

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

FORM 10-K

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

For the Fiscal Year Ended: December 31, 2020

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

(State or Other Jurisdiction of
Incorporation or Organization)

68-0329422

(I.R.S. Employer
Identification No.)

One Belvedere Place, Suite 300

Mill Valley, California

(Address of Principal Executive Offices)

94941

(Zip Code)

(415) 389-7373

(Registrant's Telephone Number, Including Area Code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Trading symbol(s)	Name of each exchange on which registered
Common stock, par value \$0.01 per share	RWT	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

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

At June 30, 2020, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$798,085,066 based on the closing sale price as reported on the New York Stock Exchange.

The number of shares of the registrant's Common Stock outstanding on February 22, 2021 was 112,090,006.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement to be filed with the Securities and Exchange Commission under Regulation 14A within 120 days after the end of registrant's fiscal year covered by this Annual Report are incorporated by reference into Part III.

REDWOOD TRUST, INC.
2020 ANNUAL REPORT ON FORM 10-K

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Special Note - Cautionary Statement

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

Statements regarding the following subjects, among others, are forward-looking by their nature: (i) statements we make regarding Redwood's business strategy and strategic focus, including statements relating to our overall market position, strategy and long-term prospects (including trends driving the flow of capital in the housing finance market, our strategic initiatives designed to capitalize on those trends, our ability to attract capital to finance those initiatives, our approach to raising capital, our ability to pay dividends in the future, and the prospects for federal housing finance reform); (ii) statements related to our financial outlook and expectations for 2021, including with respect to our operating businesses, our investment portfolio, available capital, and corporate operating expenses and unsecured debt service; (iii) statements related to our investment portfolio, including that we continue to see an opportunity for further valuation increases on these investments, and that we expect up to \$600 million of loans collateralizing certain securitizations to become redeemable in 2021, well below their estimated fair values; (iv) statements related to our residential consumer and business purpose lending platforms, including that we expect to see a significant opportunity to diversify our residential loan purchase mix into Redwood Choice expanded prime and non-QM products; (v) statements relating to our estimate of our available capital (including that we estimate our available capital at December 31, 2020 was approximately \$200 million); (vi) statements relating to acquiring residential mortgage loans in the future that we have identified for purchase or plan to purchase, including the amount of such loans that we identified for purchase during the fourth quarter of 2020, at December 31, 2020, and to date in the first quarter of 2021, and expected fallout and the corresponding volume of residential mortgage loans expected to be available for purchase, and expected residential mortgage loan sales in the first quarter of 2021, including through forward sales agreements we entered into during the fourth quarter of 2020; (vii) statements we make regarding future dividends, including with respect to our regular quarterly dividends in 2020; and (viii) statements regarding our expectations and estimates relating to the characterization for income tax purposes of our dividend distributions, our expectations and estimates relating to tax accounting, tax liabilities and tax savings, and GAAP tax provisions, and our estimates of REIT taxable income and TRS taxable income.

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

- the impact of the COVID-19 pandemic;
- general economic trends and the performance of the housing, real estate, mortgage finance, and broader financial markets;
- federal and state legislative and regulatory developments and the actions of governmental authorities and entities;
- changing benchmark interest rates, and the Federal Reserve's actions and statements regarding monetary policy;
- our ability to compete successfully;
- our ability to adapt our business model and strategies to changing circumstances;
- strategic business and capital deployment decisions we make;
- our use of financial leverage;
- our exposure to a breach of our cybersecurity or data security;
- our exposure to credit risk and the timing of credit losses within our portfolio;
- the concentration of the credit risks we are exposed to, including due to the structure of assets we hold, the geographical concentration of real estate underlying assets we own, and our exposure to environmental and climate-related risks;
- the efficacy and expense of our efforts to manage or hedge credit risk, interest rate risk, and other financial and operational risks;
- changes in credit ratings on assets we own and changes in the rating agencies' credit rating methodologies;
- changes in mortgage prepayment rates;
- changes in interest rates;
- our ability to redeploy our available capital into new investments;
- interest rate volatility, changes in credit spreads, and changes in liquidity in the market for real estate securities and loans;
- our ability to finance the acquisition of real estate-related assets with short-term debt;
- changes in the values of assets we own;

- the ability of counterparties to satisfy their obligations to us;
- our exposure to the discontinuation of LIBOR;
- our exposure to liquidity risk, risks associated with the use of leverage, and market risks;
- changes in the demand from investors for residential and business purpose mortgages and investments, and our ability to distribute residential and business purpose mortgages through our whole-loan distribution channel;
- our involvement in securitization transactions, the profitability of those transactions, and the risks we are exposed to in engaging in securitization transactions;
- exposure to claims and litigation, including litigation arising from our involvement in loan origination and securitization transactions;
- whether we have sufficient liquid assets to meet short-term needs;
- our ability to successfully retain or attract key personnel;
- changes in our investment, financing, and hedging strategies and new risks we may be exposed to if we expand our business activities;
- our exposure to a disruption of our technology infrastructure and systems;
- the impact on our reputation that could result from our actions or omissions or from those of others;
- our failure to maintain appropriate internal controls over financial reporting and disclosure controls and procedures;
- the termination of our captive insurance subsidiary's membership in the Federal Home Loan Bank and the implications for our income generating abilities;
- the impact of changes to U.S. federal income tax laws on the U.S. housing market, mortgage finance markets, and our business;
- our failure to comply with applicable laws and regulation, including our ability to obtain or maintain the governmental licenses;
- our ability to maintain our status as a REIT for tax purposes;
- limitations imposed on our business due to our REIT status and our status as exempt from registration under the Investment Company Act of 1940;
- our common stock may experience price declines, volatility, and poor liquidity, and we may reduce our dividends in a variety of circumstances;
- decisions about raising, managing, and distributing capital;
- our exposure to broad market fluctuations; and
- other factors not yet identified.

This Annual Report on Form 10-K may contain statistics and other data that in some cases have been obtained from or compiled from information made available by servicers and other third-party service providers.

PART I

ITEM 1. BUSINESS

Introduction

Redwood Trust, Inc., together with its subsidiaries, is a specialty finance company focused on several distinct areas of housing credit. Our operating platforms occupy a unique position in the housing finance value chain, providing liquidity to growing segments of the U.S. housing market not served by government programs. We deliver customized housing credit investments to a diverse mix of investors, through our best-in-class securitization platforms; whole-loan distribution activities; and our publicly-traded shares. Our consolidated investment portfolio has evolved to incorporate a diverse mix of residential, business purpose and multifamily investments. Our goal is to provide attractive returns to shareholders through a stable and growing stream of earnings and dividends, capital appreciation, and a commitment to technological innovation that facilitates risk-minded scale. We operate our business in three segments: Residential Lending, Business Purpose Lending, and Third-Party Investments.

Our primary sources of income are net interest income from our investments and non-interest 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 is generated through the origination and acquisition of loans, and their subsequent sale, securitization, or transfer to our investment portfolios.

Redwood Trust, Inc. has elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"), beginning with its taxable year ended December 31, 1994. 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 taxable REIT subsidiaries" or "TRS." Our mortgage banking activities and investments in mortgage servicing rights ("MSRs") 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 taxable income we generate at our REIT.

Redwood Trust, Inc. was incorporated in the State of Maryland on April 11, 1994, and commenced operations on August 19, 1994. On March 1, 2019, Redwood completed the acquisition of 5 Arches, LLC ("5 Arches"), at which time 5 Arches became a wholly-owned subsidiary of Redwood. On October 15, 2019, Redwood acquired CoreVest American Finance Lender, LLC and certain affiliated entities ("CoreVest"), at which time CoreVest became wholly owned by Redwood.

Our executive offices are located at One Belvedere Place, Suite 300, Mill Valley, California 94941. References herein to "Redwood," the "company," "we," "us," and "our" include Redwood Trust, Inc. and its consolidated subsidiaries, unless the context otherwise requires. In statements regarding qualification as a REIT, such terms refer solely to Redwood Trust, Inc.

Financial information concerning our business, both on a consolidated basis and with respect to each of our segments, is set forth in *Financial Statements and Supplementary Data* as well as in *Management's Discussion and Analysis of Financial Condition and Results of Operations* which are included in Part II, Items 8 and 7, respectively, of this Annual Report on Form 10-K.

Our Business Segments

Beginning in the second quarter of 2020, we combined what was previously our Multifamily Investments segment and Third-Party Residential Investments segment into a new segment called Third-Party Investments. Following is a full description of our current segments.

Residential Lending – consists of a mortgage loan conduit that acquires residential loans from third-party originators for subsequent sale, securitization, or transfer into our investment portfolio, as well as the investments we retain from these activities. We typically acquire prime, jumbo mortgages and the related mortgage servicing rights on a flow basis from our network of loan sellers and distribute those loans through our Sequoia private-label securitization program or to institutions that acquire pools of whole loans. Our investments in this segment primarily consist of residential mortgage-backed securities ("RMBS") retained from our Sequoia securitizations (some of which we consolidate for GAAP purposes) and MSRs retained from jumbo whole loans we sold or securitized. This segment also includes various derivative financial instruments that we utilize to manage certain risks associated with our inventory of residential loans held-for-sale and long-term investments we hold within this segment. This segment's main source of revenue is net interest income from its long-term investments and its inventory of loans held-for-sale, as well as income from mortgage banking activities, which includes valuation increases (or gains) on loans we acquire and subsequently sell, securitize, or transfer into our investment portfolio, and the hedges used to manage risks associated with these activities. Additionally, this segment may realize gains and losses upon the sale of securities. Funding expenses, direct operating expenses, and tax expenses associated with these activities are also included in this segment.

Business Purpose Lending – consists of a platform that originates and acquires business purpose loans for subsequent securitization or transfer into our investment portfolio, as well as the investments we retain from these activities. We typically originate single-family rental and bridge loans and distribute most of our single-family rental loans through our CoreVest American Finance Lender ("CAFL") private-label securitization program and generally retain our bridge loans for investment. Single-family rental loans are business purpose mortgage loans to investors in single-family (primarily 1-4 unit) rental properties. Bridge loans are business purpose mortgage loans to investors rehabilitating and subsequently reselling or renting residential and small-balance multifamily properties. Our investments in this segment primarily consist of securities retained from our CAFL securitizations (which we consolidate for GAAP purposes), and bridge loans. This segment also includes various derivative financial instruments that we utilize to manage certain risks associated with our inventory of single-family rental loans held-for-sale and our investments. This segment's main source of revenue is net interest income from its investments and loans held-for-sale, as well as income from mortgage banking activities, which includes valuation increases (or gains) on loans we originate or acquire and subsequently sell, securitize or transfer into our investment portfolio, and the hedges used to manage risks associated with these activities. Additionally, this segment may realize gains and losses upon the sale of securities. Funding expenses, direct operating expenses, and tax expenses associated with these activities are also included in this segment.

Third-Party Investments – consists of investments in RMBS issued by third parties, investments in Freddie Mac K-Series multifamily loan securitizations and SLST reperforming loan securitizations (both of which we consolidate for GAAP purposes), our servicer advance investments, and other residential and multifamily credit investments not generated through our Residential or Business Purpose Lending segments. This segment's main sources of revenue are interest income from securities and loans held-for-investment. Additionally, this segment may realize gains and losses upon the sale of securities. Funding expenses, hedging expenses, direct operating expenses, and tax provisions associated with these activities are also included in this segment.

Consolidated Securitization Entities

We sponsor our Sequoia securitization program, which we use for the securitization of residential mortgage loans. We are required under Generally Accepted Accounting Principles in the United States ("GAAP") to consolidate the assets and liabilities of certain securitization entities we have sponsored for financial reporting purposes. We refer to certain of these securitization entities issued prior to 2012 as "consolidated Legacy Sequoia entities," and the securitization entities formed in connection with the securitization of Redwood Choice expanded-prime loans as the "consolidated Sequoia Choice entities." We also consolidate certain third-party Freddie Mac K-Series, Freddie Mac Seasoned Loans Structured Transaction ("SLST"), and CoreVest American Finance Lender ("CAFL") securitization entities that we determined were VIEs and for which we determined we were the primary beneficiary. Where applicable, in analyzing our results of operations, we distinguish results from current operations "at Redwood" and from consolidated entities. Each of these consolidated entities is independent of Redwood and of each other, and the assets and liabilities of these entities are not owned by us or legal obligations of ours, respectively, although we are exposed to certain financial risks associated with any role we carry out for these entities (e.g., as sponsor or depositor) and, to the extent we hold securities issued by, or other investments in, these entities, we are exposed to the performance of these entities and the assets they hold.

Human Capital Resources

As of December 31, 2020, Redwood employed 247 full-time employees, 116 of whom were directly engaged in the operations of our wholly-owned subsidiary, CoreVest. Our employees are dispersed across four principal offices in California, Colorado, and New York. Redwood's talented employees are core to the long-term success of our company and we invest in programs that support our ability to attract, retain, and develop our people. Cultural priorities and values are closely intertwined with our overarching business strategy and we believe they support Redwood's ability to fulfill its mission and contribute to our ongoing focus on having a strong, healthy culture and a capable and satisfied workforce.

We are focused on developing and advancing our employees through targeted learning programs to build specific job-based skills and leadership capabilities across the company. Our Management Essentials program provides foundational leadership training to all managers of people within the company. In addition, we offer support for specific ongoing education and professional certifications for our employees. We regularly assess the talent and skills of our workforce and prioritize the promotion or transfer of current employees for open roles. Feedback and coaching are core to our overall people development programs and our performance management process is designed to foster specific and frequent performance discussions. Attracting and hiring a qualified and diverse workforce is a priority, and we strive to create robust and diverse candidate pools for open positions across the company. Our summer internship program creates an opportunity to develop a pipeline of future talent for the company.

We regularly evaluate our ability to attract and retain our employees. We have had relatively low turnover rates within our workforce, particularly within the mortgage industry, and the average tenure of our employees is over 4 years, with 38% of our workforce being with the organization for 5 years or more. We believe that the investments we make in driving a strong, values-based culture and supporting our employees through programs, development, and competitive pay enhances our organizational capability and has a direct impact on our business results and fulfillment of Redwood's mission.

We seek to retain our employees by investing in firm-wide engagement programs. We periodically commission an employee engagement survey to monitor employee satisfaction and we follow up with an action planning process to actively respond to employee feedback. We have a values-based culture and our core values of Growth, Results, Passion, Relationships, Change, and Integrity are embedded into our programs and performance goals and are regularly communicated to our employees.

We are committed to fostering diversity, inclusion, equity, and belonging within the company and we are actively in the process of developing our diversity and inclusion roadmap. Our newly created Diversity Council, which is overseen by our CEO, was formed to inform and steward the company's efforts and includes employee representatives from across the organization. With management's support, our women's employee resource group ("ERG") promotes women's leadership development and advancement within the organization.

Being involved with and giving back to our communities is an important aspect of our culture. We have an employee-led Foundation that manages and raises funds for a variety of charitable causes. All employees are invited to participate through various fundraising initiatives and by submitting grant requests for causes that they are passionate about. Volunteerism is also important at Redwood, and we regularly sponsor community events and provide paid time off for volunteer activities.

We offer a competitive compensation structure to our employees, including short- and long-term financial incentives, generous health and welfare benefits, paid family leave, and paid time off to promote a healthy work/life balance. We also offer all employees the ability to participate in our Employee Stock Purchase Plan ("ESPP"), which incentivizes stock ownership by our employees by providing the opportunity to purchase Redwood common stock at a discounted price through payroll deductions.

A key priority during the pandemic is our employees' health and well-being. In March 2020 we quickly pivoted to a broad and effective remote work model to help minimize our employees' exposure to COVID and support employees who are balancing family care and employment responsibilities during the pandemic. Currently all employees are enabled to work from their homes and we are monitoring CDC and local guidelines to inform when our offices can fully return to pre-pandemic status. We also continue to plan for a potentially hybrid long-term model in which certain members of our workforce permanently work from home on either a full- or part-time basis.

Competition

We are subject to intense competition in seeking investments, acquiring, originating, and selling loans, engaging in securitization transactions, and in other aspects of our business. Our competitors include commercial banks, other mortgage REITs, Fannie Mae, Freddie Mac, regional and community banks, broker-dealers, insurance companies, and other specialty finance companies, financial institutions, as well as investment funds and other investors in real estate-related assets. In addition, other companies may be formed that will compete with us. Some of our competitors have greater resources than us and we may not be able to compete successfully with them. Some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more favorable relationships than we can. Furthermore, competition for investments, making loans, acquiring and selling loans, and engaging in securitization transactions may lead to a decrease in the opportunities and returns available to us. For additional discussion regarding our ability to compete successfully, see the risk factor below under the heading *"We are subject to intense competition and we may not compete successfully"* in Part I, Item 1A of this Annual Report on Form 10-K.

Federal and State Regulatory and Legislative Developments

Our business is affected by conditions in the housing, business-purpose, multifamily, and real estate markets and the broader financial markets, as well as by the financial condition and resources of other participants in these markets. These markets and many of the participants in these markets are subject to, or regulated under, various federal and state laws and regulations. In some cases, the government or government-sponsored entities, such as Fannie Mae and Freddie Mac, directly participate in these markets. In particular, because issues relating to residential real estate and housing finance can be areas of political focus, federal, state and local governments may be more likely to take actions that affect residential real estate, the markets for financing residential real estate, and the participants in residential real estate-related industries than they would with respect to other industries. As a result of the government's statutory and regulatory oversight of the markets we participate in and the government's direct and indirect participation in these markets, federal and state governmental actions, policies, and directives can have an adverse effect on these markets and on our business and the value of, and the returns on, mortgages, mortgage-related securities, and other assets we own or may acquire in the future, which effects may be material. For additional discussion regarding federal and state legislative and regulatory developments, see the risk factor below under the heading *"Federal and state legislative and regulatory developments and the actions of governmental authorities and entities may adversely affect our business and the value of, and the returns on, mortgages, mortgage-related securities, and other assets we own or may acquire in the future"* in Part I, Item 1A of this Annual Report on Form 10-K.

Information Available on Our Website

Our website can be found at www.redwoodtrust.com. We make available, free of charge through the investor information section of our website, access to our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the U.S. Securities Exchange Act of 1934, as well as proxy statements, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the U.S. Securities and Exchange Commission ("SEC"). We also make available, free of charge, access to the charters for our Audit Committee, Compensation Committee, and Governance and Nominating Committee, our Corporate Governance Standards, and our Code of Ethics governing our directors, officers, and employees. Within the time period required by the SEC and the New York Stock Exchange, we will post on our website any amendment to the Code of Ethics and any waiver applicable to any executive officer, director, or senior officer (as defined in the Code). In addition, our website includes information concerning purchases and sales of our equity securities by our executive officers and directors, as well as disclosure relating to certain non-GAAP financial measures (as defined in the SEC's Regulation G) that we may make public orally, telephonically, by webcast, by broadcast, or by similar means from time to time. The information on our website is not part of this Annual Report on Form 10-K.

Our Investor Relations Department can be contacted at One Belvedere Place, Suite 300, Mill Valley, CA 94941, Attn: Investor Relations, telephone (866) 269-4976 or email investorrelations@redwoodtrust.com.

Certifications

Our Chief Executive Officer and Chief Financial Officer have executed certifications dated February 26, 2021, as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, and we have included those certifications as exhibits to this Annual Report on Form 10-K. In addition, our Chief Executive Officer certified to the New York Stock Exchange (NYSE) on July 1, 2020 that he was unaware of any violations by Redwood Trust, Inc. of the NYSE's corporate governance listing standards in effect as of that date.

Item 1A. Risk Factors

Summary of Risk Factors

The risk factors summarized and detailed below could materially harm our business, operating results and/or financial condition, impair our future prospects and/or cause the price of our common stock to decline. These are not all of the risks we face and other factors not presently known to us or that we currently believe are immaterial may also affect our business if they occur. Material risks that may affect our business, operating results and financial condition include, but are not necessarily limited to, those relating to:

Risks Related to our Business and Industry

- the impact of the COVID-19 pandemic;
- general economic trends and the performance of the housing, real estate, mortgage finance, and broader financial markets;
- federal and state legislative and regulatory developments and the actions of governmental authorities and entities;
- changing benchmark interest rates, and the Federal Reserve's actions and statements regarding monetary policy;
- our ability to compete successfully;
- our ability to adapt our business model and strategies to changing circumstances;
- strategic business and capital deployment decisions we make;
- our use of financial leverage;
- our exposure to a breach of our cybersecurity or data security;

Risks Related to our Investments and Investing Activity

- our exposure to credit risk and the timing of credit losses within our portfolio;
- the concentration of the credit risks we are exposed to, including due to the structure of assets we hold, the geographical concentration of real estate underlying assets we own, and our exposure to environmental and climate-related risks;
- the efficacy and expense of our efforts to manage or hedge credit risk, interest rate risk, and other financial and operational risks;
- changes in credit ratings on assets we own and changes in the rating agencies' credit rating methodologies;
- changes in mortgage prepayment rates;
- changes in interest rates;
- our ability to redeploy our available capital into new investments;
- interest rate volatility, changes in credit spreads, and changes in liquidity in the market for real estate securities and loans;
- our ability to finance the acquisition of real estate-related assets with short-term debt;
- changes in the values of assets we own;
- the ability of counterparties to satisfy their obligations to us;
- our exposure to the discontinuation of LIBOR;
- our exposure to liquidity risk, risks associated with the use of leverage, and market risks;

Operational and Other Risks

- changes in the demand from investors for residential and business purpose mortgages and investments, and our ability to distribute residential and business purpose mortgages through our whole-loan distribution channel;
- our involvement in securitization transactions, the profitability of those transactions, and the risks we are exposed to in engaging in securitization transactions;
- exposure to claims and litigation, including litigation arising from our involvement in loan origination and securitization transactions;
- whether we have sufficient liquid assets to meet short-term needs;
- our ability to successfully retain or attract key personnel;
- changes in our investment, financing, and hedging strategies and new risks we may be exposed to if we expand our business activities;
- our exposure to a disruption of our technology infrastructure and systems;
- the impact on our reputation that could result from our actions or omissions or from those of others;
- our failure to maintain appropriate internal controls over financial reporting and disclosure controls and procedures;

Risks Related to Legislative and Regulatory Matters Affecting our Industry

- the termination of our captive insurance subsidiary's membership in the Federal Home Loan Bank and the implications for our income generating abilities;
- the impact of changes to U.S. federal income tax laws on the U.S. housing market, mortgage finance markets, and our business;
- our failure to comply with applicable laws and regulation, including our ability to obtain or maintain the governmental licenses;

Risks Related to Redwood's Capital, REIT and Legal/Organizational Structure

- our ability to maintain our status as a REIT for tax purposes;
- limitations imposed on our business due to our REIT status and our status as exempt from registration under the Investment Company Act of 1940;

Other Risks Related to Ownership of Our Common Stock

- our common stock may experience price declines, volatility, and poor liquidity, and we may reduce our dividends in a variety of circumstances;
- decisions about raising, managing, and distributing capital;
- our exposure to broad market fluctuations; and
- other factors not yet identified.

Risk Related to our Business and Industry

The COVID-19 pandemic, the future outbreak of another highly infectious or contagious disease, or other unforeseen disaster could adversely impact or cause disruption to our financial condition and core aspects of our business operations. The spread of COVID-19 has disrupted, and could further cause severe disruptions in, the U.S. and global economy and financial markets and create widespread business continuity and viability issues.

The COVID-19 pandemic (the "pandemic") has caused, and is continuing to cause, significant repercussions across regional, national and global economies and financial markets. While the pandemic's effect on the macroeconomic environment has yet to be fully determined and could continue for months or years, the pandemic and governmental programs created as a response to the pandemic have effected, and continue to effect, the core aspects of our business, including the acquisition/origination and distribution of mortgages, our investment portfolio, our liquidity and our employees. Such effects, if they continue for a prolonged period, may have a material adverse effect on our financial condition and results of operation.

