶ Unrealized gains on our available-for-sale securities increased \$0.19 per share during the third quarter of 2017, primarily as a result of a positive \$0.27 per share mark-to-market adjustment on our available-for-sale securities due to spread tightening during the quarter. This increase was partially offset by \$0.05 per share of discount accretion income recognized in earnings from the appreciation in the amortized cost basis of our available-for-sale securities, and \$0.03 per share of previously unrealized net gains that were realized as income from the sale of securities.

### Capital Allocation Summary

We use a combination of equity and corporate debt (which we collectively refer to as “capital”) to fund our business. Our total capital at September 30, 2017 was \$1.8 billion, of which \$1.6 billion (or 90%) was allocated to our investments, with the remaining \$170 million (or 10%) allocated to our residential mortgage banking activities.

#### Capital Allocation: By Source and By Business Use

(as of September 30, 2017)



- ▶ Our total capital of \$1.8 billion at September 30, 2017 included \$1.2 billion of equity capital and \$0.6 billion of the total \$2.6 billion of long-term debt on our consolidated balance sheet. This portion of debt includes \$201 million of exchangeable debt due in 2019, \$245 million of convertible debt due in 2023, and \$140 million of trust-preferred securities due in 2037. This portion of debt has a weighted average cost of approximately 6.1% per annum.
- ▶ As of September 30, 2017, we estimate that our available capital was approximately \$330 million. Although we continue to evaluate our options with regard to our upcoming \$250 million convertible debt maturity, at current market prices the excess cost to retire this debt prior to maturity is unattractive relative to alternative short-term uses of cash. In addition, we believe we can source incremental capital on an as-needed basis for redeployment through continued optimization of our investment portfolio.
- ▶ We also utilize various forms of short-term and long-term collateralized debt to finance certain investments and to warehouse our inventory of certain residential loans held-for-sale. We do not consider this collateralized debt as "capital" and, therefore, exclude it from our capital allocation analysis.
- ▶ Further details on our capital allocation are included in the *Analysis of Capital Allocation* section.

2017 Financial Outlook

Allocation of Capital and Return Profile						
By Investment Type						
September 30, 2017						
(\$ in millions)						
	Fair Value	Collateralized Debt	Allocated Capital	% of Total Capital	YTD 2017 Annualized Return <sup>(1)</sup>	Original 2017 Return Target <sup>(1)</sup>
<b>Investment portfolio</b>						
Residential loans/FHLB stock	\$ 2,312	\$ (2,000)	\$ 312	17%	15%	12%-16%
Residential securities <sup>(2)</sup>	1,144	(371)	774	43%	14%	10%-12%
Multifamily securities <sup>(3)</sup>	243	(179)	64	4%	20%	8%-10%
Mortgage servicing rights	63	—	63	4%	6%	7%-9%
Other assets/(other liabilities)	187	(54)	133	7%	—%	N/A
Cash and liquidity capital			267	15%	—%	N/A
<b>Total investments</b>	<b>\$ 3,949</b>	<b>\$ (2,604)</b>	<b>\$ 1,613</b>	<b>90%</b>	<b>14%</b>	<b>9%-11%</b>
<b>Residential mortgage banking</b>			<b>\$ 170</b>	<b>10%</b>	<b>28%</b>	<b>10%-20%</b>
<b>Total</b>			<b>\$ 1,783</b>	<b>100%</b>		

(1) Includes net interest income, change in fair value of the investments and their associated hedges that flow through GAAP earnings, realized gains, direct operating expenses, taxes, and other income. Excludes unrealized gains and losses on our AFS securities portfolio, and corporate operating expenses. Returns are calculated based on average capital allocated during the year.

(2) In addition to our \$1.1 billion of residential securities on our GAAP balance sheet, residential securities presented above also include our \$31 million economic investment in our Sequoia Choice securitization, which represents the fair value of the securities we retained from this securitization. For GAAP purposes, we consolidated this Sequoia Choice securitization.

(3) Multifamily securities include \$20 million of investment grade CMBS.

- Our residential loans/FHLB stock investment generated an annualized return of 15% on average capital in the first nine months of 2017, in line with our original 2017 return target. These returns included \$54 million of net interest income, and an expense of \$11 million related to the change in valuation of these loans and associated derivatives. In October, the FHLB increased the capital requirement on our borrowing facility, which increases the portion of loans we hold with equity relative to what was required previously. As a result of this change, we expect returns in the fourth quarter to be at the lower end of our original 2017 return target of 12%-16% for this portfolio.

## QUARTERLY OVERVIEW

- ▶ Our residential securities portfolio generated an annualized return of 14% on average capital in the first nine months of 2017, above our original 2017 return target. These returns included \$55 million of net interest income, income of \$12 million from the net positive change in valuation of these securities and associated derivatives, and \$10 million of realized gains from securities sales. We expect fourth quarter returns to be within our original 2017 return target of 10%-12% for this portfolio.
- ▶ Our multifamily securities generated an annualized return of 20% on average capital in the first nine months of 2017, significantly above our original 2017 return target. This included \$5 million of net interest income and income of \$13 million from the net positive change in valuation of these securities and associated derivatives. We expect fourth quarter returns to be within our original 2017 return target of 8%-10%.
- ▶ Our MSR portfolio generated an annualized return of 6% on average capital in the first nine months of 2017. We expect fourth quarter returns to be within our original 2017 return target of 7%-9%.
- ▶ Our residential mortgage banking operations generated an annualized return of 28% on average capital in the first nine months of 2017. These results benefited from spread tightening on securitization execution. For the remainder of 2017, we expect margins to be more in line with our long-term expectations of 75-100 basis points per loan. Additionally, we continue to expect to purchase \$5 billion to \$6 billion of loans for the full year 2017, with higher-yielding Redwood Choice loans comprising 15%-20% of our overall purchase volume.
- ▶ Our tax provision was \$17 million in the first nine months of 2017, and is included in the year-to-date returns noted above. Our tax provision is primarily driven by our mortgage banking and mortgage servicing activities, which are performed at our taxable REIT subsidiaries. Our estimated effective tax rate on mortgage banking income is between 25% and 30%. For the remainder of 2017, our tax provision will primarily be correlated to our mortgage banking results.

As with all forward-looking statements, our forward-looking statements relating to our 2017 financial outlook are subject to risks and uncertainties, including, among other things, those described in our Annual Report on Form 10-K and in our Quarterly Reports on Form 10-Q under the caption "Risk Factors" and other risks, uncertainties, and factors that could cause actual results to differ materially from those described above, including those described below and in the "Cautionary Statement" at the beginning of this Redwood Review. Although we may update our 2017 financial outlook subsequently in 2017, as a general matter we undertake no obligation to update or revise forward-looking statements, whether as a result of new information, future events, or otherwise.

## QUARTERLY OVERVIEW

Important factors, among others, that may affect our actual results in 2017 include: the pace at which we redeploy our available capital into new investments; interest rate volatility, changes in credit spreads, and changes in liquidity in the market for real estate securities and loans; changes in the demand from investors for residential mortgages and investments, and our ability to distribute residential mortgages through our whole-loan and securitization distribution channels; our ability to finance our investments in securities and our acquisition of residential mortgages with short-term debt; the availability of assets for purchase at attractive risk-adjusted returns and our ability to reinvest the proceeds from the potential sale of securities and investments we hold; changes in the values of assets we own; higher than expected operating expenses; and other unforeseen expenses.

## GAAP Results by Business Segment

We report on our business using two distinct segments: Investment Portfolio and Residential Mortgage Banking. The *Redwood's Business Overview* section located in the *Appendix* of this Redwood Review includes full descriptions of these segments and how they fit into Redwood's business model. The following table presents the results from each of these segments reconciled to our GAAP net income for the third and second quarters of 2017.

<b>Segment Results Summary</b> <sup>(1)</sup>			
(\$ in millions)			
	Three Months Ended		
	9/30/2017	6/30/2017	
Segment contribution from:			
Investment portfolio	\$ 42	\$ 50	
Residential mortgage banking	17	7	
Corporate/Other	(22)	(21)	
<b>Net income</b>	<b>\$ 36</b>	<b>\$ 36</b>	

(1) See Table 3 in the *Financial Tables* section of the *Appendix* to this Redwood Review for a more comprehensive presentation of our segment results.

***Investment Portfolio***

The following table presents the results of our Investment Portfolio segment for the third and second quarters of 2017.

<b>Segment Results - Investment Portfolio</b>			
(\$ in millions)			
	Three Months Ended		
	9/30/2017	6/30/2017	
Net interest income			
Residential securities	\$ 19	\$ 18	
Residential loans	17	18	
Multifamily and commercial investments	1	2	
<b>Total net interest income</b>	<b>38</b>	<b>39</b>	
Non-interest income			
MSR income, net	2	3	
Investment fair value changes, net	1	9	
Other income	1	1	
Realized gains, net	2	2	
<b>Total non-interest income, net</b>	<b>6</b>	<b>15</b>	
Direct operating expenses	(1)	(1)	
Provision for income taxes	—	(2)	
<b>Segment contribution</b>	<b>\$ 42</b>	<b>\$ 50</b>	

- ▶ The contribution from this segment decreased from the second quarter of 2017, primarily as a result of reduced benefit from spread tightening on the fair value of our trading securities portfolio relative to the second quarter. As a result of these lower mark-to-market adjustments, investment fair value changes, net, was positive \$1 million for the third quarter of 2017, as compared with positive \$9 million for the second quarter of 2017.
- ▶ Net interest income decreased from the second quarter of 2017, primarily as a result of higher interest costs on FHLBC borrowings, and higher interest expense on multifamily investments, which we financed at the end of the second quarter. We seek to fix the interest cost of our FHLBC debt over its weighted average maturity by using a combination of swaps, TBAs, and other derivative instruments.

## FINANCIAL INSIGHTS

Investment fair value changes, net, includes mark-to-market changes on our long-term investments in residential loans and real estate securities, and risk management derivatives associated with these investments. The following table presents the components of investment fair value changes, net, for our Investment Portfolio segment by investment type, for the third and second quarters of 2017.

