REDWOOD TRUST INC
Form 10-Q
May 06, 2014
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UNITED STATES OF AMERICA

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended: March 31, 2014
OR

..	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from __________ to __________.

Commission File Number 1-13759

REDWOOD TRUST, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**68-0329422**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
One Belvedere Place, Suite 300 **Mill Valley, California**	**94941**
(Address of Principal Executive Offices)	(Zip Code)

(415) 389-7373

(Registrant s Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

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

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

Common Stock, $0.01 par value per share	82,971,771 shares outstanding as of May 2, 2014

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2014 FORM 10-Q REPORT

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data)

(Unaudited)	**March 31, 2014**	**December 31, 2013**
ASSETS		
Residential loans, held-for-sale	$ 774,936	$ 404,267
Residential loans, held-for-investment	1,689,994	1,762,167
Commercial loans, held-for-sale	77,155	89,111
Commercial loans, held-for-investment (includes $69,436 and $0 at fair value)	414,120	343,344
Real estate securities, at fair value	1,743,008	1,682,861
Mortgage servicing rights, at fair value	64,971	64,824
Cash and cash equivalents	149,966	173,201
Total earning assets	4,914,150	4,519,775
Restricted cash	432	398
Accrued interest receivable	14,410	13,475
Derivative assets	4,438	7,787
Deferred securities issuance costs	12,351	13,453
Other assets	61,330	53,640
Total Assets [1]	$ 5,007,111	$ 4,608,528
LIABILITIES AND EQUITY		
Liabilities		
Short-term debt	$ 1,288,761	$ 862,763
Accrued interest payable	9,832	6,366
Derivative liabilities	27,197	18,167
Accrued expenses and other liabilities	55,542	48,704
Deferred tax liability	7,316	7,316
Asset-backed securities issued	1,854,344	1,942,962
Long-term debt (includes $34,774 and $0 at fair value)	513,232	476,467
Total liabilities [1]	3,756,224	3,362,745
Equity		

Common stock, par value $0.01 per share, 180,000,000 and 165,000,000 shares authorized; 82,619,654 and 82,504,801 issued and outstanding		826		825
Additional paid-in capital		1,765,532		1,760,899
Accumulated other comprehensive income		160,652		148,766
Cumulative earnings		818,631		806,298
Cumulative distributions to stockholders		(1,494,754)		(1,471,005)
Total equity		1,250,887		1,245,783
Total Liabilities and Equity	$	5,007,111	$	4,608,528

(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 March 31, 2014 and December 31, 2013, assets of consolidated VIEs totaled $2,211,222 and $2,299,576, respectively, and liabilities of consolidated VIEs totaled $1,856,219 and $1,944,911, respectively. See *Note 4* for further discussion.

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

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REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In Thousands, Except Share Data) (Unaudited)	Three Months Ended March 31, 2014	2013
Interest Income		
Residential loans	$ 12,658	$ 17,624
Commercial loans	10,394	10,171
Real estate securities	32,431	25,717
Cash and cash equivalents	3	12
Total interest income	55,486	53,524
Interest Expense		
Short-term debt	(3,827)	(3,808)
Asset-backed securities issued	(8,441)	(10,959)
Long-term debt	(6,792)	(3,493)
Total interest expense	(19,060)	(18,260)
Net Interest Income	36,426	35,264
Provision for loan losses	(1,284)	(2,039)
Net Interest Income After Provision	35,142	33,225
Noninterest Income		
Mortgage banking activities, net	(687)	45,000
Mortgage servicing rights income, net	606	1,021
Other market valuation adjustments, net [(1)]	(6,138)	(303)
Realized gains, net	1,092	12,267
Total noninterest income (loss), net	(5,127)	57,985
Operating expenses	(19,525)	(19,691)
Net income before provision for income taxes	10,490	71,519
Benefit from (provision for) income taxes	1,843	(10,909)
Net Income	$ 12,333	$ 60,610
Basic earnings per common share	$ 0.14	$ 0.72
Diluted earnings per common share	$ 0.14	$ 0.69
Regular dividends declared per common share	$ 0.28	$ 0.28
Basic weighted average shares outstanding	82,410,562	81,556,880
Diluted weighted average shares outstanding	84,940,540	87,344,669

(1) For the three months ended March 31, 2014, other-than-temporary impairments were $1,671, of which $113 were recognized through the Income Statement, and $1,558 were recognized in Accumulated Other Comprehensive Income.

For the three months ended March 31, 2013, other-than-temporary impairments were $24, of which $24 were recognized through the Income Statement, and none was recognized in Accumulated Other Comprehensive Income.

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

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REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Thousands)	**Three Months Ended March 31,**			
(Unaudited)		**2014**		**2013**
Net Income	$	12,333	$	60,610
Other comprehensive income:				
Net unrealized gain on available-for-sale securities		19,323		9,030
Reclassification of unrealized loss (gain) to net income		1,298		(12,007)
Net unrealized (loss) gain on interest rate agreements		(8,795)		7,440
Reclassification of unrealized loss on interest rate agreements to net income		60		88
Total other comprehensive income		11,886		4,551
Total Comprehensive Income	$	24,219	$	65,161

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

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REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

For the Three Months Ended March 31, 2014

usands, Except Share Data) **ited)**	**Common Stock** **Shares**	 **Amount**	**Additional** **Paid-In Capital**	**Accumulated Other** **Comprehensive Income**	 **Cumulative Earnings**	**Cumulative** **Distributions to Stockholders**	 **To**
ber 31, 2013	82,504,801	$ 825	$ 1,760,899	$ 148,766	$ 806,298	$ (1,471,005)	$ 1,2
ome	-	-	-	-	12,333	-	
omprehensive income	-	-	-	11,886	-	-	
e of common stock:							
d reinvestment & stock plans	77,660	1	1,544	-	-	-	
ee stock purchase and e plans	37,193	-	(783)	-	-	-	
h equity award compensation	-	-	3,872	-	-	-	
n dividends declared	-	-	-	-	-	(23,749)	(2
31, 2014	82,619,654	$ 826	$ 1,765,532	$ 160,652	$ 818,631	$ (1,494,754)	$ 1,2

For the Three Months Ended March 31, 2013

usands, Except Share Data) **ited)**	**Common Stock** **Shares**	 **Amount**	**Additional** **Paid-In Capital**	**Accumulated Other** **Comprehensive Income**	 **Cumulative Earnings**	**Cumulative** **Distributions to Stockholders**	 **To**
ber 31, 2012	81,716,416	$ 817	$ 1,744,554	$ 138,332	$ 633,052	$ (1,376,591)	$ 1,1
ome	-	-	-	-	60,610	-	
omprehensive income	-	-	-	4,551	-	-	
e of common stock:							
d reinvestment & stock plans	-	-	-	-	-	-	
ee stock purchase and e plans	(10,393)	-	(178)	-	-	-	
h equity award compensation	-	-	6,202	-	-	-	
n dividends declared	-	-	-	-	-	(23,564)	(2
31, 2013	81,706,023	$ 817	$ 1,750,578	$ 142,883	$ 693,662	$ (1,400,155)	$ 1,1

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

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REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)	**Three Months Ended March 31,**	
(Unaudited)	**2014**	**2013**
Cash Flows From Operating Activities:		
Net income	$ 12,333	$ 60,610
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Amortization of premiums, discounts, and securities issuance costs, net	(9,158)	(6,037)
Depreciation and amortization of non-financial assets	106	147
Purchases of loans	(1,181,488)	(2,740,317)
Proceeds from sales of loans	785,380	2,269,845
Principal payments on loans	7,014	3,417
Net settlements of derivatives	(8,394)	1,503
Provision for loan losses	1,284	2,039
Non-cash equity award compensation	3,872	6,202
Market valuation adjustments, net	9,536	(37,861)
Realized gains, net	(1,092)	(19,445)
Net change in:		
Accrued interest receivable and other assets	(7,270)	3,230
Accrued interest payable, deferred tax liabilities, and accrued expenses and other liabilities	(13,781)	3,700
Net cash used in operating activities	(401,658)	(452,967)
Cash Flows From Investing Activities:		
Purchases of loans held-for-investment	(32,998)	(35,989)
Proceeds from sales of loans	-	440
Principal payments on loans	70,800	147,891
Purchases of real estate securities	(49,709)	-
Proceeds from sales of real estate securities	-	22,326
Principal payments on real estate securities	42,304	39,907
Purchase of mortgage servicing rights	(928)	-
Net increase in restricted cash	(34)	(14)
Net cash provided by investing activities	29,435	174,561
Cash Flows From Financing Activities:		
Proceeds from borrowings on short-term debt	920,955	1,636,428
Repayments on short-term debt	(494,956)	(1,467,032)
Proceeds from issuance of asset-backed securities	-	-

Repayments on asset-backed securities issued		(88,523)		(164,288)
Deferred securities issuance costs		-		(9,184)
Proceeds from issuance of long-term debt		36,782		304,100
Repayments on long-term debt		(17)		-
Net settlements of derivatives		(721)		-
Net proceeds from issuance of common stock		122		134
Net payments on repurchase of common stock		-		-
Taxes paid on equity award distributions		(905)		(312)
Dividends paid		(23,749)		(23,564)
Net cash provided by financing activities		348,988		276,282
Net decrease in cash and cash equivalents		(23,235)		(2,124)
Cash and cash equivalents at beginning of period		173,201		81,080
Cash and cash equivalents at end of period	$	149,966	$	78,956
Supplemental Cash Flow Information:				
Cash paid during the period for:				
Interest	$	15,386	$	18,293
Taxes		1,399		862
Supplemental Noncash Information:				
Real estate securities retained from loan securitizations	$	-	$	165,936
Retention of mortgage servicing rights from loan securitizations and sales		2,294		12,466
Transfers from loans held-for-sale to loans held-for-investment		37,631		-
Transfers from residential loans to real estate owned		135		704

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

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

(Unaudited)

Note 1. Redwood Trust

Redwood Trust, Inc., together with its subsidiaries, is a specialty finance company focused on investing in mortgage- and other real estate-related assets and engaging in residential and commercial mortgage banking activities. We seek to invest in real estate-related assets that have the potential to generate attractive cash flow returns over time and to generate income through our residential and commercial mortgage banking activities. We operate our business in three segments: residential mortgage banking, residential investments, and commercial mortgage banking and investments.

Our primary sources of income are net interest income from our investment portfolios and noninterest income from our mortgage banking activities. Net interest income consists of the interest income we earn on investments less the interest expense we incur on borrowed funds and other liabilities. Income from mortgage banking activities consists of the profit we seek to generate through the acquisition or origination of loans and their subsequent sale or securitization. References herein to Redwood, the company, we, us, and our include Redwood Trust, Inc. consolidated subsidiaries, unless the context otherwise requires.

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

Note 2. Basis of Presentation

The consolidated financial statements presented herein are at March 31, 2014 and December 31, 2013, and for the three months ended March 31, 2014 and 2013. These consolidated financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) in the United States of America as prescribed by the Financial Accounting Standards Board s (FASB) Accounting Standards Codification (ASC) and using th Securities and Exchange Commission s (SEC) instructions to Form 10-Q.

Certain prior year amounts have been reclassified in the consolidated financial statements and the related footnotes to conform to the 2014 presentation.

Organization

For tax purposes, Redwood Trust, Inc. is structured as a real estate investment trust (REIT). We generally refer, collectively, to Redwood Trust, Inc. and those of its subsidiaries that are not subject to subsidiary-level corporate income tax as the REIT or our REIT. We generally refer to subsidiaries of Redwood Trust, Inc. that are subject to subsidiary-level corporate income tax as our operating subsidiaries or our taxable REIT subsidiaries or TRS. Ou mortgage banking activities are generally carried out through our taxable REIT subsidiaries, while our portfolio of mortgage- and other real estate-related investments is primarily held at our REIT. We generally intend to retain profits generated and taxed at our taxable REIT subsidiaries, and to distribute as dividends at least 90% of the income we generate at our REIT.

We sponsor our Sequoia securitization program, which we use for the securitization of residential mortgage loans. References to Sequoia with respect to any time or period generally refer collectively to all the then consolidated Sequoia securitization entities for the periods presented. We have also engaged in securitization transactions in order to obtain financing for certain of our securities and commercial loans.

Financial Information About Industry Segments

FASB ASC 280, *Segment Reporting*, establishes standards for reporting financial and descriptive information about an enterprise s reportable segments. Our three business segments are residential mortgage banking, residential investments, and commercial mortgage banking and investments.

See *Note* 21 for further discussion on business segments.

Principles of Consolidation

We apply FASB guidance to determine whether we must consolidate transferred financial assets and variable interest entities (VIEs) for financial reporting purposes. We currently consolidate the assets and liabilities of the Sequoia securitization entities

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where we maintain an ongoing involvement, as well as an entity formed in connection with a resecuritization transaction we engaged in during 2011 (Residential Resecuritization), and an entity formed in connection with a commercial securitization we engaged in during the fourth quarter of 2012 (Commercial Securitization). Each securitization entity is independent of Redwood and of each other and the assets and liabilities are not owned by and are not legal obligations of Redwood Trust, Inc. Our exposure to these entities is primarily through the financial interests we have retained, although we are exposed to certain financial risks associated with our role as a sponsor, manager, or depositor of these entities or as a result of our having sold assets directly or indirectly to these entities.

For financial reporting purposes, the underlying loans and securities owned at the consolidated Sequoia entities, the Residential Resecuritization entity, and the Commercial Securitization entity are shown under residential and commercial loans and real estate securities on our consolidated balance sheets. The asset-backed securities (ABS) issued to third parties by these entities are shown under ABS issued. In our consolidated statements of income, we record interest income on the loans and securities owned at these entities and interest expense on the ABS issued by these entities.

See *Note* 4 for further discussion on principles of consolidation.

Note 3. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements requires us to make a number of significant estimates. These include estimates of fair value of certain assets and liabilities, amounts and timing of credit losses, prepayment rates, and other estimates that affect the reported amounts of certain assets and liabilities as of the date of the consolidated financial statements and the reported amounts of certain revenues and expenses during the reported period. It is likely that changes in these estimates (e.g., valuation changes due to supply and demand, credit performance, prepayments, interest rates, or other reasons) will occur in the near term. Our estimates are inherently subjective in nature and actual results could differ from our estimates and the differences could be material.

Fair Value Measurements

Our financial statements include assets and liabilities that are measured at their estimated fair values in accordance with GAAP. A fair value measurement represents the price at which an orderly transaction would occur between willing market participants at the measurement date. We develop fair values for financial assets or liabilities based on available inputs and pricing that is observed in the marketplace. Examples of market information that we attempt to obtain include the following:

- Quoted prices for the same or similar securities;
- Relevant reports issued by analysts and rating agencies;
- The current level of interest rates and any directional movements in relevant indices, such as credit risk indices;
- Information about the performance of mortgage loans, such as delinquency and foreclosure rates, loss experience, and prepayment rates;
- Indicative prices or yields from broker/dealers (including prices from counterparties under securities repurchase agreements); and,
- Other relevant observable inputs, including nonperformance risk and liquidity premiums.

After considering all available indications of the appropriate rate of return that market participants would require, we consider the reasonableness of the range indicated by the results to determine an estimate that is most representative of fair value.