The pandemic has impacted, and may continue to impact, our mortgage loan acquisition and origination platforms. As a result of government measures taken to slow the spread of the disease (such as shelter-in-place orders, quarantines and travel restrictions), as well as recurring waves or surges in infection rates, many businesses have been forced to close, furlough, and lay off employees, and U.S. unemployment claims have dramatically risen since the start of the pandemic and remain at elevated rates. If the pandemic leads to a prolonged economic downturn with sustained high unemployment rates, we would anticipate that real estate financing transactions could decrease. Any such slowdown may materially decrease the volume of mortgages we acquire or originate. Moreover, pandemic-related disruptions to the normal operation of mortgage finance markets have impacted, and may continue to impact, our operations focused on acquiring and distributing residential mortgage loans and originating and distributing business purpose loans including, among other factors, limiting access to short-term or long-term financing for mortgage loans, disrupting the market for securitization transactions, or restricting our ability to access these markets or execute securitization transactions.

The pandemic has impacted, and may continue to impact, our liquidity. We finance many of the mortgage loans, mortgage-backed securities, and other real estate assets in our investment portfolio with borrowings under loan warehouse facilities, securities repurchase facilities, and other financing arrangements. Given the broad impact of the pandemic on the financial markets, our future ability to continue to finance our investment portfolio is unknown. Our liquidity could also be affected as our lenders reassess their exposure to mortgage-related investments and either curtail access to uncommitted financing capacity or impose higher costs to access such capacity. For example, see the risk factor below under the heading "*Our use of financial leverage exposes us to increased risks, including liquidity risks from margin calls and potential breaches of the financial covenants under our borrowing facilities, which could result in our being required to immediately repay all outstanding amounts borrowed under these facilities and these facilities being unavailable to use for future financing needs, as well as triggering cross-defaults under other debt agreements.*" Our liquidity may be further constrained as there may be less demand by investors to acquire mortgage loans we originate or acquire for re-sale, or mortgage-backed securities we issue through our Sequoia and CoreVest securitization platforms.

Further, in light of the impact of the pandemic on the overall economy, including elevated unemployment levels and consumer behavior related to loans, as well as government policies and pronouncements, borrowers may experience difficulties meeting their obligations or seek to forebear payment on their loans, which may adversely affect our results of operations. Thus, the credit risk profile of our assets may be more pronounced during severe market disruptions in the mortgage, housing or related sectors.

We also expect that the pandemic may affect the availability and productivity of our team members. As a result of the pandemic, we transitioned to a predominantly remote working environment for the majority of our team members. While our team members have transitioned well to working from home, over time such remote operations may decrease the cohesiveness of our teams and our ability to maintain our culture, both of which are integral to our success. Additionally, a remote working environment may impede our ability to undertake new business projects, to foster a creative environment, to hire new team members and to retain existing team members.

The rapid development and fluidity of the circumstances resulting from the pandemic precludes any prediction as to the ultimate adverse impact of the pandemic. Moreover, each of the risk factors discussed below is likely to also be impacted directly or indirectly by the ongoing impact of the pandemic. Nevertheless, the pandemic and the current financial, economic and capital markets environment, and future developments in these and other areas present material uncertainty and risk with respect to our performance, financial condition, results of operations and cash flows.

General economic developments and trends and the performance of the housing, real estate, mortgage finance, and broader financial markets may adversely affect our business and the value of, and returns on, real estate-related and other assets we own or may acquire and could also negatively impact our business and financial results.

Our level of business activity and the profitability of our business, as well as the values of, and the cash flows from, the assets we own, are affected by developments in the U.S. economy and the broader global economy. As a result, negative economic developments are likely to negatively impact our business and financial results. There are a number of factors that could contribute to negative economic developments, including, but not limited to, U.S. fiscal and monetary policy changes, including Federal Reserve policy shifts and changes in benchmark interest rates, changing U.S. consumer spending patterns, negative developments in the housing, single-family rental (SFR), multifamily, and real estate markets, rising unemployment, rising government debt levels, and changing expectations for inflation and deflation.

Recently, financial markets have experienced significant volatility as a result of the pandemic. Many state and local jurisdictions have enacted measures requiring closure of businesses and other economically restrictive efforts to combat the pandemic. Unemployment levels have increased significantly and may remain at elevated levels or continue to rise. The rate and number of mortgage payment delinquencies may be significantly elevated, and housing market fundamentals may be adversely affected, leading to an overall material adverse decrease in our mortgage loan acquisition and origination platforms and investment portfolio. See the risk factor above under the heading *“The COVID-19 pandemic, the future outbreak of another highly infectious or contagious disease, or other unforeseen disaster could adversely impact or cause disruption to our financial condition and core aspects of our business operations. The spread of COVID-19 has disrupted, and could further cause severe disruptions in, the U.S. and global economy and financial markets and create widespread business continuity and viability issues.”*

Elevated U.S. budget deficits and overall debt levels, including as a result of federal pandemic relief and stimulus legislation, can put upward pressure on interest rates and could be among the factors that could lead to higher interest rates in the future. Higher interest rates could adversely affect our overall business, income, and our ability to pay dividends, as discussed further below under *“Interest rate fluctuations can have various negative effects on us and could lead to reduced earnings and increased volatility in our earnings.”* Furthermore, our business and financial results may be harmed by our inability to accurately anticipate developments associated with changes in, or the outlook for, interest rates.

Real estate values, and the ability to generate returns by owning or taking credit risk on loans secured by real estate, are important to our business. The government’s support of mortgage markets through its support of Fannie Mae and Freddie Mac has contributed to Fannie Mae’s and Freddie Mac’s continued dominance of residential mortgage finance and securitization activity, inhibiting the growth of private sector mortgage securitization. This support may continue for some time and could have potentially negative consequences to us, since we have traditionally taken an active role in assuming credit risk in the private sector mortgage market, including through investments in Sequoia securitizations we sponsor. Congress and executive branch officials have periodically proposed various plans for reform of Fannie Mae and Freddie Mac (and the broader role of the government in the U.S. mortgage markets); however, it’s unclear which reforms will ultimately be implemented, if any, what the timeframe for any such reform would be, and what the impact on our business would be.

Federal and state legislative and regulatory developments and the actions of governmental authorities and entities may adversely affect our business and the value of, and the returns on, mortgages, mortgage-related securities, and other assets we own or may acquire in the future.

As noted above, our business is affected by conditions in the housing, business-purpose, multifamily, and real estate markets and the broader financial markets, as well as by the financial condition and resources of other participants in these markets. These markets and many of the participants in these markets are subject to, or regulated under, various federal and state laws and regulations. In some cases, the government or government-sponsored entities, such as Fannie Mae and Freddie Mac, directly participate in these markets. In particular, because issues relating to residential real estate and housing finance can be areas of political focus, federal, state and local governments may be more likely to take actions that affect residential real estate, the markets for financing residential real estate, and the participants in residential real estate-related industries than they would with respect to other industries. As a result of the government’s statutory and regulatory oversight of the markets we participate in and the government’s direct and indirect participation in these markets, federal and state governmental actions, policies, and directives can have an adverse effect on these markets and on our business and the value of, and the returns on, mortgages, mortgage-related securities, and other assets we own or may acquire in the future, which effects may be material.

For example, as a result of the economic and market disruption caused by the pandemic, federal and state governmental authorities encouraged and, in certain cases, mandated, responses to forbearance requests from borrowers with respect to monthly mortgage payment obligations by enacting statutes, including the CARES Act enacted by Congress, and promulgating various orders, regulations, and guidance to enable borrowers to defer and reschedule monthly mortgage payments.

Furthermore, the financial crisis of 2007-2008 and subsequent financial turmoil prompted the federal government to put into place new statutory and regulatory frameworks and policies for reforming the U.S. financial system. These financial reforms are aimed at, among other things, promoting robust supervision and regulation of financial firms and financial markets, and protecting consumers and investors from financial abuse. Certain financial reforms focused specifically on the issuance of asset-backed securities through securitization transactions include significantly enhanced disclosure requirements, risk retention requirements, and rules restricting a broad range of conflicts of interests in regard to these transactions. Implementation of financial reforms, whether through law, regulations, or policy, including changes to the manner in which financial institutions, financial products, and financial markets operate and are regulated and any related changes in the accounting standards that govern them, could adversely affect our business and financial results by subjecting us to regulatory oversight, making it more expensive to conduct our business, reducing or eliminating any competitive advantage we may have, or limiting our ability to expand, or could have other adverse effects on us. Moreover, federal policy changes aimed at enhancing regulatory scrutiny and enforcement priorities around mortgage servicing, including by the Consumer Financial Protection Bureau ("CFPB"), could further increase our compliance costs.

Ultimately, we cannot assure you of the impact that governmental actions may have on our business or the financial markets and, in fact, they may adversely affect us, possibly materially. We cannot predict whether or when such actions may occur or what unintended or unanticipated impacts, if any, such actions could have on our business and financial results. Even after governmental actions have been taken and we believe we understand the impacts of those actions, we may not be able to effectively respond to them so as to avoid a negative impact on our business or financial results.

Changing benchmark interest rates, and the Federal Reserve's actions and statements regarding monetary policy, can affect the fixed income and mortgage finance markets in ways that could adversely affect our future business and financial results and the value of, and returns on, real estate-related investments and other assets we own or may acquire.

Actions taken by the Federal Reserve to set or adjust monetary policy, and statements it makes regarding monetary policy, may affect the expectations and outlooks of market participants in ways that disrupt our business and adversely affect our the value of, and returns on, our portfolio of real-estate related investments and the pipeline of mortgage loans we own or may originate or acquire. For example, between 2015 and 2019, the Federal Reserve raised the target federal funds rate nine times, bringing it from near zero to a high of 2.25% to 2.50%, before bringing rates back down to the current target level between 0% and 0.25%. The federal funds rate could be increased again over the next several years. Increasing rates generally reduce mortgage loan origination volumes, particularly the volume of residential mortgage refinancings. As another example, in 2020 the Federal Reserve initiated a \$1.25 trillion program to purchase agency mortgage-backed securities (MBS) to provide support to mortgage and housing markets and to foster improved conditions in financial markets more generally in response to the impact of the pandemic. The statements and the actions of the Federal Reserve significantly impacted many market participants' expectations and outlooks regarding the expected yields these market participants would require to invest in agency MBS as well as non-agency MBS such as the residential, business-purpose, and multifamily MBS that we issue and own.

To the extent benchmark interest rates rise, one of the immediate potential impacts on our business would be a reduction in the overall value of the pool of mortgage loans that we own and the overall value of the pipeline of mortgage loans that we have identified for origination or purchase. Rising benchmark interest rates also generally have a negative impact on the overall cost of short- and long-term borrowings we use to finance our acquisitions and holdings of mortgage loans, including as a result of the requirement to post additional margin (or collateral) to lenders to offset any associated decline in value of the mortgage loans we finance with short-term borrowings subject to market value-based margin calls. Several of the short-term borrowing facilities we use to finance our acquisitions and holdings of mortgage loans are uncommitted and all such short-term facilities have a limited term, which could result in these types of borrowings not being available in the future to fund our acquisitions and holdings and could result in our being required to sell holdings of mortgage loans and incur losses. Similar impacts would also be expected with respect to the short-term borrowings we use to finance our acquisitions and holdings of residential, business-purpose, and multifamily MBS. In addition, any inability to fund originations or acquisitions of mortgage loans could damage our reputation as a reliable counterparty in the mortgage finance markets.

To the extent benchmark interest rates rise, it would also likely impact the volume of residential mortgage loans available for purchase in the marketplace and our ability to compete to acquire residential mortgage loans as part of our residential mortgage banking activities. These impacts could result from, among other things, a lower overall volume of mortgage refinance activity by mortgage borrowers and an increased level of competition from large commercial banks that may operate with a lower cost of capital than we do, including as a result of Federal Reserve monetary policies that impact banks more favorably than us and other non-bank institutions. These and other impacts of developments of the type described above may have a negative impact on our business and results of operations and we cannot accurately predict the full extent of these impacts or for how long they may persist.

We are subject to intense competition and we may not compete successfully.

We are subject to intense competition in seeking investments, acquiring, originating, and selling loans, engaging in securitization transactions, and in other aspects of our business. Our competitors include commercial banks, other mortgage REITs, Fannie Mae, Freddie Mac, regional and community banks, broker-dealers, insurance companies, and other specialty finance companies, financial institutions, as well as investment funds and other investors in real estate-related assets. In addition, other companies may be formed that will compete with us. Some of our competitors have greater resources than us and we may not be able to compete successfully with them. Some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more favorable relationships than we can. Furthermore, competition for investments, making loans, acquiring and selling loans, and engaging in securitization transactions may lead to a decrease in the opportunities and returns available to us.

In addition, there are significant competitive threats to our business from governmental actions and initiatives that have already been undertaken or which may be undertaken in the future. Sustained competition from governmental actions and initiatives could have a material adverse effect on us. For example, Fannie Mae and Freddie Mac are, among other things, engaged in the business of acquiring loans and engaging in securitization transactions. Until 2008, competition from Fannie Mae and Freddie Mac was limited to some extent due to the fact that they were statutorily prohibited from purchasing loans for single unit residences in the continental United States with a principal amount in excess of \$417,000, while much of our business had historically focused on acquiring residential loans with a principal amount in excess of that amount. Since 2008, this loan size limit has been elevated above the historical loan size limit, and as of December 31, 2019, the maximum loan size limit was \$822,375 for loans made to secure real estate purchases in certain high-cost areas of the U.S.

In addition, since 2008, Fannie Mae and Freddie Mac have been in conservatorship and have become, in effect, instruments of the U.S. federal government. It is unclear whether any future federal legislation or executive or regulatory actions regarding Fannie Mae and Freddie Mac will continue to maintain, or increase, the role of those entities in the housing finance market. As long as there is governmental support for these entities to continue to operate and provide financing to a significant portion of the mortgage finance market, they will represent significant business competition due to, among other things, their large size and low cost of funding.

To the extent that laws, regulations, or policies governing the business activities of Fannie Mae and Freddie Mac are not changed to limit their role in housing finance (such as a change in these loan size limits or in the guarantee fees they charge), the competition from these two governmental entities will remain significant or could increase. In addition, to the extent that property values decline while these loan size limits remain the same, it may have the same effect as an increase in this limit, as a greater percentage of loans would likely be within the size limit. Any increase in the loan size limit, or in the overall percentage of loans that are within the limit, allows Fannie Mae and Freddie Mac to compete against us to a greater extent than they had been able to compete previously and our business could be adversely affected. Additionally, the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA) guarantee qualified residential mortgages, and FHA and VA loans accounted for approximately 22% of the aggregate dollar value of residential loans originated in the U.S. in 2019. The federal government's ability to provide financing to a significant portion of the mortgage finance market through these entities represents significant business competition due to, among other things, their size and low cost of funding.

Our business model and business strategies, and the actions we take (or fail to take) to implement them and adapt them to changing circumstances involve risk and may not be successful.

U.S. real estate markets, the mortgage industry and the related capital markets have undergone significant changes since the U.S. financial crisis, including due to the significant governmental interventions in these areas and changes to the laws and regulations that govern the banking and mortgage finance industry. Additionally, it remains unclear how any future federal legislation or executive or regulatory actions regarding Fannie Mae and Freddie Mac and the housing finance market more broadly will impact that market and our business. Additional factors, including a rising or steady interest rate environment, which may cause the volume of refinance loans to decline, and secular trends in consumer demand for renting versus owning a residence, may also contribute to evolving conditions in the mortgage industry and capital markets. Our methods of, and model for, doing business and financing our investments are changing and if we fail to develop, enhance, and implement strategies to adapt to changing conditions in the mortgage finance industry and capital markets, our business and financial results may be adversely affected. Furthermore, changes we make to our business to respond to changing circumstances may expose us to new or different risks than we were previously exposed to and we may not effectively identify or manage those risks. Further discussion is set forth in the risk factor titled “*Decisions we make about our business strategy and investments, as well as decisions about raising capital or returning capital to shareholders (through dividends or common stock repurchases), could fail to improve our business and results of operations.*”

Similarly, the competitive landscape in which we operate and the products and investments for which we compete are also affected by changing conditions. There may be trends or sudden changes in our industry or regulatory environment, changes in the role of government-sponsored entities, such as Fannie Mae and Freddie Mac, changes in the role of credit rating agencies or their rating criteria or processes, or changes in the U.S. economy more generally. If we do not effectively respond to these changes or if our strategies to respond to these changes are not successful, our ability to effectively compete in the marketplace may be negatively impacted, which would likely result in our business and financial results being adversely affected.

We have historically depended upon the issuance of mortgage-backed securities by the securitization entities we sponsor as a funding source for our residential and business purpose mortgage business. However, due to market conditions, we did not engage in residential mortgage securitization transactions in 2008 or 2009 and we only engaged in one residential mortgage securitization transaction in 2010 and two residential mortgage securitization transactions in 2011. While we engaged in numerous residential mortgage securitization transactions from 2012 through 2020, we do not know if market conditions will allow us to continue to regularly engage in these types of securitization transactions and any disruption of this market may adversely affect our earnings and growth. For example, in each of 2014 and 2015, we completed four securitization transactions, and in 2016 we completed three securitization transactions, as compared to 12 securitizations in 2013, nine securitizations in 2017, 12 securitizations in 2018, nine securitizations in 2019 (including eight Sequoia transactions and one CoreVest transaction), and 11 securitizations in 2020 (including six Sequoia transactions and five CoreVest transactions). Even if regular residential and business-purpose mortgage loan securitization activity continues among market participants other than government-sponsored entities, we do not know if it will continue to be on terms and conditions that will permit us to participate or be favorable to us. Even if conditions are favorable to us, we may not be able to sustain the volume of securitization activity we previously conducted. Additionally, securities collateralized by business-purpose loans such as those issued by our CoreVest subsidiaries make up a small portion of the total volume of mortgage-backed securities issuance. The market for such securities is not as mature as the market for residential mortgage-backed securities and dislocations in this market or a change in the risk tolerance of investors or the perception of risk related to business-purpose mortgage-backed securities may negatively impact our ability to grow or sustain the volume of business-purpose mortgage-backed securities we issue, which may result in our business and financial results being adversely affected.

Decisions we make about our business strategy and investments, as well as decisions about raising capital or returning capital to shareholders (through dividends or common stock repurchases), could fail to improve our business and results of operations.

Over recent years, we have announced several new initiatives to expand our mortgage banking activities and alter our investment portfolio, including by expanding our mortgage loan purchase activity to include, for example, loans secured by non-owner occupied rental properties generally made up of one to four units and bridge loans (which we collectively refer to as “business-purpose real estate loans”), and optimizing the size and target returns of our investment portfolio. As examples, during 2019, we completed the acquisitions of two business-purpose real estate loan origination platforms, CoreVest and 5 Arches, which we combined into a single platform, through which we now originate business-purpose loans. Other new investment initiatives include investing in residential securities collateralized by re-performing and non-performing mortgage loans, multifamily loans and securities, shared equity appreciation real estate option contracts, and investments in excess mortgage servicing rights (“MSRs”) and servicer advance investments related to pools of residential and small-balance multifamily mortgage loans. Additionally, we occasionally sell lower-yielding securities in our investment portfolio in order to redeploy capital into higher-yielding securities as part of our portfolio and capital management strategies.

These new initiatives are intended to grow our mortgage banking business and enhance our investment portfolio, as well as to allocate capital to profitable business and investment opportunities. These initiatives are premised on our outlook for economic and market conditions, secular trends in consumer demand for housing, as well as competitive considerations. Over the long-term, the assumptions underlying these trends and changes, or assumptions regarding the risk profile of these initiatives and investments, could turn out to be incorrect or economic and market conditions could develop in a manner that is not consistent with our assumptions. For example, during 2020, the composition of our investment portfolio changed significantly as a result of asset sales undertaken in response to the financing market disruptions resulting from the pandemic. As a result, the risk profile of the assets held in our investment portfolio is materially different than at December 31, 2019. Moreover, we may determine to undertake significant additional asset sales in the future, including in response to adverse economic or financial market conditions. If we are unable to adapt our strategic and capital deployment decisions and maintain an appropriately diversified investment portfolio, our achievement of growth and revenue goals, our profitability, and competitiveness in the market may be adversely impacted.

Additionally, these initiatives may have more risks, and different risks, than our traditional mortgage banking activities and investment portfolio. For example, our portfolio and capital management strategies may include selling securities and reinvesting in securities with greater exposure to credit risk due to their structural credit enhancement of senior securities, as well as more limited payment histories. As another example, originating and investing in business-purpose mortgage loans exposes us to new and different risks than our traditional residential mortgage banking activities, including higher rates of delinquency, default, foreclosure and litigation. As a result, these new initiatives could fail to improve the long-term profitability of Redwood, could fail to result in capital being available for or deployed into more profitable businesses and investments, could result in dilutive issuances of equity or debt securities convertible into equity to fund our business and investment activities, or could otherwise damage our business, our reputation, our ability to access financing, and our ability to raise capital, or could have other unforeseen consequences, any or all of which could result in a material adverse effect on our business and results of operations in the future. Decisions we make in the future about our business strategy and investments, as well as decisions about raising capital or returning capital to shareholders (through dividends or common stock repurchases), could also fail to improve our business and results of operations.

Our Board of Directors has approved authorizations for the repurchase of Redwood common stock and convertible and exchangeable debt securities issued by Redwood. In 2020, we repurchased approximately \$22 million of our common stock at an average price of \$7.10 and approximately \$125 million of our outstanding debt securities. At December 31, 2020, approximately \$78 million of this current authorization remained available for the repurchase of shares of our common stock. If we repurchase shares of Redwood common stock or other securities issued by Redwood, it is because at the time we believe the shares or securities are trading at attractive levels relative to other uses of capital or investment opportunities then available to us; however, it is possible that other uses of this capital could have been more accretive to our earnings or book value or that subsequent capital needs arise that were not contemplated at the time we made these decisions. Our past and future decisions relating to the repurchases of Redwood common stock or other securities issued by Redwood could fail to improve our results of operations or could negatively impact our ability to execute our business plans, meet financial obligations, access financing, or raise additional capital, any or all of which could result in a material adverse effect on our business and results of operations in the future.

In addition, we periodically raise capital by issuing common stock, or debt securities convertible into common stock, through underwritten public offerings, in at-the-market ("ATM") offerings, and under our direct stock purchase and dividend reinvestment plan. We may issue additional shares of common stock (or debt securities convertible into common stock) in subsequent public offerings or private placements. In addition, we may issue additional shares of common stock pursuant to our ATM offering program, upon conversion of our convertible debt or upon exchange of our exchangeable debt, to participants in our direct stock purchase and dividend reinvestment plan, to our directors, officers and employees under our employee stock purchase plan and our incentive plan, including upon the exercise of, or in respect of, distributions on equity awards previously granted thereunder, and to fund merger and acquisition activity. It may not be possible for existing stockholders to participate in future share issuances, which may dilute existing stockholders' interests in us. To the extent we raise capital to fund our operations and investment activities, our approach to raising capital is based on what we believe to be in the best interest of our shareholders. However, it is possible that our use of the proceeds of such capital raising transactions may not yield a significant return or any return at all for our stockholders. If we are not able to make prudent decisions about raising, managing, and distributing our capital, our business and financial results may be adversely impacted.

Our use of financial leverage exposes us to increased risks, including liquidity risks from margin calls and potential breaches of the financial covenants under our borrowing facilities, which could result in our being required to immediately repay all outstanding amounts borrowed under these facilities and these facilities being unavailable to use for future financing needs, as well as triggering cross-defaults under other debt agreements.