<b>Components of Investment Portfolio Fair Value Changes, Net</b>			
<b>by Investment Type</b>			
(\$ in millions)			
	<u>Three Months Ended</u>		
	9/30/2017	6/30/2017	
Market valuation changes on:			
Residential loans held-for-investment			
Change in fair value from the reduction of principal <sup>(1)</sup>	\$ (1)	\$ (1)	
Change in fair value from changes in interest rates <sup>(2)</sup>	4	9	
<b>Total change in fair value of residential loans held-for-investment</b>	<b>3</b>	<b>8</b>	
Real estate securities			
Change in fair value from the reduction of principal <sup>(1)</sup>	(2)	(1)	
Change in fair value from changes in interest rates <sup>(2)</sup>	2	20	
<b>Total change in fair value of real estate securities</b>	<b>—</b>	<b>19</b>	
Risk management derivatives			
Interest component of derivative expense	(3)	(4)	
Change in fair value of derivatives from changes in interest rates <sup>(3)</sup>	1	(14)	
<b>Total change in fair value of risk management derivatives</b>	<b>(2)</b>	<b>(18)</b>	
<b>Total investment portfolio fair value changes, net</b>	<b>\$ 1</b>	<b>\$ 9</b>	

- (1) Reflects the change in fair value due to principal changes, which is calculated as the change in principal on a given investment during the period, multiplied by the prior quarter ending price or acquisition price for that investment in percentage terms.
- (2) Reflects changes in prepayment assumptions and credit spreads on our residential loans, trading securities and conforming risk-sharing investments primarily due to changes in benchmark interest rates. This item is excluded from management's definition of core earnings.
- (3) Reflects the change in fair value of our risk management derivatives that are associated with changes in benchmark interest rates during the period. This item is excluded from management's definition of core earnings.

## FINANCIAL INSIGHTS

The following table presents our Investment Portfolio segment contribution for our residential loans held-for-investment, residential securities, multifamily securities, and MSR investments for the third quarter of 2017.

<b>Segment Contribution of Investment Portfolio by Type</b>					
For the Three Months Ended September 30, 2017					
(\$ in millions)					
	Residential Loans	Residential Securities	Multifamily Securities	MSRs	Total
Total net interest income	\$ 17	\$ 19	\$ 1	\$ —	\$ 38
Non-interest income					
MSR income, net	—	—	—	2	2
Investment fair value changes, net	1	(1)	1	—	1
Other income	—	1	—	—	1
Realized gains, net	—	2	—	—	2
Total non-interest income, net	2	1	1	2	6
Direct operating expenses	—	(1)	—	—	(1)
Provision for income taxes	—	—	—	—	—
<b>Segment contribution</b>	<b>\$ 18</b>	<b>\$ 20</b>	<b>\$ 2</b>	<b>\$ 1</b>	<b>\$ 42</b>
Core Earnings adjustments <sup>(1)</sup>					
Eliminate mark-to-market changes on long-term investments and associated derivatives	(5)	(1)	(1)	—	(7)
Include cumulative gain (loss) on long-term investments sold, net	—	1	—	—	1
Income taxes associated with core earnings adjustments	—	(1)	—	—	(1)
Total core earnings adjustments	(5)	—	(1)	—	(7)
<b>Non-GAAP core segment contribution <sup>(1)</sup></b>	<b>\$ 13</b>	<b>\$ 20</b>	<b>\$ 1</b>	<b>\$ 1</b>	<b>\$ 35</b>

(1) Consistent with management's definition of core earnings set forth on page 32, non-GAAP core segment contribution reflects GAAP segment contribution adjusted to reflect the portion of core earnings adjustments allocable to this segment.

- ▶ At September 30, 2017, we had \$4.2 billion of investments in our Investment Portfolio segment, including \$2.3 billion of residential loans held-for-investment at our FHLB member subsidiary, \$317 million of consolidated Sequoia Choice loans, \$1.4 billion of residential and multifamily securities, \$63 million of MSR investments, and \$231 million of cash and other assets.

**Residential Mortgage Banking**

The following table presents the results of our Residential Mortgage Banking segment for the third and second quarters of 2017.

<b>Segment Results - Residential Mortgage Banking</b>			
(\$ in millions)			
	Three Months Ended		
	9/30/2017	6/30/2017	
Net interest income	\$ 6	\$ 4	
Non-interest income			
Mortgage banking activities, net	21	12	
Total non-interest income	21	12	
Direct operating expenses	(6)	(6)	
Provision for income taxes	(5)	(3)	
<b>Segment contribution</b>	<b>\$ 17</b>	<b>\$ 7</b>	

- ▶ The contribution from our Residential Mortgage Banking segment increased from the second quarter of 2017, driven by higher purchase volume and higher gross margins during the third quarter.
- ▶ Gross margins, which we define as net interest income plus mortgage banking activities, net, divided by loan purchase commitments (LPCs), remained above our long-term expectations of 75 to 100 basis points during the third quarter.
- ▶ LPCs, adjusted for fallout expectations, were \$1.6 billion for the third quarter of 2017, as compared with \$1.4 billion for the second quarter of 2017.
- ▶ Residential loan sales totaled \$1.4 billion during the third quarter and included \$0.2 billion of whole loan sales to third parties, \$0.9 billion of Select loans that were securitized, and \$0.3 billion of Choice loans that were securitized. For GAAP purposes, we consolidated the Sequoia Choice loan securitization on our balance sheet, while the Select loan securitizations are not consolidated and are treated as sales.
- ▶ At September 30, 2017, we had 446 loan sellers, which included 187 jumbo sellers and 259 MPF Direct sellers from various FHLB districts.

## Balance Sheet Analysis

The following table presents our consolidated balance sheets at September 30, 2017 and June 30, 2017.

<b>Consolidated Balance Sheets <sup>(1)</sup></b>			
(\$ in millions)			
	9/30/2017		6/30/2017
Residential loans	\$ 4,185	\$	3,905
Real estate securities	1,356		1,219
Mortgage servicing rights	63		64
Cash and cash equivalents	258		217
<b>Total earning assets</b>	<b>5,862</b>		<b>5,405</b>
Other assets	269		250
<b>Total assets</b>	<b>\$ 6,131</b>	<b>\$</b>	<b>5,655</b>
<b>Short-term debt</b>			
Mortgage loan warehouse debt	\$ 438	\$	575
Security repurchase facilities	550		469
Convertible notes, net <sup>(2)</sup>	250		250
Other liabilities	166		152
Asset-backed securities issued	944		693
Long-term debt, net	2,574		2,336
<b>Total liabilities</b>	<b>4,922</b>		<b>4,476</b>
Stockholders' equity	1,209		1,179
<b>Total liabilities and equity</b>	<b>\$ 6,131</b>	<b>\$</b>	<b>5,655</b>

(1) Our consolidated balance sheets include assets of consolidated variable interest entities ("VIEs") that can only be used to settle obligations of these VIEs and liabilities of consolidated VIEs for which creditors do not have recourse to the primary beneficiary (Redwood Trust, Inc.). At September 30, 2017 and June 30, 2017, assets of consolidated VIEs totaled \$996 million and \$713 million, respectively, and liabilities of consolidated VIEs totaled \$946 million and \$693 million, respectively. See Table 7 in the *Financial Tables* section of the *Appendix* to this Redwood Review for additional detail on consolidated VIEs.

(2) During the second quarter of 2017, our convertible notes were reclassified from Long-term debt, net to Short-term debt as the maturity of the notes was less than one year as of April 2017.

## ANALYSIS OF BALANCE SHEET AND CAPITAL ALLOCATIONS

To supplement our consolidated balance sheet, the following table presents the components of the assets and liabilities of our consolidated balance sheet at September 30, 2017, by operating segment.

<b>Operating Segment Assets and Liabilities</b>				
September 30, 2017				
(\$ in millions)				
	<u>Operating Segments</u>			
	Investment Portfolio	Residential Mortgage Banking	Corporate/ Other	Redwood Consolidated
Residential loans	\$ 2,586	\$ 926	\$ 673	\$ 4,185
Residential securities	1,113	—	—	1,113
Multifamily securities	243	—	—	243
Mortgage servicing rights	63	—	—	63
Cash and cash equivalents	73	—	185	258
<b>Total earning assets</b>	<b>4,078</b>	<b>926</b>	<b>858</b>	<b>5,862</b>
Other assets	158	22	89	269
<b>Total assets</b>	<b>\$ 4,236</b>	<b>\$ 948</b>	<b>\$ 947</b>	<b>\$ 6,131</b>
<b>Short-term debt</b>				
Mortgage loan warehouse debt	\$ —	\$ 438	\$ —	\$ 438
Security repurchase facilities	550	—	—	550
Convertible notes, net	—	—	250	250
Other liabilities	54	14	98	166
ABS issued, net	286	—	658	944
Long-term debt, net	2,000	—	574	2,574
<b>Total liabilities</b>	<b>\$ 2,890</b>	<b>\$ 452</b>	<b>\$ 1,580</b>	<b>\$ 4,922</b>

## **Analysis of Capital Allocation**

Included in this section is a detailed analysis of the allocation of our \$1.8 billion of capital, which is summarized on page 13 of this Redwood Review. Our total capital of \$1.8 billion at September 30, 2017 included \$1.2 billion of equity capital and \$0.6 billion of the total \$2.6 billion of long-term debt on our consolidated balance sheet. This portion of debt includes \$201 million of exchangeable debt due in 2019, \$245 million of convertible debt due in 2023, and \$140 million of trust-preferred securities due in 2037. This portion of debt has a weighted average cost of 6.1% per annum.

## ***Investment Portfolio***

Our investment portfolio represented \$1.6 billion, or 90%, of our total capital at September 30, 2017. This portfolio provided the majority of our income during the third quarter of 2017.

## **Residential Loans/FHLB Stock**

- ▶ At September 30, 2017, our investments in residential loans included \$2.3 billion of jumbo residential loans financed with \$2.0 billion of FHLB debt by our FHLB-member subsidiary. In connection with these borrowings, our FHLB-member subsidiary is required to hold \$43 million of FHLB stock. At September 30, 2017, none of these loans were more than 90 days delinquent.
- ▶ At September 30, 2017, the weighted average maturity of this FHLB debt was approximately eight years and it had a weighted average cost of 1.3% per annum. This interest cost resets every 13 weeks, and we seek to fix the interest cost of this FHLB debt over its weighted average maturity by using a combination of swaps, TBAs, and other derivative instruments.
- ▶ Under a final rule published by the Federal Housing Finance Agency in January 2016, our FHLB-member subsidiary will remain an FHLB member through the five-year transition period for captive insurance companies. Our FHLB-member subsidiary's existing \$2.0 billion of FHLB debt, which matures beyond this transition period, is permitted to remain outstanding until the stated maturity. As residential loans pledged as collateral for this debt pay down, we are permitted to pledge additional loans or other eligible assets to collateralize this debt; however, we do not expect to be able to increase our subsidiary's FHLB debt above the existing \$2.0 billion.

## Residential Securities

At September 30, 2017, we had \$1.1 billion of residential securities. We categorize these securities by (i) whether they were issued through our Sequoia platform, by an Agency in a CRT, or by third parties, (ii) by portfolio vintage (the year the securities were issued), and (iii) priority of cash flow (senior, Re-REMIC, and subordinate). The following table presents the fair value of our residential real estate securities at September 30, 2017.