The markets for many of the loans and securities that we invest in and issue are generally illiquid. Establishing fair values for illiquid assets and liabilities is inherently subjective and is often dependent upon our estimates and modeling assumptions. If we determine that either the volume and/or level of trading activity for an asset or liability has significantly decreased from normal market conditions, or price quotations or observable inputs are not associated with orderly transactions, the market inputs that we obtain might not be relevant. For example, broker or pricing service quotes might not be relevant if an active market does not exist for the

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financial asset or liability. The nature of the quote (for example, whether the quote is an indicative price or a binding offer) is also evaluated.

In circumstances where relevant market inputs cannot be obtained, increased analysis and management judgment are required to estimate fair value. This generally requires us to establish internal assumptions about future cash flows and appropriate risk-adjusted discount rates. Regardless of the valuation inputs we apply, the objective of fair value measurement is unchanged from what it would be if markets were operating at normal activity levels and/or transactions were orderly; that is, to determine the current exit price.

See *Note* 5 for further discussion on fair value measurements.

Fair Value Option

We have the option to measure eligible financial assets, financial liabilities, and commitments at fair value on an instrument-by-instrument basis. This option is available when we first recognize a financial asset or financial liability or enter into a firm commitment. Subsequent changes in the fair value of assets, liabilities, and commitments where we have elected the fair value option are recorded in our consolidated statements of income.

We elect the fair value option for certain residential and commercial loans, Sequoia IO securities and MSRs. We generally elect the fair value option for residential and commercial loans that are held-for-sale, due to our intent to sell or securitize the loans in the near-term. We generally elect the fair value option for Sequoia IO securities as we use these in part to hedge certain risks associated with our residential loans held-for-sale. We elect the fair value option for our MSRs in order to reflect the current value of these investments in our financial position and results each period. We also elect the fair value option for certain secured borrowings we may recognize when the sale of commercial loans do not meet the sale criteria in ASC 860.

See *Note* 5 for further discussion on the fair value option.

Real Estate Loans

Residential and Commercial Loans Held-for-Sale

Residential and commercial loans held-for-sale include loans that we are marketing for sale to third parties, including transfers to securitization entities that we plan to sponsor and expect to be accounted for as sales for financial reporting purposes.

Residential and Commercial Loans Fair Value

We generally elect the fair value option for residential and commercial loans that we purchase with the intent to sell to third parties or transfer to Sequoia securitizations. Coupon interest is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due. Changes in fair value are recurring and are reported through our consolidated statements of income in mortgage banking activities, net for residential and commercial loans held at fair value.

Residential and Commercial Loans Lower of Cost or Fair Value

Certain residential and commercial loans held-for-sale that are not accounted for under the fair value option (generally loans acquired prior to 2011) are carried at the lower of their cost or fair value. If the fair value of an individual loan or pool of loans held-for-sale is lower than its amortized cost basis, this difference is reported through our consolidated statements of income as a negative market valuation adjustment (MVA) in mortgage banking activities, net. Coupon interest for loans held-for-sale is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due at which point it is placed on non-accrual status. Gains or losses on the sale of residential or commercial loans held-for-sale are based on the specific identification method for loans measured on an individual basis or in aggregate for those loans measured on a pool basis.

Residential and Commercial Loans Held-for-Investment

Commercial Loans Fair Value

We may elect the fair value option for senior commercial mortgage loans that we originate or acquire that are bifurcated into a senior portion that is sold to a third party and a junior portion that we retain as an investment. When the transfer of the senior portion

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(Unaudited)

does not meet the criteria for sale treatment under GAAP, the entire loan (the senior and junior portions) remains on our consolidated balance sheet classified as a held-for-investment loan and we account for the transfer of the senior portion as a secured borrowing. Coupon interest is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due. Changes in fair value are recurring and are reported through our consolidated statements of income in mortgage banking activities, net.

Residential and Commercial Loans At Amortized Cost

Loans held-for-investment include residential loans owned at consolidated Sequoia entities and commercial loans owned at the Commercial Securitization entity and by us, net of any allowance for loan losses. Coupon interest is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due or has been individually impaired, at which point the loan is placed on nonaccrual status. Interest previously accrued for loans that have become greater than 90 days past due or individually impaired is reserved for in the allowance for loan losses. Residential loans delinquent more than 90 days or in foreclosure are characterized as a serious delinquency. Cash principal and interest that is advanced from servicers subsequent to a loan becoming greater than 90 days past due or individually impaired is accounted for as a reduction in the outstanding loan principal balance. When a seriously delinquent loan previously placed on nonaccrual status has cured, meaning all delinquent principal and interest have been remitted by the borrower, the loan is placed back on accrual status. Alternately, loans that have been individually impaired may be placed back on accrual status if restructured and after the loan is considered reperforming. A restructured loan is considered reperforming when the loan has been current for at least 12 months.

We use the interest method to determine an effective yield to amortize the premium or discount on real estate loans held-for-investment. For residential loans acquired prior to July 1, 2004, we use coupon interest rates as they change over time and anticipated principal payments to determine periodic amortization. For residential and commercial loans acquired after July 1, 2004, we use the initial coupon interest rate of the loans (without regard to future changes in the underlying indices) and anticipated principal payments, if any, to determine periodic amortization.

We reclassify loans held-for-investment as loans held-for-sale if we determine that these loans will be sold or transferred to third parties. This may occur, for example, if we exercise our right to call ABS issued by a Sequoia securitization trust and decide to subsequently sell the underlying loans to third parties.

See *Note* 6 for further discussion on residential loans. See *Note 7* for further discussion on commercial loans.

Residential Loans Allowance for Loan Losses

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

We consider the following factors in evaluating the allowance for loan losses:

Ongoing analyses of loans, including, but not limited to, the age of loans and year of origination, underwriting standards, business climate, economic conditions, and other observable data;

Historical loss rates and past performance of similar loans;

Relevant market research and publicly available third-party reference loss rates;

Trends in delinquencies and charge-offs;

Effects and changes in credit concentrations;

Information supporting a borrower s ability to meet obligations;

Ongoing evaluations of fair values of collateral using current appraisals and other valuations; and,

Discounted cash flow analyses.

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Once we determine the amount of defaults, the timing of the defaults, and severity of losses upon the defaults, we estimate expected losses for each individual loan or pool of loans over its expected life. We then estimate the timing of these losses and the losses probable to occur over an appropriate loss confirmation period. This period is defined as the range of time between the occurrence of a credit loss (such as the initial deterioration of the borrower s financial condition) and the confirmation of that loss (the actual impairment or charge-off of the loan). The losses expected to occur within the estimated loss confirmation period are the basis of our allowance for loan losses, since we believe these losses exist at the reported date of the financial statements. We re-evaluate the adequacy of our allowance for loan losses quarterly.

As part of the loss mitigation efforts undertaken by servicers of residential loans owned at Sequoia securitization entities, a number of loan modifications have been completed to help make mortgage loans more affordable for certain borrowers. Loan modifications may include, but are not limited to: (i) conversion of a floating rate mortgage loan into a fixed rate mortgage loan; (ii) reduction in the contractual interest rate of a mortgage loan; (iii) forgiveness of a portion of the contractual interest and/or principal amounts owed on a mortgage loan; and, (iv) extension of the contractual maturity of a mortgage loan. We evaluate all loan modifications performed by servicers to determine if they constitute troubled debt restructurings (TDRs) according to GAAP. If a loan is determined to be a TDR, it is removed from the general loan pools used for calculating allowances for loan losses and assessed for impairment on an individual basis based upon any adverse change in the expected future cash flows resulting from the modification. This difference is recorded to the provision for loan losses in our consolidated statements of income.

When foreclosed property is received in full satisfaction for a defaulted loan, we estimate the fair value of the property, based on estimated net proceeds from the sale of the property (including servicer advances and other costs). To the extent that the fair value of the property is below the recorded investment of the loan, we record a charge against the allowance for loan losses for the difference. Foreclosed property is subsequently recorded as real estate owned (REO), a component of other assets on our consolidated balance sheets. Actual losses incurred on loans liquidated through a short-sale are also charged against the allowance for loan losses.

See *Note* 6 for further discussion on the allowance for loan losses for residential loans.

Commercial Loans Allowance for Loan Losses

For commercial loans classified as held-for-investment, we establish and maintain a general allowance for loan losses inherent in our portfolio at the reporting date and, where appropriate, a specific allowance for loan losses for loans we have determined to be impaired at the reporting date. An individual loan is considered impaired when it is deemed probable that we will not be able to collect all amounts due according to the contractual terms of the loan.

Our methodology for assessing the adequacy of the allowance for loan losses begins with a formal review of each commercial loan in the portfolio and the assignment of an internal impairment status. Reviews are performed at least quarterly. We consider the following factors in evaluating each loan:

- Loan to value ratios upon origination or acquisition of the loan;

- The most recent financial information available for each loan and associated properties, including net operating income, debt service coverage ratios, occupancy rates, rent rolls, as well as any other loss factors we consider relevant, such as, but not limited to, specific loan trigger events that would indicate an adverse change in expected cash flows or payment delinquency;

- Economic trends, both macroeconomic as well as those directly affecting the properties associated with our loans, and the supply and demand of competing projects in the sub-market in which the subject property is located; and,

- The loan sponsor or borrowing entity s ability to ensure that properties associated with the loan are managed and operated sufficiently.

Loan reviews are completed by asset management and finance personnel and reviewed and approved by senior management.

Based on the assigned internal impairment status, a loan is categorized as Pass, Watch List, or Workout. Pass loans are defined as loans that are performing in accordance with the contractual terms of the loan agreement. Watch List loans are defined as performing loans for which the timing of cost recovery is under review. Workout loans are defined as loans that we believe have a credit impairment that may lead to a realized loss. Workout loans are typically assessed for impairment on an individual basis. Where an individual commercial loan is impaired, we record an allowance to reduce the carrying value of the loan to the current present value

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of expected future cash flows discounted at the loan s effective rate or if a loan is collateral dependent, we reduce the carrying value to the estimated fair market value of the loan, with a corresponding charge to provision for loan losses on our consolidated statements of income.

For all commercial loans that are not individually impaired, we assess the commercial loan portfolio in aggregate for loan losses based on our expectation of credit losses inherent in the portfolio at the reporting date. Our expectation of credit losses is informed by, among other things:

- Historical loss rates and past performance of similar loans in our own portfolio, if any;
- Publicly available third-party reference loss rates on similar loans; and,
- Trends in delinquencies and charge-offs in our own portfolio and among industry participants.

See *Note 7* for further discussion on the allowance for loan losses for commercial loans.

Repurchase Reserves

We sell residential mortgage loans to various parties, including (1) securitization trusts, (2) Fannie Mae and Freddie Mac (the Agencies), and (3) other financial institutions that purchase mortgage loans for investment or private label securitization. We may be required to repurchase residential mortgage loans in the event of a breach of specified contractual representation and warranties. We do not originate residential mortgage loans and believe the initial risk of loss due to loan repurchases (i.e., due to a breach of representations and warranties) would generally be a contingency to the companies from whom we acquired the loans. However, in some cases, for example, where loans were acquired from companies that have since become insolvent, repurchase claims may result in our being liable for a repurchase obligation.

We establish reserves for mortgage repurchase liabilities related to various representations and warranties that reflect management s estimate of losses for loans for which we could have a repurchase obligation, based on a combination of factors. Such factors can include estimated future defaults and loan repurchase rates, the potential severity of loss in the event of defaults, and the probability of our being liable for a repurchase obligation. We establish a liability at the time loans are sold and continually update our liability estimate during its life. The liability for mortgage loan repurchase losses is included in other liabilities on our consolidated balance sheets and the related expense is included as a component of mortgage banking activities, net on our consolidated statements of income.

See *Note 15* for further discussion on the residential repurchase reserves.

We have originated and sold commercial mortgage loans and have made standard representations and warranties upon sale of the loans to the loan purchasers, and in some cases, to securitization trusts. We review the need for a repurchase reserve related to these commercial loans on an ongoing basis and are not aware of any breaches of representations and warranties related to these loans.

Real Estate Securities, at Fair Value

We classify our real estate securities as trading or available-for-sale securities. We use the prime or non-prime designation to categorize our residential securities based upon the general credit characteristics of the residential loans underlying each security at the time of origination. For example, prime residential loans are generally characterized by lower loan-to-value (LTV) ratios at the time the loans were originated, and are made to borrowers with higher Fair Isaac Corporation (FICO) scores. Non-prime residential loans are generally characterized by higher LTV ratios at the time the loans were originated and may have been made to borrowers with lower credit scores or impaired credit histories (while exhibiting the ability to repay their loans) at the time the loan was originated. Regardless of whether or not the loans underlying a residential security were designated as prime or non-prime at origination, there is a risk that the borrower may not be able to repay the loan.

Trading Securities

We primarily denote trading securities as those securities where we have adopted the fair value option. Trading securities are carried at their estimated fair values and coupon interest is recognized as interest income when earned and deemed collectible. Changes in the fair value of Sequoia IO securities designated as trading securities are reported in mortgage banking activities, net, a

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component of our consolidated statements of income. Changes in the fair value of other trading securities are reported through our consolidated statements of income in other market valuation adjustments, net.

Available-for-Sale Securities

AFS securities primarily consist of non-agency residential mortgage backed securities (RMBS) and may include other residential and commercial securities. Non-agency RMBS are not issued or guaranteed by a federally chartered corporation, such as Fannie Mae or Freddie Mac, or any agency of the U.S. Government. AFS securities are carried at their estimated fair value with unrealized gains and losses excluded from earnings (except when an other-than-temporary impairment (OTTI) is recognized, as discussed below) and reported in accumulated other comprehensive income (AOCI), a component of stockholders equity.

Interest income on AFS securities is accrued based on their outstanding principal balance and contractual terms and interest income is recognized based on the security s effective interest rate. In order to calculate the effective interest rate, we must project cash flows over the remaining life of each security and make assumptions with regards to interest rates, prepayment rates, the timing and amount of credit losses, and other factors. On at least a quarterly basis, we review and, if appropriate, make adjustments to our cash flow projections based on input and analysis received from external sources, internal models, and our own judgments about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. Changes in cash flows from those originally projected, or from those estimated at the last evaluation, may result in a prospective change in the yield/interest income recognized on these securities or in the recognition of OTTI as discussed below.

For AFS securities purchased and held at a discount, a portion of the discount may be designated as non-accretable purchase discount (credit reserve), based on the cash flows we have projected for the security. The amount designated as credit reserve may be adjusted over time, based on our periodic evaluation of projected cash flows. If the performance of a security with a credit reserve is more favorable than previously forecasted, a portion of the credit reserve may be reallocated to accretable discount and recognized into interest income over time. Conversely, if the performance of a security with a credit reserve is less favorable than forecasted, the amount designated as credit reserve may be increased, or impairment charges and write-downs of such securities to a new cost basis could result.