We use a variety of borrowing facilities and derivatives agreements to fund or hedge assets in our investment portfolio that present us with liquidity risks. Under our borrowing facilities, interest rate swaps and other derivatives agreements, we pledge assets as security for our payment obligations and make various representations and warranties and agree to certain covenants, events of default, and other terms. In addition, many of our borrowing facilities are uncommitted, meaning that each time we request a new borrowing under such a facility, the lender has the option to decline to extend credit to us. The terms of these facilities and agreements typically include financial covenants (such as covenants to maintain a minimum amount of tangible net worth or stockholders' equity and/or a minimum amount of liquid assets and/or a maximum amount of recourse debt to equity), margin requirements (which typically require us to pledge additional collateral if and when the value of previously pledged collateral declines), operating covenants (such as covenants to conduct our business in accordance with applicable laws and regulations and covenants to provide notice of certain events to creditors), representations and warranties (such as representations and warranties relating to characteristics of pledged collateral, our exposure to litigation and/or regulatory enforcement actions and the absence of material adverse changes to our financial condition, our operations, or our business prospects), and events of default (such as a breach of covenant or representation/warranty and cross-defaults, under which an event of default is triggered under a borrowing facility if an event of default or similar event occurs under another borrowing facility).

Due to volatility in financial markets resulting from the pandemic, the market value of loans and securities financed under our borrowing facilities declined significantly in the first half of 2020. In particular, over a compressed timeframe near end of the first quarter of 2020, and we received a material increase in margin calls from counterparties under these facilities. We satisfied these margin calls by pledging additional collateral, such as cash or additional loans or securities, with a value equal to the decline in value of the collateral, adjusted for the percentage of the asset value financed (our haircut percentage). Margin calls expose us to a number of significant risks, including that we may be unable to meet these margin calls or may be forced to sell assets pledged as collateral under adverse market conditions to meet such margin calls as a result of a decrease in the values of the assets pledged as collateral.

Additionally, significant and widespread decreases in the fair values of our assets could cause us to breach the financial covenants under our borrowing facilities related to net worth and leverage. Such covenants, if breached, can result in our being required to immediately repay all outstanding amounts borrowed under these facilities and these facilities being unavailable to use for future financing needs, as well as triggering cross-defaults under other borrowing agreements. During 2020, we amended financial covenants in several borrowing agreements in order to remain in compliance; however, we cannot be certain whether we will continue to be able to remain in compliance with these financial covenants, or whether our financing counterparties will negotiate terms or agreements in respect of these financial covenants in the future.

Our borrowing facilities also contain representations and warranties related to litigation that could be breached if we are subject to litigation proceedings and claims in excess of specified dollar thresholds or that could have a material adverse effect on our business. For example, in connection with the impact of the pandemic on the non-Agency mortgage finance market and on our business and operations, a number of the counterparties that have regularly sold residential mortgage loans to us believe that we breached perceived obligations to them, and requested or demanded that we purchase loans from them and/or compensate them for perceived damages resulting from our decisions in the first half of 2020 not to purchase certain loans from them. One of these counterparties subjected us to litigation and others made demands regarding perceived obligations to them. If the individual or aggregate amount of such litigation or any threatened litigation exceeded specified dollar thresholds or could have a material adverse effect on our business, we may be in breach of representations and warranties under our borrowing agreements, which breach could result in our being required to immediately repay all outstanding amounts borrowed under these facilities and these facilities being unavailable to use for future financing needs, as well as triggering cross-defaults under other borrowing agreements.

Volatility in the residential credit market, including continued volatility due to the pandemic, may cause the market value of loans and securities we own subject to financing to decline further, and our financing counterparties may make additional margin calls. Furthermore, if other market participants fail to meet margin calls associated with mortgage loans or securities they finance, their financing counterparties could terminate their financing and seek to sell significant amounts of loans and securities, which could further depress the market value of these types of assets and result in additional margin calls on us and other borrowers. Additionally, securities financed under our short-term securities repurchase facilities, and loans financed under certain whole-loan warehouse/secured revolving borrowing facilities, are subject to mark-to-market treatment and may incur margin calls or may require us to repurchase such loans in the event the loans become delinquent. We may receive additional margin calls in the future and there is no assurance that we will be able to meet such margin calls. We may experience an event of default under some or all of our short- and long-term debt and financing facilities if we do not meet future margin calls or maintain compliance with financial covenants and other terms of these debt obligations, which would permit the holders of the affected indebtedness to accelerate the maturity of such indebtedness and could cause defaults under our other indebtedness, which could lead to an event of bankruptcy or insolvency, which would have a material adverse effect on our business, results of operations and financial condition.

Additionally, at the end of the fixed period applicable to the financing of a security under a securities repurchase facility (which generally does not exceed 90 days), we may request the same counterparty to renew the financing for an additional fixed period. If the same counterparty renews the financing, it may not be on terms that are as favorable to us as the expiring financing and the counterparty may require us to post additional collateral to renew the financing (which requirement would impact our liquidity in the same manner as a margin call). If the same counterparty does not renew the financing, it may be difficult for us to obtain financing for that security under one of our other securities repurchase facilities, due to the fact that the financial institution counterparties to our securities repurchase facilities generally only provide financing for securities that we purchased from them or one of their affiliates. If we are not able to obtain additional financing when we need it, we could be exposed to liquidity risks of the types described above.

At the end of the fixed period applicable to the financing of a security under a securities repurchase facility, if we intend to continue to obtain financing for that security we would typically request the same counterparty to renew the financing for an additional fixed period. If the same counterparty does not renew the financing, it may be difficult for us to obtain financing for that security under one of our other securities repurchase facilities, due to the fact that the financial institution counterparties to our securities repurchase facilities generally only provide financing for securities that we purchased from them or one of their affiliates.

Our use of leverage increases our exposure to liquidity risks, including liquidity risks related to unforeseen economic developments such as the pandemic, and may adversely impact our liquidity, cash balances, and financial results. For additional information regarding our exposure to liquidity risks and other risks related to our use of leverage, refer to Part II, Item 7 of this Annual Report on Form 10-K under the headings “Risks Relating to Debt Incurred under Short- and Long-Term Borrowing Facilities,” and “Margin Call Provisions Associated with Short-Term Debt and Other Debt Financing.”

Maintaining cybersecurity and data security is important to our business and a breach of our cybersecurity or data security could result in serious harm to our reputation and have a material adverse impact on our business and financial results.

When we acquire or originate real estate mortgage loans, or the rights to service mortgage loans, we come into possession of borrower non-public personal information that an identity thief could utilize in engaging in fraudulent activity or theft. We may share this information with third parties, such as loan sub-servicers, outside vendors, third parties interested in acquiring such loans from us, or lenders extending credit to us collateralized by such loans. We have acquired more than 100,000 residential mortgage loans and rights to service residential mortgage loans since 2010 and have also acquired or originated thousands of these or other types of mortgage loans prior to and following 2010.

While we have security measures in place to protect this information and prevent security breaches, these security measures may be compromised as a result of third-party action, including intentional misconduct by computer hackers, cyber-attacks, "phishing" attacks, service provider or vendor error, or malfeasance or other intentional or unintentional acts by third parties and bad actors, including third-party service providers. Furthermore, borrower data, including personally identifiable information, may be lost, exposed, or subject to unauthorized access or use as a result of accidents, errors, or malfeasance by our employees, independent contractors, or others working with us or on our behalf. Our servers and systems, and those of our service providers, may be vulnerable to computer malware, break-ins, denial-of-service attacks, and similar disruptions from unauthorized tampering with our computer systems, which could result in someone obtaining unauthorized access to borrowers' data or our data, including other confidential business information. In the past, we have experienced unauthorized access to certain data and information. Our response was to take immediate steps to investigate and address the unauthorized access, and past unauthorized access has not had, and is not expected to have, a material adverse effect on our business and financial results. We have further developed and enhanced our cybersecurity systems and processes that are intended to protect this type of data and information; however, they may not be effective in preventing unauthorized access in the future. While past unauthorized access has been immaterial to our business and financial results, there can be no assurance of a similar result in the future. Furthermore, because the techniques used to obtain unauthorized access to, or to sabotage, systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or implement adequate preventative measures. We may also experience security breaches that may remain undetected for an extended period.

We may be liable for losses suffered by individuals whose identities are stolen as a result of a breach of the security of the systems that we or third-parties and service providers of ours store this information on, and any such liability could be material. Even if we are not liable for such losses, any breach of these systems could expose us to material costs in notifying affected individuals and providing credit monitoring services to them, as well as regulatory fines or penalties. In addition, any breach of these systems could disrupt our normal business operations and expose us to reputational damage and lost business, revenues, and profits. Any insurance we maintain against the risk of this type of loss may not be sufficient to cover actual losses, or may not apply to the circumstances relating to any particular breach.

Security breaches could also significantly damage our reputation with existing and prospective loan sellers, borrowers, and third parties with whom we do business. Any publicized security problems affecting our businesses and/or those of such third parties may negatively impact the market perception of our products and discourage market participants from doing business with us. These risks may increase in the future as we continue to increase our reliance on the internet and use of web-based product offerings and on the use of cybersecurity.

Risks Related to our Investments and Investing Activity

The nature of the assets we hold and the investments we make expose us to credit risk that could negatively impact the value of those assets and investments, our earnings, dividends, cash flows, and access to liquidity, or otherwise negatively affect our business.

Overview of credit risk

We assume credit risk primarily through the ownership of securities backed by residential, business-purpose, and multifamily real estate loans and through direct investments in residential, business-purpose, and multifamily real estate loans. We may also assume similar credit risks through other types of transactions with counterparties who are seeking to reduce their exposure to credit risk or who are seeking financing for their own holdings of residential, business-purpose, and multifamily real estate loans or servicing rights relating to residential, business-purpose, and multifamily real estate loans. Credit losses on these types of real estate loans can occur for many reasons, including: fraud; poor underwriting; poor servicing practices; weak economic conditions; increases in payments required to be made by borrowers; declines in the value of real estate; declining rents on single- and multifamily residential rental properties; the outbreak of highly infectious or contagious diseases; natural disasters, the effects of climate change (including flooding, drought, wildfires, and severe weather) and other natural events; uninsured property loss; over-leveraging of the borrower; costs of remediation of environmental conditions, such as indoor mold; changes in zoning or building codes and the related costs of compliance; acts of war or terrorism; changes in legal protections for lenders and other changes in law or regulation; and personal events affecting borrowers, such as reduction in income, job loss, divorce, or health problems. In addition, the amount and timing of credit losses could be affected by loan modifications, delays in the liquidation process, documentation errors, and other action by servicers. Weakness in the U.S. economy or the housing market could cause our credit losses to increase beyond levels that we currently anticipate.

In addition, rising interest rates may increase the credit risks associated with certain residential real estate loans. For example, the interest rate is adjustable for some of the loans held at securitization entities we have sponsored and for a portion of the loans underlying residential securities we have acquired from securitizations sponsored by others. In addition, a portion of the loans we have pledged to secure short-term warehouse borrowings and a portion of the business-purpose and multifamily real estate loans and loans underlying multifamily securities we have acquired may have adjustable interest rates. Accordingly, when short-term interest rates rise, required monthly payments from borrowers will rise under the terms of these adjustable-rate mortgages, and this may increase borrowers' delinquencies and defaults.

Credit losses on business-purpose and multifamily real estate loans and real estate loans collateralizing business-purpose and multifamily securities can occur for many of the reasons noted above for residential real estate loans. Moreover, these types of real estate loans may not be fully amortizing and, therefore, the borrower's ability to repay the principal when due may depend upon the ability of the borrower to refinance or sell the property at maturity. Business-purpose and multifamily real estate loans and real estate loans collateralizing business-purpose and multifamily securities are particularly sensitive to conditions in the rental housing market and to demand for rental residential properties.

We may have heightened credit losses associated with certain securities and investments we own.

Within a securitization of residential, multifamily, or business-purpose real estate loans, various securities are created, each of which has varying degrees of credit risk. We may own the securities in which there is more (or the most) concentrated credit risk associated with the underlying real estate loans.

In general, losses on an asset securing a residential, multifamily, or business-purpose real estate loan included in a securitization will be borne first by the owner of the property (i.e., the owner will first lose any equity invested in the property) and, thereafter, by the first-loss security holder, and then by holders of more senior securities. In the event the losses incurred upon default on the loan exceed any classes of securities junior to those in which we invest (if any), we may not be able to recover all of our investment in the securities we hold. In addition, if the underlying properties have been overvalued by the originating appraiser or if the values subsequently decline and, as a result, less collateral is available to satisfy interest and principal payments due on the related security, then the first-loss securities may suffer a total loss of principal, followed by losses on the second-loss and then third-loss securities (or other residential, business-purpose, and multifamily securities that we own). In addition, with respect to residential securities we own, we may be subject to risks associated with the determination by a loan servicer to discontinue servicing advances (advances of mortgage interest payments not made by a delinquent borrower) if they deem continued advances to be unrecoverable, which could reduce the value of these securities or impair our ability to project and realize future cash flows from these securities.

For loans or other investments we own directly (not through a securitization structure), we will most likely be in a position to incur credit losses - should they occur - only after losses are borne by the owner of the property (e.g., by a reduction in the owner's equity stake in the property). Similar to our exposure to credit losses on loans we own directly, we have committed to assume credit losses - but only up to a specified amount - on certain conforming residential mortgage loans that we acquired and then sold to Fannie Mae and Freddie Mac pursuant to risk-sharing arrangements we entered into with those entities, to the extent any such losses exceed the owner's equity investment in the property. We may take actions available to us in an attempt to protect our position and mitigate the amount of credit losses, but these actions may not prove to be successful and could result in our increasing the amount of credit losses we ultimately incur on a loan.

Additionally, loans to small, privately owned businesses such as borrowers from our business-purpose loan origination platforms involve a high degree of business and financial risk. Often, there is little or no publicly available information about these businesses. Accordingly, we must rely on our own due diligence to obtain information in connection with our investment decisions. A borrower's ability to repay its loan may be adversely impacted by numerous factors, including a downturn in its industry or other negative local or more general economic conditions. Deterioration in a borrower's financial condition and prospects may be accompanied by deterioration in the collateral for the loan. These factors may have an impact on loans involving such businesses, and can result in substantial losses, which in turn could have a material and adverse effect on our business, results of operations and financial condition.

The nature of the assets underlying some of the securities and investments we hold could increase the credit risk of those securities.

For certain types of loans underlying securities we may own or acquire, the loan rate or borrower payment rate may increase over time, increasing the potential for default. For example, securities may be backed by residential real estate loans that have negative amortization features. The rate at which interest accrues on these loans may change more frequently or to a greater extent than payment adjustments on an adjustable-rate loan, and adjustments of monthly payments may be subject to limitations or may be limited by the borrower's option to pay less than the full accrual rate. As a result, the amount of interest accruing on the remaining principal balance of the loans at the applicable adjustable mortgage loan rate may exceed the amount of the monthly payment. To the extent we are exposed to it, this is particularly a risk in a rising interest rate environment. Negative amortization occurs when the resulting excess (of interest owed over interest paid) is added to the unpaid principal balance of the related adjustable mortgage loan. For certain loans that have a negative amortization feature, the required monthly payment is increased after a specified number of months or after a maximum amount of negative amortization has occurred in order to amortize fully the loan by the end of its original term. Other negative amortizing loans limit the amount by which the monthly payment can be increased, which results in a larger final payment at maturity. As a result, negatively amortizing loans have performance characteristics similar to those of balloon loans. Negative amortization may result in increases in delinquencies, loan loss severity, and loan defaults, which may, in turn, result in payment delays and credit losses on our investments. Other types of loans and investments to which we are exposed, such as hybrid loans and adjustable-rate loans, may also have greater credit risk than more traditional amortizing fixed-rate mortgage loans.

Many of the real estate loans collateralizing multifamily securities and business-purpose and multifamily real estate loans we own or may acquire are only partially amortizing or do not provide for any principal amortization prior to a balloon principal payment at maturity. Real estate loans that only partially amortize or that have a balloon principal payment at maturity may have a higher risk of default at maturity than fully amortizing loans. In addition, since most of the principal of these loans is repaid at maturity, the amount of loss upon default is generally greater than on other loans that provide for more principal amortization.

We have concentrated credit risk in certain geographical regions and may be disproportionately affected by an economic or housing downturn, natural disaster, terrorist event, climate change, or any other adverse event specific to those regions.

A decline in the economy or difficulties in certain real estate markets, such as a high level of foreclosures in a particular area, are likely to cause a decline in the value of residential and multifamily properties. This, in turn, will increase the risk of delinquency, default, and foreclosure on real estate underlying securities and loans we hold with properties in those regions, and it will increase the risk of loss on other investments we own. This may then adversely affect our credit loss experience and other aspects of our business, including our ability to securitize (or otherwise sell) real estate loans and securities.

The occurrence of a natural disaster (such as an earthquake, tornado, hurricane, flood, landslide, or wildfire), or the effects of climate change (including flooding, drought, and severe weather), may cause decreases in the value of real estate (including sudden or abrupt changes) and would likely reduce the value of the properties collateralizing real estate loans we own or those underlying the securities or other investments we own. For example, in recent years, hurricanes have caused widespread flooding in Florida and Texas and wildfires and mudslides in northern and southern California have destroyed or damaged thousands of homes. Since certain natural disasters may not typically be covered by the standard hazard insurance policies maintained by borrowers, the borrowers may have to pay for repairs due to the disasters. Borrowers may not repair their property or may stop paying their mortgage loans under those circumstances, especially if the property is damaged. This would likely cause foreclosures to increase and lead to higher credit losses on our loans or investments or on the pool of mortgage loans underlying securities we own.

A significant number of residential real estate loans that we own, or that underlie the securities we own, are secured by properties in California and, thus, we have a higher concentration of credit risk within California than in other states. Additional states where we have concentrations of residential loan credit risk are set forth in Note 6 to the Financial Statements within this Annual Report on Form 10-K. Balances on real estate loans collateralizing multifamily securities and business-purpose real estate loans we own and may originate or acquire are larger than residential loans and in the past we have had, and may have in the future, a geographically concentrated portfolio of such loans and securities. Real estate loans collateralizing consolidated multifamily securities and business-purpose real estate loans we currently own are generally concentrated in Texas, New Jersey, Georgia, Florida, and California.

The timing of credit losses can harm our economic returns.

The timing of credit losses can be a material factor in our economic returns from real estate loans, investments, and securities. If unanticipated losses occur within the first few years after a loan is originated, an investment is made, or a securitization is completed, those losses could have a greater negative impact on our investment returns than unanticipated losses on more seasoned loans, investments, or securities. In addition, higher levels of delinquencies and cumulative credit losses within a securitized loan pool can delay our receipt of principal and interest that is due to us under the terms of the securities backed by that pool. This would also lower our economic returns. The timing of credit losses could be affected by the creditworthiness of the borrower, the borrower's willingness and ability to continue to make payments, and new legislation, legal actions, or programs that allow for the modification of loans or ability for borrowers to get relief through forbearance, bankruptcy or other avenues.

Our efforts to manage credit risks may fail.

We attempt to manage risks of credit losses by continually evaluating our investments for impairment indicators and establishing reserves under GAAP for credit and other risks based upon our assessment of these risks. We cannot establish credit reserves for tax accounting purposes. The amount of reserves that we establish may prove to be insufficient, which would negatively impact our financial results and would result in decreased earnings. In addition, cash and other capital we hold to help us manage credit and other risks and liquidity issues may prove to be insufficient. If these increased credit losses are greater than we anticipated and we need to increase our credit reserves, our GAAP earnings might be reduced. Increased credit losses may also adversely affect our cash flows, ability to invest, dividend distribution requirements and payments, asset fair values, access to short-term borrowings, and ability to securitize or finance assets.

Despite our efforts to manage credit risk, there are many aspects of credit risk that we cannot control. Our quality control and loss mitigation policies and procedures may not be successful in limiting future delinquencies, defaults, and losses, or they may not be cost effective. Our underwriting reviews may not be effective. The securitizations in which we have invested may not receive funds that we believe are due from mortgage insurance companies and other counterparties. Loan servicing companies may not cooperate with our loss mitigation efforts or those efforts may be ineffective. Service providers to securitizations, such as trustees, loan servicers, bond insurance providers, and custodians, may not perform in a manner that promotes our interests. Delay of foreclosures could delay resolution and increase ultimate loss severities, as a result.

The value of the homes or properties collateralizing or underlying real estate loans or investments may decline, and rents on single and multifamily rental properties may decline. The frequency of default and the loss severity on loans upon default may be greater than we anticipate. Interest-only loans, negative amortization loans, adjustable-rate loans, larger balance loans, reduced documentation loans, subprime loans, Alt-A quality loans, second lien loans, loans in certain locations, residential mortgage loans that are not "qualified mortgages" under regulations promulgated by the CFPB, re-performing and non-performing loans, and loans or investments that are partially collateralized by non-real estate assets may have increased risks and severity of loss. If property securing or underlying loans becomes real estate owned as a result of foreclosure, we bear the risk of not being able to sell the property and recovering our investment and of being exposed to the risks attendant to the ownership of real property.

Changes in consumer behavior, bankruptcy laws, tax laws, regulation of the mortgage industry, and other laws may exacerbate loan or investment losses. Changes in rules that would cause loans owned by a securitization entity to be modified may not be beneficial to our interests if the modifications reduce the interest we earn and increase the eventual severity of a loss. In some states and circumstances, the securitizations in which we invest have recourse as owner of the loan against the borrower's other assets and income in the event of loan default. However, in most cases, the value of the underlying property will be the sole effective source of funds for any recoveries. Other changes or actions by judges or legislators regarding mortgage loans and contracts, including the voiding of certain portions of these agreements, may reduce our earnings, impair our ability to mitigate losses, or increase the probability and severity of losses. Any expansion of our loss mitigation efforts could increase our operating costs and the expanded loss mitigation efforts may not reduce our future credit losses.

Credit ratings assigned to debt securities by the credit rating agencies may not accurately reflect the risks associated with those securities. Furthermore, downgrades in credit ratings could increase our credit risk, reduce our cash flows, or otherwise adversely affect our business and operations.

We generally do not consider credit ratings in assessing our estimates of future cash flows and desirability of our investments (although our assessment of the quality of an investment may prove to be inaccurate and we may incur credit losses in excess of our initial expectations). The assignment of an “investment grade” rating to a security by a rating agency does not mean that there is not credit risk associated with the security or that the risk of a credit loss with respect to such security is necessarily remote. Many of the securities we own do have credit ratings and, to the extent we securitize loans and securities, we expect to retain credit rating agencies to provide ratings on the securities created by these securitization entities (as we have in the past).

Rating agencies rate debt securities based upon their assessment of the safety of the receipt of principal and interest payments. Rating agencies do not consider the risks of fluctuations in fair value or other factors that may influence the value of debt securities and, therefore, any assigned credit rating may not fully reflect the true risks of an investment in securities. Also, rating agencies may fail to make timely adjustments to credit ratings based on available data or changes in economic outlook or may otherwise fail to make changes in credit ratings in response to subsequent events, so that our investments may be better or worse than the ratings indicate. Credit rating agencies may change their methods of evaluating credit risk and determining ratings on securities backed by real estate loans and securities. These changes may occur quickly and often. The market’s ability to understand and absorb these changes and the impact to the securitization market in general are difficult to predict. Such changes may have an impact on the amount of investment-grade and non-investment-grade securities that are created or placed on the market in the future. Downgrades to the ratings of securities could have an adverse effect on the value of some of our investments and our cash flows from those investments.

Residential mortgage loan borrowers that have been negatively impacted by the pandemic may not make payments of principal and interest relating to their mortgage loans on a timely basis, or at all, which could negatively impact our business.