Residential Securities - Vintage and Category							
September 30, 2017							
(\$ in millions)							
	RMBS 2.0			Legacy RMBS		Total Residential Securities	% of Total
	Sequoia 2012-2017	Third Party 2013-2017	Agency CRT 2013-2017	Third Party <=2008			
Senior	\$ 34	\$ 25	\$ —	\$ 157	\$ 216	19%	
Re-REMIC	—	—	—	39	39	4%	
Subordinate							
Mezzanine <sup>(1)</sup>	157	178	—	—	335	30%	
Subordinate	132	78	287	27	523	47%	
Subordinate	289	255	287	27	858	77%	
<b>Total real estate securities</b>	<b>\$ 323</b>	<b>\$ 280</b>	<b>\$ 287</b>	<b>\$ 223</b>	<b>\$ 1,113</b>	<b>100%</b>	

(1) Mezzanine includes securities initially rated AA through BBB- and issued in 2012 or later.

At September 30, 2017, residential securities we owned consisted of fixed-rate assets (81%), adjustable-rate assets (6%), hybrid assets that reset within the next year (11%), and hybrid assets that reset between 12 and 36 months (2%).

In addition to the \$1.1 billion of securities presented above, at September 30, 2017, we owned securities with a fair value of \$31 million that we retained from our Sequoia Choice securitization, which is consolidated for GAAP purposes. These securities included \$22 million of mezzanine securities, \$6 million of subordinate securities, and \$3 million of senior, interest-only securities. At September 30, 2017, we consolidated \$317 million of residential loans and \$286 million of non-recourse ABS debt from this securitization on our balance sheet (see Table 7 in the *Financial Tables* section of the *Appendix* to this Redwood Review for additional detail on our consolidated VIEs).

## Multifamily Securities

At September 30, 2017, we had \$243 million of multifamily securities, which included \$223 million of subordinate Agency multifamily securities and \$20 million of CMBS securities. The majority of the securities in this portfolio have an investment grade rating and were issued between 2015 and 2017. Additionally, these investments have 7%-8% of structural credit enhancement.

## ANALYSIS OF BALANCE SHEET AND CAPITAL ALLOCATIONS

We finance our holdings of real estate securities with a combination of capital and collateralized debt in the form of repurchase (or “repo”) financing. At September 30, 2017, we had short-term debt incurred through repurchase facilities of \$550 million, which was secured by \$663 million of real estate securities. The remaining \$673 million of residential securities and \$20 million of multifamily securities were financed with capital.

The following table presents the fair value of our real estate securities that are financed with repurchase debt, at September 30, 2017.

<b>Real Estate Securities Financed with Repurchase Debt</b>						
September 30, 2017						
(\$ in millions, except weighted average price)						
	Real Estate Securities	Repurchase Debt	Allocated Capital	Weighted Average Price <sup>(1)</sup>	Financing Haircut <sup>(2)</sup>	
Residential securities						
Senior	\$ 103	\$ (90)	\$ 13	\$ 98	13%	
Mezzanine	337	(281)	56	\$ 99	17%	
Total residential securities	440	(371)	69			
Multifamily securities	223	(179)	44	\$ 96	20%	
<b>Total</b>	<b>\$ 663</b>	<b>\$ (550)</b>	<b>\$ 113</b>	<b>\$ 98</b>	<b>17%</b>	

(1) GAAP fair value per \$100 of principal.

(2) Allocated capital divided by GAAP fair value.

- ▶ At September 30, 2017, the securities we financed through repurchase facilities had no material credit issues. In addition to the allocated capital listed in the table above that directly supports our repurchase facilities (i.e., “the haircut”), we continue to hold a designated amount of supplemental risk capital available for potential margin calls or future obligations relating to these facilities.
- ▶ At September 30, 2017, we had securities repurchase facilities with eight different counterparties. The weighted average cost of funds for the financing at these facilities during the third quarter of 2017 was approximately 2.5% per annum.
- ▶ At September 30, 2017, the weighted average GAAP fair value of our financed securities was 98% of their aggregate principal balance. All financed securities received external third-party market price indications as of September 30, 2017, and were, in aggregate, valued within 1% of these indications.

- ▶ Most of the \$103 million of senior securities noted in the preceding table are supported by seasoned residential loans originated prior to 2008. The credit performance of these investments continues to exceed our original investment expectations.
- ▶ The \$337 million of mezzanine securities financed through repurchase facilities at September 30, 2017 carry investment-grade credit ratings and are supported by residential loans originated between 2012 and 2017. The loans underlying these securities have experienced minimal delinquencies to date.
- ▶ The majority of the \$223 million of multifamily securities financed through repurchase facilities at September 30, 2017 carry investment-grade credit ratings with 7%-8% of structural credit enhancement.
- ▶ Additional information on the residential securities we own is set forth in Table 6 in the *Financial Tables* section of the *Appendix* to this Redwood Review.

### **Mortgage Servicing Rights**

- ▶ At September 30, 2017, we had \$63 million, or 4%, of our total capital invested in MSR. This portfolio primarily includes jumbo MSR retained from loans transferred to Sequoia securitizations we completed over the past several years.
- ▶ The GAAP carrying value, which is the estimated fair value of our MSR, was equal to 1.09% of the aggregate principal balance of the associated residential loans at September 30, 2017, as compared with 1.08% at June 30, 2017.
- ▶ At September 30, 2017, the 60-day-plus delinquency rate (by current principal balance) of loans associated with our MSR investments was 0.09%.
- ▶ We earn fees from these MSR, but outsource the actual servicing of the associated loans to third-party servicers.

***Residential Mortgage Banking***

At September 30, 2017, \$170 million, or 10%, of our total capital was allocated to our residential mortgage banking operations to support the purchase and sale of residential loans.

We utilize a combination of this allocated capital and our residential loan warehouse facilities to manage our inventory of residential loans held-for-sale. At September 30, 2017, we had \$926 million of residential mortgages held-for-sale financed with \$438 million of warehouse debt. The weighted average cost of the borrowings outstanding under these facilities during the third quarter of 2017 was 2.9% per annum.

Our warehouse capacity at September 30, 2017 totaled \$1.3 billion across four separate counterparties.

# APPENDIX



REDWOOD TRUST

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## Redwood's Business

Redwood invests in residential mortgages and other real estate-related assets and engages in residential mortgage banking activities. We are structured as a REIT for federal tax purposes. Our REIT holds most of our mortgage-related investments, due to the tax advantages afforded to REITs. Our mortgage-banking activities are conducted through taxable REIT subsidiaries that pay corporate income taxes. We operate and report our businesses through two segments - Investment Portfolio and Residential Mortgage Banking.

**Investment Portfolio:** Our Investment Portfolio segment primarily consists of investments in residential jumbo loans and real estate securities. Our securities portfolio primarily includes investments in residential mortgage-backed securities ("RMBS") retained from our Sequoia securitizations and RMBS issued by third parties, Agency CRT securities, as well as investments in Agency multifamily securities. Our loan investments are primarily made through a subsidiary of Redwood Trust that is a member of the Federal Home Loan Bank of Chicago ("FHLBC"). This subsidiary utilizes attractive long-term financing from the FHLBC to make long-term investments directly in residential mortgage loans.

This segment's main source of revenue is net interest income from these investments. Additionally, this segment may realize gains and losses upon the sale of investments. Funding, hedging, tax, and direct operating expenses associated with these activities are also included in this segment.

**Residential Mortgage Banking:** Our Residential Mortgage Banking segment primarily consists of operating a mortgage loan conduit that acquires prime jumbo residential loans on a flow basis from a network of third-party originators for subsequent sale, securitization, or transfer to our investment portfolio. We occasionally supplement our flow purchases with bulk loan acquisitions. We typically distribute the loans through either our Sequoia private-label securitization program or to institutions that acquire pools of whole loans.

This segment's main source of revenue is income from mortgage banking activities, which includes valuation increases (or gains) on the sale or securitization of loans and valuation changes from hedges used to manage the risks associated with these activities. Additionally, this segment may generate interest income on loans held pending securitization or sale. Funding, tax, and direct operating expenses associated with these activities are also included in this segment.

## Dividend Policy

### *Summary*

As a REIT, Redwood is required to distribute to shareholders at least 90% of its REIT taxable income, excluding net capital gains. To the extent Redwood retains REIT taxable income, including net capital gains, it is taxed at corporate tax rates. Redwood also earns taxable income at its taxable REIT subsidiaries (TRS), which it is not required to distribute.

### *Dividend Policy Overview*

Our Board of Directors has maintained a policy of paying regular quarterly dividends, although we have not been required to distribute dividends in recent years in order to comply with the provisions of the Internal Revenue Code applicable to REITs. In December 2016, the Board of Directors announced its intention to pay a regular dividend of \$0.28 per share per quarter in 2017. During the first, second, and third quarters of 2017, the Board of Directors declared and paid regular quarterly dividends of \$0.28 per share. In November 2017, the Board of Directors declared a regular dividend of \$0.28 per share for the fourth quarter of 2017, which is payable on December 28, 2017 to shareholders of record on December 15, 2017.

### *Dividend Distribution Requirement*

Our estimated REIT taxable income was \$20 million, or \$0.26 per share, for the third quarter of 2017 and \$19 million, or \$0.25 per share, for the second quarter of 2017. Under normal circumstances, our minimum REIT dividend requirement would be 90% of our annual REIT taxable income. However, we currently maintain a \$59 million federal net operating loss carry forward (NOL) at the REIT that affords us the option of retaining REIT taxable income up to the NOL amount, tax free, rather than distributing it as dividends. Federal income tax rules require the dividends paid deduction to be applied to reduce REIT taxable income before the applicability of NOLs is considered. We currently do not expect our estimated REIT taxable income to exceed our dividend distributions in 2017; therefore, our entire NOL will likely carry forward into 2018.

### *Income Tax Characterization of Dividend for Shareholders*

We currently expect all or nearly all of the dividends we distribute in 2017 will be taxable to shareholders as ordinary income and a smaller portion, if any, will be a return of capital, which is generally non-taxable. Based on federal income tax rules related to capital loss carryforwards, none of our 2017 dividend distributions are expected to be characterized as long-term capital gains for federal income tax purposes.

## Core Earnings

Core earnings is a non-GAAP measure of Redwood's earnings and results of operations. Specifically, management has defined core earnings as: GAAP net income adjusted to (i) eliminate the impact of quarterly mark-to-market changes on the fair value of long-term investments (and associated derivatives) related to changes in benchmark interest rates and credit spreads, (ii) include the cumulative net gains or losses on long-term investments accounted for as trading securities under GAAP that were sold during the period presented, net of any gains or losses from derivatives associated with the investments sold, and (iii) include the hypothetical income taxes associated with core earnings adjustments.

Management utilizes this core earnings measure internally as one way of analyzing Redwood's performance over multiple periods, as it believes it provides useful comparative results absent the impact of certain quarterly mark-to-market changes on investments held through the end of the period presented and inclusive of all realized gains and losses from securities sales.