When the fair value of an AFS security is less than its amortized cost at the reporting date, the security is considered impaired. We assess our impaired securities at least quarterly to determine if the impairment is temporary or other-than-temporary (resulting in an OTTI). If we either (i) intend to sell the impaired security; (ii) will more likely than not be required to sell the impaired security before it recovers in value; or (iii) if there has been an adverse change in cash flows the impairment is deemed an OTTI. In the case of criteria (i) and (ii), we record the entire difference between the security s estimated fair value and its amortized cost at the reporting date in our consolidated statements of income. If there has been an adverse change in cash flows, only the portion of the OTTI related to credit losses is recognized through other market valuation adjustments, net on our consolidated statements of income, with the remaining non-credit portion recognized through AOCI on our consolidated balance sheet. If the first two criteria are not met and there has not been an adverse change in cash flows, the impairment is considered temporary and the entire unrealized loss is recognized through AOCI on our consolidated balance sheets.

For impaired AFS securities, to determine if there has been an adverse change in cash flows and if any portion of a resulting OTTI is related to credit losses, we compare the present value of the cash flows expected to be collected as of the current financial reporting date to the amortized cost basis of the security. The discount rate used to calculate the present value of expected future cash flows is the current yield used for income recognition purposes. If the present value of the current expected cash flows is less than the amortized cost basis, there has been an adverse change and the security is considered OTTI with the difference between these two amounts representing the credit loss. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective and based on information available at the time of the assessment as well as our estimates of future performance and cash flows. As a result, the timing and amount of OTTI constitute a material estimate that is susceptible to significant change.

See *Note 8* for further discussion on real estate securities.

MSRs

We recognize MSRs through the retention of servicing rights associated with residential mortgage loans that we have acquired and subsequently transferred to third parties (including the Agencies) or through the direct acquisition of MSRs sold by third parties.

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Typically, our MSRs are created through the transfer of loans to a third party or to a Sequoia residential mortgage securitization sponsored by us that meets the GAAP criteria for sale accounting.

Our MSRs are held and managed at Redwood Residential Acquisition Corporation, a wholly-owned subsidiary of RWT Holdings, Inc., which is a taxable REIT subsidiary of ours. We contract with a licensed sub-servicer to perform servicing functions for loans associated with our MSRs. We have elected the fair value option for all of our MSRs, and they are initially recognized and carried at their estimated fair values. Income from MSRs and changes in the estimated fair value of MSRs are reported in MSR income, net, a component of our consolidated statements of income.

See *Note 9* for further discussion on MSRs.

Cash and Cash Equivalents

Cash and cash equivalents include non-restricted cash and highly liquid investments with original maturities of three months or less.

Restricted Cash

Restricted cash primarily includes principal and interest payments that are collateral for, or payable to, owners of ABS issued by consolidated securitization entities. Restricted cash may also include cash retained in the Sequoia securitization entities or in the Residential Resecuritization or Commercial Securitization entities prior to the payments on or redemptions of outstanding ABS issued.

Accrued Interest Receivable

Accrued interest receivable includes interest that is due and payable to us and deemed collectible. Cash interest is generally received within thirty days of recording the receivable. For financial assets where we have elected the fair value option, the associated accrued interest receivable on these assets is measured at fair value. For financial assets where we have not elected the fair value option, the associated accrued interest carrying values approximate fair values.

Derivative Financial Instruments

Derivative financial instruments we typically utilize include swaps, swaptions, financial futures contracts, and To Be Announced (TBA) contracts. These derivatives are primarily used to manage interest rate risk associated with our operations. In addition, we enter into certain residential loan purchase commitments (LPCs) and residential loan forward sale commitments (FSCs) that are treated as derivatives for financial reporting purposes. All derivative financial instruments are recorded at their estimated fair values on our consolidated balance sheets. Derivatives with positive fair values to us are reported as assets and derivatives with negative fair values to us are reported as liabilities. We classify each derivative as either (i) a trading instrument (no specific hedging designation for financial reporting purposes) or (ii) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge).

Changes in the fair values of derivatives accounted for as trading instruments, including any associated interest income or expense, are recorded in our consolidated statements of income through other market valuation adjustments, net, to the extent they are used to manage risks associated with our residential investment portfolio. Derivatives used to manage certain risks associated with our residential and commercial mortgage banking activities, including valuation changes related to residential LPCs and FSCs, are included in mortgage banking activities, net, on our consolidated statements of income.

Changes in the fair values of derivatives accounted for as cash flow hedges, to the extent they are effective, are recorded in accumulated other comprehensive income, a component of equity on our consolidated balance sheets. Interest income or expense, and any ineffectiveness associated with these derivatives, are recorded as a component of net interest income in our consolidated statements of income. We measure the effective portion of cash flow hedges by comparing the change in fair value of the expected future variable cash flows of the derivative hedging instruments with the change in fair value of the expected future variable cash flows of the hedged item.

We will discontinue a designated cash flow hedging relationship if (i) we determine that the hedging derivative is no longer expected to be effective in offsetting changes in the cash flows of the designated hedged item; (ii) the derivative expires or is sold,

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terminated, or exercised; (iii) the derivative is de-designated as a cash flow hedge; or, (iv) it is probable that a forecasted transaction associated with the hedged item will not occur by the end of the originally specified time period. To the extent we de-designate or terminate a cash flow hedging relationship and the associated hedged item continues to exist, any unrealized gain or loss of the cash flow hedge at the time of de-designation remains in accumulated other comprehensive income and is amortized using the straight-line method through interest expense over the remaining life of the hedged item.

Swaps and Swaptions

Interest rate swaps are agreements in which (i) one counterparty exchanges a stream of fixed interest payments for another counterparty s stream of variable interest cash flows; or, (ii) each counterparty exchanges variable interest cash flows that are referenced to different indices. Interest rate swaptions are agreements that provide the owner the right but not the obligation to enter into an underlying interest rate swap with a counterparty in the future. Interest rate caps are agreements in which the owner receives payments at the end of each period for which the prevailing interest rate exceeds an agreed upon strike price. We enter into interest rate agreements primarily to reduce significant changes in our income or equity caused by interest rate volatility. Certain of these interest rate agreements may be designated as cash flow hedges.

Eurodollar Futures and Financial Futures

Eurodollar futures are futures contracts on time deposits denominated in U.S. dollars at banks outside the United States. Eurodollar futures, unlike our other derivatives, have maturities of only three months. Therefore, in order to achieve the desired interest rate offset necessary to manage our risk, consecutively maturing contracts are required, resulting in a stated notional amount that is typically higher than our other derivatives. Financial futures are futures contracts on benchmark U.S. Treasury rates.

TBA Contracts

TBA contracts are forward contracts to purchase mortgage-backed securities that will be issued by a U.S. government sponsored enterprise in the future. We purchase or sell these derivatives to offset to varying degrees changes in the values of mortgage products for which we have exposure to interest rate volatility.

Loan Purchase and Forward Sale Commitments

We refer to LPCs as agreements with third-party residential loan originators to purchase residential loans at a future date that qualify as a derivative under GAAP. LPCs that qualify as derivatives are recorded at their estimated fair values on our consolidated balance sheets. Changes in fair value are recurring and are reported through our consolidated statements of income in mortgage banking activities, net. We refer to FSCs as agreements with third-parties to sell residential loans at a future date that also qualify as derivatives under GAAP. FSCs are recorded at their estimated fair values on our consolidated balance sheets. Changes in fair value are recurring and are reported through our consolidated statements of income in mortgage banking activities, net.

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

Deferred Tax Assets and Liabilities

Our deferred tax assets/liabilities are generated by temporary differences in GAAP and taxable income at our taxable subsidiaries. These differences generally reflect differing accounting treatments for GAAP and tax, such as accounting for mortgage servicing rights, discount and premium amortization, credit losses, equity awards, asset impairments, and certain valuation estimates. As a result of these differences, we may recognize taxable income in periods prior to when we recognize income for GAAP. When this occurs, we pay the tax liability as required and establish a deferred tax asset. As the income is subsequently realized in future periods under GAAP, the deferred tax asset is reduced. We may also recognize income under GAAP in periods prior to when we recognize the income for tax. When this occurs, we establish a deferred tax liability. As the income is subsequently realized in future periods for tax, the deferred tax liability is reduced.

In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider historical and projected

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future taxable income and capital gains as well as tax planning strategies in making this assessment. We determine the extent to which realization of this deferred asset is not assured and establish a valuation allowance accordingly. The estimate of net deferred tax assets could change in future periods to the extent that actual or revised estimates of future taxable income during the carryforward periods change from current expectations.

Deferred Securities Issuance Costs

Securities issuance costs are expenses associated with the issuance of long-term debt, and the ABS issued from the Residential Resecuritization, the Commercial Securitization, and Sequoia securitization entities we sponsor and consolidate for financial reporting purposes. These expenses typically include underwriting, rating agency, legal, accounting, and other fees. ABS issuance costs associated with liabilities reported at cost are deferred. Deferred securities issuance costs are reported on our consolidated balance sheets as deferred charges (an asset) and are amortized as an adjustment to interest expense using the interest method, based upon the actual and estimated repayment schedules of the related securities issued.

Other Assets

Other assets include margin and investment receivable, REO, income tax receivables, fixed assets, principal receivable, and other prepaid expenses and receivables.

REO property acquired through, or in lieu of, foreclosure is initially recorded at fair value, and subsequently reported at the lower of its carrying amount or fair value (less estimated cost to sell). Changes in the fair value of an REO property that has a fair value at or below its carrying amount are recorded in our consolidated statements of income as a component of other market valuation adjustments, net. Margin receivable reflects cash collateral we have posted with various counterparties relating to our derivative and lending agreements with those counterparties, as applicable.

See *Note 11* for further discussion on other assets.

Short-Term Debt

Short-term debt includes borrowings under master repurchase agreements, loan warehouse facilities, and other forms of borrowings that expire within one year with various counterparties. These borrowings may be unsecured or collateralized by cash, loans, or securities. If the value (as determined by the applicable counterparty) of the collateral securing those borrowings decreases, we may be subject to margin calls during the period the borrowings are outstanding. In instances where we do not satisfy the margin calls within the required time frame, the counterparty may retain the collateral and pursue any outstanding debt amount from us.

See *Note 12* for further discussion on short-term debt.

Accrued Interest Payable

Accrued interest payable includes interest that is due and payable to third parties. Interest is generally paid within one to three months of recording the payable, based upon our remittance requirements, and is paid semi-annually for our convertible debt. For borrowings where we have elected the fair value option, the associated accrued interest on these liabilities is measured at fair value. For financial liabilities where we have not elected the fair value option, the associated accrued interest carrying values approximate fair values.

Asset-Backed Securities Issued

The majority of the liabilities reported on our consolidated balance sheets represent ABS issued by bankruptcy-remote entities sponsored by Redwood. Sequoia, the Residential Resecuritization, and the Commercial Securitization assets are held in the custody of securitization trustees and are not owned by Redwood. These trustees collect principal and interest payments (less servicing and related fees) from the assets and make corresponding principal and interest payments to the ABS investors.

Residential Resecuritization, Commercial Securitization, and Sequoia ABS issued are carried at their unpaid principal balances net of any unamortized discount or premium.

See *Note 13* for further discussion on ABS issued.

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Long-Term Debt

Commercial Long-term Debt

Commercial long-term debt includes borrowings under a master repurchase agreement that expires in more than one year with a financial institution counterparty. These borrowings are collateralized by commercial loans. If the value (as determined by the applicable counterparty) of the collateral securing those borrowings decreases, we may be subject to margin calls during the period the borrowings are outstanding. In instances where we do not satisfy the margin calls within the required time frame, the counterparty may retain the collateral and pursue any outstanding debt amount from us.

Commercial Secured Borrowings

Commercial secured borrowings represent liabilities recognized in association with cash received from transfers of portions of senior commercial mortgage loans to third parties that did not meet the criteria for sale treatment under ASC 860 and were accounted for as financings. We elect the fair value option for these secured borrowings and they are held at their estimated fair value on our consolidated balance sheets.

Convertible Notes

Convertible notes include unsecured convertible senior notes and are carried at their unpaid principal balance. Interest on the notes is payable semiannually and the notes mature on April 15, 2018. If converted by a holder, upon conversion, the holder of the notes would receive shares of our common stock.

Trust Preferred Securities and Subordinated Notes

Trust preferred securities and subordinated notes are carried at their unpaid principal balance. This long-term debt is unsecured with quarterly interest payments determined based upon a floating rate equal to the three-month London Interbank Offered Rate (LIBOR) plus a margin until it is redeemed in whole or matures at a future date.

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

Equity

Accumulated Other Comprehensive Income

Net unrealized gains and losses on real estate securities available-for-sale and interest rate agreements designated as cash flow hedges are reported as components of accumulated other comprehensive income on our consolidated statements of changes in equity and our consolidated balance sheets. Net unrealized gains and losses on securities and interest rate agreements held by our taxable subsidiaries that are reported in other comprehensive income are adjusted for the effects of taxation and may create deferred tax assets or liabilities.

Earnings Per Common Share

Basic earnings per common share (EPS) is computed by dividing net income allocated to common shareholders by the weighted average common shares outstanding. Net income allocated to common shareholders represents net income allocable to common shareholders, less income allocated to participating securities (as described herein). Diluted EPS is computed by dividing income allocated to common shareholders by the weighted average common shares outstanding plus amounts representing the dilutive effect of share-based payment awards and the assumed conversion of convertible notes to common shares (accomplished by adding back the periodic interest expense associated with dilutive convertible debt to net income and adding the shares issued in an assumed conversion to the diluted share count).

The two-class method is an earnings allocation formula under which EPS is calculated for common stock and participating securities according to dividends declared and participating rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated between participating securities and common shares based on their respective rights to receive dividends or dividend equivalents. Accounting guidance on EPS defines vested and unvested share-based payment awards

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containing nonforfeitable rights to dividends or dividend equivalents as participating securities that are included in computing EPS under the two-class method.

See *Note 16* for further discussion on equity.

Incentive Plans

In May 2013, our shareholders approved an amendment and restatement to our previously amended 2002 Redwood Trust, Inc. Incentive Plan (Incentive Plan) for executive officers, employees, and non-employee directors. The amendment provided, among other things, for an increase in the number of shares available for distribution under the plan. The Incentive Plan authorizes our Board of Directors (or a committee appointed by our Board of Directors) to grant incentive stock options (ISOs), non-qualifying stock options (NQSOs), performance stock units (PSUs) deferred stock units (DSUs), restricted stock, performance shares, performance units, stock appreciation rights, limited stock appreciation rights (awards), and dividend equivalent rights (DERs) to eligible recipients. Long-term incentive awards granted under the Incentive Plan generally vest over a three- or four-year period. Awards made under the Incentive Plan to officers and other employees in lieu of the payment in cash of a portion of annual bonuses earned generally vest immediately, but are subject to a three-year mandatory holding period. Non-employee directors are also provided annual awards under the Incentive Plan that generally vest immediately. The cost of the awards is amortized over the vesting period on a straight-line basis.

Employee Stock Purchase Plan

In May 2013, our shareholders approved an amendment to our previously amended 2002 Redwood Trust, Inc. Employee Stock Purchase Plan (ESPP) to increase the number of shares available under the ESPP. The purpose of the ESPP is to give our employees an opportunity to acquire an equity interest in the Company through the purchase of shares of common stock at a discount. The ESPP allows eligible employees to purchase common stock at 85% of its fair value, subject to certain limits. Fair value as defined under the ESPP is the lesser of the closing market price of the common stock on the first day of the calendar year or the last day of the calendar quarter.