Residential mortgage loan borrowers that have been negatively impacted by the pandemic may not remit payments of principal and interest relating to their mortgage loans on a timely basis, or at all. This could be due to an inability to make such payments, an unwillingness to make such payments, or a temporary or permanent waiver of the requirement to make such payments, including under the terms of any applicable forbearance, modification, or maturity extension agreement or program. Such forbearance, waiver, or maturity extension may be available as a result of a government-sponsored or -imposed program or under any such agreement or program we or our sub-servicers may otherwise offer to mortgage borrowers. To the extent mortgage loan borrowers do not make payments on their loans, the value of residential mortgage loans and residential mortgage backed securities we own will likely be impaired, potentially materially. Additionally, to the extent the pandemic impacts local, regional or national economic conditions, the value of residential real estate may decline, which would also likely negatively impact the value of mortgage loans and mortgage backed securities we own, potentially materially.

We are exposed to the negative financial impact of COVID-19 related payment forbearances with respect loans securitized in Sequoia transactions, loans held for investment or sale, and a variety of other investments, including third-party issued mortgage-backed securities, mortgage servicing rights and related cash flows, re-performing residential mortgage loans, and business purpose loans. In addition, transactions we have entered into, including to finance loans with warehouse financing providers and to sell whole loans to third parties, may be negatively impacted by COVID-19 related payment forbearances, including by reducing our proceeds from these transactions or if we are required to repurchase impacted loans.

With respect to MSRs we own that are associated with mortgage loans that become delinquent (including MSRs retained for jumbo mortgage loans that we securitize through our Sequoia securitization platform and investments we have made in excess MSRs and servicing advances), cash flows we would otherwise expect to receive from our retained investments in Sequoia securitization transactions or other investments may be redirected to other investors in mortgage backed securities issued in those securitization transactions (or may be otherwise not remitted to us) or we may be obligated to fund loan servicers' principal and interest advances, as well as advances of property taxes, insurance and other amounts. Additionally, through our investment in servicer advances and associated excess MSRs, we may fund an increased amount of servicer advances on loans underlying the associated transactions. Further, any federal assistance programs available to mortgage loan servicers may not be available to us because our business and investments are not focused on mortgage loans that are eligible to be purchased or guaranteed by Fannie Mae, Freddie Mac or governmental agencies such as the Federal Housing Administration or Department of Veteran Affairs. To the extent our otherwise expected cash flows are so impaired or to the extent we are required to fund loan servicers' advances it may have a material adverse effect on our financial condition, results of operations and cash flows.

Multifamily and business purpose mortgage loan borrowers that have been negatively impacted by the pandemic may not make payments of principal and interest relating to their mortgage loans on a timely basis, or at all, which could negatively impact our business.

Multifamily and business purpose loans and securities backed by multifamily and business purpose mortgage loans we own are subject to similar risks as those described above with respect to residential mortgage loans, and will likely be impaired, potentially materially to the extent multifamily and business purpose loan borrowers that have been negatively impacted by the pandemic do not timely remit payments of principal and interest relating to their mortgage loans. In addition, if tenants who rent their residence from a multifamily or business purpose loan borrower are unable to make rental payments, are unwilling to make rental payments, or a waiver of the requirement to make rental payments on a timely basis, or at all, is available under the terms of any applicable forbearance or waiver agreement or program (which rental payment forbearance or waiver program may be available as a result of a government-sponsored or -imposed program or under any such agreement or program a landlord may otherwise offer to tenants), then the value of multifamily and business purpose loans and multifamily and business purpose mortgage backed securities we own will likely be impaired, potentially materially. Moreover, to the extent the economic impact of any such pandemic impacts local, regional or national economic conditions, the value of multifamily and residential real estate that secures multifamily and business purpose loans is likely to decline, which would also likely negatively impact the value of mortgage loans and mortgage backed securities we own, potentially materially.

Additionally, a significant amount of the business purpose loans that we own are short-term bridge loans that are secured by residential properties that are undergoing rehabilitation or construction and not occupied by tenants. Because these properties are generally not income producing (e.g., from rental revenue), in order to fund principal and interest payments, these borrowers may seek to renegotiate the terms of their mortgage loan, including by seeking payment forbearances, waivers, or maturity extensions as a result of being negatively impacted by the pandemic. Moreover, planned construction or rehabilitation of these properties may not be able to proceed on a timely basis or at all due to operating disruptions or government mandated moratoriums on construction, development or redevelopment. All of the foregoing factors would also likely negatively impact the value of mortgage loans and mortgage backed securities we own, potentially materially.

Changes in prepayment rates of mortgage loans could reduce our earnings, dividends, cash flows, and access to liquidity.

The economic returns we earn from most of the real estate securities and loans we own (directly or indirectly) are affected by the rate of prepayment of the underlying mortgage loans. Prepayments are difficult to accurately predict and adverse changes in the rate of prepayment could reduce our cash flows, earnings, and dividends. Adverse changes in cash flows would likely reduce the fair values of many of our assets, which could reduce our ability to borrow against our assets and may cause market valuation adjustments for GAAP purposes, which could reduce our reported earnings. While we estimate prepayment rates to determine the effective yield of our assets and valuations, these estimates are not precise and prepayment rates do not necessarily change in a predictable manner as a function of interest rate changes. Prepayment rates can change rapidly. As a result, changes can cause volatility in our financial results, affect our ability to securitize assets, affect our ability to fund acquisitions, and have other negative impacts on our ability to generate earnings.

We may own securities backed by residential loans that are particularly sensitive to changes in prepayments rates. These securities include interest-only securities (IOs) that we acquire from third parties and from our Sequoia entities. Faster prepayments than we anticipated on the underlying loans backing these IOs will have an adverse effect on our returns on these investments and may result in losses. Similarly, we own mortgage servicing rights, or MSR, associated with residential mortgage loans, and excess MSR investments associated with residential and multifamily mortgage loans, all of which are particularly sensitive to changes in prepayments rates. As the owner of an MSR (or excess MSR investment), we are entitled to a portion of the interest payments made by the borrower in respect of the associated loan and, in the case of MSRs, we are responsible for hiring and compensating a sub-servicer to directly service the associated loan. Faster prepayments than we anticipate on loans associated with MSRs and excess MSR investments we own will have an adverse effect on our returns from these MSRs and may result in losses.

Some of the business-purpose loans we originate or hold may allow the borrower to make prepayments without incurring a prepayment penalty and some may include provisions allowing the borrower to extend the term of the loan beyond the originally scheduled maturity. Because the decision to prepay or extend a business-purpose loan is controlled by the borrower, we may not accurately anticipate the timing of these events, which could affect the earnings and cash flows we anticipate and could impact our ability to finance these assets.

Interest rate fluctuations can have various negative effects on us and could lead to reduced earnings and increased volatility in our earnings.

Changes in interest rates, the interrelationships between various interest rates, and interest rate volatility could have negative effects on our earnings, the fair value of our assets and liabilities, loan prepayment rates, and our access to liquidity. Changes in interest rates can also harm the credit performance of our assets. We generally seek to hedge some but not all interest rate risks. Our hedging may not work effectively and we may change our hedging strategies or the degree or type of interest rate risk we assume.

Some of the loans and securities we own or may acquire have adjustable-rate coupons (i.e., they may earn interest at a rate that adjusts periodically based on an interest rate index). The cash flows we receive from these assets may vary as a function of interest rates, as may the reported earnings generated by these assets. We also acquire loans and securities for future sale, as assets we are accumulating for securitization, or as a longer-term investment. We expect to fund assets with a combination of equity, fixed rate debt and adjustable rate debt. To the extent we use adjustable rate debt to fund assets that have a fixed interest rate (or use fixed rate debt to fund assets that have an adjustable interest rate), an interest rate mismatch could exist and we could, for example, earn less (and fair values could decline) if interest rates rise, at least for a time. We may or may not seek to mitigate interest rate mismatches for these assets with hedges such as interest rate agreements and other derivatives and, to the extent we do use hedging techniques, they may not be successful.

Higher interest rates generally reduce the fair value of many of our assets, with the exception of our IOs, MSRs, excess MSR investments, and adjustable-rate assets. This may affect our earnings results, reduce our ability to securitize, re-securitize, or sell our assets, or reduce our liquidity. Higher interest rates could reduce the ability of borrowers to make interest payments or to refinance their loans. Higher interest rates could reduce property values and increased credit losses could result. Higher interest rates could reduce mortgage originations, thus reducing our opportunities to acquire new assets.

When short-term interest rates are high relative to long-term interest rates, an increase in adjustable-rate residential loan prepayments may occur, which would likely reduce our returns from owning interest-only securities backed by adjustable-rate residential loans.

It can be difficult to predict the impact on interest rates of unexpected and uncertain global political and economic events, such as the outbreak of pandemic or epidemic disease, economic and international trade conflicts, the change in the U.S. presidential administration and political makeup of the Congress, the U.K. exit from the European Union, or changes in the credit rating of the U.S. government, the United Kingdom, or one or more Eurozone nations; however, increased uncertainty or changes in the economic outlook for, or rating of, the creditworthiness of the U.S. government, the United Kingdom, or Eurozone nations may have adverse impacts on, among other things, the U.S. economy, financial markets, the cost of borrowing, the financial strength of counterparties we transact business with, and the value of assets we hold. Any such adverse impacts could negatively impact the availability to us of short-term debt financing, our cost of short-term debt financing, our business, and our financial results.

We have significant investment and reinvestment risks.

New assets we acquire or originate may not generate yields as attractive as yields on our current assets, which could result in a decline in our earnings per share over time.

Assets we acquire, originate, or invest in may not generate the economic returns and GAAP yields we expect. Realized cash flow could be significantly lower than expected and returns from new investments, originations, and acquisitions could be negative. In order to maintain our portfolio size and our earnings, we must reinvest in new assets a portion of the cash flows we receive from principal, interest, and sales. We receive monthly payments from many of our assets, consisting of principal and interest. In addition, occasionally some of our residential securities are called (effectively sold). We may also sell assets from time to time as part of our portfolio and capital management strategies. For example, during 2020, the composition of our investment portfolio changed significantly as a result of asset sales undertaken in response to the financing market disruptions resulting from the pandemic. Principal payments, calls, and sales reduce the size of our current portfolio and generate cash for us.

If the assets we invest in or acquire in the future earn lower GAAP yields than do the assets we currently own, our reported earnings per share could decline over time as the older assets are paid down, are called, or are sold, assuming comparable expenses, credit costs, and market valuation adjustments. Under the effective yield method of accounting that we use for GAAP purposes for some of our assets, we recognize yields on assets based on our assumptions regarding future cash flows. A portion of the cash flows we receive may be used to reduce our basis in these assets. As a result of these various factors, our basis for GAAP amortization purposes may be lower than the current fair values of these assets. Assets with a lower GAAP basis than current fair values generate higher GAAP yields, and such yields are not necessarily available on newly acquired assets. Future economic conditions, including credit results, prepayment patterns, and interest rate trends, are difficult to project with accuracy over the life of the assets we acquire, so there will be volatility in the reported returns over time.

Our growth may be limited if assets are not available or not available at attractive prices.

To reinvest the proceeds from principal repayments we receive on our existing investments and deploy capital we raise, we may seek to originate, invest in, or acquire new assets. If the availability of new assets is limited, we may not be able to originate, invest in, or acquire assets that will generate attractive returns. Generally, asset supply can be reduced if originations of a particular product are reduced or if there are fewer sales in the secondary market of seasoned product from existing portfolios. In particular, assets we believe have a favorable risk/reward ratio may not be available for purchase (or origination by our business-purpose loan origination platform).

We do not originate residential loans; rather, we rely on the origination market to supply the types of loans we seek to invest in. At times, due to increases in interest rates, heightened credit concerns, strengthened underwriting standards, increased regulation, and/or concerns about economic growth or housing values, the volume of originations may decrease significantly. For example, in 2019 and 2020, residential mortgage interest rates generally declined, with the result that a significant portion of industry-wide origination volumes were related to residential borrowers refinancing existing mortgage loans. To the extent interest rates increase in the future, refinance loan volume is likely to decline, and this volume may not return to previous levels. A reduced volume of loan originations may make it difficult for us to acquire loans and securities. Similar factors may contribute to reduced volumes of loan originations by our business-purpose loan origination platforms, which would otherwise be available for transfer to our investment portfolio.

We originate business-purpose loans, but we may not be willing to provide the level of loan proceeds to the borrower or interest rate that borrowers find acceptable or that matches our competitors, which would likely reduce the volume of these types of loans that we originate.

The supply of new issue residential mortgage-backed securities (RMBS) collateralized by jumbo mortgage loans available for purchase could be adversely affected if the economics of executing securitizations are not favorable or if the regulations governing the execution of securitizations discourage or preclude certain potential market participants from engaging in these transactions. In addition, if there is not a robust market for triple-A rated securities, the supply of real estate subordinate securities could be significantly diminished.

We have entered into risk-sharing arrangements with Fannie Mae and Freddie Mac and have purchased credit risk transfer (CRT) securities issued by Fannie Mae and Freddie Mac under which we are compensated for agreeing to absorb credit losses on new conforming loans or for engaging in similar types of credit risk-sharing or -transfer structures. We may continue to make these types of credit-related investments and may also continue recent initiatives to grow our investment portfolio, including investing in residential securities collateralized by re-performing and non-performing mortgage loans, multifamily securities, shared equity appreciation real estate option contracts, and investments in excess MSR and servicer advance investments related to pools of residential and small-balance multifamily mortgage loans. While these initiatives represent potential opportunities for future capital deployment, ultimately these initiatives may not produce sizable or attractive investment opportunities due to competition from other investors, regulatory issues, or federal housing finance reform initiatives that impact Fannie Mae and Freddie Mac.

Investments in diverse types of assets and businesses could expose us to new, different, or increased risks.

We have invested in and may in the future invest in a variety of real estate and non-real estate related assets that may not be closely related to the types of investments we have traditionally made. Additionally, we may enter into or engage in various types of securitizations, transactions, services, and other operating businesses that are different than the types we have traditionally entered into or engaged in. For example, in recent years we began expanding our mortgage loan purchase activity to include business-purpose loans secured by non-owner occupied rental properties and bridge loans. Also, in 2019 we completed the acquisitions of two business-purpose real estate loan origination platforms, CoreVest and 5 Arches, which we combined into a single platform through which we originate business-purpose loans, and as a result our holdings of business-purpose whole loans have increased. In recent years we have also made investments in subordinate securities backed by re-performing and non-performing residential loans, multifamily securities, shared equity appreciation real estate option contracts, excess MSR investments collateralized by residential and multifamily loans, and servicer advance investments related to residential mortgage loans.

Any of these actions may expose us to new, different, or increased investment, operational, financial, or management risks. Several of these investments were complex, highly structured, and involve partnerships and joint ventures with co-investors, any or all of which may limit the liquidity of such investments. Additionally, when investing in transactions with complex or novel structures, the risks associated with the transactions and structures may not be fully known to buyers and sellers. For example, we recently invested in shared equity appreciation real estate option contracts, which expose us to risk of loss related to home price appreciation (or depreciation). If our assumptions regarding the valuation and rate of appreciation in value of the property securing an option contract are wrong, our returns will be reduced, and if the value of the property securing the contract decreases, we may suffer losses, up to the total loss of our investment. Additionally, real estate option contracts may be subject to regulatory risk from federal, state, and local regulators. For example, if a state mortgage regulator determines that entering into, or investing in, a real estate option contract is activity covered by that state's mortgage licensing statute, our investment may be at risk if we and our purchase and sale counterparty, who enters into the option contract with the homeowner, do not possess the applicable license.

As another example, one of our excess MSR investments includes an associated investment in servicer advances financed with non-recourse debt. Non-recourse financing generally limits our exposure to losses to the value of the collateral securing the financing (i.e., the servicer advances). However, a default on such non-recourse financing of servicer advances could result in a complete loss of our servicer advance investments and the related excess MSRs. Additionally, this non-recourse financing is short-term. We may not be able to renew this financing on favorable terms, or at all, which may have a negative impact on the value of our investment. A more detailed discussion of the risks related to this servicer advance financing is described below in Part II, Item 7 of this Annual Report on Form 10-K under the heading, *"Risks Relating to Debt Incurred under Short- and Long-Term Borrowing Facilities."*

As another example, in connection with our acquisitions of CoreVest and 5 Arches, we made assumptions about the cash flows and investments that will be generated from these acquisitions. There may be continuing risks and challenges associated with the integration of the CoreVest and 5 Arches platforms and workforces that we recently completed that we did not anticipate or may not be able to mitigate. Additionally, originating and investing in business-purpose mortgage loans exposes us to new and different risks than our traditional residential mortgage banking activities, including higher rates of delinquency, default, foreclosure and litigation. If our assumptions are wrong, or if market conditions change, it could have a negative impact on our financial or operational results related to these acquisitions and to our business as a whole.

We may invest in non-real estate asset-backed securities (ABS), corporate debt, or equity. We have invested in diverse types of IOs from residential, business-purpose, and multifamily securitizations sponsored by us or by others. The higher credit and prepayment risks associated with these types of investments may increase our exposure to losses. We may invest in non-U.S. assets that may expose us to currency risks (which we may choose not to hedge) and different types of credit, prepayment, hedging, interest rate, liquidity, legal, and other risks. These types of investments could expose us to new, different, or increased risks that we did not anticipate, which could have a negative impact on the financial returns generated.

In addition, when investing in assets or businesses we are exposed to the risk that those assets, or interest income or revenue generated by those assets or businesses, result in our not meeting the requirements to maintain our REIT status or our status as exempt from registration under the Investment Company Act of 1940, as amended (Investment Company Act), as further described in the risk factors titled *"We have elected to be taxed as a REIT and, as such, are required to meet certain tests in order to maintain our REIT status. This adds complexity and costs to running our business and exposes us to additional risks"* and *"Conducting our business in a manner so that we are exempt from registration under, and in compliance with, the Investment Company Act may reduce our flexibility and could limit our ability to pursue certain opportunities. At the same time, failure to continue to qualify for exemption from the Investment Company Act could adversely affect us."*

We may change our investment strategy or financing plans, which may result in riskier investments and diminished returns.

We may change our investment strategy or financing plans at any time, which could result in our making investments that are different from, and possibly riskier than, the investments we have previously made or described. A change in our investment strategy or financing plans may increase our exposure to interest rate and default risk and real estate market fluctuations. Decisions to employ additional leverage could increase the risk inherent in our investment strategy. Additionally, a portion of our recent investment activity has included financing that is either short-term securitization debt or is incurred by entities that we do not control and thus is not reflected on our balance sheet. Furthermore, a change in our investment strategy could result in our making investments in new asset categories or in different proportions among asset categories than we previously have. For example, as noted above, since December 2017, we have announced several new initiatives to expand our mortgage banking and investment activities, including by expanding our mortgage loan purchase activity to include business-purpose loans secured by non-owner occupied rental properties and bridge loans, completing the acquisitions of two business-purpose real estate loan origination platforms, CoreVest and 5 Arches, to enter the business of originating business-purpose loans, and optimizing the size and target returns of our investment portfolio. We have also made investments in subordinate securities backed by re-performing and non-performing residential loans, multifamily securities, shared equity appreciation real estate option contracts, excess MSR and servicer advance investments collateralized by residential and multifamily loans, and a whole loan investment fund created to acquire light-renovation multifamily loans. As another example, in the future, we could determine to invest a greater proportion of our assets in securities backed by non-prime or subprime residential mortgage loans. These changes could result in our making riskier investments, which could ultimately have an adverse effect on our financial returns. Alternatively, we could determine to change our investment strategy or financing plans to be more risk averse, resulting in potentially lower returns, which could also have an adverse effect on our financial returns.

The performance of the assets we own and the investments we make will vary and may not meet our earnings or cash flow expectations. In addition, the cash flows and earnings from, and market values of, securities, loans, and other assets we own may be volatile.

We seek to manage certain of the risks associated with acquiring, originating, holding, selling, and managing real estate loans and securities and other real estate-related investments. No amount of risk management or mitigation, however, can change the variable nature of the cash flows of, fair values of, and financial results generated by these loans, securities, and other assets. Changes in the credit performance of, or the prepayments on, these investments, including real estate loans and the loans underlying real estate securities, and changes in interest rates impact the cash flows on these securities and investments, and the impact could be significant for our loans, securities, and other assets with concentrated risks. Changes in cash flows lead to changes in our return on investment and also to potential variability in and level of reported income. The revenue recognized on some of our assets is based on an estimate of the yield over the remaining life of the asset. Thus, changes in our estimates of expected cash flow from an asset will result in changes in our reported earnings on that asset in the current reporting period. We may be forced to recognize adverse changes in expected future cash flows as a current expense, further adding to earnings volatility. Additionally, our non-GAAP measures of financial performance and our earnings calculated in accordance with GAAP may be subject to volatility. Moreover, the Securities and Exchange Commission's focus on the use of non-GAAP financial metrics may require us to change the presentation or method of calculation of our non-GAAP metrics which may result in variability and volatility.

Changes in the fair values of our assets, liabilities, and derivatives can have various negative effects on us, including reduced earnings, increased earnings volatility, and volatility in our book value.

Fair values for our assets and liabilities, including derivatives, can be volatile and our revenue and income can be impacted by changes in fair values. The fair values can change rapidly and significantly and changes can result from changes in interest rates, perceived risk, supply, demand, and actual and projected cash flows, prepayments, and credit performance. A decrease in fair value may not necessarily be the result of deterioration in future cash flows. Fair values for illiquid assets can be difficult to estimate, which may lead to volatility and uncertainty of earnings and book value.

For example, real estate-related securities in our investment portfolio may be subject to changes in credit spreads. Credit spreads measure the yield demanded on securities by the market based on their credit relative to a specific benchmark, and is a measure of the perceived risk of the investment. Fixed rate securities are valued based on a market credit spread over the rate payable on fixed rate swaps or fixed rate U.S. Treasuries of like maturity. Floating rate securities are typically valued based on a market credit spread over LIBOR (or another floating rate index such as the Secured Overnight Financing Rate (“SOFR”)) and are affected similarly by changes in LIBOR (or other index) spreads. Excessive supply of these securities or reduced demand may cause the market to require a higher yield on these securities, resulting in the use of a higher, or “wider,” spread over the benchmark rate to value such securities. Under such conditions, the value of our securities portfolios would tend to decline. For example, due to the volatility in financial markets resulting from the pandemic, the market value of our securities portfolio declined significantly, in a compressed timeframe during 2020. Conversely, if the spread used to value such securities were to decrease, or “tighten,” the value of our real estate and other securities portfolio would tend to increase. Such changes in the market value of our real estate-related securities portfolio may affect our net equity, net income or cash flow directly through their impact on unrealized gains or losses on available-for-sale securities, and therefore our ability to realize gains on such securities, or indirectly through their impact on our ability to borrow and access capital. Widening credit spreads could cause the net unrealized gains on our securities and derivatives, recorded in accumulated other comprehensive income or retained earnings, and therefore our book value per share, to decrease and result in net losses.

For GAAP purposes, we mark to market most of the assets and some of the liabilities on our consolidated balance sheet. In addition, valuation adjustments on certain consolidated assets and many of our derivatives are reflected in our consolidated statement of income. Assets that are funded with certain liabilities and hedges may have differing mark-to-market treatment than the liability or hedge. If we sell an asset that has not been marked to market through our consolidated statement of income at a reduced market price relative to its cost basis, our reported earnings will be reduced.

Our loan sale profit margins are generally reflective of gains (or losses) over the period from when we identify a loan for purchase until we subsequently sell or securitize the loan. These profit margins may encompass elements of positive or negative market valuation adjustments on loans, hedging gains or losses associated with related risk management activities, and any other related transaction expenses; however, under GAAP, the differing elements may be realized unevenly over the course of one or more quarters for financial reporting purposes, with the result that our financial results may be more volatile and less reflective of the underlying economics of our business activity.