Specifically, the quarterly mark-to-market changes in the value of our long-term investments in loans, trading securities, and other investments, as well as the associated derivatives, resulting from changes in benchmark interest rates and credit spreads may not be reflective of the total return management would expect to earn from them over the longer-term.

Additionally, the adjustment to include cumulative net gains or losses from the sale of trading securities is to ensure that core earnings presents consistently the impact of the sales of investments regardless of whether they are accounted for as (i) trading securities or (ii) available-for-sale securities, in each case under GAAP, as outlined below.

- Under GAAP, available-for-sale securities are reported at their fair value with periodic changes in fair value recognized through the balance sheet in Shareholders' equity. When an available-for-sale security is sold, the cumulative gain or loss since purchase is recognized through the income statement, in Realized gains, net, in the period the sale occurred. As a result, any such cumulative gains or losses are reflected in core earnings in the period the sale occurred.
- Under GAAP, trading securities are reported at their fair value with periodic changes in fair value recognized through the income statement in Investment fair value changes, net. Certain of these periodic changes in fair value (as described above) are excluded from core earnings. Core earnings includes an adjustment to include the cumulative net gains or losses (from purchase through the sale of the investment) for sold trading securities in the period they are sold. The result is to consistently present within core earnings the cumulative gains or losses from the sale of long-term investments, regardless of how they are accounted for under GAAP.

## CORE EARNINGS DEFINITION

Core earnings also includes adjustments to show the hypothetical tax provision or benefit that would be associated with the core earnings adjustments made to net income. As a REIT, we are subject to income taxes on earnings generated at our taxable REIT subsidiaries (TRS) and generally not subject to income taxes on earnings generated at the REIT (to the extent we distribute our REIT taxable income as dividends). In order to present the hypothetical income taxes associated with core earnings adjustments made to net income, estimated effective tax rates are applied to the core earnings adjustments occurring within our TRS.

We caution that core earnings and core segment contribution should not be utilized in isolation, nor should they be considered as alternatives to GAAP net income or other measurements of results of operations computed in accordance with GAAP.

**ADJUSTABLE-RATE MORTGAGES (ARMs)** - Adjustable-rate mortgages are loans that have coupons that adjust at least once per year. We make a distinction between ARMs (loans with a rate adjustment at least annually) and hybrids (loans that have a fixed-rate period of 2-10 years and then become adjustable-rate).

**ADJUSTED ROE** - Adjusted ROE, or Adjusted Return on Equity, is a non-GAAP financial performance metric used in determining performance-based annual bonus compensation for executives. Non-GAAP Adjusted ROE is defined as GAAP earnings divided by average equity capital adjusted to exclude average accumulated other comprehensive income, as reported under GAAP. Average accumulated other comprehensive income generally represents certain unrealized mark-to-market gains and losses.

**AGENCY** - Agency refers to government-sponsored enterprises (“GSEs”), including Federal National Mortgage Association (“Fannie Mae”), Federal Home Loan Mortgage Corporation (“Freddie Mac”), and Government National Mortgage Association (“Ginnie Mae”).

**ALT-A SECURITIES and ALT-A LOANS** - As categories, Alt-A securities and Alt-A loans were commonly used prior to the financial crisis (i.e., prior to 2009), but are no longer typically used to describe securities or loans issued or originated since 2009. Alt-A securities was a term used to describe residential mortgage-backed securities backed by loans that had higher credit quality than subprime and lower credit quality than prime. Alt-A originally represented loans with alternative documentation, but the definition shifted over time to include loans with additional risk characteristics and in some cases investor loans. An Alt-A loan was a term used to describe a loan where the borrower’s income may not have been verified, and in some cases, may not have been disclosed on the loan application. Alt-A loans was also a term used to describe loans with expanded criteria that allowed for higher debt-to-income ratios with higher accompanying loan-to-value ratios than would otherwise have applied prime loans.

**AMORTIZED COST** - Amortized cost is the initial acquisition cost of an available-for-sale (“AFS”) security, minus principal repayments or principal reductions through credit losses, plus or minus premium or discount amortization. At the point in time an AFS security is deemed other-than-temporarily impaired, the amortized cost is adjusted (by changing the amount of unamortized premium or discount) by the amount of other-than temporary impairment taken through the income statement.

**ASSET-BACKED SECURITIES (ABS)** - Asset-backed securities are securities backed by financial assets that generate cash flows. Each ABS issued from a securitization entity has a unique priority with respect to receiving principal and interest cash flows and absorbing any credit losses from the assets owned by the entity.

**AVAILABLE CAPITAL** - Available Capital represents a combination of capital available for investment and risk capital we hold for liquidity management purposes.

## GLOSSARY

**AVAILABLE-FOR-SALE (AFS)** - An accounting method for debt and equity securities in which the securities are reported at their fair value. Positive changes in the fair value are accounted for as increases to stockholders' equity and do not flow through the income statement. Negative changes in fair value may be recognized through the income statement or balance sheet.

**BOOK VALUE (GAAP)** - Book value is the value of our common equity in accordance with GAAP.

**COMMERCIAL MORTGAGE-BACKED SECURITIES (CMBS)** - A type of mortgage-backed security that is secured by one or more loans on commercial properties.

**CONFORMING LOAN** - A conforming loan is a mortgage loan that conforms to the underwriting standards of Fannie Mae and Freddie Mac, including the maximum loan limit, which is currently \$424,100 except in defined high-cost areas of the country, where the limit is higher. Changes to this maximum loan limit are announced annually by the Federal Housing Finance Agency ("FHFA"), which is the regulator and conservator of both Fannie Mae and Freddie Mac.

**CONSTANT (or CONDITIONAL) PREPAYMENT RATE (CPR)** - Constant (or conditional) prepayment rate is an industry-standard measure of the speed at which mortgage loans prepay. It approximates the annual percentage rate at which a pool of loans is paying down due to unscheduled principal prepayments.

**CORE EARNINGS** - Core earnings is a non-GAAP measure of Redwood's earnings and results of operations. See the preceding *Core Earnings Definition* section for additional information on this metric.

**CREDIT RISK TRANSFER (CRT) INVESTMENTS** - Credit risk transfer investments generally refer to transactions in which mortgage loan credit risk is shifted from one party to another, examples of which may include structured debt issuances, credit-linked notes, insurance/reinsurance transactions, front-end or back-end lender risk-sharing transactions, and senior subordinate securities. Among the CRT investments that Redwood holds are CRT transactions it entered into with the Agencies relating to conforming loans.

**CREDIT SUPPORT** - Credit support is the face amount of securities subordinate (or junior) to the applicable security that protects the security from credit losses and is generally expressed as a percentage of the securitization's underlying pool balance.

**DISREGARDED ENTITY** - An entity wholly owned, directly or indirectly through other disregarded entities, by another entity (the "parent entity"), whose separate existence from the parent entity is disregarded for federal income tax purposes.

**FALLOUT** - The percentage of loans that an originator plans or commits to sell to a buyer that ultimately do not close and are not delivered to the buyer.

## GLOSSARY

**FASB** - Financial Accounting Standards Board.

**FHFA** - The FHFA refers to the Federal Housing Finance Authority.

**FHLB and FHLBC** - The FHLB refers to the Federal Home Loan Bank system. The FHLBC refers to the Federal Home Loan Bank of Chicago.

**GAAP** - Generally Accepted Accounting Principles in the United States.

**GOVERNMENT-SPONSORED ENTERPRISE (GSE)** - A government-sponsored enterprise is a financial services corporation created by the United States Congress to enhance the flow of credit to targeted sectors of the economy. Among the GSEs chartered by Congress are Fannie Mae, Freddie Mac, Ginnie Mae, and the Federal Home Loan Banks. When we refer to GSEs, we are generally referring to Fannie Mae and Freddie Mac.

**INTEREST-ONLY SECURITIES (IOs)** - Interest-only securities are specialized securities created by securitization entities where the projected cash flows generated by the underlying assets exceed the cash flows projected to be paid to the securities that are issued with principal balances. Typically, IOs do not have a principal balance and they will not receive principal payments. Interest payments to IOs usually equal an interest rate formula multiplied by a "notional" principal balance. The notional principal balances for IOs are typically reduced over time as the actual principal balance of the underlying pool of assets pays down, thus reducing the cash flows to the IOs over time. Cash flows on IOs are typically reduced more quickly when asset prepayments increase.

**JUMBO LOAN** - A jumbo loan is a residential mortgage loan that generally conforms to the underwriting standards of Fannie Mae and Freddie Mac except that the dollar amount of the loan exceeds the conforming loan limit set annually by the FHFA. See Conforming Loan Definition.

**LEGACY RMBS** - Residential mortgage-backed securities issued prior to 2009.

**LEVERAGE RATIOS** - Leverage ratios measure financial leverage and are used to assess a company's ability to meet its financial obligations. Financial leverage ratios are often expressed as debt to equity and assets to equity. In the mortgage banking industry, financial leverage is most commonly calculated using debt to equity. At Redwood, the two financial leverage ratios used are consolidated GAAP debt to equity and recourse debt (or, debt at Redwood) to equity. The former calculation includes the consolidated ABS issued from certain Sequoia securitization entities even though those obligations are not financial obligations of Redwood but are obligations of each the consolidated securitization trusts and are payable only from the cash flow from the assets owned by each of those trusts. The latter calculation of recourse debt to equity excludes debt related to consolidated securitizations and only includes debt for which Redwood has an obligation to repay. Both ratios are calculated at the bottom of Table 5: Financial Ratios and Book Value in the *Appendix* section.

**LOAN PURCHASE COMMITMENT (LPC)** - A commitment to purchase a residential mortgage loan from a mortgage loan originator at a specified price and within a specified time period. A “best efforts” loan purchase commitment becomes effective once the originator has closed the loan with the borrower. A “mandatory” loan purchase commitment becomes effective once the commitment is entered into among the buyer and the originator, regardless if the originator has closed the loan. Mortgage buyers such as Redwood often issue 30 to 60 day loan purchase commitments to loan originators so they can in turn offer a similar commitments to their borrowers. To hedge interest rate risk during the commitment period, buyers will often enter in to a forward sale commitment or hedge the risk using derivatives. (See Forward Sale Commitment definition.) A loan purchase commitment for a conforming loan qualifies as a derivative in accordance with GAAP. Beginning January 1, 2015, our loan purchase commitment for a non-conforming loan qualifies as a derivative in accordance with GAAP. Any change in the value of a loan purchase commitment is recorded in mortgage banking activities.

**LONG-TERM DEBT** - Long-term debt is debt that is an obligation of Redwood that is not payable within a year and includes convertible debt, exchangeable debt, junior subordinated notes and trust preferred securities. We generally treat long-term debt as part of our capital base when it is not payable in the near future.