Executive Deferred Compensation Plan

In November 2013, our Board of Directors approved an amendment to our 2002 Executive Deferred Compensation Plan (EDCP) to allow non-employee directors to defer certain cash payments and dividends into DSUs. The EDCP allows eligible employees and directors to defer portions of current salary and certain other forms of compensation. The Company matches some deferrals. Compensation deferred under the EDCP is recorded as a liability on our consolidated balance sheets. The EDCP allows for the investment of deferrals in either an interest crediting account or DSUs.

401(k) Plan

We offer a tax-qualified 401(k) Plan to all employees for retirement savings. Under this Plan, employees are allowed to defer and invest up to 100% of their cash earnings, subject to the maximum 401(k) Plan contribution limit set forth by the Internal Revenue Service. We match some employee contributions to encourage participation and to provide a retirement planning benefit to employees. Vesting of the 401(k) Plan matching contributions is based on the employee s tenure at the Company, and over time an employee becomes increasingly vested in both prior and new matching contributions.

See *Note 17* for further discussion on equity compensation plans.

Taxes

We have elected to be taxed as a REIT under the Internal Revenue Code and the corresponding provisions of state law. To qualify as a REIT we must distribute at least 90% of our annual REIT taxable income to shareholders (not including taxable income retained in our taxable subsidiaries) within the time frame set forth in the tax code and also meet certain other requirements related to assets, income, and stock ownership. We assess our tax positions for all open tax years and record tax benefits only if tax positions meet a more-likely-than-not threshold in accordance with FASB guidance on accounting for uncertainty in income taxes. We classify interest and penalties on material uncertain tax positions as interest expense and operating expense, respectively, in our consolidated statements of income.

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See *Note 20* for further discussion on taxes.

Balance Sheet Netting

Certain of our derivatives, loan warehouse, and repurchase agreements are subject to master netting arrangements or similar agreements. Under GAAP, in certain circumstances we may elect to present certain financial assets, liabilities and related collateral subject to master netting arrangements in a net position on our consolidated balance sheets. However, we do not report any of these financial assets or liabilities on a net basis, and instead present them on a gross basis on our consolidated balance sheets.

The table below presents financial assets and liabilities that are subject to master netting arrangements or similar agreements categorized by financial instrument, together with corresponding financial instruments and corresponding collateral received or pledged at March 31, 2014 and December 31, 2013.

Offsetting of Financial Assets, Liabilities, and Collateral

March 31, 2014 (In Thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in Consolidated Balance Sheet	Net Amounts of Assets (Liabilities) Presented in Consolidated Balance Sheet	Gross Amounts Not Offset in Consolidated Balance Sheet(1) Financial Instruments	Gross Amounts Not Offset in Consolidated Balance Sheet(1) Cash Collateral (Received) Pledged	Net Amount
Assets (2)						
Interest rate agreements	$ 3,421	$ -	$ 3,421	$ (3,278)	$ (70)	$ 73
TBAs	913	-	913	(360)	-	553
Futures	-	-	-	-	-	-
Total Assets	$ 4,334	$ -	$ 4,334	$ (3,638)	$ (70)	$ 626
Liabilities (2)						
Interest rate agreements	$ (26,043)	$ -	$ (26,043)	$ 3,278	$ 22,765	$ -

TBAs		(360)		-		(360)		360	-		-
Futures		(503)		-		(503)		-	503		-
Loan warehouse debt		(580,348)		-		(580,348)		580,348	-		-
Security repurchase agreements		(708,413)		-		(708,413)		708,413	-		-
Commercial borrowings		(51,458)		-		(51,458)		51,458	-		-
Total Liabilities	$	(1,367,125)	$	-	$	(1,367,125)	$	1,343,857	$ 23,268	$	-

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December 31, 2013 (In Thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in Consolidated Balance Sheet	Net Amounts of Assets (Liabilities) Presented in Consolidated Balance Sheet	Gross Amounts Not Offset in Consolidated Balance Sheet [(1)] Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets [(2)]						
Interest rate agreements	$ 6,566	$ -	$ 6,566	$ (5,402)	$ -	$ 1,164
TBAs	1,138	-	1,138	(656)	(482)	-
Futures	-	-	-	-	-	-
Total Assets	$ 7,704	$ -	$ 7,704	$ (6,058)	$ (482)	$ 1,164
Liabilities [(2)]						
Interest rate agreements	$ (16,599)	$ -	$ (16,599)	$ 5,402	$ 11,197	$ -
TBAs	(661)	-	(661)	656	5	-
Futures	(528)	-	(528)	-	528	-
Loan warehouse debt	(184,789)	-	(184,789)	184,789	-	-
Security repurchase agreements	(677,974)	-	(677,974)	677,974	-	-
Commercial borrowings	(49,467)	-	(49,467)	49,467	-	-
Total Liabilities	$ (930,018)	$ -	$ (930,018)	$ 918,288	$ 11,730	$ -

(1) Amounts presented in these columns are limited in total to the net amount of assets or liabilities presented in the prior column by instrument. In certain cases, there is excess cash collateral or financial assets we have pledged to a counterparty (which may, in certain circumstances, be a clearinghouse) that exceed the financial liabilities subject to a master netting arrangement or similar agreement. Additionally, in certain cases, counterparties may have pledged excess cash collateral to us that exceeds our corresponding financial assets. In each case, any of these excess amounts are excluded from the table although they are separately reported in our consolidated balance sheets as assets or liabilities, respectively.

(2) Interest rate agreements, TBAs, and futures are components of derivatives instruments on our consolidated balances sheets. Loan warehouse debt, which is secured by residential and commercial mortgage loans, and security repurchase agreements are components of short-term debt on our consolidated balance sheets. Commercial borrowings are a component of long-term debt on our consolidated balance sheets.

For each category of financial instrument set forth in the table above, the assets and liabilities resulting from individual transactions within that category between Redwood and a counterparty are subject to a master netting arrangement or similar agreement with that counterparty that provides for individual transactions to be treated as a single transaction. For certain categories of these instruments, some of our transactions are cleared and settled through one or more clearinghouses that are substituted as our counterparty and references herein to master netting arrangements or similar agreements include the arrangements and agreements governing the clearing and settlement of these transactions through the clearinghouses. In the event of the termination and close-out of any of those transactions, the corresponding master netting arrangement or similar agreement provides for settlement on a net basis and for settlement to include the proceeds of the liquidation of any corresponding collateral, subject to certain limitations on termination, settlement, and liquidation of collateral that may apply in the event of the bankruptcy or insolvency of a party that should not inhibit the eventual practical realization of the principal benefits of those transactions or the corresponding master netting arrangement or similar agreement and any corresponding collateral.

Note 4. Principles of Consolidation

GAAP requires us to consider whether securitizations and other transfers of financial assets should be treated as sales or financings, as well as whether any VIEs for example, certain legal entities often used in securitization and other structured finance transactions should be included in our consolidated financial statements. The GAAP principles we apply require us to reassess our requirement to consolidate VIEs each quarter and therefore our determination may change based upon new facts and circumstances pertaining to each VIE. This could result in a material impact to our consolidated financial statements during subsequent reporting periods.

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(Unaudited)

Analysis of Consolidated VIEs

The VIEs we are required to consolidate include certain Sequoia securitization entities, the Residential Resecuritization entity, and the Commercial Securitization entity. Each of these entities is independent of Redwood and of each other and the assets and liabilities are not owned by and are not legal obligations of ours, although we are exposed to certain financial risks associated with our role as the sponsor or manager of these entities as well as from retained financial interests we hold in certain of these entities. The following table presents a summary of the assets and liabilities of these VIEs. Intercompany balances have been eliminated for purposes of this presentation.

Assets and Liabilities of Consolidated VIEs at March 31, 2014

March 31, 2014 (Dollars in Thousands)	**Sequoia Entities**	**Residential Resecuritization**	**Commercial Securitization**	**Total**
Residential loans, held-for-investment	$ 1,689,994	$ -	$ -	$ 1,689,994
Commercial loans, held-for-investment	-	-	257,375	257,375
Real estate securities, at fair value	-	255,834	-	255,834
Restricted cash	189	-	134	323
Accrued interest receivable	2,507	580	1,919	5,006
Other assets	2,607	-	83	2,690
Total Assets	$ 1,695,297	$ 256,414	$ 259,511	$ 2,211,222
Accrued interest payable	$ 1,158	$ 25	$ 692	$ 1,875
Asset-backed securities issued	1,624,591	82,179	147,574	1,854,344
Total Liabilities	$ 1,625,749	$ 82,204	$ 148,266	$ 1,856,219
Number of VIEs	24	1	1	26

We consolidate the assets and liabilities of certain Sequoia securitization entities, as we did not meet the GAAP sale criteria at the time we transferred financial assets to these entities. Our involvement in consolidated Sequoia entities continues in the following ways: (i) we continue to hold subordinate investments in each entity, and for certain entities, more senior investments; (ii) we maintain certain discretionary rights associated with our sponsorship of, or our subordinate investments in, each entity; and (iii) we continue to hold a right to call the assets of certain entities (once they have been paid down below a specified threshold) at a price equal to, or in excess of, the current outstanding principal amount of the entity s asset-backed securities issued. These factors have resulted in our continuing to consolidate the assets and liabilities of these Sequoia entities in accordance with GAAP.

We consolidate the assets and liabilities of the Residential Resecuritization entity as we did not meet the GAAP sale criteria at the time the financial assets were transferred to this entity based on our role in the entity s inception and design. We transferred senior residential securities to Credit Suisse First Boston Mortgage Securities Corp., which subsequently sold them to CSMC 2011-9R, the Residential Resecuritization entity. In connection with this transaction, we acquired certain senior and subordinate securities that we continue to hold. We engaged in the Residential Resecuritization primarily for the purpose of obtaining permanent non-recourse financing on a portion of our senior residential securities portfolio. Our credit risk exposure is largely unchanged as a result of engaging in the transaction, as we remain economically exposed to the financed securities through our senior and subordinate investment in the Residential Resecuritization.

We consolidate the assets and liabilities of the Commercial Securitization entity, as we did not meet the GAAP sale criteria at the time the financial assets were transferred to this entity based on our role in the entity s inception and design. We transferred subordinate commercial loans to RCMC 2012-CREL1, a securitization entity. In connection with this transaction, we acquired certain subordinate securities that we continue to hold. We engaged in the Commercial Securitization primarily for the purpose of obtaining permanent non-recourse financing on a portion of our commercial mezzanine loan portfolio. Our credit risk exposure is largely unchanged as a result of engaging in the transaction, as we remain economically exposed to the financed loans through our subordinate investment in the Commercial Securitization.

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Analysis of Unconsolidated VIEs with Continuing Involvement

Since 2012, we have transferred residential loans to 18 Sequoia securitization entities sponsored by us and accounted for these transfers as sales for financial reporting purposes. We also determined we were not the primary beneficiary of these VIEs as we lacked the power to direct the activities that will have the most significant economic impact on the entities. For the transferred loans where we held the servicing rights prior to the transfer and continue to hold the servicing rights, we recorded MSRs on our consolidated balance sheets, and classified those MSRs as Level 3 assets. We also retained senior and subordinate securities in these securitizations that we classified as Level 3 assets.

The following table presents information related to securitization transactions that occurred during the three months ended March 31, 2014 and 2013.

Securitization Activity Related to Unconsolidated VIEs Sponsored by Redwood

	Three Months Ended March 31,	
(In Thousands)	**2014**	**2013**
Principal balance of loans transferred	$ -	$ 2,240,652
Trading securities retained, at fair value	-	51,208
AFS securities retained, at fair value	-	114,728
Gains on sale	-	138
MSRs recognized	-	12,466

Our continuing involvement in these securitizations is limited to customary servicing obligations associated with retaining residential MSRs (which we retain a third-party servicer to perform) and the receipt of interest income associated with the securities we retained. The following table summarizes the cash flows between us and the unconsolidated VIEs sponsored by us during the three months ended March 31, 2014 and 2013.

Cash Flows Related to Unconsolidated VIEs Sponsored by Redwood

	Three Months Ended March 31,	
(In Thousands)	**2014**	**2013**
Cash proceeds	$ -	$ 2,153,850
MSR fees received	3,423	976

Funding of compensating interest	(33)	(118)
Cash flows received on retained securities	12,303	5,067

The following table presents the key weighted-average assumptions to measure MSRs at the date of securitization.

MSR Assumptions Related to Unconsolidated VIEs Sponsored by Redwood

	Issued During Three Months Ended March 31,	
At Date of Securitization	**2014**	**2013**
Prepayment speeds	N/A	5 - 17 %
Discount rates	N/A	12 %

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The following table presents additional information at March 31, 2014 and December 31, 2013, related to unconsolidated securitizations accounted for as sales since 2012. These securitizations have not incurred any credit losses.

Unconsolidated VIEs Sponsored by Redwood

(In Thousands)	**March 31, 2014**		**December 31, 2013**	
On-balance sheet assets, at fair value:				
Interest-only securities, classified as trading	$	106,228	$	110,505
Senior and subordinate securities, classified as AFS		417,188		405,415
Maximum loss exposure [(1)]		523,416		515,920
Assets transferred:				
Principal balance of loans outstanding		6,516,252		6,627,874
Principal balance of delinquent loans 30+ days delinquent		14,223		14,587

(1) Maximum loss exposure from our involvement with unconsolidated VIEs pertains to the carrying value of our securities retained from these VIEs and represents estimated losses that would be incurred under severe, hypothetical circumstances, such as if the value of our interests and any associated collateral declines to zero. This does not include, for example, any potential exposure to representation and warranty claims associated with our initial transfer of loans into a securitization.

The following table presents key economic assumptions for assets retained from unconsolidated VIEs and the sensitivity of their fair values to immediate adverse changes in those assumptions at March 31, 2014 and December 31, 2013.

Key Assumptions and Sensitivity Analysis for Assets Retained from Unconsolidated VIEs Sponsored by Redwood

March 31, 2014 **(Dollars in Thousands)**		**MSRs**			**Senior Interest-only Securities**			**Subordinate Securities**	
Fair value at March 31, 2014	$	57,882		$	106,228		$	417,188	
Expected life (in years) [(1)]		8			7			11	
		9	%		9	%		9	%

Prepayment speed assumption (annual CPR) (1)						
Decrease in fair value from:						
10% adverse change	$ 1,886		$ 5,314		$ 1,450	
25% adverse change	3,984		12,546		3,816	
Discount rate assumption (1)	11	%	6	%	6	%
Decrease in fair value from:						
100 basis point increase	$ 2,519		$ 5,251		$ 31,989	
200 basis point increase	4,735		10,043		60,272	
Credit loss assumption (1)	N/A		0.23	%	0.23	%
Decrease in fair value from:						
10% higher losses	N/A		$ 84		$ 1,320	
25% higher losses	N/A		209		3,298	

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December 31, 2013

(Dollars in Thousands)	MSRs	Senior Interest-only Securities	Subordinate Securities
Fair value at December 31, 2013	$ 60,318	$ 110,505	$ 405,415
Expected life (in years) [1]	8	7	11
Prepayment speed assumption (annual CPR) [1]	8 %	10 %	11 %
Decrease in fair value from:			
10% adverse change	$ 1,649	$ 5,773	$ 1,658
25% adverse change	4,218	13,555	4,354
Discount rate assumption [1]	11 %	5 %	6 %
Decrease in fair value from:			
100 basis point increase	$ 2,468	$ 5,632	$ 30,644
200 basis point increase	4,828	10,757	57,836
Credit loss assumption [1]	N/A	0.23 %	0.23 %
Decrease in fair value from:			
10% higher losses	N/A	$ 70	$ 1,369
25% higher losses	N/A	175	3,420

(1) Expected life, prepayment speed assumption, discount rate assumption, and credit loss assumption presented in the tables above represent weighted averages.