Our calculations of the fair value of the securities, loans, MSR, derivatives, and certain other assets we own or consolidate are based upon assumptions that are inherently subjective and involve a high degree of management judgment.

We report the fair values of securities, loans, MSR, derivatives, and certain other assets on our consolidated balance sheets. In computing the fair values for these assets we may make a number of market-based assumptions, including assumptions regarding future interest rates, prepayment rates, discount rates, credit loss rates, and the timing of credit losses. These assumptions are inherently subjective and involve a high degree of management judgment, particularly for illiquid securities and other assets for which market prices are not readily determinable. For further information regarding our assets recorded at fair value see Note 5 to the Financial Statements within this Annual Report on Form 10-K. Use of different assumptions could materially affect our fair value calculations and our financial results. Further discussion of the risk of our ownership and valuation of illiquid securities is set forth under the heading “*Investments we make, hedging transactions that we enter into, and the manner in which we finance our investments and operations expose us to various risks, including liquidity risk, risks associated with the use of leverage, market risks, and counterparty risk.*”

Changes in banks' inter-bank lending rate reporting practices, the method pursuant to which LIBOR is determined, or the discontinuation of LIBOR may adversely affect the value of the financial obligations to be held or issued by us that are linked to LIBOR.

LIBOR and other indices which are deemed “benchmarks” are the subject of recent national, international, and other regulatory guidance and proposals for reform. Some of these reforms are already effective while others are still to be implemented. These reforms may cause such benchmarks to perform differently than in the past, or have other consequences which cannot be predicted. It currently appears that, over time, U.S. Dollar LIBOR will be replaced by the Secured Overnight Financing Rate (“SOFR”) published by the Federal Reserve Bank of New York. However, the manner and timing of this shift is uncertain. U.S. banking regulators are encouraging banks to cease entering into new contracts that use U.S. Dollar LIBOR as a reference rate as soon as practicable and, in any event, by December 31, 2021, but it currently appears that rates based on U.S. Dollar LIBOR could continue to be published through June 2023. It is also possible that LIBOR will effectively end earlier if the number of panel banks reporting to LIBOR continues to decrease. Market participants are still considering how various types of financial instruments and securitization vehicles should react to a discontinuation of LIBOR. It is possible that not all of our assets and liabilities will transition away from LIBOR at the same time, and it is possible that not all of our assets and liabilities will transition to the same alternative reference rate, in each case increasing the difficulty of hedging. For example, switching existing financial instruments and hedging transactions from LIBOR to SOFR requires calculations of a spread. Industry organizations are attempting to structure the spread calculation in a manner that minimizes the possibility of value transfer between counterparties, borrowers, and lenders by virtue of the transition, but there is no assurance that the calculated spread will be fair and accurate or that all asset types and all types of securitization vehicles will use the same spread. We and other market participants have less experience understanding and modeling SOFR-based assets and liabilities than LIBOR-based assets and liabilities, increasing the difficulty of investing, hedging, and risk management. The process of transition involves operational risks. It is also possible that no transition will occur for many financial instruments. At this time, it is not possible to predict the effect of any such changes, any establishment of alternative reference rates or any other reforms to LIBOR that may be implemented. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may adversely affect the market for or value of any securities on which the interest or dividend is determined by reference to LIBOR, loans, derivatives and other financial obligations or on our overall financial condition or results of operations. More generally, any of the above changes or any other consequential changes to LIBOR or any other “benchmark” as a result of international, national or other proposals for reform or other initiatives, or any further uncertainty in relation to the timing and manner of implementation of such changes, could have a material adverse effect on the value of and return on any securities based on or linked to a “benchmark.”

Investments we make, hedging transactions that we enter into, and the manner in which we finance our investments and operations expose us to various risks, including liquidity risk, risks associated with the use of leverage, market risks, and counterparty risk.

Many of our investments have limited liquidity.

Many of the residential, business-purpose, multifamily, and other securities we own or may own are generally illiquid - that is, there is not a significant pool of potential investors that are likely to invest in these, or similar, securities. This illiquidity can also exist for the real estate loans we may hold and the business-purpose loans we originate. At times, the vast majority of the assets we own are illiquid. In turbulent markets, it is likely that the securities, loans, and other assets we own may become even less liquid. As a result, we may not be able to sell certain assets at opportune times or at attractive prices or we may incur significant losses upon sale of these assets, should we want or need to sell them.

Our level of indebtedness and liabilities could limit cash flow available for our operations, expose us to risks that could adversely affect our business, financial condition and results of operations and impair our ability to satisfy our obligations under our convertible notes and other debt instruments.

At December 31, 2020, our total consolidated liabilities (excluding indebtedness associated with asset-backed securities issued and other liabilities of consolidated entities, for which we are not liable) was \$2.1 billion. We may also incur additional indebtedness to meet future financing needs. Our indebtedness could have significant negative consequences for our business, results of operations and financial condition, including:

- increasing our vulnerability to adverse economic and industry conditions;
- limiting our ability to obtain additional financing;
- requiring the dedication of a substantial portion of our cash flow from operations to service our indebtedness, thereby reducing the amount of our cash flow available for other purposes;

- requiring asset sales to fund the repayment of maturing debt;
- limiting our flexibility in planning for, or reacting to, changes in our business;
- dilution experienced by our existing stockholders as a result of the conversion of the convertible notes or exchangeable securities into shares of common stock; and
- placing us at a possible competitive disadvantage with less leveraged competitors and competitors that may have better access to capital resources.

We cannot assure you that we will be able to continue to maintain sufficient cash reserves or continue to generate cash flow from operations at levels sufficient to permit us to pay principal, premium, if any, and interest on our indebtedness, or that our cash needs will not increase. If we are unable to generate sufficient cash flow or otherwise obtain funds necessary to make required payments, or if we fail to comply with the various requirements of our indebtedness then outstanding, we would be in default, which would permit the holders of the affected indebtedness to accelerate the maturity of such indebtedness and could cause defaults under our other indebtedness. Any default under any indebtedness could have a material adverse effect on our business, results of operations and financial condition. For an additional discussion of our outstanding indebtedness, see Part II, Item 7 of this Annual Report on Form 10-K under the heading “*Risks Relating to Debt Incurred under Short- and Long-Term Borrowing Facilities.*”

Our use of financial leverage could expose us to increased risks.

We fund the residential loans we acquire in anticipation of a future sale or securitization with a combination of equity and short-term debt. In addition, we also make investments in securities and loans financed with short- and long-term debt. By incurring this debt (i.e., by applying financial leverage), we expect to generate more attractive returns on our invested equity capital. However, as a result of using financial leverage (whether for the accumulation of loans or related to longer-term investments), we could also incur significant losses if our borrowing costs increase relative to the earnings on our assets and costs of any related hedges. Financing facility creditors may also force us to sell assets pledged as collateral under adverse market conditions to meet margin calls, for example, in the event of a decrease in the fair values of the assets pledged as collateral. Further discussion of the risk associated with our use of leverage is set forth under the heading “*Our use of financial leverage exposes us to increased risks, including liquidity risks from margin calls and potential breaches of the financial covenants under our borrowing facilities, which could result in our being required to immediately repay all outstanding amounts borrowed under these facilities and these facilities being unavailable to use for future financing needs, as well as triggering cross-defaults under other debt agreements.*” Liquidation of the collateral could create negative tax consequences and raise REIT qualification issues. Further discussion of the risk associated with maintaining our REIT status is set forth under the heading “*We have elected to be taxed as a REIT and, as such, are required to meet certain tests in order to maintain our REIT status. This adds complexity and costs to running our business and exposes us to additional risks.*” In addition, we make financial covenants to creditors in connection with incurring short- and long-term debt, such as covenants relating to our maintaining a minimum amount of tangible net worth or stockholders’ equity and/or a minimum amount of liquid assets, and a maximum ratio of recourse debt to stockholders’ equity. If we fail to comply with these financial covenants we would be in default under our financing facilities, which could result in, among other things, the liquidation of collateral we have pledged pursuant to these facilities under adverse market conditions and the inability to incur additional borrowings to finance our business activities. A further discussion of financial covenants we are subject to and related risks associated with our use of short-term debt is set forth under the heading “*Our use of financial leverage exposes us to increased risks, including liquidity risks from margin calls and potential breaches of the financial covenants under our borrowing facilities, which could result in our being required to immediately repay all outstanding amounts borrowed under these facilities and these facilities being unavailable to use for future financing needs, as well as triggering cross-defaults under other debt agreements.*” and in Part II, Item 7 of this Annual Report on Form 10-K under the heading, “*Risks Relating to Debt Incurred Under Short- and Long-Term Borrowing Facilities.*” Additionally, our ability to increase our borrowing limits under our debt financing facilities (and therefore increase our investment capacity) may be limited by our ability to raise equity capital, which we may not be able to raise at attractive prices or at all.

The inability to access financial leverage through warehouse and repurchase facilities, credit facilities, or other forms of debt financing may inhibit our ability to execute our business plan, which could have a material adverse effect on our financial results, financial condition, and business.

Our ability to fund our business and our investment strategy depends on our securing warehouse, repurchase, or other forms of debt financing (or leverage) on acceptable terms. For example, pending the sale or securitization of a pool of mortgage loans or other assets we generally fund the acquisition of those mortgage loans or other assets through borrowings from warehouse, repurchase, and credit facilities, and other forms of short-term financing.

We cannot assure you that we will be successful in establishing sufficient sources of short-term debt when needed. In addition, because of its short-term nature, lenders may decline to renew our short-term debt upon maturity or expiration, and it may be difficult for us to obtain continued short-term financing. During certain periods, such as during 2020 when there were, at times, severe market dislocations resulting from the pandemic, lenders may curtail their willingness to provide financing, as liquidity in short-term debt markets, including repurchase facilities and commercial paper markets, can be withdrawn suddenly, making it difficult or expensive to renew short-term borrowings as they mature. To the extent our business or investment strategy calls for us to access financing and counterparties are unable or unwilling to lend to us, then our business and financial results will be adversely affected. It is also possible that lenders who provide us with financing could experience changes in their ability to advance funds to us, independent of our performance or the performance of our investments, in which case funds we had planned to be able to access may not be available to us. Additionally, our ability to increase borrowing limits under our debt financing facilities (and therefore increase our investment capacity) may be limited by our ability to raise equity capital, which we may not be able to raise at attractive prices or at all.

In June 2014, we announced that our wholly-owned captive insurance company subsidiary, RWT Financial, LLC, was approved as a member of the Federal Home Loan Bank of Chicago (“FHLBC”). This membership provided RWT Financial with access to attractive long-term collateralized financing for mortgage loans and securities. As a result of the economic and financial market impacts of the pandemic, the terms of our FHLBC facility evolved and we transferred or sold nearly all of our residential loans previously financed at the FHLBC, and repaid all but \$1 million of borrowings under this facility. We do not expect to increase borrowings under our FHLBC facility above the existing \$1 million of borrowings outstanding. Additionally, pursuant federal regulations adopted in January 2016 by the Federal Housing Finance Agency (“FHFA”), which is the regulator of the Federal Home Loan Bank System, RWT Financial’s membership in the FHLBC terminated in February 2021. FHLBC financing enabled RWT Financial to earn attractive returns on loans held as long-term investments, contributing a significant amount to our historical earnings between 2014 and 2019. The expiration of RWT Financial's FHLBC membership may negatively impact us in a number of different ways, including, without limitation, by eliminating a source of attractive financing for our investment portfolio, limiting our ability to acquire (or the attractiveness of acquiring) residential and business-purpose mortgage loans to hold as long-term investments, and reducing net interest income earned by RWT Financial, any of which could negatively impact our business and operating results, as further described under the risk factor titled *“The termination of our subsidiary’s membership in the Federal Home Loan Bank of Chicago may limit our ability to acquire mortgage loans and securities to hold for investment and reduce our net interest income, which could negatively impact our business and operating results.”*

Hedging activities may reduce earnings, may fail to reduce earnings volatility, and may fail to protect our capital in difficult economic environments.

We attempt to hedge certain interest rate risks (and, at times, prepayment risks and fair values) by balancing the characteristics of our assets and associated (existing and anticipated) liabilities with respect to those risks and entering into various interest rate agreements. The number and scope of the interest rate agreements we utilize may vary significantly over time. We generally seek to enter into interest rate agreements that provide an appropriate and efficient method for hedging certain risks related to changes in interest rates.

The use of interest rate agreements and other instruments to hedge certain of our risks may have the effect over time of lowering long-term earnings to the extent these risks do not materialize. To the extent that we hedge, it is usually to seek to protect us from some of the effects of short-term interest rate volatility, to lower short-term earnings volatility, to stabilize liability costs or fair values, to stabilize our economic returns from, or meet rating agency requirements with respect to, a securitization transaction, or to stabilize the future cost of anticipated issuance of securities by a securitization entity. Hedging may not achieve our desired goals. For example, in response to market dislocations during 2020 resulting from the pandemic, we made the determination that our interest rate hedges were no longer effective in hedging asset market values and we terminated or closed out substantially all of our outstanding interest rate hedges and, overall, incurred realized losses. Although we have re-established our interest rate risk hedging program, there can be no assurance that future market conditions and our financial condition in the future will enable us to maintain an effective interest rate risk hedging program. Even in times of ordinary market and economic conditions, hedging with respect to the pipeline of loans we plan to purchase may not be effective due to loan fallout or other reasons. Using interest rate agreements as a hedge may increase short-term earnings volatility, especially if we do not elect certain accounting treatments for our hedges. Reductions in fair values of interest rate agreements may not be offset by increases in fair values of the assets or liabilities being hedged. Conversely, increases in fair values of interest rate agreements may not fully offset declines in fair values of assets or liabilities being hedged. Changes in fair values of interest rate agreements may require us to pledge significant amounts of cash or other acceptable forms of collateral.

We also may hedge by taking short, forward, or long positions in U.S. Treasuries, mortgage securities, or other cash instruments. We may take both long and short positions in credit derivative transactions linked to real estate assets. These derivatives may have additional risks to us, such as: liquidity risk, due to the fact that there may not be a ready market into which we could sell these derivatives if needed; basis risk, which could result in a decline in value or a requirement to make a cash payment as a result of changes in interest rates; and the risk that a counterparty to a derivative is not willing or able to perform its obligations to us due to its financial condition or otherwise.

Our earnings may be subject to fluctuations from quarter to quarter as a result of the accounting treatment for certain derivatives or for assets or liabilities whose terms do not necessarily match those used for derivatives, or as a result of our inability to meet the requirements necessary to obtain specific hedge accounting treatment for certain derivatives.

Additionally, the interest rate agreements and other instruments that we may use to hedge certain risks are also subject to risks related to the transition away from the use of LIBOR as a floating rate index, as further described above under the risk factor titled *“The performance of the assets we own and the investments we make will vary and may not meet our earnings or cash flow expectations. In addition, the cash flows and earnings from, and market values of, securities, loans, and other assets we own may be volatile - Changes in banks’ inter-bank lending rate reporting practices, the method pursuant to which LIBOR is determined, or the discontinuation of LIBOR may adversely affect the value of the financial obligations to be held or issued by us that are linked to LIBOR.”*

We enter into derivative contracts that may expose us to contingent liabilities and those contingent liabilities may not appear on our balance sheet. We may invest in synthetic securities, credit default swaps, and other credit derivatives, which expose us to additional risks.

We enter into derivative contracts, including interest rate swaps, options, and futures, that could require us to make cash payments in certain circumstances. Additionally, we may be required to make capital contributions to an investment fund in certain circumstances, including if debt covenants relating to financing incurred by the investment fund are not maintained. Such potential payment or capital call obligations would be contingent liabilities and may not appear on our balance sheet. Our ability to satisfy these contingent liabilities depends on the liquidity of our assets and our access to capital and cash. The need to fund these contingent liabilities could adversely impact our financial condition.

We may in the future invest in synthetic securities, credit default swaps, and other credit derivatives that reference other real estate securities or indices. These investments may present risks in excess of those resulting from the referenced security or index. These investments are typically contractual relationships with counterparties and not acquisitions of referenced securities or other assets. In these types of investments, we have no right directly to enforce compliance with the terms of the referenced security or other assets and we have no voting or other consensual rights of ownership with respect to the referenced security or other assets. In the event of insolvency of a counterparty, we will be treated as a general creditor of the counterparty and will have no claim of title with respect to the referenced security.

Hedging activities may subject us to increased regulation.

Under the Dodd-Frank Act, there is increased regulation of companies, such as Redwood and certain of our subsidiaries, that enter into interest rate hedging agreements and other hedging instruments and derivatives. This increased regulation could result in Redwood or certain of our subsidiaries being required to register and be regulated as a commodity pool operator or a commodity trading advisor. If we are not able to maintain an exemption from these regulations, it could have a negative impact on our business or financial results. Moreover, rules requiring central clearing of certain interest rate swap and other transactions, as well as rules relating to margin and capital requirements for swap transactions and regulated participants in the swap markets, as well as other swap market regulatory reforms, may increase the cost or decrease the availability to us of hedging transactions, and may also limit our ability to include swaps in our securitization transactions.

Our results could be adversely affected by counterparty credit risk.

We have credit risks that are generally related to the counterparties with which we do business. There is a risk that counterparties will fail to perform under their contractual arrangements with us and this risk is usually more pronounced during an economic downturn. The economic impact of the pandemic and the associated volatility in the financial markets is likely to trigger a period of economic slowdown or recession, and could jeopardize the solvency of counterparties with which we do business. Counterparties may seek to eliminate credit exposure by entering into offsetting, or “back-to-back,” hedging transactions, and the ability of a counterparty to settle a synthetic transaction may be dependent on whether the counterparties to the back-to-back transactions perform their delivery obligations. Those risks of non-performance may differ materially from the risks entailed in exchange-traded transactions, which generally are backed by clearing organization guarantees, daily mark-to-market and settlement of positions, and segregation and minimum capital requirements applicable to intermediaries. Transactions entered into directly between parties generally do not benefit from those protections, and expose the parties to the risk of counterparty default. Furthermore, there may be practical and timing problems associated with enforcing our rights to assets in the case of an insolvency of a counterparty.

In the event a counterparty to our borrowings becomes insolvent, we may fail to recover the full value of our pledged collateral, thus reducing our earnings and liquidity. In addition, the insolvency of one or more of our financing counterparties could reduce the amount of financing available to us, which would make it more difficult for us to leverage the value of our assets and obtain substitute financing on attractive terms or at all. A material reduction in our financing sources or an adverse change in the terms of our financings could have a material adverse effect on our financial condition and results of operations. In the event a counterparty to our interest rate agreements or other derivatives becomes insolvent or interprets our agreements with it in a manner unfavorable to us, our ability to realize benefits from the hedge transaction may be diminished, any cash or collateral we pledged to the counterparty may be unrecoverable, and we may be forced to unwind these agreements at a loss. In the event a counterparty that sells us residential mortgage loans becomes insolvent or is acquired by a third party, we may be unable to enforce our loan repurchase rights in connection with a breach of loan representations and warranties and we may suffer losses if we must repurchase delinquent loans. In the event that one of our sub-servicers becomes insolvent or fails to perform, loan delinquencies and credit losses may increase and we may not receive the funds to which we are entitled. We attempt to diversify our counterparty exposure and (except with respect to loan representations and warranties) attempt to limit our counterparty exposure to counterparties with investment-grade credit ratings, although we may not always be able to do so. Our counterparty risk management strategy may prove ineffective and, accordingly, our earnings and cash flows could be adversely affected.

Operational and Other Risks

Through certain of our wholly-owned subsidiaries we have engaged in the past, and plan to continue to engage, in acquiring residential mortgage loans and originating business-purpose mortgage loans with the intent to sell these loans to third parties or hold them as investments. Similarly, we have engaged in the past, and may continue to engage, in acquiring residential MSRs. These types of transactions and investments expose us to potentially material risks.

Acquiring and originating mortgage loans with intent to sell these loans to third parties generally requires us to incur short-term debt, either on a recourse or non-recourse basis, to finance the accumulation of loans or other assets prior to sale. This type of debt may not be available to us, or may only be available to us on an uncommitted basis, including in circumstances where a line of credit had previously been made available or committed to us. In addition, the terms of any available debt may be unfavorable to us or impose restrictive covenants that could limit our business and operations or the violation of which could lead to losses and inhibit our ability to borrow in the future. We expect to pledge assets we acquire to secure the short-term debt we incur. To the extent this debt is recourse to us, if the value of the assets pledged as, or underlying our, collateral declines, we may be required to increase the amount of collateral pledged to secure the debt or to repay all or a portion of the debt. In addition, when we originate or acquire assets for a sale, we make assumptions about the cash flows that will be generated from those assets and the market value of those assets. If these assumptions are wrong, or if market values change or other conditions change, it could result in a sale that is less favorable to us than initially assumed, which would typically have a negative impact on our financial results.

Furthermore, if we are unable to complete the sale of these types of assets, it could have a negative impact on our business and financial results. We have a limited capacity to hold residential and business-purpose loans on our balance sheet as investments, and our business is not structured to buy-and-hold the full volume of loans that we routinely acquire or originate with the intent to sell. If demand for buying whole-loans weakens, we may be forced to incur additional debt on unfavorable terms or may be unable to borrow to finance these assets, which may in turn impact our ability to continue acquiring or originating loans over the short or long term.

Additionally, residential mortgage loan borrowers that have been negatively impacted by the pandemic may not remit payments of principal and interest relating to their mortgage loans on a timely basis, or at all. To the extent mortgage loan borrowers do not make payments on their loans, the value of residential mortgage loans we own will likely be impaired, potentially materially, as further described above under the heading “*Residential mortgage loan borrowers that have been negatively impacted by the pandemic may not make payments of principal and interest relating to their mortgage loans on a timely basis, or at all, which could negatively impact our business.*”

Prior to originating or acquiring loans or other assets for sale, we may undertake underwriting and due diligence efforts with respect to various aspects of the loan or asset. When underwriting or conducting due diligence, we rely on resources and data available to us, which may be limited, and we rely on investigations by third parties. We may also only conduct due diligence on a sample of a pool of loans or assets we are acquiring and assume that the sample is representative of the entire pool. Our underwriting and due diligence efforts may not reveal matters which could lead to losses. If our underwriting process is not robust enough or if we do not conduct adequate due diligence, or the scope of our underwriting or due diligence is limited, we may incur losses. Losses could occur due to the fact that a counterparty that sold us a loan or other asset (or that is the obligor or a party related to an obligor of a business-purpose loan we originate) refuses or is unable (e.g., due to its financial condition) to repay or repurchase that loan or asset or pay damages to us if we determine subsequent to purchase that one or more of the representations or warranties made to us in connection with the sale or origination was inaccurate.

Our ability to operate our business in the manner described above depends on the availability and productivity of our personnel. To the extent our management or personnel are impacted in significant numbers by the outbreak of pandemic or epidemic disease, such as the coronavirus or COVID-19, our business and operating results may be negatively impacted.