**MARK-TO-MARKET (MTM) ACCOUNTING** - Mark-to-market accounting uses estimated fair values of assets, liabilities, and hedges. Many assets on our consolidated balance sheet are carried at their fair value rather than amortized cost. Taxable income is generally not affected by mark-to-market fair value changes.

**MEZZANINE SECURITIES** - Mezzanine securities are a type of subordinate security and refer to the securities in a residential mortgage-backed securitization that are rated AA, A, and BBB. They rank junior to the AAA securities, and senior to the securities rated below BBB which typically include BB and B rated securities, and any non-rated securities.

**MORTGAGE SERVICING RIGHT (MSR)** - A mortgage servicing right gives the holder the contractual right to service a mortgage loan. MSRs typically include the right to collect monthly mortgage principal and interest payments, as well as related tax and insurance payments, from borrowers, disburse funds to the mortgage debt holders and remit related insurance and tax payments, collect late payments, and process modifications and foreclosures. MSRs are created when mortgage loans are sold in a transaction in which the seller retains the right to service the loans. The holder of an MSR receives a monthly servicing fee (which generally ranges from 0.25% to 0.375% per annum of the outstanding principal balance of the related mortgage loan), which is deducted from the borrower’s monthly interest payments. For accounting purposes, MSRs are capitalized at the net present value of the servicing fee less the servicing cost. When Redwood holds an MSR relating to a residential mortgage loan, it retains a sub-servicer to carry out actual servicing functions, as Redwood does not directly service residential mortgage loans.

**MPF DIRECT** - MPF Direct is a mortgage loan product offered by the Federal Home Loan Bank of Chicago under the Mortgage Partnership Finance ("MPF") program. Members of the FHLB system that are eligible to participate in the MPF Direct product ("MPF Direct sellers") sell high-balance loans to the Federal Home Loan Bank of Chicago which in turn sells the loans to Redwood, which we also refer to as our MPF Direct channel.

**MULTIFAMILY SECURITIES** - A type of mortgage-backed security that is secured by one or more loans on multifamily properties. Our Investment Portfolio includes securities primarily issued through Freddie Mac's conventional multifamily securitization platform.

**NON-PRIME SECURITIES** - Non-prime securities are Alt-A, option ARM, and subprime securities. See definitions of Alt-A, option ARM, and subprime securities.

**NON-RECOURSE DEBT** - Debt that is secured by collateral, but for which the borrower is not personally liable. If the borrower defaults, the lender may seize the collateral, but cannot seek repayment from the borrower for any unpaid principal or interest, even if the value of the collateral does not cover the unpaid amount due following default.

**PRIME RESIDENTIAL REAL ESTATE LOANS** - Prime loans are residential loans with higher quality credit characteristics, such as borrowers with relatively higher FICO credit scores, relatively lower loan-to-value ratios, relatively lower debt-to-income ratios, and/or relatively greater levels of other assets.

**PRIME SECURITIES** - Prime securities are residential mortgage-backed securities backed by prime loans. Prime securities are typically backed by loans that have relatively higher weighted average FICO scores, relatively lower weighted average LTVs, and relatively limited concentrations of investor properties.

**PRINCIPAL-ONLY SECURITIES (POs)** - Principal-only securities are specialized securities created by securitization entities where the holder is only entitled to receive regular cash flows that are derived from incoming principal repayments on an underlying mortgage loan pool. This security is created by splitting a mortgage-backed security into its interest and principal payments. The principal payments create a stream of cash flows which are sold at a discount to investors. These investors will receive the principal portions of the monthly mortgage payments from the underlying pool of loans. The yield on a PO strip depends on the prepayment speed of the underlying loan. The faster the principal is repaid, the higher the yield an investor will receive.

**PROFITABILITY RATIOS** - Many financial institution analysts use asset-based profitability ratios such as interest rate spread and interest rate margin when analyzing financial institutions. These are asset-based measures. Since we consolidate the assets and liabilities of certain securitization entities for GAAP purposes, our total GAAP assets and liabilities may vary over time, and may not be comparable to assets typically used in profitability calculations for other financial institutions. As a result, we believe equity-based profitability ratios may be more appropriate than asset-based measures for analyzing Redwood's operations and results. We provide various profitability ratios in Table 5 in the *Financial Tables* in this Review.

**QUALIFIED REIT SUBSIDIARY** - An entity treated as a corporation for federal income tax purposes, 100% of the outstanding equity interests of which is owned by a REIT directly or through one or more disregarded entities or qualified REIT subsidiaries, and with respect to which no election is made to treat such entity as a taxable REIT subsidiary. A qualified REIT subsidiary is treated as a disregarded entity with respect to its parent REIT for federal income tax purposes.

**REAL ESTATE INVESTMENT TRUST (REIT)** - A real estate investment trust is an entity that makes a tax election to be taxed as a REIT, invests in real estate and real estate-related assets, and meets other requirements for REIT qualification, including the distribution as dividends of at least 90% of its REIT taxable income, excluding net capital gains. A REIT's REIT taxable income is not taxed at the corporate level to the extent that the REIT taxable income is distributed as dividends to stockholders, providing an operating cost savings. On the other hand, the requirement to pay out as dividends most of the REIT's REIT taxable income means it can be harder for a REIT to grow using only internally-generated funds (as opposed to raising new capital).

**REAL ESTATE OWNED (REO)** - Real estate owned refers to real property owned by the lender or loan owner that has been acquired through foreclosure.

**REDWOOD CHOICE and REDWOOD SELECT** - Redwood Choice is an expanded credit loan acquisition program launched in April 2016. The Choice program is a prime program that is fully documented, but with credit parameters outside Redwood's traditional jumbo loan purchase guidelines. Redwood's traditional prime jumbo loan acquisition program is now referred to as Redwood Select.

**REIT TAXABLE INCOME** - REIT taxable income is a non-GAAP measure calculated for tax purposes for a REIT. REIT taxable income is an important measure as it is the basis of a REIT's dividend distribution requirements. A REIT must annually distribute at least 90% of its REIT taxable income, excluding net capital gains, as dividends to its shareholders. A REIT is subject to corporate income taxes to the extent it does not distribute 100% of its REIT taxable income, including net capital gains.

**REMIC** - A real estate mortgage investment conduit (“REMIC”) is a special purpose vehicle used to pool real estate mortgages and issue mortgage-backed securities. REMICs are typically exempt from tax at the entity level. REMICs may invest only in qualified mortgages and permitted investments, including single family or multifamily mortgages, commercial mortgages, second mortgages, mortgage participations, and Agency pass-through securities.

**RE-REMIC SECURITY** - A Re-REMIC is a re-securitization of asset-backed securities. The cash flows from and any credit losses absorbed by the underlying assets can be redirected to the resulting Re-REMIC securities in a variety of ways.

**RESECURITIZATION** - A resecuritization is a securitization of two or more mortgage-backed securities into a new mortgage-backed security.

**RESIDENTIAL MORTGAGE-BACKED SECURITIES (RMBS)** - A type of mortgage-backed security that is backed by a pool of mortgages on residential properties.

**RETURN ON EQUITY (ROE)** - ROE is a measure of the amount of profit we generate over a given period per dollar of equity capital; ROE equals GAAP income divided by average GAAP equity.

**RMBS 2.0** - Residential mortgage-backed securities issued after 2008.

**SENIOR SECURITIES** - Generally, senior securities have the least credit risk in a securitization transaction because they are the last securities to absorb credit losses and have the highest claim on the principal and interest payments (after the fees to servicers and trustees are paid). To further reduce credit risk, most if not all, principal collected from the underlying asset pool is used to pay down the senior securities until certain performance tests are satisfied. If certain performance tests are satisfied, principal payments are shared between the senior securities and the subordinate securities, generally on a pro rata basis. At issuance, senior securities are generally triple A-rated.

**SEQUOIA** - Sequoia is the brand name for securitizations of residential real estate loans Redwood sponsors. Sequoia entities are independent securitization entities that acquire residential mortgage loans and create and issue asset-backed securities (“ABS”) backed by these loans. These ABS are also referred to as RMBS. Most of the loans that Sequoia entities acquire are prime-quality loans. Most of the senior ABS created by Sequoia are sold to third-party investors. Redwood usually acquires most of the subordinated ABS and may also acquire the IOs.

**SHORT-TERM DEBT** - Short-term debt is a debt obligation of Redwood payable within a year. We may obtain this form of debt from a variety of Wall Street firms, banks, and other institutions. We may issue this or other forms of short term debt in the future, use it to finance the accumulation of assets prior to sale or securitization, or to finance investments in loans and securities.

**SUBORDINATE SECURITIES (JUNIOR SECURITIES or NON-SENIOR SECURITIES)** - Subordinate securities absorb the initial credit losses from a securitization, thus protecting the senior securities. Subordinate securities have a lower priority to receive principal and interest payments than the senior securities. Subordinate securities receive little, if any, principal payments until certain performance tests are satisfied. If certain performance tests are satisfied, principal payments are shared between the senior securities and the subordinate securities, generally on a pro rata basis. Subordinate securities generally receive interest payments even if they do not receive principal payments. At issuance, subordinate securities are generally rated double-A or below.

**TAXABLE INCOME** - Taxable income is a non-GAAP measure calculated for tax purposes for Redwood and all its subsidiaries. As taxable income calculations differ significantly from GAAP income calculations, a reconciliation is provided in Table 4 in the *Financial Tables* in this Review.

**TAXABLE REIT SUBSIDIARY (TRS)** - A corporation in which a REIT directly or indirectly owns stock, that jointly elects with such REIT to have such corporation treated as a taxable REIT subsidiary within the meaning of the Internal Revenue Code and that does not directly or indirectly engage in certain prohibited activities. A TRS is subject to corporate income tax on its taxable income. A TRS is not limited to investing in real estate and real estate-related assets and it can choose to retain all of its after-tax profits.

**TO BE ANNOUNCED (TBA)** - A term used to describe a forward Agency mortgage-backed securities trade. Pass-through securities issued by Freddie Mac, Fannie Mae and Ginnie Mae trade in the TBA market. The term TBA is derived from the fact that the actual mortgage-backed security that will be delivered to fulfill a TBA trade is not designated at the time the trade is made. The securities are "to be announced" 48 hours prior to the established trade settlement date.

**TRADING SECURITIES** - The trading designation for securities represents an accounting method under GAAP, whereby securities are reported at their fair value with periodic changes in fair value (both unrealized and realized) recognized through the income statement in Investment fair value changes, net.