Continuing Involvement with VIEs with No Economic Interest

We maintain limited continuing involvement in certain Acacia securitization entities we sponsored, but have no current economic interest in these entities. Our continuing involvement as collateral manager has, under the terms of the applicable management agreements, been significantly curtailed or eliminated with respect to the Acacia entities, as all but one of these entities have experienced events of default. We will continue to receive the collateral management fees for these entities, which have decreased significantly and will continue to do so as the balances on which the fees are determined continue to decline.

Analysis of Third-Party VIEs

Third-party VIEs are securitization entities for which we maintain an economic interest but do not sponsor. Our economic interest may include several securities from the same third-party VIE, and in those cases, the analysis is performed in consideration of all of our interests. The following table presents a summary of our interests in third-party VIEs at March 31, 2014, grouped by collateral type.

Third-Party Sponsored VIE Summary

(Dollars in Thousands)	**March 31, 2014**
Residential real estate securities at Redwood	
Senior	$ 642,785
Re-REMIC	192,208
Subordinate	128,765
Total Investments in Third-Party Real Estate Securities	$ 963,758

We determined that we are not the primary beneficiary of any third-party residential, commercial, or collateralized debt obligation entities, as we do not have the required power to direct the activities that most significantly impact the economic performance of these entities. Specifically, we do not service or manage these entities or otherwise hold decision making powers that are significant. As a result of this assessment, we do not consolidate any of the underlying assets and liabilities of these third-party VIEs we only account for our specific interests in them.

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Our assessments of whether we are required to consolidate a VIE may change in subsequent reporting periods based upon changing facts and circumstances pertaining to each VIE. Any related accounting changes could result in a material impact to our financial statements.

Other Transfers of Financial Assets

As part of our commercial mortgage banking activities, we originate senior commercial mortgage loans that may be bifurcated into a senior portion that is sold to a third party and a junior portion that we retain as an investment. When the transfer of the senior portion does not meet the criteria for sale treatment under GAAP, the entire loan (the senior and junior portions) remains on our consolidated balance sheet classified as a held-for-investment loan and we account for the transfer of the senior portion as a secured borrowing. We elect the fair value option for the senior and junior portions of these loans and their related secured borrowings. We generally do not maintain continuing involvement with senior portions of the loans sold to a third party and our credit risk exposure is limited to our investment in the junior portion of the loan, which we retain.

The following table presents commercial loan transfers accounted for as secured borrowing for the three months ended March 31, 2014.

Loan Transfers Accounted for as Secured Borrowings

(In Thousands)	Three Months Ended March 31, 2014
Principal balance	$ 33,875
Cash proceeds	34,774

Note 5. Fair Value of Financial Instruments

For financial reporting purposes, we follow a fair value hierarchy established under GAAP that is used to determine the fair value of financial instruments. This hierarchy prioritizes relevant market inputs in order to determine an exit price at the measurement date, or the price at which an asset could be sold or a liability could be transferred in an orderly process that is not a forced liquidation or distressed sale. Level 1 inputs are observable inputs that reflect quoted prices for identical assets or liabilities in active markets. Level 2 inputs are observable inputs other than quoted prices for an asset or liability that are obtained through corroboration with observable market data. Level 3 inputs are unobservable inputs (e.g., our own data or assumptions) that are used when there is little, if any, relevant market activity for the asset or liability required to be measured at fair value.

In certain cases, inputs used to measure fair value fall into different levels of the fair value hierarchy. In such cases, the level at which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. Our assessment of the significance of a particular input requires judgment and considers factors specific to the asset or liability being measured.

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The following table presents the carrying values and estimated fair values of assets and liabilities that are required to be recorded or disclosed at fair value at March 31, 2014 and December 31, 2013.

	March 31, 2014		December 31, 2013	
(In Thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Residential loans, held-for-sale				
At fair value	$ 773,294	$ 773,294	$ 402,602	$ 402,602
At lower of cost or fair value	1,642	1,798	1,665	1,817
Residential loans, held-for-investment	1,689,994	1,555,530	1,762,167	1,610,024
Commercial loans, held-for-sale	77,155	77,155	89,111	89,111
Commercial loans, held-for-investment				
At fair value	69,436	69,436	-	-
At amortized cost	344,684	350,261	343,344	348,305
Trading securities	120,123	120,123	124,555	124,555
Available-for-sale securities	1,622,885	1,622,885	1,558,306	1,558,306
MSRs	64,971	64,971	64,824	64,824
Cash and cash equivalents	149,966	149,966	173,201	173,201
Restricted cash	432	432	398	398
Accrued interest receivable	14,410	14,410	13,475	13,475
Derivative assets	4,438	4,438	7,787	7,787
REO (1)	2,607	2,995	3,661	4,084
Margin receivable (1)	44,746	44,746	31,149	31,149
Other collateral posted (1)	5,000	5,000	5,000	5,000
Liabilities				
Short-term debt	$ 1,288,761	$ 1,288,761	$ 862,763	$ 862,763
Accrued interest payable	9,832	9,832	6,366	6,366
Derivative liabilities	27,197	27,197	18,167	18,167
ABS issued	1,854,344	1,722,220	1,942,962	1,746,906
Commercial long-term debt	51,458	51,458	49,467	49,467
Commercial secured borrowings	34,774	34,774	-	-
Convertible notes	287,500	309,063	287,500	299,719

Other long-term debt	139,500	112,995	139,500	111,600

(1) These assets are included in Other Assets on our consolidated balance sheets.

We elected the fair value option for $1.07 billion and $119 million of residential loans and commercial loans, respectively, we acquired during the three months ended March 31, 2014. We also elected the fair value option for $35 million of commercial secured borrowings we recorded during the three months ended March 31, 2014. We anticipate electing the fair value option for all future purchases of residential loans and commercial senior loans that we intend to sell to third parties or transfer to securitizations.

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The following table presents the assets and liabilities recorded that are reported at fair value on our consolidated balance sheets on a recurring basis at March 31, 2014, as well as the fair value hierarchy of the valuation inputs used to measure fair value.

Assets and Liabilities Measured at Fair Value on a Recurring Basis at March 31, 2014

March 31, 2014	Carrying	Fair Value Measurements Using		
(In Thousands)	Value	Level 1	Level 2	Level 3
Assets				
Residential loans, at fair value	$ 773,294	$ -	$ 149,749	$ 623,545
Commercial loans, at fair value	146,591	-	-	146,591
Trading securities	120,123	-	-	120,123
Available-for-sale securities	1,622,885	-	-	1,622,885
MSRs	64,971	-	-	64,971
Derivative assets	4,438	913	3,430	95
Liabilities				
Derivative liabilities	27,197	863	26,045	289
Commercial secured borrowings	34,774	-	-	34,774

The following table presents additional information about Level 3 assets and liabilities measured at fair value on a recurring basis for the three months ended March 31, 2014.

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

	Assets						Liabilities
						Loan	Commercial
	Residential	Commercial	Trading	AFS		Purchase	Secured
(In Thousands)	Loans	Loans	Securities	Securities	MSRs	Commitments	Borrowings
Beginning balance - December 31, 2013	$ 391,100	$ 89,111	$ 124,555	$ 1,558,306	$ 64,824	$ 379	$ -
Principal paydowns	(6,922)	(3,254)	(2)	(42,303)	-	-	-
Gains (losses) in net income, net	7,449	3,626	(4,430)	12,172	(2,711)	(84)	-
	-	-	-	20,621	-	-	-

Unrealized gains in OCI, net							
Acquisitions	794,031	122,509	-	74,089	2,858	-	34,774
Sales	(561,550)	(65,401)	-	-	-	-	-
Other settlements, net	(563)	-	-	-	-	(101)	-
Ending Balance - March 31, 2014	$ 623,545	$ 146,591	$ 120,123	$ 1,622,885	$ 64,971	$ 194	$ 34,774

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The following table presents the portion of gains or losses included in our consolidated statements of income that were attributable to Level 3 assets and liabilities recorded at fair value on a recurring basis and held at March 31, 2014 and 2013. Gains or losses incurred on assets or liabilities sold, matured, called, or fully written down during the three months ended March 31, 2014 and 2013 are not included in this presentation.

Portion of Net Gains (Losses) Attributable to Level 3 Assets and Liabilities Still Held at March 31, 2014 and 2013 Included in Net Income

	Included in Net Income Three Months Ended March 31,	
(In Thousands)	**2014**	**2013**
Assets		
Residential loans, at fair value	$ 3,483	$ 4,326
Commercial loans, at fair value	2,530	-
Trading securities	(4,431)	(488)
Available-for-sale securities	(113)	(24)
MSRs	(2,291)	811
Liabilities		
Loan purchase commitments	(235)	-

The following table presents information on assets recorded at fair value on a non-recurring basis at March 31, 2014. This table does not include the carrying value and gains or losses associated with the asset types below that were not recorded at fair value on our balance sheet at March 31, 2014.

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis at March 31, 2014

March 31, 2014	**Carrying**	**Fair Value Measurements Using**			**Gain (Loss) for Three Months Ended March 31,**
(In Thousands)	**Value**	**Level 1**	**Level 2**	**Level 3**	**2014**
Assets					
Residential loans, at lower of cost or fair value	$ 1,229	$ -	$ -	$ 1,229	$ (2)
REO	829	-	-	829	169

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The following table presents the components of market valuation adjustments, net, recorded in our consolidated statements of income for the three months ended March 31, 2014 and 2013.

Market Valuation Adjustments, Net

	Three Months Ended March 31,			
(In Thousands)		**2014**		**2013**
Mortgage banking activities				
Residential loans, at fair value	$	7,037	$	34,870
Commercial loans, at fair value		3,626		-
Trading securities		(4,277)		1,930
Derivative instruments, net		(7,081)		1,022
Loan purchase and forward sale commitments		8		-
Total mortgage banking activities		(687)		37,822
MSRs		(2,711)		342
Other				
Residential loans, at lower of cost or fair value		(2)		40
Trading securities		(154)		(567)
Impairments on AFS securities		(113)		(24)
REO		(142)		227
Other derivative instruments, net		(5,727)		21
Total other		(6,138)		(303)
Total Market Valuation Adjustments, Net	$	(9,536)	$	37,861

Valuation Policy

We maintain a policy that specifies the methodologies we use to value different types of financial instruments. Significant changes to the valuation methodologies are reviewed by members of senior management to confirm the changes are appropriate and reasonable. Valuations based on information from external sources are performed on an instrument-by-instrument basis with the resulting amounts analyzed individually against internal calculations as well as in the aggregate by product type classification. Initial valuations are performed by our portfolio management group using the valuation processes described below. A subset of our finance department then independently reviews all fair value estimates using available market, portfolio, and industry information to ensure they are reasonable. Finally, members of senior management review all fair value estimates, including an analysis of valuation changes from prior reporting periods.

Valuation Process

We estimate fair values for financial assets or liabilities based on available inputs observed in the marketplace as well as unobservable inputs. We primarily use two pricing valuation techniques: market comparable pricing and discounted cash flow analysis. Market comparable pricing is used to determine the estimated fair value of certain instruments by incorporating known inputs and performance metrics, such as observed prepayment rates, delinquencies, credit support, recent transaction prices, pending transactions, or prices of other similar instruments. Discounted cash flow analysis techniques generally consist of developing an estimate of future cash flows that are expected to occur over the life of an instrument and then discounting those cash flows at a rate of return that results in an estimate of fair value. After considering all available indications of the appropriate rate of return that market participants would require, we consider the reasonableness of the range indicated by the results to determine an estimate that is most representative of fair value. We also consider counterparty credit quality and risk as part of our fair value assessments.

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The following table provides quantitative information about the significant unobservable inputs used in the valuation of our Level 3 assets and liabilities measured at fair value.

Fair Value Methodology for Level 3 Financial Instruments

March 31, 2014							
(Dollars in Thousands)		**Fair Value**	**Unobservable Input**	**Range**		**Weighted Average**	
Assets							
Residential loans, at fair value:							
Loans priced to securitization or priced to whole	$	517,542	Discount rate	3 - 4	%	3	%
loan market and uncommitted to sell			Prepayment rate	10 - 10	%	10	%
			Default rate	1 - 1	%	1	%
			Loss severity	22 - 22	%	22	%
			Credit support	7 - 8	%	7	%
			Spread to securitization	50 bps -50 bps		50	bps
Loans priced to whole loan market, committed to sell		106,003	Pool fallout assumption	10 bps -10 bps		10	bps
Residential loans, at lower of cost or fair value		1,229	Loss severity	15- 28	%	22	%
Commercial loans, at fair value		146,591	Credit spread	148 bps -148 bps		148	bps
			Credit support	24 - 24	%	24	%
Trading and AFS securities		1,743,008	Discount rate	4 - 12	%	6	%
			Prepayment speed	1 - 35	%	11	%
			Default rate	0 - 35	%	8	%
			Loss severity	20 - 64	%	33	%
			Credit support	0 - 84	%	6	%

MSRs	64,971	Discount rate	9 - 12	%	11	%
		Prepayment rate	5 - 50	%	9	%
REO	829	Loss severity	0 - 60	%	41	%
Liabilities						
Commercial secured financing	34,774	Credit spread	148 bps - 148 bps		148	bps
		Credit support	24 - 24	%	24	%
Loan purchase commitments, net	194	MSR multiple	1 - 5	%	4	%
		Pullthrough rate	65 - 99	%	84	%

Determination of Fair Value

A description of the instruments measured at fair value as well as the general classification of such instruments pursuant to the Level 1, Level 2, and Level 3 valuation hierarchy is listed herein. We generally use both market comparable information and discounted cash flow modeling techniques to determine the fair value of our Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the preceding table. Accordingly, a significant increase or decrease in any of these inputs such as anticipated credit losses, prepayment speeds, interest rates, or other valuation assumptions in isolation, would likely result in a significantly lower or higher fair value measurement.

Residential loans

Estimated fair values for residential loans are determined based on either an exit price to securitization or the whole loan market. For loans valued based on an exit to securitization, significant inputs in the valuation analysis are predominantly Level 3 in nature, due

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to the limited availability of market quotes on newly issued Residential Mortgage-Backed Securities (RMBS) and related inputs. Relevant market indicators that are factored into the analyses include third-party RMBS sales, pricing points for secondary sales of RMBS we have issued in past periods, yields for RMBS issued by government sponsored enterprises, indexed swap yields, credit rating agency guidance on expected credit enhancement levels for newly issued RMBS transactions, interest rates, and prepayment speeds (Level 3).

Estimated fair values for conforming loans are determined based upon quoted market prices (Level 2). Conforming loans are mortgage loans that conform to Agency guidelines. As necessary, these values are adjusted for servicing value and market conditions and liquidity.