In addition, when selling mortgage loans or acquiring servicing rights associated with residential mortgage loans, we typically make representations and warranties to the purchaser or to other third parties regarding, among other things, certain characteristics of those assets, including characteristics we seek to verify through our underwriting and due diligence efforts. If our representations and warranties are inaccurate with respect to any asset, we may be obligated to repurchase that asset or pay damages, which may result in a loss. We generally only establish reserves for potential liabilities relating to representations and warranties we make if we believe that those liabilities are both probable and estimable, as determined in accordance with GAAP. As a result, we may not have reserves relating to these potential liabilities or any reserves we may establish could be inadequate. Even if we obtain representations and warranties from the counterparties from whom we acquired the loans or other assets or the borrowers to whom we made the loans, or their related parties, they may not parallel the representations and warranties we make or may otherwise not protect us from losses, including, for example, due to the fact that the counterparty may be insolvent or otherwise unable to make a payment to us at the time we make a claim for repayment or damages for a breach of representation or warranty. Furthermore, to the extent we claim that counterparties we have acquired loans from or borrowers to whom we made the loan, or their related parties have breached their representations and warranties to us, it may adversely impact our business relationship with those counterparties, including by reducing the volume of business we conduct with those counterparties, which could negatively impact our ability to acquire loans and our business. To the extent we have significant exposure to representations and warranties made to us by one or more counterparties we acquire loans from, we may determine, as a matter of risk management, to reduce or discontinue loan acquisitions from those counterparties, which could reduce the volume of residential loans we acquire and negatively impact our business and financial results.

Our portfolio of business-purpose loans held for investment represents a growing portion of our overall investment portfolio, and such loans expose us to new and different risks from our traditional investments in jumbo residential mortgage loans.

A growing portion of our portfolio of loans held for investment is made up of business-purpose mortgage loans. Business-purpose mortgage loans are directly exposed to losses resulting from default and foreclosure. Therefore, the value of the underlying property, the creditworthiness and financial position of the borrower and the priority and enforceability of the lien will significantly impact the value of such mortgages. Whether or not we have participated in the negotiation of the terms of any such mortgages, there can be no assurance as to the adequacy of the protection of the terms of the loan, including the validity or enforceability of the loan and the maintenance of the anticipated priority and perfection of the applicable security interests. Furthermore, claims may be asserted that might interfere with enforcement of our rights. In the event of a foreclosure, we may assume direct ownership of the underlying real estate. The liquidation proceeds upon sale of such real estate may not be sufficient to recover our cost basis in the loan, resulting in a loss to us. Any costs or delays involved in the completion of a foreclosure of the loan or a liquidation of the underlying property will further reduce the proceeds and thus increase the loss.

Business purpose loans we own are subject to similar risks as those described above with respect to residential mortgage loans, to the extent business purpose loan borrowers that have been negatively impacted by the pandemic do not timely remit payments of principal and interest relating to their mortgage loans. In addition, if tenants who rent their residence from a multifamily or business purpose loan borrower are unable to make rental payments, are unwilling to make rental payments, or a waiver of the requirement to make rental payments on a timely basis, or at all, is available under the terms of any applicable forbearance or waiver agreement or program (which rental payment forbearance or waiver program may be available as a result of a government-sponsored or -imposed program or under any such agreement or program a landlord may otherwise offer to tenants), then the value of multifamily and business purpose loans and multifamily and business purpose mortgage backed securities we own will likely be impaired, potentially materially, as further discussed under the heading *“Multifamily and business purpose mortgage loan borrowers that have been negatively impacted by the pandemic may not make payments of principal and interest relating to their mortgage loans on a timely basis, or at all, which could negatively impact our business.”*

A portion of our business-purpose loan portfolio currently is, and in the future may be, delinquent and subject to increased risks of credit loss for a variety of reasons, including, without limitation, because the underlying property is too highly-leveraged or the borrower experiences financial distress. Delinquent loans may require a substantial amount of workout negotiations or restructuring, which may entail, among other things, a reduction in the interest rate or capitalization of past due interest. However, even if restructurings are successfully accomplished, risks still exist that borrowers will not be able or willing to maintain the restructured payments or refinance the restructured mortgage upon maturity.

If restructuring is not successful, we may find it necessary to foreclose on the underlying property, and the foreclosure process may be lengthy and expensive, including out-of-pocket costs and increased use of our internal resources. Borrowers may resist mortgage foreclosure actions by asserting numerous claims, counterclaims and defenses against us including, without limitation, numerous lender liability claims and defenses, even when such assertions may have no basis in fact, in an effort to prolong the foreclosure action and exert negotiating pressure on us to agree to a modification of the loan or a favorable buy-out of the borrower's position. In some states, foreclosure actions can sometimes take several years or more to litigate. Foreclosure may create a negative public perception of the related mortgaged property, resulting in a decrease in its value. Even if we are successful in foreclosing on a loan, the liquidation proceeds upon sale of the underlying real estate may not be sufficient to recover our cost basis in the loan, resulting in a loss to us. Furthermore, any costs or delays involved in the completion of a foreclosure of the loan or a liquidation of the underlying property will further reduce the proceeds and thus increase the loss. Any such reductions could materially and adversely affect the value of the loan and could, in aggregate, have a material and adverse effect on our business, results of operations and financial condition.

Additionally, bridge loans on properties in transition may involve a greater risk of loss than traditional mortgage loans. This type of loan is typically used for acquiring and rehabilitating or improving the quality of single-family residential investment properties and generally serves as an interim financing solution for borrowers and/or properties prior to the borrower selling the property or stabilizing the property and obtaining long-term permanent financing. The typical borrower of these bridge loans has often identified an undervalued asset that has been under-managed or is located in a recovering market. If the market in which the asset is located fails to improve according to the borrower's projections, or if the borrower fails to improve the quality of the asset's management or the value of the asset, the borrower may not receive a sufficient return on the asset to satisfy the transitional loan, and we bear the risk that we may not recover some or all of our investment. In addition, borrowers often use the proceeds of a conventional mortgage to repay a bridge loan. Bridge loans therefore are subject to risks of a borrower's inability to obtain permanent financing to repay the loan. Bridge loans are also subject to risks of borrower defaults, bankruptcies, fraud, and other losses. In the event of any default under bridge loans that may be held by us, we bear the risk of loss of principal and non-payment of interest and fees to the extent of any deficiency between the value of the mortgage collateral and the principal amount and unpaid interest of the transitional loan. To the extent we suffer such losses with respect to these loans, our business, results of operations and financial condition may be materially adversely affected.

Through certain of our wholly-owned subsidiaries we have engaged in the past, and expect to continue to engage in, securitization transactions relating to real estate mortgage loans. In addition, we have invested in and continue to invest in mortgage-backed securities and other ABS issued in securitization transactions sponsored by other companies. These types of transactions and investments expose us to potentially material risks.

Engaging in securitization transactions and other similar transactions generally requires us to incur short-term debt on a recourse basis to finance the accumulation of loans or other assets prior to securitization. If demand for investing in securitization transactions weakens, we may be unable to complete the securitization of loans accumulated for that purpose, which may hurt our business or financial results. In addition, in connection with engaging in securitization transactions, we engage in due diligence with respect to the loans or other assets we are securitizing and make representations and warranties relating to those loans and assets. The risks associated with incurring this type of debt in connection with securitization activity, the risks related to our ability to complete securitization transactions after we have accumulated loans for that purpose, and the risks associated with the due diligence we conduct, and the representations and warranties we make, in connection with securitization activity are similar to the risks associated with acquiring and originating loans with the intent to sell them to third parties, as described in the immediately preceding risk factor titled "*Through certain of our wholly-owned subsidiaries we have engaged in the past, and plan to continue to engage, in acquiring residential mortgage loans and originating business-purpose mortgage loans with the intent to sell these loans to third parties or hold them as investments. Similarly, we have engaged in the past, and continue to engage, in acquiring residential MSRs. These types of transactions and investments expose us to potentially material risks.*"

When engaging in securitization transactions, we also prepare marketing and disclosure documentation, including term sheets, offering documents, and prospectuses, that include disclosures regarding the securitization transactions and the assets being securitized. If our marketing and disclosure documentation are alleged or found to contain inaccuracies or omissions, we may be liable under federal and state securities laws (or under other laws) for damages to third parties that invest in these securitization transactions, including in circumstances where we relied on a third party in preparing accurate disclosures, or we may incur other expenses and costs in connection with disputing these allegations or settling claims. We have also engaged in selling or contributing commercial and multifamily real estate loans, to third parties who, in turn, have securitized those loans. In these circumstances, we have in the past and may in the future also prepare marketing and disclosure documentation, including documentation that is included in term sheets, offering documents, and prospectuses relating to those securitization transactions. We could be liable under federal and state securities laws (or under other laws) for damages to third parties that invest in these securitization transactions, including liability for disclosures prepared by third parties or with respect to loans that we did not sell or contribute to the securitization. Additionally, we typically retain various third-party service providers when we engage in securitization transactions, including underwriters or initial purchasers, trustees, administrative and paying agents, and custodians, among others. We frequently contractually agree to indemnify these service providers against various claims and losses they may suffer in connection with the provision of services to us and/or the securitization trust. To the extent any of these service providers are liable for damages to third parties that have invested in these securitization transactions, we may incur costs and expenses as a result of these indemnities.

There may be defects in the legal process and legal documents governing transactions in which securitization trusts and other secondary purchasers take legal ownership of residential mortgage loans and establish their rights as first priority lien holders on underlying mortgaged property. To the extent there are problems with the manner in which title and lien priority rights were established or transferred, securitization transactions that we sponsored and third-party sponsored securitizations that we hold investments in may experience losses, which could expose us to losses and could damage our ability to engage in future securitization transactions.

The effects of the pandemic could negatively impact our operating platforms, including our business purpose loan origination and residential loan purchase activities.

The effects of the pandemic could adversely impact our business and operations due to temporary or lasting changes involving the status, practices and procedures of our operating platforms, including with respect to loan origination and loan purchase activities. In the first half of 2020, the impact of the pandemic caused us to temporarily limit our residential loan purchases and reduce our business purpose loan origination activities, which may have impacted our relationships with business partners, customers and counterparties. To the extent any of these counterparties believe that we have breached actual or perceived obligations to them, they may subject us to litigation and claims, any of which could have a material adverse effect on our reputation, business, financial condition, results of operations and cash flows. Moreover, because of the disruptions to the normal operation of mortgage finance markets, our operations focused on acquiring and distributing residential mortgage loans and originating and distributing business purpose loans may not be able to function efficiently because of, among other factors, an inability to access short-term or long-term financing for mortgage loans, a disruption to the market for securitization transactions, or our inability to access these markets or execute securitization transactions. Any or all of these impacts could result in reduced (or negative) mortgage banking income and gain on sale income, and reduced net interest income, all of which would negatively impact our financial results.

In connection with our operating and investment activity, we rely on third parties to perform certain services, comply with applicable laws and regulations, and carry out contractual covenants and terms, the failure of which by any of these third parties may adversely impact our business and financial results.

In connection with our business of acquiring and originating loans, engaging in securitization transactions, and investing in third-party issued securities and other assets, we rely on third party service providers to perform certain services, comply with applicable laws and regulations, and carry out contractual covenants and terms. As a result, we are subject to the risks associated with a third party's failure or inability to perform, including failure to perform due to the impact of the pandemic on such third party's ability to operate, including due to the bankruptcy of one or more loan servicers, or reasons such as fraud, negligence, errors, miscalculations, or insolvency. For example, as a result of the pandemic, residential mortgage subservicers are seeking to respond to an unprecedented level of requests from mortgage borrowers for payment forbearances and, as a result, their operational infrastructures may not be able to properly process this increased volume of requests effectively or in a manner that is in our best interests. Many loan servicers have been accused of improprieties in the handling of the loan modification or foreclosure process with respect to residential mortgage loans that have gone into default. To the extent a third-party loan servicer fails to fully and properly perform its obligations, loans and securities that we hold as investments may experience losses and securitizations that we have sponsored may experience poor performance, and our ability to engage in future securitization transactions could be harmed. Moreover, the CFPB has indicated that under the Biden presidential administration it intends to revitalize enforcement of fair lending laws and prioritize protecting consumers facing financial hardship due to COVID-19 and racial equity including through supervisory and enforcement activity directed at mortgage subservicer performance. As another example, our residential lending and business-purpose lending segments utilize third party appraisals during the loan underwriting process, obtained on the collateral underlying each prospective mortgage. The quality of these appraisals may vary widely in accuracy and consistency. The appraiser may feel pressure from the broker or lender to provide an appraisal in the amount necessary to enable the originator to make the loan, whether or not the value of the property justifies such an appraised value. Inaccurate or inflated appraisals may result in an increase in the severity of losses on the mortgage loans, which could have a material and adverse effect on our business, results of operations and financial condition. Additionally, our business-purpose loan origination platforms may utilize third party inspectors in connection with funding advances on bridge loans for rehabilitation or ground-up construction. These third parties may be required to certify a borrower's eligibility for advances based on the satisfaction of construction milestones. In the past we have experienced, and may in the future experience, fraudulent or negligent activity among borrowers and certain of these third parties that has led to the disbursement of under-collateralized funds and could cause us to incur financial losses on loans we have originated.

For some of the loans that we hold and for some of the loans we sell or securitize, we hold the right to service those loans and we retain a sub-servicer to service those loans. In these circumstances we are exposed to certain risks, including, without limitation, that we may not be able to enter into subservicing agreements on favorable terms to us or at all, or that the sub-servicer may not properly service the loan in compliance with applicable laws and regulations or the contractual provisions governing their sub-servicing role, and that we would be held liable for the sub-servicer's improper acts or omissions. Additionally, in its capacity as a servicer of residential mortgage loans, a sub-servicer will have access to borrowers' non-public personal information, and we could incur liability in connection with a data breach relating to a sub-servicer, as discussed further below under the risk factor titled "*Maintaining cybersecurity and data security is important to our business and a breach of our cybersecurity or data security could result in serious harm to our reputation and have a material adverse impact on our business and financial results.*" When we retain a sub-servicer we are generally also obligated to fund any obligation of the sub-servicer to make advances on behalf of a delinquent loan obligor. To the extent any one sub-servicer counterparty services a significant percentage of the loans with respect to which we own the servicing rights, the risks associated with our use of that sub-servicer are concentrated around this single sub-servicer counterparty. To the extent that there are significant amounts of advances that need to be funded in respect of loans where we own the servicing right, it could have a material adverse effect on our business and financial results.

In addition, we have participated in various investments structured as joint ventures or partnerships with unaffiliated third parties. Some of these joint venture entities rely, in part, on their members or partners to make committed capital contributions in order to pay the purchase price for investments, to fund shortfalls in capital under related financing agreements, or to fund indemnification or repurchase obligations related to securitization. A failure by one of the members to make such capital contributions for amounts required could result in events of default under the terms of the investment or the related financing and a loss of our investment in the joint venture entity and its related investments. For example, in connection with our servicer advance investments, we consolidate an entity that was formed to finance servicing advances and for which we, through our control of an affiliated partnership entity (the "SA Buyer") formed to invest in servicer advance investments and excess MSR, are the primary beneficiary. SA Buyer has agreed to purchase all future arising servicer advances under certain residential mortgage servicing agreements. SA Buyer relies, in part, on its members to make committed capital contributions in order to pay the purchase price for future servicer advances. A failure by any or all of the members to make such capital contributions for amounts required to fund servicer advances could result in an event of default under our servicer advance financing and a complete loss of our investment in SA Buyer and its servicer advance investments and excess MSR. Additionally, to the extent that the servicer of the underlying mortgage loans (who is unaffiliated with us except through their co-investment in SA Buyer and the related financing entity) fails to recover the servicer advances in which we have invested, or takes longer than we expect to recover such advances, the value of our investment could be adversely affected and we could fail to achieve our expected return and suffer losses.

We also rely on corporate trustees to act on behalf of us and other holders of ABS in enforcing our rights as security holders. Under the terms of most ABS we hold, we do not have the right to directly enforce remedies against the issuer of the security, but instead must rely on a trustee to act on behalf of us and other security holders. Should a trustee not be required to take action under the terms of the securities, or fail to take action, we could experience losses. Our business could also be negatively impacted by the inability of other third-party vendors we rely on to perform and operate effectively, including vendors that provide IT services, legal and accounting services, or other operational support services. Further, an inability of our counterparties to make or satisfy the conditions or representations and warranties in agreements they have entered into with us could also have a material adverse effect on our financial condition, results of operations and cash flows.

Our ability to execute or participate in future securitization transactions, including, in particular, securitizations of residential and business-purpose mortgage loans, could be delayed, limited, or precluded by legislative and regulatory reforms applicable to asset-backed securities and the institutions that sponsor, service, rate, or otherwise participate in or contribute to the successful execution of a securitization transaction. Other factors could also limit, delay, or preclude our ability to execute securitization transactions. These legislative, regulatory, and other factors could also reduce the returns we would otherwise expect to earn in connection with executing securitization transactions.

Various federal and state laws and regulations impact our ability to execute securitization transactions, including the Dodd-Frank Act. Provisions of the Dodd-Frank Act relate, among other things, to the legal and regulatory framework under which ABS, including RMBS and securities backed by business-purpose mortgage loans, are issued through the execution of securitization transactions. In addition, the Securities and Exchange Commission (SEC) and the Federal Deposit Insurance Corporation have published regulations relating to the issuance of ABS, including RMBS. Additional federal or state laws and regulations that could affect our ability to execute future securitization transactions could be proposed, enacted, or implemented. In addition, various federal and state agencies and law enforcement authorities, as well as private litigants, have initiated and may, in the future, initiate additional broad-based enforcement actions or claims, the resolution of which may include industry-wide changes to the way residential mortgage loans are originated, transferred, serviced, and securitized, and any of these changes could also affect our ability to execute future securitization transactions. For an example, please refer to the risk factor titled "*Federal and state legislative and regulatory developments and the actions of governmental authorities and entities may adversely affect our business and the value of, and the returns on, mortgages, mortgage-related securities, and other assets we own or may acquire in the future.*"

Rating agencies can affect our ability to execute or participate in a securitization transaction, or reduce the returns we would otherwise expect to earn from executing securitization transactions, not only by deciding not to publish ratings for our securitization transactions (or deciding not to consent to the inclusion of those ratings in the prospectuses or other documents we file with the SEC relating to securitization transactions), but also by altering the criteria and process they follow in publishing ratings. Rating agencies could alter their ratings processes or criteria after we have accumulated loans or other assets for securitization in a manner that effectively reduces the value of those previously acquired or originated loans or requires that we incur additional costs to comply with those processes and criteria. For example, to the extent investors in a securitization transaction would have significant exposure to representations and warranties made by us or by one or more counterparties we acquire loans from, rating agencies may determine that this exposure increases investment risks relating to the securitization transaction. Rating agencies could reach this conclusion either because of our financial condition or the financial condition of one or more counterparties we acquire loans from, or because of the aggregate amount of loan-related representations and warranties (or other contingent liabilities) we, or one or more counterparties we acquire loans from, have made or have exposure to. In addition, our ability to continue to securitize residential mortgage loans in the future will depend, in part, on the rating agencies' assessment of the investment risks that result from the ability-to-repay regulations and the TILA-RESPA Integrated Disclosure Rule (TRID). This includes, for example, how they assess investment risks associated with (a) non-material errors in loan-related disclosures made to mortgage borrowers, (b) residential mortgage loans that have an interest-only payment feature, or (c) loans under which the borrower has a debt-to-income ratio of more than 43%. These types of loans have historically accounted for a significant amount of the loans we have securitized, but they are not considered "qualified mortgages" under the ability-to-repay regulations. Since these provisions were implemented over the past several years, the rating agencies' assessment of these risks has generally been consistent with ours, but to the extent their assessments diverge from ours, this could negatively impact our ability to execute securitization transactions. If, as a result of any of the foregoing issues, rating agencies place limitations on our ability to execute future securitization transactions or impose unfavorable ratings levels or conditions on our securitization transactions, it could reduce the returns we would otherwise expect to earn from executing these transactions and negatively impact our business and financial results.

Furthermore, other matters, such as (i) accounting standards applicable to securitization transactions and (ii) capital and leverage requirements applicable to banks' and other regulated financial institutions' holdings of ABS, could result in less investor demand for securities issued through securitization transactions we execute or increased competition from other institutions that originate, acquire, and hold residential and business-purpose mortgage loans, multifamily real estate loans, and other types of assets and execute securitization transactions.

Our ability to profitably execute or participate in future securitizations transactions, including, in particular, securitizations of residential and business-purpose mortgage loans, is dependent on numerous factors and if we are not able to achieve our desired level of profitability or if we incur losses in connection with executing or participating in future securitizations it could have a material adverse impact on our business and financial results.

There are a number of factors that can have a significant impact on whether a securitization transaction that we execute or participate in is profitable to us or results in a loss. One of these factors is the price we pay for (or cost of originating) the mortgage loans that we securitize, which, in the case of residential mortgage loans, is impacted by the level of competition in the marketplace for acquiring mortgage loans and the relative desirability to originators of retaining mortgage loans as investments or selling them to third parties such as us. Another factor that impacts the profitability of a securitization transaction is the cost to us of the short-term debt that we use to finance our holdings of mortgage loans prior to securitization, which cost is affected by a number of factors including the availability of this type of financing to us, the interest rate on this type of financing, the duration of the financing we incur, and the percentage of our mortgage loans for which third parties are willing to provide short-term financing.

After we acquire or originate mortgage loans that we intend to securitize, we can also suffer losses if the value of those loans declines prior to securitization. Declines in the value of a mortgage loan, for example, can be due to, among other things, changes in interest rates, changes in the credit quality of the loan, and changes in the projected yields required by investors to invest in securitization transactions. To the extent we seek to hedge against a decline in loan value due to changes in interest rates, there is a cost of hedging that also affects whether a securitization is profitable. Other factors that can significantly affect whether a securitization transaction is profitable to us include the criteria and conditions that rating agencies apply and require when they assign ratings to the mortgage-backed securities issued in our securitization transactions, including the percentage of mortgage-backed securities issued in a securitization transaction that the rating agencies will assign a triple-A rating to, which is also referred to as a rating agency subordination level. Rating agency subordination levels can be impacted by numerous factors, including, without limitation, the credit quality of the loans securitized, the geographic distribution of the loans to be securitized, and the structure of the securitization transaction and other applicable rating agency criteria. All other factors being equal, the greater the percentage of the mortgage-backed securities issued in a securitization transaction that the rating agencies will assign a triple-A rating to, the more profitable the transaction will be to us.

The price that investors in mortgage-backed securities will pay for securities issued in our securitization transactions also has a significant impact on the profitability of the transactions to us, and these prices are impacted by numerous market forces and factors. In addition, the underwriter(s) or placement agent(s) we select for securitization transactions, and the terms of their engagement, can also impact the profitability of our securitization transactions. Also, transaction costs incurred in executing transactions impact the profitability of our securitization transactions and any liability that we may incur, or may be required to reserve for, in connection with executing a transaction can cause a loss to us. To the extent that we are not able to profitably execute future securitizations of residential or business-purpose mortgage loans or other assets, including for the reasons described above or for other reasons, it could have a material adverse impact on our business and financial results.

Our past and future loan origination and securitization activities or other past and future business or operating activities or practices could expose us to litigation, which may adversely affect our business and financial results.

Through certain of our wholly-owned subsidiaries we have in the past engaged in or participated in loan origination and securitization transactions relating to residential mortgage loans, business-purpose mortgage loans, multifamily mortgage loans, commercial real estate loans, and other types of assets. In the future we expect to continue to engage in or participate in loan origination and securitization transactions, including, in particular, securitization transactions relating to residential and business-purpose mortgage loans, and may also engage in other types of securitization transactions or similar transactions. Sequoia securitization entities we sponsored issued ABS backed by residential mortgage loans held by these Sequoia entities. Similarly, CoreVest securitization entities (or “CAFL” entities) we sponsor issued ABS backed by business-purpose mortgage loans held by these CAFL entities. In Acacia securitization transactions we participated in, Acacia securitization entities issued ABS backed by securities and other assets held by these Acacia entities. As a result of declining property values, increasing defaults, changes in interest rates, and other factors, the aggregate cash flows from the loans held by the Sequoia and CAFL entities and the securities and other assets held by the Acacia entities may be insufficient to repay in full the principal amount of ABS issued by these securitization entities. We are not directly liable for any of the ABS issued by these entities. Nonetheless, third parties who hold the ABS issued by these entities may try to hold us liable for any losses they experience, including through claims under federal and state securities laws or claims for breaches of representations and warranties we made in connection with engaging in these securitization transactions. Additionally, holders of ABS issued by CAFL entities prior to our acquisition of CoreVest may make claims against us for losses arising from activities that occurred prior to our acquisition.