# FINANCIAL TABLES



REDWOOD TRUST

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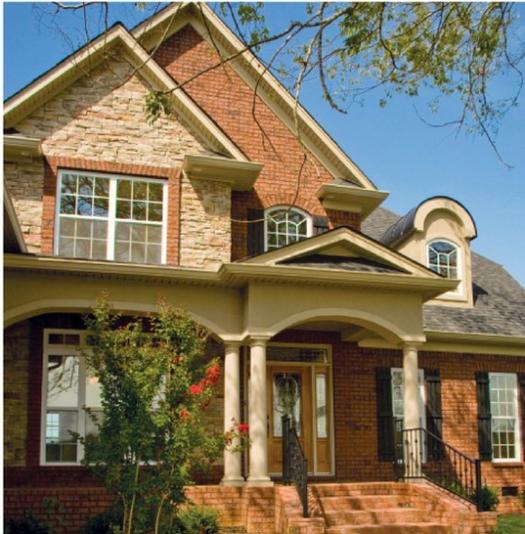




Table 1: GAAP Earnings (in thousands, except per share data)

	2017 Q3	2017 Q2	2017 Q1	2016 Q4	2016 Q3	2016 Q2	2016 Q1	2015 Q4	2015 Q3	Nine Months 2017	Nine Months 2016
Interest income	\$ 58,106	\$ 54,419	\$ 49,367	\$ 50,612	\$ 54,781	\$ 60,307	\$ 54,071	\$ 60,074	\$ 54,191	\$ 161,892	\$ 169,159
Discount amortization on securities, net	4,631	4,805	5,261	5,722	6,125	6,339	8,068	8,573	9,115	14,697	20,532
Discount (premium) amortization on loans, net	—	—	—	—	—	141	189	182	178	—	330
Total interest income	62,737	59,224	54,628	56,334	60,906	66,787	62,328	68,829	63,484	176,589	190,021
Interest expense on short-term debt	(7,158)	(6,563)	(4,453)	(4,848)	(5,405)	(5,337)	(6,697)	(9,194)	(7,627)	(18,174)	(17,439)
Interest expense on short-term convertible notes <sup>(1)</sup>	(3,024)	(2,787)	—	—	—	—	—	—	—	(5,811)	—
Interest expense on ABS issued from consolidated trusts	(3,956)	(3,705)	(3,530)	(3,278)	(3,193)	(3,982)	(4,282)	(4,432)	(5,190)	(11,191)	(11,457)
Interest expense on long-term debt	(13,305)	(11,179)	(13,048)	(12,411)	(12,999)	(13,125)	(12,971)	(11,413)	(11,058)	(37,532)	(39,095)
Total interest expense	(27,443)	(24,234)	(21,031)	(20,537)	(21,597)	(22,444)	(23,950)	(25,039)	(23,875)	(72,708)	(67,991)
Net interest income	35,294	34,990	33,597	35,797	39,309	44,343	38,378	43,790	39,609	103,881	122,030
(Provision for) reversal of provision for loan losses – Commercial	—	—	—	—	859	6,532	(289)	240	60	—	7,102
Net interest income after provision	35,294	34,990	33,597	35,797	40,168	50,875	38,089	44,030	39,669	103,881	129,132
Non-interest income											
Mortgage banking activities, net											
Residential mortgage banking	21,200	12,046	17,604	13,979	9,766	7,728	9,280	885	331	50,850	26,774
Commercial mortgage banking	—	—	—	—	—	—	(2,062)	(620)	1,002	—	(2,062)
Mortgage servicing rights income, net	1,615	2,778	1,713	1,519	3,770	2,783	6,281	2,623	3,549	6,106	12,834
Investment fair value changes, net	324	8,115	1,551	(9,888)	11,918	(11,066)	(19,538)	(4,251)	(14,169)	9,990	(18,686)
Realized gains, net	1,734	1,372	5,703	1,972	6,615	9,884	9,538	20,199	5,548	8,809	26,037
Other income	1,197	986	1,184	2,181	1,643	1,559	955	757	327	3,367	4,157
Total non-interest income (loss), net	26,070	25,297	27,755	9,763	33,712	10,888	4,454	19,593	(3,412)	79,122	49,054
Fixed compensation expense	(5,233)	(5,321)	(6,002)	(5,310)	(5,253)	(5,875)	(7,894)	(8,009)	(8,642)	(16,556)	(19,022)
Variable compensation expense	(6,467)	(4,313)	(3,933)	(4,757)	(5,802)	(4,262)	(1,760)	(1,470)	(3,567)	(14,713)	(11,824)
Equity compensation expense	(2,337)	(3,121)	(2,176)	(1,976)	(2,031)	(2,754)	(2,332)	(2,809)	(2,835)	(7,634)	(7,117)
Restructuring charges	—	—	—	144	(4)	118	(10,659)	—	—	—	(10,545)
Other operating expense	(5,885)	(5,886)	(6,115)	(5,925)	(7,265)	(7,382)	(7,807)	(10,350)	(9,453)	(17,886)	(22,454)
Total operating expenses	(19,922)	(18,641)	(18,226)	(17,824)	(20,355)	(20,155)	(30,452)	(22,638)	(24,497)	(56,789)	(70,962)
(Provision for) benefit from income taxes	(5,262)	(5,322)	(6,157)	(2,381)	(972)	(327)	(28)	74	7,404	(16,741)	(1,327)
<b>Net income</b>	<b>\$ 36,180</b>	<b>\$ 36,324</b>	<b>\$ 36,969</b>	<b>\$ 25,355</b>	<b>\$ 52,553</b>	<b>\$ 41,281</b>	<b>\$ 12,063</b>	<b>\$ 41,059</b>	<b>\$ 19,164</b>	<b>\$ 109,473</b>	<b>\$ 105,897</b>
Diluted average shares <sup>(2)</sup>	102,703	97,494	97,946	85,838	97,832	97,762	77,138	103,377	85,075	99,398	97,992
<b>Diluted earnings per common share</b>	<b>\$ 0.41</b>	<b>\$ 0.43</b>	<b>\$ 0.43</b>	<b>\$ 0.31</b>	<b>\$ 0.58</b>	<b>\$ 0.48</b>	<b>\$ 0.15</b>	<b>\$ 0.46</b>	<b>\$ 0.22</b>	<b>\$ 1.26</b>	<b>\$ 1.23</b>

(1) Represents interest expense on \$250 million of convertible notes that were reclassified from Long-term debt to Short-term debt as the maturity of the notes was less than one year as of April 2017.

(2) Diluted average shares includes shares from the assumed conversion of our convertible and/or exchangeable debt in certain periods, in accordance with GAAP diluted EPS provisions. See Table 2 that follows for details of this calculation for the current and prior quarter and our respective Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K for prior periods.



Table 2: GAAP and Non-GAAP Core Diluted Earnings <sup>(1)</sup> per Common Share (in thousands, except per share data)

	2017 Q3	2017 Q2
<b>GAAP Diluted Earnings per Common Share:</b>		
Net income attributable to Redwood	\$ 36,180	\$ 36,324
Less: Dividends and undistributed earnings allocated to participating securities	(986)	(935)
Add back: Interest expense on convertible notes for the period, net of tax <sup>(2)</sup>	6,564	6,205
<b>Net income allocated to common shareholders</b>	<b>\$ 41,758</b>	<b>\$ 41,594</b>
Basic weighted average common shares outstanding	76,851	76,820
Net effect of dilutive equity awards	299	235
Net effect of assumed convertible notes conversion to common shares <sup>(2)</sup>	25,553	20,439
Diluted weighted average common shares outstanding	102,703	97,494
<b>GAAP Diluted Earnings per Common Share</b>	<b>\$ 0.41</b>	<b>\$ 0.43</b>
<b>Non-GAAP Core Diluted Earnings per Common Share:</b>		
Non-GAAP core earnings	\$ 30,432	\$ 28,591
Less: Dividends and undistributed earnings allocated to participating securities	(873)	(711)
Add back: Interest expense on convertible notes for the period, net of tax <sup>(2)</sup>	6,564	2,072
<b>Non-GAAP core earnings allocated to common shareholders</b>	<b>\$ 36,123</b>	<b>\$ 29,952</b>
Basic weighted average common share outstanding	76,851	76,820
Net effect of dilutive equity awards	299	235
Net effect of assumed convertible notes conversion to common shares <sup>(2)</sup>	25,553	9,271
Diluted weighted average common shares outstanding	102,703	86,326
<b>Non-GAAP Core Diluted Earnings per Common Share</b>	<b>\$ 0.35</b>	<b>\$ 0.35</b>

(1) A reconciliation of GAAP net income to non-GAAP core earnings is included in the *GAAP Net Income and Reconciliation to Non-GAAP Core Earnings* section that starts on page 10 and a definition of core earnings is included in the *Core Earnings Definition* section of the *Appendix*.

(2) Certain convertible notes were determined to be dilutive in the periods presented and were included in the calculations of diluted EPS under the "if-converted" method. Under this method, the periodic interest expense (net of applicable taxes) for dilutive notes is added back to the numerator and the number of shares that the notes are entitled to (if converted, regardless of whether they are in or out of the money) are included in the denominator.



Table 3: Segment Results (\$ in thousands)

	Three Months Ended September 30, 2017				Three Months Ended June 30, 2017			
	Investment Portfolio	Residential Mortgage Banking	Corporate/ Other	Total	Investment Portfolio	Residential Mortgage Banking	Corporate/ Other	Total
Interest income	\$ 47,023	\$ 10,626	\$ 5,088	\$ 62,737	\$ 45,833	\$ 8,415	\$ 4,976	\$ 59,224
Interest expense	(9,445)	(4,135)	(13,863)	(27,443)	(7,231)	(4,403)	(12,600)	(24,234)
Net interest income (expense)	37,578	6,491	(8,775)	35,294	38,602	4,012	(7,624)	34,990
Non-interest income								
Mortgage banking activities, net	—	21,200	—	21,200	—	12,046	—	12,046
MSR income, net	1,615	—	—	1,615	2,778	—	—	2,778
Investment fair value changes, net	1,372	—	(1,048)	324	9,115	—	(1,000)	8,115
Other income	1,197	—	—	1,197	986	—	—	986
Realized gains, net	1,734	—	—	1,734	2,124	—	(752)	1,372
Total non-interest income (loss)	5,918	21,200	(1,048)	26,070	15,003	12,046	(1,752)	25,297
Operating expenses	(1,324)	(6,107)	(12,491)	(19,922)	(1,454)	(6,021)	(11,166)	(18,641)
Provision for income taxes	(433)	(4,829)	—	(5,262)	(2,320)	(3,002)	—	(5,322)
Segment contribution	\$ 41,739	\$ 16,755	\$ (22,314)		\$ 49,831	\$ 7,035	\$ (20,542)	
Net income				\$ 36,180				\$ 36,324