For loans valued based on an exit to the whole loan market, significant inputs in the valuation analysis are predominantly Level 3 in nature. Relevant market indicators that are factored into the analyses include prices on recent sales of our own whole loans, indexed swap yields, interest rates, prepayment speeds, and loss severities (Level 3). These assets would generally decrease in value based upon an increase in the loss severity assumption and would generally increase in value if the loss severity assumption were to decrease.

Commercial loans

Estimated fair values for mezzanine commercial loans are determined by both market comparable pricing and discounted cash flow analysis valuation techniques (Level 3). Our discounted cash flow models utilize certain significant unobservable inputs including the underwritten net operating income and debt coverage ratio assumptions and actual performance relative to those underwritten metrics. A decrease in these unobservable inputs will reduce the estimated fair value of the commercial loans.

Estimated fair values for senior commercial loans are determined by an exit price to securitization. Certain significant inputs in the valuation analysis are Level 3 in nature. Relevant market indicators that are factored into the analyses include third-party Commercial Mortgage-Backed Securities (CMBS) sales, pricing points for secondary sales of CMBS, yields for synthetic instruments that use CMBS bonds as an underlying index, indexed swap yields, credit rating agency guidance on expected credit enhancement levels for newly issued CMBS transactions, and interest rates (Level 3). In certain cases, commercial senior mortgage loans are valued based on third-party offers for the securities for purchase into securitization (Level 2).

Real estate securities

Real estate securities primarily include residential mortgage-backed securities that are generally illiquid in nature and trade infrequently. Significant inputs in the valuation analysis are predominantly Level 3 in nature, due to the lack of readily available market quotes and related inputs. For real estate securities, we utilize both market comparable pricing and discounted cash flow analysis valuation techniques. Relevant market indicators that are factored into the analyses include bid/ask spreads, the amount and timing of credit losses, interest rates, and prepayment speeds. Estimated fair values are based on applying the market indicators to generate discounted cash flows (Level 3). These cash flow models use significant unobservable inputs such as a discount rate, prepayment rate, default rate, loss severity and credit support. The estimated fair value of our securities would generally decrease based upon an increase in serious delinquencies. Conversely, the estimated fair value of our securities would generally increase if the prepayment rate or credit support inputs were to increase.

As part of our securities valuation process, we request and consider indications of value from third-party securities dealers. For purposes of pricing our securities at March 31, 2014, we received dealer price indications on 85% of our securities, representing 96% of our carrying value. In the aggregate, our internal valuations of the securities for which we received dealer price indications were within 1% of the aggregate dealer valuations. Once we receive the price indications from dealers, they are compared to other relevant market inputs, such as actual or comparable trades, and the results of our discounted cash flow analysis. In circumstances where relevant market inputs cannot be obtained, increased reliance on discounted cash flow analysis and management judgment are required to estimate fair value.

Derivative assets and liabilities

Our derivative instruments include swaps, swaptions, TBAs, financial futures, LPCs, and FSCs. Fair values of derivative instruments are determined using quoted prices from active markets, when available, or from valuation models and are supported by valuations provided by dealers active in derivative markets. TBA and financial futures fair values are generally obtained using quoted

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prices from active markets (Level 1). Our derivative valuation models for swaps and swaptions require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates, and correlations of certain inputs. Model inputs can generally be verified and model selection does not involve significant management judgment (Level 2). LPC fair values are estimated based on quoted Agency MBS prices, estimates of the fair value of the MSRs we expect to retain in the sale of the loans, and the probability that the mortgage loan will be purchased (Level 3). FSC fair values are obtained using quoted Agency prices. Model inputs can generally be verified and model selection does not involve significant management judgment (Level 2).

For other derivatives, valuations are based on various factors such as liquidity, bid/ask spreads, and credit considerations for which we rely on available market inputs. In the absence of such inputs, management s best estimate is used (Level 3).

MSRs

MSRs represent the rights to service jumbo and conforming residential mortgage loans. Significant inputs in the valuation analysis are predominantly Level 3, due to the nature of these instruments and the lack of readily available market quotes. These inputs include market discount rates, prepayment speeds of serviced loans, and the market cost of servicing. Changes in the fair value of MSRs occur primarily due to the collection/realization of expected cash flows, as well as changes in valuation inputs and assumptions. Estimated fair values are based on applying the inputs to generate the net present value of estimated MSR income, which is what we believe market participants would use to estimate fair value (Level 3). These discounted cash flow models utilize certain significant unobservable inputs including prepayment rate and discount rate assumptions. An increase in these unobservable inputs will reduce the estimated fair value of the MSRs.

As part of our MSR valuation process, we received a valuation estimate from a third-party valuations group. In the aggregate, our internal valuation of the MSRs was less than 1% lower than the third-party valuation at March 31, 2014.

Cash and cash equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less. Fair values equal carrying values (Level 1).

Restricted cash

Restricted cash primarily includes interest-earning cash balances at consolidated Sequoia entities and at the Residential Resecuritization and Commercial Securitization entities for the purpose of distribution to investors and reinvestment. Due to the short-term nature of the restrictions, fair values approximate carrying values (Level 1).

Accrued interest receivable and payable

Accrued interest receivable and payable includes interest due on our assets and payable on our liabilities. Due to the short-term nature of when these interest payments will be received or paid, fair values approximate carrying values (Level 1).

REO

REO includes properties owned in satisfaction of foreclosed loans. Fair values are determined using available market quotes, appraisals, broker price opinions, comparable properties, or other indications of value (Level 3).

Margin receivable

Margin receivable reflects cash collateral we have posted with our various derivative and debt counterparties as required to satisfy margin requirements. Fair values approximate carrying values (Level 1).

Short-term debt

Short-term debt includes our credit facilities that mature within one year. Fair values approximate carrying values (Level 1).

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ABS issued

ABS issued includes asset-backed securities issued through the Sequoia, Residential Resecuritization, and Commercial Securitization entities. These instruments are illiquid in nature and trade infrequently, if at all. For ABS issued, we utilize both market comparable pricing and discounted cash flow analysis valuation techniques. Significant inputs in the valuation analysis are predominantly Level 3, due to the nature of these instruments and the lack of readily available market quotes. Relevant market indicators factored into the analyses include bid/ask spreads, external spreads, collateral credit losses, interest rates, default rates, loss severities, and collateral prepayment speeds. Estimated fair values are based on applying the market indicators to generate discounted cash flows (Level 3). These liabilities would generally increase in value based upon a decrease in default rates and would generally decrease in value if the prepayment rate or credit support input were to decrease.

As part of our ABS issued valuation process, we also request and consider indications of value from third-party securities dealers. For purposes of pricing our ABS issued at March 31, 2014, we received dealer price indications on 51% of our ABS issued. In the aggregate, our internal valuations of the ABS issued for which we received dealer price indications were within 1% of the aggregate dealer valuations. Once we receive the price indications from dealers, they are compared to other relevant market inputs, such as actual or comparable trades, and the results of our discounted cash flow analysis.

Commercial long-term debt

Commercial long-term debt includes our commercial loan repurchase agreement that matures in more than one year. Fair values approximate carrying values (Level 1).

Commercial secured borrowings

Commercial secured borrowings represent liabilities recognized as a result of transfers of portions of senior commercial mortgage loans to third parties that do not meet the criteria for sale treatment under GAAP and are accounted for as secured borrowings. Fair values for commercial secured borrowings are based on the fair values of the senior commercial loans associated with the borrowings (Level 3).

Convertible notes

Convertible notes include unsecured convertible senior notes. Fair values are determined using quoted prices in active markets (Level 1).

Trust preferred securities and subordinated notes

Estimated fair values of trust preferred securities and subordinated notes are determined using discounted cash flow analysis valuation techniques. Significant inputs in the valuation analysis are predominantly Level 3, due to the nature of these instruments and the lack of readily available market quotes. Estimated fair values are based on applying the market indicators to generate discounted cash flows (Level 3).

Note 6. Residential Loans

We acquire residential loans from third-party originators. The following table summarizes the classifications and carrying value of the residential loans owned at Redwood and at consolidated Sequoia entities at March 31, 2014 and December 31, 2013.

March 31, 2014 **(In Thousands)**	**Redwood**	**Sequoia**	**Total**
Held-for-sale			
Fair value - Conforming	$ 149,749	$ -	$ 149,749
Fair value - Jumbo	623,545	-	623,545
Lower of cost or fair value	1,642	-	1,642
Held-for-investment	-	1,689,994	1,689,994
Total Residential Loans	$ 774,936	$ 1,689,994	$ 2,464,930

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December 31, 2013 **(In Thousands)**	**Redwood**	**Sequoia**	**Total**
Held-for-sale			
Fair value - Conforming	$ 11,502	$ -	$ 11,502
Fair value - Jumbo	391,100	-	391,100
Lower of cost or fair value	1,665	-	1,665
Held-for-investment	-	1,762,167	1,762,167
Total Residential Loans	$ 404,267	$ 1,762,167	$ 2,166,434

Residential Loans Held-for-Sale

Residential Loans at Fair Value

At March 31, 2014, there were 1,365 residential loans at fair value, with an aggregate outstanding principal balance of $758 million and an aggregate fair value of $773 million. During the three months ended March 31, 2014, we purchased $1.07 billion (principal balance) of residential loans, for which we elected the fair value option. During the three months ended March 31, 2014 and 2013, we recorded $7 million and $35 million of positive valuation adjustments, respectively, on residential loans for which we elected the fair value option through mortgage banking activities, net, a component of our consolidated income statement. At December 31, 2013, there were 537 residential loans at fair value, with an aggregate outstanding principal balance of $399 million and an aggregate fair value of $403 million.

Residential Loans at Lower of Cost or Fair Value

At March 31, 2014, there were 10 residential loans at lower of cost or fair value with $2 million in outstanding principal balance and a carrying value of $2 million. At December 31, 2013, there were 10 residential loans at lower of cost or fair value with $2 million in outstanding principal balance and a carrying value of $2 million. During the three months ended March 31, 2014 and 2013, we recorded valuation adjustments for residential loans held-for-sale of negative $2 thousand and positive $40 thousand, respectively.

Residential Loans Held-for-Investment

The following table details the carrying value for residential loans held-for-investment at March 31, 2014 and December 31, 2013. These loans are owned at Sequoia securitization entities that we consolidate for financial reporting purposes.

(In Thousands)		March 31, 2014		December 31, 2013
Principal balance	$	1,699,887	$	1,770,803
Unamortized premium, net		15,678		16,791
Recorded investment		1,715,565		1,787,594
Allowance for loan losses		(25,571)		(25,427)
Carrying Value	$	1,689,994	$	1,762,167

Of the $1.70 billion of principal balance and $16 million of unamortized premium on loans held-for-investment at March 31, 2014, $699 million of principal balance and $10 million of unamortized premium relate to residential loans acquired prior to July 1, 2004. During the three months ended March 31, 2014, 4% of these residential loans prepaid and we amortized 8% of the premium based upon the accounting elections we apply. For residential loans acquired after July 1, 2004, the principal balance was $1.00 billion and the unamortized premium was $6 million. During the three months ended March 31, 2014, 4% of these loans prepaid and we amortized 4% of the premium.

Of the $1.77 billion of principal balance and $17 million of unamortized premium on loans held-for-investment at December 31, 2013, $731 million of principal balance and $11 million of unamortized premium relate to residential loans acquired prior to July 1, 2004. For residential loans acquired after July 1, 2004, the principal balance was $1.00 billion and the unamortized premium was $6 million.

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Credit Characteristics of Residential Loans Held-for-Investment

As a percentage of our recorded investment, 99% of residential loans held-for-investment at March 31, 2014, were first lien, predominately prime-quality loans at the time of origination. The remaining 1% of loans were second lien, home equity lines of credit. The weighted average original LTV ratio for our residential loans held-for-investment outstanding at March 31, 2014, was 66%. The weighted average FICO score for the borrowers of these loans was 733 at the time the loans were originated.

We consider the year of origination of our residential loans held-for-investment to be a general indicator of credit performance as loans originated in specific years have often possessed similar product and credit characteristics. The following table displays our recorded investment in residential loans held-for-investment at March 31, 2014 and December 31, 2013, organized by year of origination.

(In Thousands)	**March 31, 2014**	**December 31, 2013**
2003 & Earlier	$ 840,351	$ 881,364
2004	501,520	513,458
2005	62,313	62,675
2006	143,813	149,776
2007	-	-
2008	-	-
2009	21,765	25,860
2010	87,319	92,728
2011	58,484	61,733
Total Recorded Investment	$ 1,715,565	$ 1,787,594

Allowance for Loan Losses on Residential Loans

For residential loans held-for-investment, we establish and maintain an allowance for loan losses. The allowance includes a component for pools of residential loans owned at Sequoia securitization entities that we collectively evaluated for impairment, and a component for loans individually evaluated for impairment that includes modified residential loans at Sequoia entities that have been determined to be troubled debt restructurings.

Activity in the Allowance for Loan Losses on Residential Loans

The following table summarizes the activity in the allowance for loan losses for the three months ended March 31, 2014 and 2013.

(In Thousands)	Three Months Ended March 31, 2014		2013	
Balance at beginning of period	$	25,427	$	28,504
Charge-offs, net		(484)		(795)
Provision for loan losses		628		1,355
Balance at End of Period	$	25,571	$	29,064

During the three months ended March 31, 2014 and 2013, there were less than $1 million and $1 million of charge-offs of residential loans that reduced our allowance for loan losses, respectively. These charge-offs both arose from $2 million of defaulted loan principal.

Residential Loans Collectively Evaluated for Impairment

We establish the collective component of the allowance for residential loan losses based primarily on the characteristics of the loan pools underlying the securitization entities that own the loans, including loan product types, credit characteristics, and origination years. The collective analysis is further divided into two segments. The first segment reflects our estimate of losses on delinquent loans within each loan pool. These loss estimates are determined by applying the loss factors described in *Note 3* to the delinquent

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loans, including our expectations of the timing of defaults and the loss severities we expect once defaults occur. The second segment relates to our estimate of losses incurred on nondelinquent loans within each loan pool. This estimate is based on losses we expect to realize over a 23 month loss confirmation period, which is based on our historical loss experience as well as consideration of the loss factors described in *Note 3*.

The following table summarizes the balances for loans collectively evaluated for impairment at March 31, 2014 and December 31, 2013.

(In Thousands)	March 31, 2014	December 31, 2013
Principal balance	$ 1,689,413	$ 1,762,165
Recorded investment	1,705,306	1,779,161
Related allowance	24,690	24,762

The following table summarizes the recorded investment and past due status of residential loans collectively evaluated for impairment at March 31, 2014 and December 31, 2013.

(In Thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Current	Total Loans
March 31, 2014	$ 31,308	$ 6,942	$ 81,699	$ 1,585,357	$ 1,705,306
December 31, 2013	34,187	13,248	79,010	1,652,716	1,779,161

Residential Loans Individually Evaluated for Impairment

As part of the loss mitigation efforts undertaken by servicers of residential loans owned at Sequoia securitization entities, a number of loan modifications have been completed to help make mortgage loans more affordable for qualifying borrowers and potentially reduce a future impairment. For the three months ended March 31, 2014 and 2013, all of the loan modifications determined to be TDRs were either: (i) conversions of a floating rate mortgage loan into a fixed rate mortgage loan; (ii) reductions in the contractual interest rates of a mortgage loan paired with capitalization of accrued interest; or (iii) principal forgiveness paired with interest rate reductions.