For example, as discussed below in Part I, Item 3 of this Annual Report on Form 10-K, on December 23, 2009, the Federal Home Loan Bank of Seattle filed a claim in the Superior Court for the State of Washington against us and our subsidiary, Sequoia Residential Funding, Inc. The complaint related in part to residential mortgage-backed securities that were issued by a Sequoia securitization entity and alleged that, at the time of issuance, we, Sequoia Residential Funding, Inc. and the underwriters made various misstatements and omissions about these securities in violation of Washington state law. We have also been named in other similar lawsuits. A further discussion of these lawsuits is set forth in Note 16 to the Financial Statements within this Annual Report on Form 10-K. For another example, refer to the risk factor below, titled *“Litigation of the type initiated against various trustees of residential mortgage-backed securitization transactions issued prior to financial crisis of 2007-2008 (“RMBS trustee litigation”) negatively impacted, and could further negatively impact, the value of securities we hold, could expose us to indemnification claims, and could impact the profitability of our participation in future securitization transactions.”*

Other aspects of our business operations or practices could also expose us to litigation. In the ordinary course of our business we enter into agreements relating to, among other things, loans we originate and acquire and investments we make, assets and loans we sell, financing transactions, third parties we retain to provide us with goods and services, and our leased office space. We also regularly enter into confidentiality agreements with third parties under which we receive confidential information. If we breach any of these agreements, we could be subject to claims for damages and related litigation. For example, when we sell whole loans in the secondary market, we are required to make customary representations and warranties about such loans to the loan purchaser. Our mortgage loan sale agreements may require us to repurchase or substitute loans or indemnify investors in the event we breach a representation or warranty made to the loan purchaser. In addition, we may be required to repurchase loans as a result of borrower fraud or in the event of early payment default on a mortgage loan. The remedies available to a purchaser of mortgage loans may be broader than those available to us against the borrower or correspondent. Further, if a purchaser enforces its remedies against us, we may not be able to enforce the remedies we have against the borrower or correspondent seller. Financing for repurchased loans may be limited or unavailable, and may incur a steep discount to their repurchase price from financing counterparties. They are also typically sold at a significant discount to the loan's unpaid principal balance. Significant repurchase activity could harm our business, cash flow, results of operations and financial condition.

As a result of past or future actions of our business purpose lending platforms, we may be subject to lender liability claims, and if we are held liable under such claims, we could be subject to losses. A number of judicial decisions have upheld the right of borrowers to sue lending institutions on the basis of various evolving legal theories, collectively termed “lender liability.” Generally, lender liability is founded on the premise that a lender has either violated a duty, whether implied or contractual, of good faith and fair dealing owed to the borrower or has assumed a degree of control over the borrower resulting in the creation of a fiduciary duty owed to the borrower or its other creditors or stockholders. We could also be subject to litigation, including class action litigation, or regulatory enforcement action, relating to residential mortgage servicer performance failing to adhere to requirements governing forbearance and foreclosure as a result of the pandemic. Additionally, federal regulators under the Biden presidential administration have signaled a renewed focus on fair lending and fair servicing guidelines and practices to identify potential discriminatory loss mitigation and foreclosure practices and hold residential mortgage servicers accountable. We cannot assure investors that such claims will not arise through litigation or regulatory action or that we will not be subject to significant liability if a claim of this type did arise. Additionally, we could be subject to such claims relating to activities that occurred prior to our acquisitions of 5 Arches and CoreVest.

We are also subject to various other laws and regulations relating to our business and operations, including, without limitation, privacy laws and regulations and labor and employment laws and regulations, and if we fail to comply with these laws and regulations we could also be subjected to claims for damages and litigation. In particular, if we fail to maintain the confidentiality of consumers’ personal or financial information we obtain in the course of our business (such as social security numbers), we could be exposed to losses. A further discussion of some of these risks is set forth in the risk factor titled “*Maintaining cybersecurity and data security is important to our business and a breach of our cybersecurity or data security could result in serious harm to our reputation and have a material adverse impact on our business and financial results.*”

Defending a lawsuit can consume significant resources and may divert management’s attention from our operations. We may be required to establish or increase reserves for potential losses from litigation, which could be material. To the extent we are unsuccessful in our defense of any lawsuit, we could suffer losses which could be in excess of any reserves established relating to that lawsuit) and these losses could be material.

Litigation of the type initiated against various trustees of residential mortgage-backed securitization transactions issued prior to financial crisis of 2007-2008 (“RMBS trustee litigation”) during 2017 negatively impacted, and could further negatively impact, the value of securities we hold, could expose us to indemnification claims, and could impact the profitability of our participation in future securitization transactions.

Litigation against RMBS trustees has related to, among other things, claims by certain investors in the RMBS issued in those transactions that the trustees of those transactions breached their obligations to investors by, among other things, not appropriately investigating and pursuing remedies against the originators and servicers of the underlying mortgage loans. We are not a party to any RMBS trustee litigation; however, RMBS trustee litigation has, in the past, negatively impacted the value of certain residential mortgage-backed securities issued prior to the crisis (“legacy RMBS”) that were held in our investment portfolio. The value of other legacy RMBS we continue to hold or acquire could be impacted in the future. In particular, trustees of various legacy RMBS transactions that have been the subject of RMBS trustee litigation have withheld funds from investors in the RMBS issued in those transactions by asserting that, pursuant to their indemnification rights against the securitization trusts established under the applicable transaction documents, they are entitled to apply those funds to offset litigation expenses. Further, certain trustees have asserted that their indemnification rights entitle them to withhold large lump sum amounts to hold and apply to anticipated future litigation expenses. Similar holdbacks by trustees of legacy RMBS transactions could result in losses to the value of our portfolio of securities in the future, which losses could be material.

Our acquisitions of 5 Arches and CoreVest could fail to improve our business or result in diminished returns, could expose us to new or increased risks, and could increase our cost of doing business.

During 2019, we completed the acquisitions of two business-purpose real estate loan origination platforms, 5 Arches and CoreVest, which we subsequently combined into one platform to originate business-purpose loans. Prior to the completion of these two acquisitions, we had not previously acquired an operating company, and we had not been engaged in directly originating mortgage loans since 2016, when we ceased our commercial origination and mortgage banking activities. If we experience challenges related to the acquisitions of the 5 Arches and CoreVest platforms that we did not anticipate or cannot mitigate, the returns we expected with respect to these investments may not be generated. For example, originating business-purpose mortgage loans could fail to improve our business or financial results if we do not have the opportunity to originate quality investments or if our estimates or projections of overall rates of return on such investments are incorrect. If our assumptions are wrong, or if market conditions change, we may, as a result, not have capital available for deployment into more profitable businesses and investments.

Our business-purpose loan origination platform is dependent upon conditions in the investor real estate market, and conditions that negatively impact this market may reduce demand for our loans and adversely impact our business, results of operations and financial condition. Our borrowers are primarily owners of residential rental and small multifamily properties, and residential properties for rehabilitation and subsequent resale or rental. Accordingly, the success of our business is closely tied to the overall success of the investors and small business owners in these markets. Various changes in real estate conditions may impact this market. Any negative trends in such real estate conditions may reduce demand for our products and services and, as a result, adversely affect our results of operations.

Directly originating mortgage loans could also expose us to new or increased risks, including increased regulation by federal and state authorities, challenges in effectively integrating operations, failure to maintain effective internal controls, procedures and policies, and other unknown liabilities and unforeseen increased expenses or delays associated with the acquisitions or the business of originating mortgage loans. Additionally, CoreVest engages in and sponsors securitization transactions relating to SFR mortgage loans, and in connection with the acquisition of CoreVest, we acquired, and we expect to continue to retain, mortgage-backed securities issued in CoreVest's securitization transactions. These securitization transactions and investments expose us to potentially material risks, in the same manner as described in the risk factor titled *“Through certain of our wholly-owned subsidiaries we have engaged in the past, and expect to continue to engage in, securitization transactions relating to real estate mortgage loans. In addition, we have invested in and continue to invest in mortgage-backed securities and other ABS issued in securitization transactions sponsored by other companies. These types of transactions and investments expose us to potentially material risks.”*

Additionally, in connection with our acquisitions of CoreVest and 5 Arches, a portion of the purchase price of each acquisition was allocated to goodwill and intangible assets. The amount of the purchase price which is allocated to goodwill and intangible assets is determined by the excess of the purchase price over the net identifiable assets acquired. Accounting standards require that we test goodwill and intangible assets for impairment at least annually (or more frequently if impairment indicators arise). As a result of the pandemic and its impact on our business, following an impairment assessment, we recorded a non-cash goodwill impairment expense and wrote down the entire \$89 million remaining value of our goodwill asset associated with these acquisitions. In conjunction with our assessment of goodwill, we also assessed our intangible assets for impairment at March 31, 2020 and determined they were not impaired. As of December 31, 2020, \$57 million of intangible assets were recorded on our consolidated balance sheet. If, in the future, we determine intangible assets are impaired, we will be required to write down the value of this asset, as we did with our goodwill asset, up to the entire balance. Any write-down would have a negative effect on our consolidated financial statements.

Our cash balances and cash flows may be insufficient relative to our cash needs.

We need cash to make interest payments, to post as collateral to counterparties and lenders who provide us with short-term debt financing and who engage in other transactions with us, for working capital, to fund REIT dividend distribution requirements, to comply with financial covenants and regulatory requirements, to fund general and administrative expenses, and for other needs and purposes. We may also need cash to repay short-term borrowings when due or in the event the fair values of assets that serve as collateral for that debt decline, the terms of short-term debt become less attractive, or for other reasons. In addition, we may need to use cash to post in response to margin calls relating to various derivative instruments we hold as the values of these derivatives change. Over the longer term, we may need cash to fund the repayment of outstanding convertible notes and exchangeable securities that mature in 2023, 2024, and 2025.

Our sources of cash flow include the principal and interest payments on the loans and securities we own, asset sales, securitizations, short-term borrowing, issuing long-term debt, and issuing stock. Our sources of cash may not be sufficient to satisfy our cash needs. Cash flows from principal repayments could be reduced if prepayments slow or if credit quality deteriorates. For example, for some of our assets, cash flows are “locked-out” and we receive less than our pro-rata share of principal payment cash flows in the early years of the investment.

Additionally, the effects of the pandemic could adversely impact our ability to access debt and equity capital on attractive terms, or at all. Any disruption and instability in the global financial markets or deteriorations in credit and financing conditions may affect our ability and mortgage loan borrowers' ability to make regular payments of principal and interest (e.g., due to unemployment, underemployment, or reduced income or revenues, including as a result of tenants' inability to make rental payments) or to access savings or capital necessary to fund business operations or replace or renew maturing liabilities on a timely basis, and may adversely affect the valuation of financial assets and liabilities. Any of foregoing circumstances could increase margin calls under our borrowing facilities, affect our ability to meet liquidity, net worth, and leverage covenants under our borrowing facilities or have a material adverse effect on the value of investment assets we hold or our business, financial condition, results of operations and cash flows.

Our minimum dividend distribution requirements could exceed our cash flows if our income as calculated for tax purposes significantly exceeds our net cash flows. This could occur when taxable income (including non-cash income such as discount amortization and interest accrued on negative amortizing loans) exceeds cash flows received. The Internal Revenue Code provides a limited relief provision concerning certain items of non-cash income; however, this provision may not sufficiently reduce our cash dividend distribution requirement. In the event that our liquidity needs exceed our access to liquidity, we may need to sell assets at an inopportune time, thus reducing our earnings. In an adverse cash flow situation, we may not be able to sell assets effectively and our REIT status or our solvency could be threatened. Further discussion of the risk associated with maintaining our REIT status is set forth in the risk factor titled *“We have elected to be taxed as a REIT and, as such, are required to meet certain tests in order to maintain our REIT status. This adds complexity and costs to running our business and exposes us to additional risks.”*

Initiating new business activities or significantly expanding existing business activities may expose us to new risks and will increase our cost of doing business.

Initiating new business activities or significantly expanding existing business activities, including through acquisitions, are two ways to grow our business and respond to changing circumstances in our industry; however, they may expose us to new risks and regulatory compliance requirements. We cannot be certain that we will be able to manage these risks and compliance requirements effectively. Furthermore, our efforts may not succeed and any revenues we earn from any new or expanded business initiative may not be sufficient to offset the initial and ongoing costs of that initiative, which would result in a loss with respect to that initiative.

For example, in recent years, we have announced several new initiatives to expand our mortgage banking and investment activities, including by expanding our mortgage loan purchase activity to include business-purpose loans secured by non-owner occupied rental properties and bridge loans, completing the acquisitions of two business-purpose real estate loan origination platforms, CoreVest and 5 Arches and entering the business of originating business-purpose loans, and optimizing the size and target returns of our investment portfolio. We have also made investments in subordinate securities backed by re-performing and non-performing residential loans, multifamily securities, shared equity appreciation real estate option contracts, excess MSR and servicer advance investments collateralized by residential and multifamily loans, and a whole loan investment fund created to acquire light-renovation multifamily loans. Further discussion of these business changes is set forth in the risk factor titled *“Decisions we make about our business strategy and investments, as well as decisions about raising capital or returning capital to shareholders (through dividends or common stock repurchases), could fail to improve our business and results of operations.”*

In connection with initiating new business activities or expanding existing business activities, or for other business reasons, we may create new subsidiaries. Frequently, these subsidiaries would be wholly-owned, directly or indirectly, by Redwood, but we may also create or participate in partnerships and joint ventures with third-party co-investors and in those cases, the entities may be partially-owned by Redwood. The creation of those subsidiaries may increase our administrative costs and expose us to other legal and reporting obligations, including, for example, because they may be incorporated in states other than Maryland or may be established in a foreign jurisdiction. Any new subsidiary we create may elect, together with us, to be treated as our taxable REIT subsidiary. Taxable REIT subsidiaries are wholly-owned or partially-owned subsidiaries of a REIT that pay corporate income tax on the income they generate. A taxable REIT subsidiary is not able to deduct its dividends paid to its parent in determining its taxable income and any dividends paid to the parent are generally recognized as income at the parent level.

Our future success depends on our ability to attract and retain key personnel.

Our future success depends on the continued service and availability of skilled personnel, including our executive officers and other business leaders that are part of our management team. To the extent personnel we attempt to hire, or have already hired, are concerned that economic, regulatory, or other factors could impact our ability to maintain or expand our current level of business, it could negatively impact our ability to hire or retain the personnel we need to operate our business. We cannot assure you that we will be able to attract and retain key personnel.

Additionally, the effects of the pandemic could adversely impact our financial condition and results of operations due to interrupted service and availability of personnel, and an inability to recruit, attract and retain skilled personnel. To the extent our management teams or personnel are impacted in significant numbers by the pandemic and are not available or allowed to conduct work, our business and operating results may be negatively impacted. Moreover, the negative impacts of the pandemic necessitated a reduction in our workforce in April 2020 and additional reductions in our workforce could become necessary if business or economic conditions deteriorate, which could negatively impact our business and results of operations. Additionally, the pandemic could negatively impact our ability to ensure operational continuity in the event our business continuity plan is not effective or ineffectually implemented or deployed during a disruption.

Our technology infrastructure and systems are important and any significant disruption or breach of the security of this infrastructure or these systems could have an adverse effect on our business. We also rely on technology infrastructure and systems of third parties who provide services to us and with whom we transact business.

We are dependent on the secure, efficient, and uninterrupted operation of our technology infrastructure, including computer systems, related software applications and data centers, as well as those of certain third parties and affiliates. Our websites and computer/telecommunication networks must accommodate a high volume of traffic and deliver frequently updated information, the accuracy and timeliness of which is critical to our business. Our technology must be able to facilitate loan application and loan acquisition experiences that equal or exceed the experience provided by our competitors. In addition, we rely on our computer hardware and software systems in order to analyze, acquire, and manage our investments, manage the operations and risks associated with our business, assets, and liabilities, and prepare our financial statements. Some of these systems are located at our offices and some are maintained by third party vendors or located at facilities maintained by third parties. We also rely on technology infrastructure and systems of third parties who provide services to us and with whom we transact business. Any significant interruption in the availability or functionality of these systems could impair our access to liquidity, damage our reputation, and have an adverse effect on our operations and on our ability to timely and accurately report our financial results.

We have or may in the future experience service disruptions and failures caused by system or software failure, fire, power outages, telecommunications failures, team member misconduct, human error, computer hackers, computer viruses and disabling devices, malicious or destructive code, denial of service or information, as well as natural disasters, the pandemic, and other similar events, and our business continuity and disaster recovery planning may not be sufficient for all situations. This is especially applicable in the current response to the pandemic and the shift we have experienced in having most of our team members work remotely for the time being, as our team members access our secure networks through their home networks. The implementation of technology changes and upgrades to maintain current and integrate new technology systems may also cause service interruptions. Any such disruption could interrupt or delay our ability to provide services to our loan sellers and loan applicants, and could also impair the ability of third parties to provide critical services to us.

In addition, any breach of the security of these systems could have an adverse effect on our operations and the preparation of our financial statements. Steps we have taken to provide for the security of our systems and data may not effectively prevent others from obtaining improper access to our systems data. Improper access could expose us to risks of data loss, reputational damage, increased regulatory scrutiny, litigation, and liabilities to third parties, and otherwise disrupt our operations.

We may not be able to make technological improvements as quickly as demanded by our loan sellers and borrowers, which could harm our ability to attract loan sellers and borrowers and adversely affect our results of operations, financial condition and liquidity.

The financial services industry is undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial and lending institutions to better serve clients and reduce costs. Our future success will depend, in part, upon our ability to address the needs of our loans sellers and borrowers by using technology, such as mobile and online services, to provide products and services that will satisfy demands for convenience, as well as to create additional efficiencies in our operations. We may not be able to effectively implement new technology-driven products and services as quickly as competitors or be successful in marketing these products and services to our loan sellers and borrowers. Failure to successfully keep pace with technological change affecting the financial services industry could harm our ability to attract loan sellers and borrowers and adversely affect our results of operations, financial condition and liquidity.

Our business could be adversely affected by deficiencies in our disclosure controls and procedures or internal controls over financial reporting.

The design and effectiveness of our disclosure controls and procedures and internal controls over financial reporting may not prevent all errors, misstatements, or misrepresentations. While management continues to review the effectiveness of our disclosure controls and procedures and internal controls over financial reporting, there can be no assurance that our disclosure controls and procedures or internal controls over financial reporting will be effective in accomplishing all control objectives all of the time. Deficiencies, particularly material weaknesses or significant deficiencies, in internal controls over financial reporting which have occurred or which may occur in the future could result in misstatements of our financial results, restatements of our financial statements, a decline in our stock price, or an otherwise material and adverse effect on our business, reputation, financial results, or liquidity and could cause investors and creditors to lose confidence in our reported financial results.

Our risk management efforts may not be effective.

We could incur substantial losses and our business operations could be disrupted if we are unable to effectively identify, manage, monitor, and mitigate financial risks, such as credit risk, interest rate risk, prepayment risk, liquidity risk, and other market-related risks, as well as operational risks related to our business, assets, and liabilities, such as mortgage operations risk, legal and compliance risk, human resources-related risk, cybersecurity and technology-related risk, and financial reporting risk. Our risk management policies, procedures, and techniques may not be sufficient to identify all of the risks we are exposed to, mitigate the risks we have identified for mitigation, or to identify additional risks to which we may become subject in the future. Expansion of our business activities, including through acquisitions such as our acquisitions of 5 Arches and CoreVest, generally also results in our being exposed to risks that we have not previously been exposed to or may increase our exposure to certain types of risks and we may not effectively identify, manage, monitor, and mitigate these risks as our business activity changes or increases. Further discussion is set forth in the risk factor titled *“Initiating new business activities or significantly expanding existing business activities may expose us to new risks and will increase our cost of doing business.”*

We could be harmed by misconduct or fraud that is difficult to detect.

We are exposed to risks relating to misconduct by our employees, contractors we use, or other third parties with whom we have relationships. For example, our employees could execute unauthorized transactions, use our assets improperly or without authorization, perform improper activities, use confidential information for improper purposes, or mis-record or otherwise try to hide improper activities from us. This type of misconduct could also relate to loan administration services that we provide for others. This type of misconduct can be difficult to detect and if not prevented or detected could result in claims or enforcement actions against us or losses. Accordingly, misconduct by employees, contractors, or others could subject us to losses or regulatory sanctions and seriously harm our reputation. Our controls may not be effective in detecting this type of activity.

Inadvertent errors, including, for example, errors in the implementation of information technology systems, could subject us to financial loss, litigation, or regulatory action.

Our employees, contractors we use, or other third parties with whom we have relationships may make inadvertent errors that could subject us to financial losses, claims, or enforcement actions. These types of errors could include, but are not limited to, mistakes in executing, recording, or reporting transactions we enter into for ourselves or with respect to assets we manage for others, or mistakes related to settling payment obligations, including with respect to wire transfers. Errors in the implementation of information technology systems, compliance systems and procedures, or other operational systems and procedures could also interrupt our business or subject us to financial losses, claims, or enforcement actions. Errors could also result in the inadvertent disclosure of mortgage-borrower non-public personal information. Inadvertent errors expose us to the risk of material losses until the errors are detected and remedied prior to the incurrence of any loss. The risk of errors may be greater for business activities that are new for us or have non-standardized terms, for areas of our business that we are expanding, or for areas of our business that rely on new employees or on third parties that we have only recently established relationships with.

Our business may be adversely affected if our reputation is harmed.

Our business is subject to significant reputational risks. If we fail, or appear to fail, to address various issues that may affect our reputation, our business could be harmed. Issues could include real or perceived legal or regulatory violations or be the result of a failure in governance, risk-management, technology, or operations. Similarly, market rumors and actual or perceived association with counterparties whose own reputation is under question could harm our business. Lawsuits brought against us (or the resolution of lawsuits brought against us), claims of employee misconduct, claims of wrongful termination, adverse publicity, conflicts of interest, ethical issues, or failure to maintain the security of our information technology systems or to protect non-public personal information could also cause significant reputational damages. Such reputational damage could result not only in an immediate financial loss, but could also result in a loss of business relationships, the ability to raise capital, the ability to recruit and retain human resources, and the ability to access liquidity through borrowing facilities.

Our financial results are determined and reported in accordance with generally accepted accounting principles (and related conventions and interpretations), or GAAP, and are based on estimates and assumptions made in accordance with those principles, conventions, and interpretations. Furthermore, the amount of dividends we are required to distribute as a REIT is driven by the determination of our income in accordance with the Internal Revenue Code rather than GAAP.

Our reported GAAP financial results differ from the taxable income results that drive our dividend distribution requirements and, therefore, our GAAP results may not be an accurate indicator of taxable income and dividend distributions.

Generally, the cumulative income we report relating to an investment asset will be the same for GAAP and tax purposes, although the timing of this recognition over the life of the asset could be materially different. There are, however, certain permanent differences in the recognition of certain expenses under the respective accounting principles applied for GAAP and tax purposes and these differences could be material. Thus, the amount of GAAP earnings reported in any given period may not be indicative of future dividend distributions. A further explanation of differences between our GAAP and taxable income is presented in “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*,” which is set forth in Part II, Item 7 of this Annual Report on Form 10-K.