Segment assets and liabilities	September 30, 2017				June 30, 2017			
Residential loans	\$ 2,586,105	\$ 925,681	\$ 673,134	\$ 4,184,920	\$ 2,360,234	\$ 837,371	\$ 707,686	\$ 3,905,291
Real estate securities	1,356,272	—	—	1,356,272	1,218,503	—	—	1,218,503
Mortgage servicing rights	62,928	—	—	62,928	63,770	—	—	63,770
Cash and cash equivalents	72,949	—	184,662	257,611	36,983	—	180,235	217,218
Other assets	157,769	21,822	89,377	268,968	130,128	22,335	98,237	250,700
Total assets	\$ 4,236,023	\$ 947,503	\$ 947,173	\$ 6,130,699	\$ 3,809,618	\$ 859,706	\$ 986,158	\$ 5,655,482
Short-term debt								
Mortgage loan warehouse debt	\$ —	\$ 438,243	\$ —	\$ 438,243	\$ —	\$ 575,303	\$ —	\$ 575,303
Security repurchase facilities	549,811	—	—	549,811	469,491	—	—	469,491
Convertible notes, net	—	—	250,142	250,142	—	—	250,013	250,013
Other liabilities	53,551	13,851	97,734	165,136	59,108	13,011	80,180	152,299
ABS issued	286,328	—	657,960	944,288	—	—	692,606	692,606
Long-term debt, net	1,999,999	—	574,440	2,574,439	1,999,999	—	336,347	2,336,346
Total liabilities	\$ 2,889,689	\$ 452,094	\$ 1,580,276	\$ 4,922,059	\$ 2,528,598	\$ 588,314	\$ 1,359,146	\$ 4,476,058



Table 4: Taxable and GAAP Income <sup>(1)</sup> Differences and Dividends (\$ in thousands, except for per share data)

	Estimated Nine Months 2017 <sup>(2)</sup>			Actual Twelve Months 2016 <sup>(2)</sup>			Actual Twelve Months 2015 <sup>(2)</sup>		
	Taxable Income	GAAP Income	Differences	Taxable Income	GAAP Income	Differences	Taxable Income	GAAP Income	Differences
<b>Taxable and GAAP Income Differences</b>									
Interest income	\$ 164,553	\$ 176,589	\$ (12,036)	\$ 233,259	\$ 246,355	\$ (13,096)	\$ 227,133	\$ 259,432	\$ (32,299)
Interest expense	(62,289)	(72,708)	10,419	(76,396)	(88,528)	12,132	(79,830)	(95,883)	16,053
Net interest income	102,264	103,881	(1,617)	156,863	157,827	(964)	147,303	163,549	(16,246)
Reversal of provision (provision for) loan losses	—	—	—	—	7,102	(7,102)	—	355	(355)
Realized credit losses	(2,865)	—	(2,865)	(7,989)	—	(7,989)	(8,645)	—	(8,645)
Mortgage banking activities, net	41,905	50,850	(8,945)	26,477	38,691	(12,214)	(24,637)	10,972	(35,609)
MSR income (loss), net	5,149	6,106	(957)	86,955	14,353	72,602	33,669	(3,922)	37,591
Investment fair value changes, net	(9,263)	9,990	(19,253)	(10,410)	(28,574)	18,164	(2,827)	(21,357)	18,530
Operating expenses	(55,567)	(56,789)	1,222	(88,416)	(88,786)	370	(103,236)	(97,416)	(5,820)
Other income (expense), net	11,800	3,367	8,433	2,760	6,338	(3,578)	2,174	3,192	(1,018)
Realized gains, net	(736)	8,809	(9,545)	284	28,009	(27,725)	—	36,369	(36,369)
(Provision for) benefit from income taxes	(117)	(16,741)	16,624	(155)	(3,708)	3,553	(150)	10,346	(10,496)
Income	\$ 92,570	\$ 109,473	\$ (16,903)	\$ 166,369	\$ 131,252	\$ 35,117	\$ 43,651	\$ 102,088	\$ (58,437)
REIT taxable income	\$ 56,042			\$ 97,577			\$ 85,685		
Taxable income (loss) at taxable subsidiaries	36,528			68,792			(42,034)		
Taxable income	\$ 92,570			\$ 166,369			\$ 43,651		
Shares used for taxable EPS calculation	77,123			76,835			78,163		
REIT taxable income per share <sup>(3)</sup>	\$ 0.73			\$ 1.27			\$ 1.05		
Taxable income (loss) per share at taxable subsidiaries	\$ 0.48			\$ 0.90			\$ (0.50)		
Taxable income per share <sup>(3)</sup>	\$ 1.21			\$ 2.17			\$ 0.55		
<b>Dividends</b>									
Dividends declared	\$ 64,753			\$ 86,240			\$ 92,493		
Dividends per share <sup>(4)</sup>	\$ 0.84			\$ 1.12			\$ 1.12		

(1) Taxable income for 2017 is an estimate until we file our tax returns for this year. To the extent we expect to pay tax at the corporate level (generally as a result of activity at our taxable REIT subsidiaries), we are required to record a tax provision for GAAP reporting purposes. Any tax provision (or benefit) is not necessarily the actual amount of tax currently due (or receivable as a refund) as a portion of our provision (or benefit) is deferred in nature. It is our intention to retain any excess inclusion income generated in 2017 at our TRS and not pass it through to our shareholders.

(2) Reconciliation of GAAP income to taxable income (loss) for prior quarters is provided in the respective Redwood Reviews for those quarters.

(3) REIT taxable income per share and taxable income (loss) per share are based on the number of shares outstanding at the end of each quarter. The estimated nine months 2017 and annual 2016 and 2015 REIT taxable income per share and taxable income (loss) per share are the sum of the quarterly per share estimates.

(4) Dividends in 2016 were characterized as 100% ordinary income (or \$86 million). Dividends in 2015 were characterized as 100% ordinary income (or \$92 million).



Table 5: Financial Ratios and Book Value (\$ in thousands, except per share data)

	2017 Q3	2017 Q2	2017 Q1	2016 Q4	2016 Q3	2016 Q2	2016 Q1	2015 Q4	2015 Q3	Nine Months 2017	Nine Months 2016
<b>Financial performance ratios</b>											
Net interest income	\$ 35,294	\$ 34,990	\$ 33,597	\$ 35,797	\$ 39,309	\$ 44,343	\$ 38,378	\$ 43,790	\$ 39,609	\$ 103,881	\$ 122,030
Operating expenses	\$ (19,922)	\$ (18,641)	\$ (18,226)	\$ (17,824)	\$ (20,355)	\$ (20,155)	\$ (30,452)	\$ (22,638)	\$ (24,497)	\$ (56,789)	\$ (70,962)
GAAP net income	\$ 36,180	\$ 36,324	\$ 36,969	\$ 25,355	\$ 52,553	\$ 41,281	\$ 12,063	\$ 41,059	\$ 19,164	\$ 109,473	\$ 105,897
Average total assets	\$5,851,133	\$5,685,460	\$5,471,154	\$5,613,048	\$5,880,281	\$5,954,162	\$6,131,715	\$6,480,586	\$5,977,645	\$ 5,670,666	\$ 5,988,332
Average total equity	\$1,189,540	\$1,167,438	\$1,158,732	\$1,137,948	\$1,111,507	\$1,089,289	\$1,110,187	\$1,189,289	\$1,244,327	\$ 1,172,021	\$ 1,103,705
Operating expenses / average total assets	1.36%	1.31%	1.33%	1.27%	1.38%	1.35%	1.99%	1.40%	1.64%	1.34%	1.58%
Operating expenses / average total equity	6.70%	6.39%	6.29%	6.27%	7.33%	7.40%	10.97%	7.61%	7.87%	6.46%	8.57%
GAAP net income / average total assets	2.47%	2.56%	2.70%	1.81%	3.57%	2.77%	0.79%	2.53%	1.28%	2.57%	2.36%
GAAP net income / average equity (GAAP ROE)	12.17%	12.45%	12.76%	8.91%	18.91%	15.16%	4.35%	13.81%	6.16%	12.45%	12.79%
<b>Leverage ratios and book value per share</b>											
Short-term debt	\$1,238,196	\$1,294,807	\$ 563,773	\$ 791,539	\$1,117,405	\$1,059,045	\$ 804,175	\$1,855,003	\$1,872,793		
Long-term debt – Commercial secured borrowing	—	—	—	—	—	65,240	65,181	63,152	65,578		
Long-term debt – Other <sup>(1)</sup>	2,585,264	2,340,264	2,627,764	2,627,764	2,627,764	2,627,764	2,627,764	1,975,023	1,756,299		
Total debt at Redwood	\$3,823,460	\$3,635,071	\$3,191,537	\$3,419,303	\$3,745,169	\$3,752,049	\$3,497,120	\$3,893,178	\$3,694,670		
<b>ABS issued at consolidated entities</b>											
Residential Resecuritization ABS issued	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 5,261		
Commercial Securitization ABS issued	—	—	—	—	—	—	51,680	53,137	67,946		
Legacy Sequoia entities ABS issued	657,960	692,606	728,391	773,462	819,868	859,628	907,023	996,820	1,105,588		
Sequoia Choice entity ABS issued	286,328	—	—	—	—	—	—	—	—		
Total ABS issued <sup>(1)</sup>	\$ 944,288	\$ 692,606	\$ 728,391	\$ 773,462	\$ 819,868	\$ 859,628	\$ 958,703	\$1,049,957	\$1,178,795		
Consolidated Debt	\$4,767,748	\$4,327,677	\$3,919,928	\$4,192,765	\$4,565,037	\$4,611,677	\$4,455,823	\$4,943,135	\$4,873,465		
Stockholders' equity	\$1,208,640	\$1,179,424	\$1,165,771	\$1,149,428	\$1,130,130	\$1,092,603	\$1,085,750	\$1,146,265	\$1,206,575		
Debt at Redwood to stockholders' equity <sup>(2)</sup>	3.2x	3.1x	2.7x	3.0x	3.3x	3.4x	3.2x	3.4x	3.1x		
Consolidated debt to stockholders' equity	3.9x	3.7x	3.4x	3.6x	4.0x	4.2x	4.1x	4.3x	4.0x		
Shares outstanding at period end (in thousands)	77,123	77,117	77,039	76,835	76,682	76,935	76,627	78,163	82,125		
Book value per share	\$ 15.67	\$ 15.29	\$ 15.13	\$ 14.96	\$ 14.74	\$ 14.20	\$ 14.17	\$ 14.67	\$ 14.69		

(1) Long-term debt - other and ABS issued presented above do not include deferred securities issuance costs.

(2) Excludes ABS issued at consolidated entities and commercial secured borrowings associated with commercial A-notes that were sold, but treated as secured borrowings under GAAP.