The following table presents the details of the loan modifications determined to be TDRs for the three months ended March 31, 2014 and 2013.

(Dollars in Thousands)	Three Months Ended March 31, 2014	2013
TDRs		
Number of modifications	5	3
Pre-modification outstanding recorded investment	$ 1,915	$ 764
Post-modification outstanding recorded investment	1,893	796
Loan modification effect on net interest income after provision and other MVA	(409)	(169)
TDRs that Subsequently Defaulted		
Number of modifications	3	2
Recorded investment	$ 919	$ 409

If we determine that a restructured loan is a TDR, we remove it from the general loan pools used for determining the allowance for residential loan losses and assess it for impairment on an individual basis. This assessment is based primarily on whether an adverse change in the expected future cash flows resulted from the restructuring. The average recorded investment of loans individually evaluated for impairment for the three months ended March 31, 2014 and 2013 was $9 million and $6 million, respectively. For the three months ended March 31, 2014 and 2013, we recorded interest income of $38 thousand and $11 thousand, respectively, on individually impaired loans.

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The following table summarizes the balances for loans individually evaluated for impairment, all of which had an allowance, at March 31, 2014 and December 31, 2013.

(In Thousands)	March 31, 2014	December 31, 2013
Principal balance	$ 10,474	$ 8,638
Recorded investment	10,259	8,433
Related allowance	881	665

The following table summarizes the recorded investment and past due status of residential loans individually evaluated for impairment at March 31, 2014 and December 31, 2013.

(In Thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Current	Total Loans
March 31, 2014	$ 1,545	$ -	$ 560	$ 8,154	$ 10,259
December 31, 2013	1,560	-	567	6,306	8,433

Note 7. Commercial Loans

We invest in commercial loans that we originate and service as well as loans that we acquire from third-party originators. The following table summarizes the classifications and carrying value of commercial loans at March 31, 2014 and December 31, 2013.

(In Thousands)	March 31, 2014	December 31, 2013
Held-for-sale, at fair value	$ 77,155	$ 89,111
Held-for-investment		
At fair value	69,436	-
At amortized cost	344,684	343,344
Total Commercial Loans	$ 491,275	$ 432,455

Of the held-for-investment commercial loans shown above at March 31, 2014 and December 31, 2013, $257 million and $258 million, respectively, were financed through the Commercial Securitization entity, as discussed in *Note 4*.

Commercial Loans Held-for-Sale

Commercial loans held-for-sale include loans we originate and intend to sell to third parties. At March 31, 2014, there were four commercial loans at fair value, with an aggregate outstanding principal balance of $75 million and an aggregate fair value of $77 million. During the three months ended March 31, 2014, we originated and funded senior commercial loans for $88 million and recorded $2 million of positive valuation adjustments on commercial loans for which we elected the fair value option through mortgage banking activities, net, a component of our consolidated income statement. At December 31, 2013, there were seven senior commercial loans at fair value, with an aggregate outstanding principal balance of $88 million and an aggregate fair value of $89 million.

Commercial Loans Held-for-Investment

Commercial Loans Held-for-Investment, at Fair Value

Commercial loans held-for-investment at fair value include certain loans we hold for investment for which we have elected the fair value option. At March 31, 2014, there were three of these commercial loans, with an aggregate outstanding principal balance of $68 million and an aggregate fair value of $69 million. During the three months ended March 31, 2014, we originated and funded senior commercial loans for $31 million and recorded $1 million of positive valuation adjustments on commercial loans for which we elected the fair value option through mortgage banking activities, net, a component of our consolidated income statement. We did not have any commercial loans held-for-investment at fair value at December 31, 2013.

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Commercial Loans Held-for-Investment, at Amortized Cost

Commercial loans held-for-investment at amortized cost include loans we originate and preferred equity investments we make or, in either case, acquire from third parties. Through March 31, 2014, these loans have typically been mezzanine loans that are secured by a borrower s ownership interest in a single purpose entity that owns commercial property, rather than a lien on the commercial property. The preferred equity investments are typically preferred equity interests in a single purpose entity that owns commercial property and are included within, and referred to herein, as commercial loans held-for-investment due to the fact that their risks and payment characteristics are nearly equivalent to commercial mezzanine loans.

The following table provides additional information for our commercial loans held-for-investment at amortized cost at March 31, 2014 and December 31, 2013.

(In Thousands)	**March 31, 2014**	**December 31, 2013**
Principal balance	$ 355,183	$ 353,331
Unamortized discount, net	(2,471)	(2,614)
Recorded investment	352,712	350,717
Allowance for loan losses	(8,028)	(7,373)
Carrying Value	$ 344,684	$ 343,344

At March 31, 2014, there were 51 commercial loans held-for-investment at amortized cost with an outstanding principal balance of $355 million and a carrying value of $345 million. During the three months ended March 31, 2014, we originated or acquired $2 million of commercial loans held-for-investment. Of the $353 million of recorded investment in commercial loans held-for-investment at March 31, 2014, 1% was originated in 2014, 18% was originated in 2013, 43% was originated in 2012, 34% was originated in 2011, and 4% was originated in 2010.

At December 31, 2013, there were 50 commercial loans held-for-investment at amortized cost with an outstanding principal balance of $353 million and a carrying value of $343 million. Of the $351 million of recorded investment in commercial loans held-for-investment at December 31, 2013, 19% was originated in 2013, 43% was originated in 2012, 34% was originated in 2011, and 4% was originated in 2010.

Allowance for Loan Losses on Commercial Loans

For commercial loans classified as held-for-investment, we establish and maintain an allowance for loan losses. The allowance includes a component for loans collectively evaluated for impairment and a component for loans individually evaluated for impairment.

Our methodology for assessing the adequacy of the allowance for loan losses includes a formal review of each commercial loan in the portfolio and the assignment of an internal impairment status. Based on the assigned impairment status, a loan is categorized as Pass, Watch List, or Workout. The following table presents the principa balance of commercial loans held-for-investment by risk category.

(In Thousands)		March 31, 2014		December 31, 2013
Pass	$	311,699	$	309,792
Watch list		43,484		43,539
Workout		-		-
Total Commercial Loans Held-for-Investment	$	355,183	$	353,331

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Activity in the Allowance for Loan Losses on Commercial Loans

The following table summarizes the activity in the allowance for commercial loan losses for the three months ended March 31, 2014 and 2013.

(In Thousands)	Three Months Ended March 31, 2014		2013	
Balance at beginning of period	$	7,373	$	4,084
Charge-offs, net		-		-
Provision for loan losses		655		685
Balance at End of Period	$	8,028	$	4,769

Commercial Loans Collectively Evaluated for Impairment

At March 31, 2014 and December 31, 2013, all of our commercial loans collectively evaluated for impairment were current. The following table summarizes the balances for loans collectively evaluated for impairment at March 31, 2014 and December 31, 2013.

(In Thousands)	March 31, 2014		December 31, 2013	
Principal balance	$	355,183	$	353,331
Recorded investment		352,712		350,717
Related allowance		8,028		7,373

Commercial Loans Individually Evaluated for Impairment

We did not have any loans individually evaluated for impairment at either March 31, 2014 or December 31, 2013.

Note 8. Real Estate Securities

We invest in mortgage-backed securities. The following table presents the fair values of our real estate securities by type at March 31, 2014 and December 31, 2013.

(In Thousands)	**March 31, 2014**	**December 31, 2013**
Trading	$ 120,123	$ 124,555
Available-for-sale	1,622,885	1,558,306
Total Real Estate Securities	$ 1,743,008	$ 1,682,861

Our residential securities herein are presented in accordance with their general position within a securitization structure based on their rights to cash flows. Senior securities are those interests in a securitization that generally have the first right to cash flows and are last in line to absorb losses. Re-REMIC securities, as presented herein, were created through the resecuritization of certain senior interests to provide additional credit support to those interests. These re-REMIC securities are therefore subordinate to the remaining senior interest, but senior to any subordinate tranches of the securitization from which they were created. Subordinate securities are all interests below senior and re-REMIC interests.

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Trading Securities

We elected the fair value option for certain securities and classify them as trading securities. At March 31, 2014, our trading securities included $115 million of interest-only securities, for which there is no principal balance, and $5 million of residential subordinate securities. The unpaid principal balance of residential subordinate securities classified as trading was $15 million at both March 31, 2014 and December 31, 2013. The following table presents trading securities by collateral type at March 31, 2014 and December 31, 2013.

(In Thousands)	March 31, 2014	December 31, 2013
Senior Securities		
Prime	$ 106,228	$ 110,505
Non-prime	8,729	9,070
Total Senior Securities	114,957	119,575
Subordinate Securities		
Prime	5,166	4,980
Non-prime	-	-
Total Subordinate Securities	5,166	4,980
Total Trading Securities	$ 120,123	$ 124,555

AFS Securities

The following table presents the fair value of our available-for-sale securities held at Redwood by collateral type at March 31, 2014 and December 31, 2013.

(In Thousands)	March 31, 2014	December 31, 2013
Senior Securities		
Prime	$ 699,786	$ 662,306
Non-prime	192,997	193,386

Total Senior Securities		892,783		855,692
Re-REMIC Securities		192,208		176,376
Subordinate Securities				
Prime		537,735		526,095
Non-prime		159		143
Total Subordinate Securities		537,894		526,238
Total AFS Securities	$	1,622,885	$	1,558,306

The senior securities shown above at March 31, 2014 and December 31, 2013, included $125 million and $131 million, respectively, of prime securities, and $131 million and $132 million, respectively, of non-prime securities that were financed through the Residential Resecuritization entity, as discussed in *Note 4*.

We often purchase AFS securities at a discount to their outstanding principal balances. To the extent we purchase an AFS security that has a likelihood of incurring a loss, we do not amortize into income the portion of the purchase discount that we do not expect to collect due to the inherent credit risk of the security. We may also expense a portion of our investment in the security to the extent we believe that principal losses will exceed the purchase discount. We designate any amount of unpaid principal balance that we do not expect to receive and thus do not expect to earn or recover as a credit reserve on the security. Any remaining net unamortized discounts or premiums on the security are amortized into income over time using the effective yield method.

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At March 31, 2014, there were $729 thousand of AFS residential securities with contractual maturities less than five years, $2 million of AFS residential securities with contractual maturities greater than five years but less than ten years, and the remainder of our real estate securities had contractual maturities greater than ten years.

The following table presents the components of carrying value (which equals fair value) of residential AFS securities at March 31, 2014 and December 31, 2013.

Carrying Value of Residential AFS Securities

March 31, 2014	**Senior**				
(In Thousands)	**Prime**	**Non-prime**	**Re-REMIC**	**Subordinate**	**Total**
Principal balance	$ 703,977	$ 212,629	$ 223,709	$ 696,717	$ 1,837,032
Credit reserve	(6,815)	(11,625)	(20,590)	(56,658)	(95,688)
Unamortized discount, net	(42,255)	(36,867)	(87,910)	(136,701)	(303,733)
Amortized cost	654,907	164,137	115,209	503,358	1,437,611
Gross unrealized gains	46,589	28,860	76,999	46,432	198,880
Gross unrealized losses	(1,710)	-	-	(11,896)	(13,606)
Carrying Value	$ 699,786	$ 192,997	$ 192,208	$ 537,894	$ 1,622,885

December 31, 2013	**Senior**				
(In Thousands)	**Prime**	**Non-prime**	**Re-REMIC**	**Subordinate**	**Total**
Principal balance	$ 670,051	$ 218,603	$ 214,046	$ 706,292	$ 1,808,992
Credit reserve	(10,144)	(13,840)	(30,429)	(62,457)	(116,870)
Unamortized discount, net	(44,133)	(36,882)	(80,188)	(137,266)	(298,469)
Amortized cost	615,774	167,881	103,429	506,569	1,393,653
	47,980	25,654	72,947	41,205	187,786

Gross unrealized gains										
Gross unrealized losses		(1,448)		(149)		-		(21,536)		(23,133)
Carrying Value	$	662,306	$	193,386	$	176,376	$	526,238	$	1,558,306

The following table presents the changes for the three months ended March 31, 2014, in unamortized discount and designated credit reserves on residential AFS securities.

Changes in Unamortized Discount and Designated Credit Reserves on Residential AFS Securities

	Three Months Ended March 31, 2014			
(In Thousands)		**Credit Reserve**		**Unamortized Discount, Net**
Beginning balance	$	116,870	$	298,469
Amortization of net discount		-		(11,298)
Realized credit losses		(3,337)		-
Acquisitions		-		(409)
Sales, calls, other		(936)		(51)
Impairments		113		-
Transfers to (release of) credit reserves, net		(17,022)		17,022
Ending Balance	$	95,688	$	303,733

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Residential AFS Securities with Unrealized Losses

The following table presents the components comprising the total carrying value of residential AFS securities that were in a gross unrealized loss position at March 31, 2014 and December 31, 2013.

	Less Than 12 Consecutive Months			12 Consecutive Months or Longer		
(In Thousands)	Amortized Cost	Unrealized Losses	Fair Value	Amortized Cost	Unrealized Losses	Fair Value
March 31, 2014	$ 430,056	$ (7,795)	$ 422,261	$ 97,790	$ (5,811)	$ 91,979
December 31, 2013	607,030	(21,195)	585,835	19,828	(1,938)	17,890

At March 31, 2014, after giving effect to purchases, sales, and extinguishments due to credit losses, our consolidated balance sheet included 298 AFS securities, of which 59 were in an unrealized loss position and 14 were in a continuous unrealized loss position for 12 consecutive months or longer. At December 31, 2013, our consolidated balance sheet included 303 AFS securities, of which 76 were in an unrealized loss position and five were in a continuous unrealized loss position for 12 consecutive months or longer.

Evaluating AFS Securities for Other-than-Temporary Impairments

Gross unrealized losses on our AFS securities were $14 million at March 31, 2014. We evaluate all securities in an unrealized loss position to determine if the impairment is temporary or other-than-temporary (resulting in an OTTI). At March 31, 2014, we did not intend to sell any of our AFS securities that were in an unrealized loss position, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost basis, which may be at their maturity. We review our AFS securities that are in an unrealized loss position to identify those securities with losses that are other-than-temporary based on an assessment of changes in expected cash flows for such securities, which considers recent security performance and expected future performance of the underlying collateral.

During the three months ended March 31, 2014, we determined that unrealized losses of $2 million related to our AFS securities were OTTI, of which $113 thousand was determined to be credit related and recorded in Other market valuation adjustments in our consolidated statements of income and $1.6 million was determined to be non-credit related and recorded through AOCI on our consolidated balance sheets. AFS securities on which OTTI is recognized have experienced, or are expected to experience, credit-related adverse cash flow changes. In determining our estimate of cash flows for AFS securities we considered factors such as structural credit enhancement, past and expected future performance of underlying mortgage loans, including timing of expected future cash flows, which are informed by prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, FICO scores at loan origination, year of origination, loan-to-value ratios, and geographic concentrations, as well as general market assessments. Changes in our evaluation of these factors impacted the cash flows expected to be collected at the OTTI assessment date and were used to determine if there were credit-related adverse cash flows and if so, the amount of credit related losses. Significant judgment is used in both our analysis of the expected cash flows for our AFS securities and any determination of the credit loss component of OTTI.

The table below summarizes the significant valuation assumptions we used for our AFS securities at March 31, 2014.