**Table 6: Securities and Loan Activity (\$ in thousands)**

	2017 Q3	2017 Q2	2017 Q1	2016 Q4	2016 Q3		2017 Q3	2017 Q2	2017 Q1	2016 Q4	2016 Q3
<b>Securities – Senior</b>						<b>Residential Loans, held-for-sale</b>					
Beginning fair value	\$ 176,962	\$ 176,099	\$ 173,613	\$ 95,782	\$ 96,456	Beginning carrying value	\$ 837,371	\$ 376,607	\$ 835,399	\$ 1,188,514	\$ 882,380
Acquisitions	16,383	12,842	3,231	4,943	—	Acquisitions	1,462,116	1,221,051	1,108,304	1,132,561	1,252,135
Sales	(2,500)	(628)	(4,944)	(1,463)	—	Sales <sup>(3)</sup>	(1,393,323)	(694,875)	(1,377,637)	(1,268,943)	(774,106)
Effect of principal payments	(7,324)	(7,828)	(6,247)	(5,364)	(4,552)	Principal repayments	20,025	(9,273)	(12,995)	(24,427)	(20,574)
Transfers between portfolios <sup>(1)</sup>	34,375	—	12,229	75,058	1,889	Transfers between portfolios	(16,436)	(61,922)	(184,996)	(186,116)	(151,919)
Change in fair value, net	(1,897)	(3,523)	(1,783)	4,657	1,989	Changes in fair value, net	15,928	5,783	8,532	(6,190)	598
<b>Ending fair value</b>	<b>\$ 215,999</b>	<b>\$ 176,962</b>	<b>\$ 176,099</b>	<b>\$ 173,613</b>	<b>\$ 95,782</b>	<b>Ending fair value</b>	<b>\$ 925,681</b>	<b>\$ 837,371</b>	<b>\$ 376,607</b>	<b>\$ 835,399</b>	<b>\$ 1,188,514</b>
<b>Ending Balances for Senior Sub-Categories</b>						<b>Residential Loans, held-for-investment at Redwood</b>					
Senior RMBS Securities	\$ 153,232	\$ 128,330	\$ 137,210	\$ 136,547	\$ 71,290	Beginning carrying value	\$ 2,360,234	\$ 2,350,013	\$ 2,261,016	\$ 2,282,674	\$ 2,277,561
Senior IO Securities	62,767	48,632	38,889	37,066	24,492	Principal repayments	(74,550)	(60,055)	(93,666)	(162,512)	(146,151)
<b>Total senior securities</b>	<b>\$ 215,999</b>	<b>\$ 176,962</b>	<b>\$ 176,099</b>	<b>\$ 173,613</b>	<b>\$ 95,782</b>	Transfers between portfolios	(20,025)	61,922	184,996	186,116	151,919
<b>Securities – Re-REMIC</b>						<b>Ending fair value</b>					
Beginning fair value	\$ 73,337	\$ 73,730	\$ 85,479	\$ 161,234	\$ 165,707		<b>\$ 2,268,802</b>	<b>\$ 2,360,234</b>	<b>\$ 2,350,013</b>	<b>\$ 2,261,016</b>	<b>\$ 2,282,674</b>
Effect of principal payments	(1,745)	(488)	(866)	(1,828)	(4,917)	<b>Ending Balances for Other Loan and MSR Investments</b>					
Transfers between portfolios <sup>(1)</sup>	(34,375)	—	(12,229)	(75,058)	(1,889)	<b>Residential Loans, HFI</b>					
Change in fair value, net	1,816	95	1,346	1,131	2,333	Legacy Sequoia entities	\$ 673,134	\$ 707,686	\$ 745,621	\$ 791,636	\$ 839,976
<b>Ending fair value</b>	<b>\$ 39,033</b>	<b>\$ 73,337</b>	<b>\$ 73,730</b>	<b>\$ 85,479</b>	<b>\$ 161,234</b>	Sequoia Choice entity	\$ 317,303	\$ —	\$ —	\$ —	\$ —
<b>Securities – Subordinate <sup>(2)</sup></b>						<b>Commercial Loans</b>					
Beginning fair value	\$ 968,204	\$ 916,111	\$ 759,347	\$ 679,894	\$ 621,638		\$ —	\$ —	\$ 2,700	\$ 2,700	\$ 30,400
Acquisitions	171,755	104,018	167,498	106,415	75,676	<b>Mortgage Servicing Rights</b>					
Sales	(44,576)	(69,048)	(16,816)	(11,809)	(25,610)		\$ 62,928	\$ 63,770	\$ 111,013	\$ 118,526	\$ 106,009
Effect of principal payments	(10,428)	(7,538)	(7,798)	(8,182)	(7,985)						
Change in fair value, net	16,285	24,661	13,880	(6,971)	16,175						
<b>Ending fair value</b>	<b>\$ 1,101,240</b>	<b>\$ 968,204</b>	<b>\$ 916,111</b>	<b>\$ 759,347</b>	<b>\$ 679,894</b>						
<b>Ending Balances for Subordinate Sub-Categories</b>											
RMBS 2.0 Mezzanine	\$ 334,915	\$ 343,013	\$ 368,919	\$ 315,397	\$ 283,561						
RMBS 2.0 Subordinate	209,554	195,039	191,321	177,760	165,721						
Agency CRT	286,780	229,510	198,197	152,126	134,460						
Legacy RMBS Subordinate	26,920	30,333	18,993	22,294	23,542						
Total residential subordinates	858,169	797,895	777,430	667,577	607,284						
Multifamily	243,071	170,309	138,681	91,770	72,610						
<b>Total subordinate securities</b>	<b>\$ 1,101,240</b>	<b>\$ 968,204</b>	<b>\$ 916,111</b>	<b>\$ 759,347</b>	<b>\$ 679,894</b>						

(1) In 2016 and 2017, certain Re-REMIC securities we held were exchanged for the underlying senior securities.

(2) Securities-subordinate, as presented above, includes mezzanine securities.

(3) Includes \$318 million of Choice loans securitized during the third quarter of 2017, which were not treated as sales for GAAP purposes and continue to be reported on our consolidated balance sheets as residential loans held-for-investment within our Investment Portfolio segment.



Table 7: Consolidating Balance Sheet (\$ in thousands)

	September 30, 2017				June 30, 2017			
	Consolidated VIEs <sup>(1)</sup>				Consolidated VIEs <sup>(1)</sup>			
	At Redwood <sup>(1)</sup>	Legacy Sequoia	Sequoia Choice	Redwood Consolidated	At Redwood <sup>(1)</sup>	Legacy Sequoia	Sequoia Choice	Redwood Consolidated
Residential loans	\$ 3,194,483	\$ 673,134	\$ 317,303	\$ 4,184,920	\$ 3,197,605	\$ 707,686	\$ —	\$ 3,905,291
Real estate securities	1,356,272	—	—	1,356,272	1,218,503	—	—	1,218,503
Mortgage servicing rights	62,928	—	—	62,928	63,770	—	—	63,770
Cash and cash equivalents	257,611	—	—	257,611	217,218	—	—	217,218
Total earning assets	4,871,294	673,134	317,303	5,861,731	4,697,096	707,686	—	5,404,782
Other assets <sup>(2)</sup>	263,637	4,065	1,266	268,968	244,982	5,718	—	250,700
<b>Total assets</b>	<b>\$ 5,134,931</b>	<b>\$ 677,199</b>	<b>\$ 318,569</b>	<b>\$ 6,130,699</b>	<b>\$ 4,942,078</b>	<b>\$ 713,404</b>	<b>\$ —</b>	<b>\$ 5,655,482</b>
Short-term debt	\$ 1,238,196	\$ —	\$ —	\$ 1,238,196	\$ 1,294,807	\$ —	\$ —	\$ 1,294,807
Other liabilities	163,551	540	1,045	165,136	151,768	531	—	152,299
ABS issued	—	657,960	286,328	944,288	—	692,606	—	692,606
Long-term debt, net	2,574,439	—	—	2,574,439	2,336,346	—	—	2,336,346
Total liabilities	3,976,186	658,500	287,373	4,922,059	3,782,921	693,137	—	4,476,058
Equity	1,158,745	18,699	31,196	1,208,640	1,159,157	20,267	—	1,179,424
<b>Total liabilities and equity</b>	<b>\$ 5,134,931</b>	<b>\$ 677,199</b>	<b>\$ 318,569</b>	<b>\$ 6,130,699</b>	<b>\$ 4,942,078</b>	<b>\$ 713,404</b>	<b>\$ —</b>	<b>\$ 5,655,482</b>

(1) The format of this consolidating balance sheet is provided to more clearly delineate between the assets belonging to consolidated Sequoia securitization entities that we are required to consolidate on our balance sheet in accordance with GAAP, but which are not legally ours, and the liabilities of these consolidated entities, which are payable only from the cash flows generated by their assets and are, therefore, nonrecourse to us, and the assets that are legally ours and the liabilities of ours for which there is recourse to us.

(2) At both September 30, 2017 and June 30, 2017, other assets at Redwood included a total of \$43 million of assets held by third-party custodians and pledged as collateral to the GSEs in connection with credit risk-sharing arrangements relating to conforming residential loans. These pledged assets can only be used to settle obligations to the GSEs under these risk-sharing arrangements.

## REDWOOD TRUST CORPORATE INFORMATION

### EXECUTIVE MANAGEMENT:

**Marty Hughes**

Chief Executive Officer

**Christopher J. Abate**

President

**Dashiell I. Robinson**

Executive Vice President

**Andrew P. Stone**

Executive Vice President,  
General Counsel and Secretary

**Collin L. Cochrane**

Chief Financial Officer

**Bo Stern**

Chief Investment Officer

**Garnet W. Kanouse**

Managing Director - Head of Residential

### CORPORATE HEADQUARTERS:

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Mill Valley, California 94941  
Telephone: (415) 389-7373

### CHICAGO OFFICE:

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Chicago, IL 60606

### DENVER METRO AREA OFFICE:

8310 South Valley Highway, Suite 425  
Englewood, Colorado 80112

### INVESTOR RELATIONS:

**Kristin Brown**

Vice President, Investor Relations  
Telephone: (866) 269-4976  
Email: [investorrelations@redwoodtrust.com](mailto:investorrelations@redwoodtrust.com)

### DIRECTORS:

**Richard D. Baum**

Chairman of the Board  
and Former Chief Deputy Insurance  
Commissioner for the State of California

**Douglas B. Hansen**

Vice-Chairman of the Board  
and Private Investor

**Mariann Byerwalter**

Chairman, SRI International  
Chairman, JDN Corporate Advisory LLC

**Debora D. Horvath**

Principal, Horvath Consulting LLC

**Marty Hughes**

Chief Executive Officer

**Greg H. Kubicek**

President, The Holt Group, Inc.

**Karen R. Pallotta**

Owner, KRP Advisory Services, LLC

**Jeffrey T. Pero**

Retired Partner, Latham & Watkins LLP

**Georganne C. Proctor**

Former Chief Financial Officer, TIAA-CREF

### STOCK LISTING:

The Company's common stock is traded  
on the New York Stock Exchange under  
the symbol **RWT**

### TRANSFER AGENT:

Computershare Trust Company, N.A.  
2 North LaSalle Street  
Chicago, IL 60602  
Telephone: (888) 472-1955



REDWOOD TRUST

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