Significant Valuation Assumptions

March 31, 2014	**Prime Securities**
Prepayment rates	7 - 20 %
Loss severity	20 - 55 %
Projected default rate	1 - 22 %

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The following table details the activity related to the credit loss component of OTTI (i.e., OTTI recognized through earnings) for AFS securities held at March 31, 2014 and 2013, for which a portion of an OTTI was recognized in other comprehensive income.

Activity of the Credit Component of Other-than-Temporary Impairments

(In Thousands)	Three Months Ended March 31, 2014		2013	
Balance at beginning of period	$	37,149	$	50,852
Additions		-		-
Initial credit impairments		71		-
Subsequent credit impairments		42		-
Reductions		-		-
Securities sold, or expected to sell		-		-
Securities with no outstanding principal at period end		(1,476)		(5,241)
Balance at End of Period	$	35,786	$	45,611

Gross Realized Gains and Losses on AFS Securities

Gains and losses from the sale of AFS securities are recorded as realized gains, net, in our consolidated statements of income. The following table presents the gross realized gains and losses on sales and calls of AFS securities for the three months ended March 31, 2014 and 2013.

(In Thousands)	Three Months Ended March 31, 2014		2013	
Gross realized gains - sales	$	-	$	12,038
Gross realized gains - calls		987		-
Gross realized losses - sales		-		-
Gross realized losses - calls		-		-
Total Realized Gains on Sales and Calls of AFS Securities, Net	$	987	$	12,038

Note 9. Mortgage Servicing Rights

During the three months ended March 31, 2014, we recorded MSRs of $488 thousand associated with $59 million (principal balance) of jumbo loans sold to third parties. In addition, during the three months ended March 31, 2014, we recorded MSRs of $2 million associated with $155 million (principal balance) of conforming loans sold to the Agencies and we purchased less than $1 million of MSRs associated with $59 million of conforming loan principal balance. At March 31, 2014, the principal balance of the loans associated with our MSRs was $6.0 billion. At March 31, 2014, we also owned MSRs that provided us with the rights to service $674 million (principal balance) of consolidated residential loans purchased from third-party originators.

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We contract with a licensed sub-servicer to perform all servicing functions for loans associated with our MSRs. The following table presents activity for MSRs for the three months ended March 31, 2014 and 2013.

MSR Activity

	Three Months Ended March 31,			
(In Thousands)	**2014**		**2013**	
Balance at beginning of period	$	64,824	$	5,315
Additions		2,858		12,466
Changes in fair value due to:				
Changes in assumptions (1)		(1,125)		713
Other changes (2)		(1,586)		(371)
Balance at End of Period	$	64,971	$	18,123

(1) Primarily reflects changes in prepayment assumptions due to changes in interest rates and discount rates.
(2) Represents changes due to realization of expected cash flows.

MSR Income

The following table presents the income from MSRs, net.

	Three Months Ended March 31,			
(In Thousands)	**2014**		**2013**	
Servicing income, net:				
Income	$	3,598	$	851
Late charges		35		6
Cost of sub-servicer		(316)		(178)
Net servicing income		3,317		679
Market valuation adjustments		(2,711)		342
Income from MSRs, Net	$	606	$	1,021

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Note 10. Derivative Financial Instruments

The following table presents the fair value and notional amount of derivative financial instruments held by us at March 31, 2014 and December 31, 2013.

	March 31, 2014		December 31, 2013	
(In Thousands)	**Fair Value**	**Notional Amount**	**Fair Value**	**Notional Amount**
Assets - Risk Management Derivatives				
Interest rate swaps	$ 1,978	$ 65,000	$ 5,972	$ 268,000
TBAs	913	393,000	1,138	241,000
Futures	-	-	-	-
Swaptions	1,443	270,000	595	340,000
Assets - Other Derivatives				
Loan purchase commitments	96	43,731	-	360
Loan forward sale commitments	8	10,000	81	10,000
Total Assets	$ 4,438	$ 781,731	$ 7,786	$ 859,360
Liabilities - Cash Flow Hedges				
Interest rate swaps	$ (25,316)	$ 139,500	$ (16,519)	$ 139,500
Liabilities - Risk Management Derivatives				
Interest rate swaps	(727)	176,500	(80)	50,500
TBAs	(360)	308,000	(661)	235,000
Futures	(503)	144,000	(528)	162,000
Liabilities - Other Derivatives				
Loan purchase commitments	(289)	110,830	(379)	42,562
Loan forward sale commitments	(2)	7,500		
Total Liabilities	$ (27,197)	$ 886,330	$ (18,167)	$ 629,562
Total Derivative Financial Instruments, Net	$ (22,759)	$ 1,668,061	$ (10,381)	$ 1,488,922

Risk Management Derivatives

To offset, to varying degrees, risks associated with certain assets and liabilities on our consolidated balance sheet, we may enter into derivative contracts. In order to manage certain risks associated with residential loans, residential securities, and commercial loans we own or plan to acquire, at March 31, 2014, we were party to swaps and swaptions with an aggregate notional amount of $512 million, TBA contracts sold with an aggregate notional amount of $701 million and financial futures contracts with an aggregate notional amount of $144 million. Net market valuation adjustments on risk management derivatives were negative $13 million and positive $1 million for the three months ended March 31, 2014 and 2013, respectively.

Loan Purchase and Forward Sale Commitments

LPCs and FSCs that qualify as derivatives are recorded at their estimated fair values. Net valuation adjustments on LPCs and FSCs were less than negative $1 million for the three months ended March 31, 2014, and are reported through our consolidated statements of income in mortgage banking activities, net.

Derivatives Designated as Cash Flow Hedges

To hedge the variability in interest expense related to our long-term debt and certain adjustable-rate securitization entity liabilities that are included in our consolidated balance sheets for financial reporting purposes, we designated certain interest rate swaps as cash flow hedges with an aggregate notional balance of $140 million.

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For the three months ended March 31, 2014 and 2013, designated cash flow hedges decreased in value by $9 million and increased in value by $7 million, respectively, which was recorded in accumulated other comprehensive income, a component of equity. For interest rate agreements currently or previously designated as cash flow hedges, our total unrealized loss reported in accumulated other comprehensive income was $25 million and $16 million at March 31, 2014 and December 31, 2013, respectively. For both of the three months ended March 31, 2014 and 2013, we reclassified less than $100 thousand of unrealized losses on derivatives to interest expense. Accumulated other comprehensive loss of less than $1 million will be amortized into interest expense, a component of our consolidated statements of income, over the remaining life of the hedged liabilities

The following table illustrates the impact on interest expense of our interest rate agreements accounted for as cash flow hedges for the three months ended March 31, 2014 and 2013.

Impact on Interest Expense of Our Interest Rate Agreements Accounted for as Cash Flow Hedges

(In Thousands)		**Three Months Ended March 31, 2014**		**2013**
Net interest expense on cash interest rate agreements	$	(1,488)	$	(1,464)
Realized expense due to ineffective portion of cash flow hedges		-		-
Realized net losses reclassified from other comprehensive income		(60)		(88)
Total Interest Expense	$	(1,548)	$	(1,552)

Derivative Counterparty Credit Risk

We incur credit risk to the extent that counterparties to our derivative financial instruments do not perform their obligations under specified contractual agreements. If a derivative counterparty does not perform, we may not receive the proceeds to which we may be entitled under these agreements. Each of our derivative counterparties that is not a clearinghouse must maintain compliance with International Swaps and Derivatives Association (ISDA) agreements or other similar agreements (or receive a waiver of non-compliance after a specific assessment) in order to conduct derivative transactions with us. Additionally, we review non-clearinghouse derivative counterparty credit standings, and in the case of a deterioration of creditworthiness, appropriate remedial action is taken. To further mitigate counterparty risk, we exit derivatives contracts with counterparties that (i) do not maintain compliance with (or obtain a waiver from) the terms of their ISDA or other agreements with us; or (ii) do not meet internally established guidelines regarding creditworthiness. Our ISDA and similar agreements currently require full bilateral collateralization of unrealized loss exposures with our derivative counterparties. Through a margin posting process, our positions are revalued with counterparties each business day and cash margin is generally transferred to either us or our derivative counterparties as collateral based upon the directional changes in fair value of the positions. We also attempt to transact with several different counterparties in order to reduce our specific counterparty exposure. With respect to certain of our derivatives, clearing and settlement is through one or more clearinghouses, which may be substituted as a counterparty. Clearing and settlement of derivative transactions through a clearinghouse is also intended to reduce specific counterparty exposure. We consider counterparty risk as part of our fair value assessments of all derivative financial instruments.

At March 31, 2014, we were in compliance with ISDA and similar agreements governing our open derivative positions. We assessed the risk associated with our counterparties as remote and did not record a specific valuation adjustment.

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Note 11. Other Assets and Liabilities

Other assets at March 31, 2014 and December 31, 2013, are summarized in the following table.

Other Assets

(In Thousands)	March 31, 2014	December 31, 2013
Margin receivable	$ 44,746	$ 31,149
Investment receivable	1,571	8,923
Other pledged collateral	5,000	5,000
REO	2,607	3,661
Prepaid expenses	1,595	1,850
Fixed assets and leasehold improvements	1,870	1,232
Income tax receivables	2,546	170
Other	1,395	1,655
Total Other Assets	$ 61,330	$ 53,640

Margin receivable resulted from margin calls from our swap, master repurchase agreements, and warehouse facilities counterparties that required us to post collateral.

The carrying value of REO at March 31, 2014, was $3 million, which includes the net effect of $135 thousand related to transfers into REO during the three months ended March 31, 2014, offset by $1 million of REO liquidations. At March 31, 2014 and December 31, 2013, there were 19 and 20 REO properties, respectively, recorded on our consolidated balance sheets, all of which were owned at consolidated Sequoia entities.

Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities at March 31, 2014 and December 31, 2013 are summarized in the following table.

(In Thousands)	March 31, 2014	December 31, 2013
Accrued compensation	$ 6,976	$ 22,160
Legal reserve	12,000	12,000

Derivative margin payable		3,260		4,700
Accrued operating expenses		3,671		4,291
Residential repurchase reserve		1,871		1,771
Income tax payable		470		1,337
Unsettled trades		24,380		-
Other		2,914		2,445
Total Other Liabilities	$	55,542	$	48,704

See *Note 15* for additional information on the legal and residential repurchase reserves.

Note 12. Short-Term Debt

We enter into repurchase agreements, bank warehouse agreements, and other forms of collateralized (and generally uncommitted) short-term borrowings with several banks and major investment banking firms. At March 31, 2014, we had outstanding agreements with 13 counterparties and we were in compliance with all of the related covenants. Further information about these financial covenants is set forth in Part I, Item 2 *Management s Discussion and Analysis of Financial Condition and Results of Operations* of this Quarterly Report on Form 10-Q.

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The table below summarizes the facilities that are available to us and the balances of short-term debt at March 31, 2014 and December 31, 2013 by the type of collateral securing the debt.

	March 31, 2014			
(Dollars in Thousands)	Number of Facilities	Outstanding	Limit	Maturity
Collateral Type				
Residential loans	5	$ 512,305	$ 1,400,000	4/2014-2/2015
Commercial loans	1	68,043	100,000	4/2014
Real estate securities	7	708,413	-	4/2014-5/2014
Total	13	$ 1,288,761		

	December 31, 2013			
(Dollars in Thousands)	Number of Facilities	Outstanding	Limit	Maturity
Collateral Type				
Residential loans	5	$ 184,789	$ 1,400,000	1/2014 - 12/2014
Commercial loans	1	-	100,000	4/2014
Real estate securities	7	677,974	-	1/2014 - 2/2014
Total	13	$ 862,763		

Borrowings under these facilities are generally charged interest based on a specified margin over the one-month LIBOR interest rate. At March 31, 2014, all of these borrowings were under uncommitted facilities and were due within 364 days (or less) of the borrowing date. The fair value of residential loans, commercial loans, and real estate securities pledged as collateral was $574 million, $93 million, and $875 million, respectively, at March 31, 2014. For the three months ended March 31, 2014, the average balance of short-term debt was $1.01 billion. At March 31, 2014 and December 31, 2013, accrued interest payable on short-term debt was less than $1 million.

We also maintain a $10 million committed line of credit with one financial institution, which is secured by our pledge of certain mortgage-backed securities we own. At both March 31, 2014 and December 31, 2013, we had no outstanding borrowings on this facility.

Characteristics of Short-Term Debt

The table below summarizes short-term debt by weighted average interest rates and by collateral type at March 31, 2014 and December 31, 2013.

	March 31, 2014			December 31, 2013		
(Dollars in Thousands)	**Amount Borrowed**	**Weighted Average Interest Rate**	**Weighted Average Days Until Maturity**	**Amount Borrowed**	**Weighted Average Interest Rate**	**Weighted Average Days Until Maturity**
Collateral Type						
Residential loan collateral	$ 512,305	1.71%	159	$ 184,789	1.71%	228
Commercial loan collateral	68,043	2.41%	26	-	-	-
Real estate securities collateral	708,413	1.34%	16	677,974	1.34%	15
Total Short-Term Debt	$ 1,288,761	1.54%	73	$ 862,763	1.42%	61

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Remaining Maturities of Short-Term Debt

The following table presents the remaining maturities of short-term debt at March 31, 2014 and December 31, 2013.

(In Thousands)	March 31, 2014		December 31, 2013	
Within 30 days	$	790,958	$	659,262
31 to 90 days		234,156		54,434
Over 90 days		263,647		149,067
Total Short-Term Debt	$	1,288,761	$	862,763

Note 13. Asset-Backed Securities Issued

Through our Sequoia securitization program, we sponsor securitization transactions in which ABS backed by residential mortgage loans are issued by Sequoia entities. ABS were also issued by securitization entities in the Residential Resecuritization and the Commercial Securitization. Each securitization entity is independent of Redwood and of each other and the assets and liabilities are not owned by and are not legal obligations of Redwood. Our exposure to these entities is primarily through the financial interests we have retained, although we are exposed to certain financial risks associated with our role as a sponsor, manager, or depositor of these entities.

As a general matter, ABS have been issued by these securitization entities to fund the acquisition of assets from us or from third parties. The ABS issued by these entities consist of various classes of securities that pay interest on a monthly or quarterly basis. Substantially all ABS issued pay variable rates of interest, which are indexed to one-, three-, or six-month LIBOR. Some ABS issued pay fixed rates of interest or pay hybrid rates, which are fixed rates that subsequently adjust to variable rates. ABS issued also includes some interest-only classes with coupons set at a fixed rate or a fixed spread to a benchmark rate, or set at a spread to the interest rates earned on the assets less the interest rates paid on the liabilities of a securitization entity.

The carrying values of ABS issued by consolidated securitization entities we sponsored at March 31, 2014 and December 31, 2013, along with other selected information, are summarized in the following table.

Asset-Backed Securities Issued

March 31, 2014

(Dollars in Thousands)	Sequoia	Residential Resecuritization	Commercial Securitization	Total
Certificates with principal balance	$ 1,637,485	$ 82,179	$ 147,574	$ 1,867,238
Interest-only certificates	2,951	-	-	2,951
Unamortized discount	(15,845)	-	-	(15,845)
Total ABS Issued	$ 1,624,591	$ 82,179	$ 147,574	