Our minimum dividend distribution requirements are determined under the REIT tax laws and are based on our REIT taxable income as calculated for tax purposes pursuant to the Internal Revenue Code. Our Board of Directors may also decide to distribute more dividends than required based on these determinations. One should not expect that our retained GAAP earnings will equal cumulative distributions, as the Board of Directors’ dividend distribution decisions, permanent differences in GAAP and tax accounting, and even temporary differences may result in material differences in these balances.

Over time, accounting principles, conventions, rules, and interpretations may change, which could affect our reported GAAP and taxable earnings and stockholders’ equity.

Accounting rules for the various aspects of our business change from time to time. Changes in GAAP, or the accepted interpretation of these accounting principles, can affect our reported income, earnings, and stockholders’ equity. In addition, changes in tax accounting rules or the interpretations thereof could affect our taxable income and our dividend distribution requirements. Predicting and planning for these changes can be difficult.

Risks Related to Redwood's Legislative and Regulatory Matters Affecting our Industry

The termination of our subsidiary’s membership in the Federal Home Loan Bank of Chicago may limit our ability to acquire mortgage loans and securities to hold for investment and reduce our net interest income, which could negatively impact our business and operating results.

In June 2014, we announced that our wholly-owned captive insurance company subsidiary, RWT Financial, LLC, was approved as a member of the Federal Home Loan Bank of Chicago (“FHLBC”). This membership provided RWT Financial with access to attractive long-term collateralized financing for mortgage loans and securities. As a result of the economic and financial market impacts of the pandemic, the terms of our FHLBC facility evolved and we transferred or sold nearly all of our residential loans previously financed at the FHLBC, and repaid all but \$1 million of borrowings under this facility. We do not expect to increase borrowings under our FHLBC facility above the existing \$1 million of borrowings outstanding. Additionally, pursuant federal regulations adopted in January 2016 by the Federal Housing Finance Agency (“FHFA”), which is the regulator of the Federal Home Loan Bank System, RWT Financial’s membership in the FHLBC terminated in February 2021.

FHLBC financing enabled RWT Financial to earn attractive returns on loans held as long-term investments, contributing a significant amount to our earnings between 2014 and 2019. The expiration of RWT Financial's FHLBC membership may negatively impact us in a number of different ways, including, without limitation, by eliminating an attractive source of financing for our investment portfolio, limiting our ability to acquire (or the attractiveness of acquiring) residential and business-purpose mortgage loans to hold as long-term investments, and reducing net interest income earned by RWT Financial, any of which could negatively impact our business and operating results.

Changes to the U.S. federal income tax laws could have an adverse impact on the U.S. housing market, mortgage finance markets, and our business.

In December 2017, President Trump signed into law the Tax Cuts and Jobs Act (the “Tax Act”), which contained significant changes to the Internal Revenue Code for taxable years beginning in 2018. Among other things, the Tax Act reduced for individuals the annual residential mortgage-interest deduction for purchase money mortgage debt incurred after December 15, 2017, in taxable years beginning after December 31, 2017, and beginning before January 1, 2026, from \$1,000,000 (or \$500,000 in the case of married taxpayers filing separately) to \$750,000 (or \$375,000 in the case of married taxpayers filing separately), as well as eliminated for individuals the deduction for interest with respect to home equity indebtedness, with certain exceptions for indebtedness from refinancing existing indebtedness. The Tax Act also limits the state and local tax deduction for individuals to a combined \$10,000 for income, sales, and property taxes (for both single and married tax filers) in taxable years beginning after December 31, 2017, and beginning before January 1, 2026. The reduction or limitation of these tax deductions is a factor that, all other things being equal, would generally adversely affect home prices at the higher end of the housing market, particularly in states with high state and local taxes and property values. In addition, such changes increase taxes payable by certain borrowers, thereby reducing their available cash and adversely impacting their ability to make payment on the mortgage loans, which in turn, could cause a rise in delinquencies. The impact of these changes has yet to be fully determined, but the limitations on these deductions could have an adverse impact on the U.S. residential housing market, the market value of residential mortgage loans and residential mortgage-backed securities, and the volume of future originations of residential mortgage loans, particularly jumbo mortgage loans, all of which could negatively impact our business or financial results.

State and/or local rent control or rent stabilization regulations may reduce the value of single-family rental or multifamily properties collateralizing mortgage loans we own, or those underlying the securities or other investments we own. As a result, the value of these types of mortgage loans, securities, and other investments may be negatively impacted, which impacts could be material.

Numerous counties and municipalities, including those in which certain of the properties securing SFR and multifamily mortgage loans we own, or those underlying the securities or other investments we own, are located, impose rent control or rent stabilization rules on apartment buildings. These ordinances may limit rent increases to fixed percentages, to percentages of increases in the consumer price index, to increases set or approved by a governmental agency, or to increases determined through mediation or binding arbitration. In some jurisdictions, including, for example, New York City, many apartment buildings are subject to rent stabilization and some units are subject to rent control. These regulations, among other things, may limit the ability of single-family rental and multifamily property owners who have borrowed money (including in the form of mortgage debt) to finance their property or properties to raise rents above specified percentages. Any limitations on a borrower’s ability to raise property rents may impair such borrower’s ability to repair or renovate the mortgaged property or repay its mortgage loan.

Some states, counties and municipalities have imposed or may impose in the future stricter rent control regulations. For example, on June 14, 2019, the New York State Senate passed the Housing Stability and Tenant Protection Act of 2019 (the “HSTP Act”), which, among other things, limits the ability of landlords to increase rents in rent stabilized apartments in New York State at the time of lease renewal and after a vacancy. The HSTP Act also limits potential rent increases for major capital improvements and for individual apartment improvements in such rent stabilized apartments. In addition, the HSTP Act permits certain qualified localities in the State of New York to implement the rent stabilization system. In addition, the California State Assembly passed Assembly Bill 1482 (“AB 1482”), which, among other things, will prevent landlords in California from increasing the gross rental rate by more than 5% plus the percentage change in the cost of living in any 12-month period and require landlords to have “just cause” when evicting a tenant that has continuously and lawfully occupied a residential property for 12 months. Such “just cause” may include, among other things, the failure to pay rent, causing damage or destruction to the property, and assigning or subletting the premises in violation of the tenant’s lease. In addition, the Oregon State House passed Senate Bill 608 (“SB 608”), which, among other things, will limit rent increases to 7% each year, in addition to inflation, and would, in most cases, require landlords to provide notice and give a reason for evicting tenants. The HSTP Act, AB 1482 or SB 608 may reduce the value of the SFR and multifamily properties collateralizing mortgage loans we own, or those underlying the securities or other investments we own, that are located in the States of New York, California or Oregon, respectively, that are subject to the applicable rent control regulations. The value of SFR and multifamily mortgage loans, securities, and other investments we own may be negatively impacted by rent control or rent stabilization laws, regulations, or ordinances, which impacts may be material.

We may not be able to obtain or maintain the governmental licenses required to operate our business and we may fail to comply with various state and federal laws and regulations applicable to our business of acquiring residential mortgage loans and servicing rights and originating business-purpose real estate loans. We are approved to service residential mortgage loans sold to Freddie Mac and Fannie Mae and failure to maintain our status as an approved servicer could harm our business.

While we are not required to obtain licenses to purchase mortgage-backed securities, the purchase of residential and business-purpose mortgage loans in the secondary market, and the origination of business-purpose loans, may, in some circumstances, require us to maintain various state licenses. Acquiring the right to service residential mortgage loans and certain business-purpose mortgage loans may also, in some circumstances, require us to maintain various state licenses even though we currently do not expect to directly engage in loan servicing ourselves. As a result, we could be delayed in conducting certain business if we were first required to obtain a state license. We cannot assure you that we will be able to obtain all of the licenses we need or that we would not experience significant delays in obtaining these licenses. Furthermore, once licenses are issued we are required to comply with various information reporting and other regulatory requirements to maintain those licenses, and there is no assurance that we will be able to satisfy those requirements or other regulatory requirements applicable to our business of acquiring mortgage loans on an ongoing basis. Our failure to obtain or maintain required licenses or our failure to comply with regulatory requirements that are applicable to our business of acquiring or originating mortgage loans may restrict our business and investment options and could harm our business and expose us to penalties or other claims.

For example, under the Dodd-Frank Act, the CFPB also has regulatory authority over certain aspects of our business as a result of our residential mortgage banking activities, including, without limitation, authority to bring an enforcement action against us for failure to comply with regulations promulgated by the CFPB that are applicable to our business. One of the CFPB's areas of focus has been on whether companies like Redwood take appropriate steps to ensure that business arrangements with service providers do not present risks to consumers. The sub-servicers we retain to directly service residential mortgage loans (when we own the associated MSR) are among our most significant service providers with respect to our residential mortgage banking activities and our failure to take steps to ensure that these sub-servicers are servicing these residential mortgage loans in accordance with applicable law and regulation could result in enforcement action by the CFPB against us that could restrict our business, expose us to penalties or other claims, negatively impact our financial results, and damage our reputation.

As another example, rules under the Home Mortgage Disclosure Act (HMDA) that took effect in January 2018 impose expanded data collection requirements and additional reporting obligations on mortgage lenders and purchasers of residential mortgage loans. The expanded data collection requirements may result in a higher frequency of data errors, which in turn could be perceived by regulators as an indication of inadequate controls and poor compliance processes, and could lead to monetary civil penalties. Additionally, the availability of increased amounts of data may increase regulatory scrutiny of our mortgage loan purchasing patterns. In addition, the Equal Credit Opportunity Act, and other Federal and state laws and regulations that apply to certain of our investment and business activities, include consumer protections relating to discrimination, abusive and deceptive practices, and other consumer-related matters. To the extent these laws and regulations apply to us, our failure to comply with them, even if not intentional, could give rise to liabilities, fines, and remediation requirements, which could be material. Failure to comply with these laws and regulations could also result for incorrectly concluding that certain aspects of our investment and business activities are not subject to certain laws or regulations.

In addition, we are a servicer approved to service residential mortgage loans sold to Freddie Mac and Fannie Mae. As an approved servicer, we are required to conduct certain aspects of our operations in accordance with applicable policies and guidelines published by Freddie Mac and Fannie Mae. Failure to maintain our status as an approved servicer would mean we would not be able to service mortgage loans for these entities, or could otherwise restrict our business and investment options and could harm our business and expose us to losses or other claims.

With respect to mortgage loans we own, or which we have purchased and subsequently sold, we may be subject to liability for potential violations of the CFPB's TILA-RESPA Integrated Disclosure rule (also referred to as "TRID") or other similar consumer protection laws and regulations, which could adversely impact our business and financial results.

Federal consumer protection laws and regulations have been enacted and promulgated that are designed to regulate residential mortgage loan underwriting and originators' lending processes, standards, and disclosures to borrowers. These laws and regulations include the CFPB's "TRID", "ability-to-repay" and "qualified mortgage" regulations. In addition, there are various other federal, state, and local laws and regulations that are intended to discourage predatory lending practices by residential mortgage loan originators. For example, the federal Home Ownership and Equity Protection Act of 1994 (HOEPA) prohibits inclusion of certain provisions in residential mortgage loans that have mortgage rates or origination costs in excess of prescribed levels and requires that borrowers be given certain disclosures prior to origination. Some states have enacted, or may enact, similar laws or regulations, which in some cases may impose restrictions and requirements greater than those in place under federal laws and regulations. In addition, under the anti-predatory lending laws of some states, the origination of certain residential mortgage loans, including loans that are classified as "high cost" loans under applicable law, must satisfy a net tangible benefits test with respect to the borrower. This test, as well as certain standards set forth in the "ability-to-repay" and "qualified mortgage" regulations, may be highly subjective and open to interpretation. In particular, the CFPB's "qualified mortgage" regulations are in a transition phase beginning on March 1, 2021, during which both the current regulations and updated "qualified mortgage" regulations will be in effect, which may introduce interpretive and implementation questions and challenges. As a result, a court may determine that a residential mortgage loan did not meet the standard or test even if the originator reasonably believed such standard or test had been satisfied. Failure of residential mortgage loan originators or servicers to comply with these laws and regulations could subject us, as an assignee or purchaser of these loans (or as an investor in securities backed by these loans), to monetary penalties and defenses to foreclosure, including by recoupment or setoff of finance charges and fees collected, and could result in rescission of the affected residential mortgage loans, which could adversely impact our business and financial results. Moreover, the CFPB has announced that, with respect to the "qualified mortgage" regulations, they may continue to analyze the updated regulations and revisit whether additional updates should be made to these regulations, further introducing uncertainty around these regulations, which could negatively impact our residential mortgage banking business.

Environmental protection laws that apply to properties that secure or underlie our loan and investment portfolio could result in losses to us. We may also be exposed to environmental liabilities with respect to properties we become direct or indirect owners of or to which we take title, which could adversely affect our business and financial results.

Under the laws of several states, contamination of a property may give rise to a lien on the property to secure recovery of the cleanup costs. In certain of these states, such a lien has priority over the lien of an existing mortgage against the property, which could impair the value of an investment in a security we own backed by such a property or could reduce the value of such a property that underlies loans we have made or own. In addition, under the laws of some states and under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, we may be liable for costs of addressing releases or threatened releases of hazardous substances that require remedy at a property securing or underlying a loan we hold if our agents or employees have become sufficiently involved in the hazardous waste aspects of the operations of the borrower of that loan, regardless of whether or not the environmental damage or threat was caused by us or the borrower.

In the course of our business, we may take title to real estate or may otherwise become direct or indirect owners of real estate. If we do take title or become a direct or indirect owner, we could be subject to environmental liabilities with respect to the property, including liability to a governmental entity or third parties for property damage, personal injury, investigation, and clean-up costs. In addition, we may be required to investigate or clean up hazardous or toxic substances or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. If we ever become subject to significant environmental liabilities, our business and financial results could be materially and adversely affected.

Risks Related to Redwood's Capital, REIT and Legal/Organizational Structure

We have elected to be taxed as a REIT and, as such, are required to meet certain tests in order to maintain our REIT status. This adds complexity and costs to running our business and exposes us to additional risks.

Failure to qualify as a REIT could adversely affect our net income and dividend distributions and could adversely affect the value of our common stock.

We have elected to be taxed as a REIT for federal income tax purposes for all tax years since 1994. However, many of the requirements for qualification as a REIT are highly technical and complex and require an analysis of particular facts and an application of the legal requirements to those facts in situations where there is only limited judicial and administrative guidance. Thus, we cannot assure you that the Internal Revenue Service (the "IRS") or a court would agree with our conclusion that we have qualified as a REIT historically, or that changes to our investments or business or the law will not cause us to fail to qualify as a REIT in the future. Furthermore, in an environment where assets may quickly change in value, previous planning for compliance with REIT qualification rules may be disrupted. If we failed to qualify as a REIT for federal income tax purposes and did not meet the requirements for statutory relief, we would be subject to federal corporate income tax on our taxable income, and we would not be allowed a deduction for distributions to shareholders in computing our taxable income. In such a case, we may need to borrow money or sell assets in order to pay the taxes due, even if the market conditions are not favorable for such sales or borrowings. In addition, unless we are entitled to relief under applicable statutory provisions, we could not elect to be taxed as a REIT for four years thereafter. Failure to qualify as a REIT could adversely affect our dividend distributions and could adversely affect the value of our common stock.

Maintaining REIT status and avoiding the generation of excess inclusion income at Redwood Trust, Inc. and certain of our subsidiaries may reduce our flexibility and could limit our ability to pursue certain opportunities. Failure to appropriately structure our business and transactions to comply with laws and regulations applicable to REITs could have adverse consequences.

To maintain REIT status, we must follow certain rules and meet certain tests. In doing so, our flexibility to manage our operations may be reduced. For instance:

- Compliance with the REIT income and asset rules, or uncertainty about the application of those rules to certain investments, may result in our holding investments in our taxable REIT subsidiaries (where any income they produce is subject to corporate-level taxation) when we would prefer to hold those investments in an entity that is taxed as a REIT (where they generally would not be subject to corporate-level taxation).
- Compliance with the REIT income and asset rules may limit the type or extent of financing or hedging that we can undertake.
- Our ability to own non-real estate assets and earn non-real estate related income is limited, and the rules for classifying assets and income are complicated. Our ability to own equity interests in other entities is also limited. If we fail to comply with these limits, we may be forced to liquidate attractive investments on short notice on unfavorable terms in order to maintain our REIT status.
- We generally use taxable REIT subsidiaries to own non-real estate assets and engage in activities that may give rise to non-real estate related income under the REIT rules. However, our ability to invest in taxable REIT subsidiaries is limited under the REIT rules. No more than 20% of the value of our total assets can be represented by securities of one or more taxable REIT subsidiaries. Maintaining compliance with this limit could require us to constrain the growth of our taxable REIT subsidiaries (and the business and investing activities they conduct) in the future.
- Meeting minimum REIT dividend distribution requirements could reduce our liquidity. We may earn non-cash REIT taxable income due to timing and/or character mismatches between the computation of our income for tax and accounting purposes. Earning non-cash REIT taxable income could necessitate our selling assets, incurring debt, or raising new equity in order to fund dividend distributions.
- We could be viewed as a "dealer" with respect to certain transactions and become subject to a 100% prohibited transaction tax or other entity-level taxes on income from such transactions.

Furthermore, the rules we must follow and the tests we must satisfy to maintain our REIT status may change, or the interpretation of these rules and tests by the IRS may change.

In addition, our stated goal has been to not generate excess inclusion income at Redwood Trust, Inc. and certain of its subsidiaries that would be taxable as unrelated business taxable income (“UBTI”) to our tax-exempt shareholders. Achieving this goal has limited, and may continue to limit, our flexibility in pursuing certain transactions or has resulted in, and may continue to result in, our having to pursue certain transactions through a taxable REIT subsidiary, which would reduce the net returns on these transactions by the associated tax liabilities payable by such subsidiary. Despite our efforts to do so, we may not be able to avoid creating or distributing UBTI to our shareholders.

To maintain our REIT status, we may be forced to borrow funds during unfavorable market conditions, and the unavailability of such capital on favorable terms at the desired times, or at all, may cause us to curtail our investment activities and/or to dispose of assets at inopportune times, which could adversely affect our financial condition, results of operations, cash flow and per share trading price of our common stock.

To qualify as a REIT, we generally must distribute to our shareholders at least 90% of our REIT taxable income each year (excluding any net capital gains), and we will be subject to regular corporate income taxes to the extent that we distribute less than 100% of our REIT taxable income each year. In addition, we will be subject to a 4% nondeductible excise tax on the amount, if any, by which distributions we pay in any calendar year are less than the sum of 85% of our ordinary income, 95% of our net capital gains, and 100% of our undistributed income from prior years. To maintain our REIT status and avoid the payment of federal income and excise taxes, we may need to borrow funds to meet the REIT distribution requirements, even if the then-prevailing market conditions are not favorable for these borrowings. These borrowing needs could result from differences in timing between the actual receipt of income and inclusion of income for federal income tax purposes. For example, we may be required to accrue interest and discount income on mortgage loans, MBS, and other types of debt securities or interests in debt securities before we receive any payments of interest or principal on such assets. Our access to third-party sources of capital depends on a number of factors, including the market’s perception of our growth potential, our current debt levels, the market price of our common stock, and our current and potential future earnings. We cannot assure you that we will have access to such capital on favorable terms at the desired times, or at all, which may cause us to curtail our investment activities and/or to dispose of assets at inopportune times, and could adversely affect our financial condition, results of operations, cash flow and per share trading price of our common stock.

Dividends payable by REITs, including us, generally do not qualify for the reduced tax rates available for some dividends.

The maximum U.S. federal income tax rate for qualified dividends paid by domestic non-REIT corporations to U.S. stockholders that are individuals, trust or estates is generally 20%. Although dividends paid by REITs to such stockholders are generally not eligible for that rate (subject to limited exceptions), such stockholders may deduct up to 20% of ordinary dividends from a REIT for taxable years beginning before January 1, 2026. Although this deduction reduces the effective tax rate applicable to certain dividends paid by REITs, such tax rate is still higher than the tax rate applicable to regular corporate qualified dividends. This may cause investors to view REIT investments as less attractive than investments in non-REIT corporations, which in turn may adversely affect the value of shares of REITs, including the shares of our common stock.

The failure of mortgage loans or MBS subject to a repurchase agreement or a mezzanine loan to qualify as a real estate asset would adversely affect our ability to qualify as a REIT.

When we enter into short-term financing arrangements in the form of repurchase agreements, we will sell certain of our assets to a counterparty and simultaneously enter into an agreement to repurchase the sold assets. We believe that we will be treated for U.S. federal income tax purposes as the owner of the assets that are the subject of any such agreements notwithstanding that such agreements may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the assets during the term of the repurchase agreement, in which case we could fail to qualify as a REIT.

In addition, we have and may continue to acquire mezzanine loans. Mezzanine loans are loans secured by equity interests in a partnership or limited liability company that directly or indirectly owns real estate. In Revenue Procedure 2003-65, the IRS provided a safe harbor pursuant to which a mezzanine loan, if it meets each of the requirements contained in the Revenue Procedure, will be treated by the IRS as a real estate asset for purposes of the REIT asset tests, and interest derived from the mezzanine loan will be treated as qualifying mortgage interest for purposes of the REIT 75% gross income test. Although the Revenue Procedure provides a safe harbor on which taxpayers may rely, it does not prescribe rules of substantive tax law. We believe that the mezzanine loans that we have treated as real estate assets generally met all of the requirements for reliance on this safe harbor. However, there can be no assurance that the IRS will not challenge the tax treatment of these mezzanine loans, and if such a challenge were sustained, we could in certain circumstances be required to pay a penalty tax or fail to qualify as a REIT.

Changes in tax rules could adversely affect REITs and could adversely affect the value of our common stock.

The rules addressing federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the U.S. Department of the Treasury. Any future changes in the regulations or tax laws applicable to REITs or to mortgage related financial products could negatively impact our operations or reduce any competitive advantages we may have relative to non-REIT entities, either of which could reduce the value of our common stock.

The application of the tax laws to our business is complicated, and we may not interpret and apply some of the rules and regulations correctly. In addition, we may not make all available elections, which could result in our not being able to fully benefit from available deductions or benefits. Furthermore, the elections, interpretations and applications we do make could be deemed by the IRS to be incorrect and could have adverse impacts on our GAAP earnings and potentially on our REIT status.

The Internal Revenue Code may change and/or the interpretation of the rules and regulations by the IRS may change. In circumstances where the application of these rules and regulations affecting our business is not clear, we may have to interpret them and their application to us. We seek the advice of outside tax advisors in arriving at these interpretations, but our interpretations may prove to be wrong, which could have adverse consequences.

Our tax payments and dividend distributions, which are intended to meet the REIT distribution requirements, are based in large part on our estimate of taxable income which includes the application and interpretation of a variety of tax rules and regulations. While there are some relief provisions should we incorrectly interpret certain rules and regulations, we may not be able to fully take advantage of these provisions, and this could have an adverse effect on our REIT status. In addition, our GAAP earnings include tax provisions and benefits based on our estimates of taxable income and should our estimates prove to be wrong, we could have to make an adjustment to our tax provisions and this adjustment could be material.

Our decisions about raising, managing, and distributing our capital may adversely affect our business and financial results. Furthermore, our growth may be limited if we are not able to raise additional capital.

We are required to distribute at least 90% of our REIT taxable income as dividends to shareholders. Thus, we do not generally have the ability to retain all of the earnings generated by our REIT and, to a large extent, we rely on our ability to raise capital to grow. We may raise capital through the issuance of new shares of our common stock, either through our direct stock purchase and dividend reinvestment plan or through public or private offerings. We may also raise capital by issuing other types of securities, such as preferred stock, convertible or exchangeable debt, or other types of debt securities. As of December 31, 2020, we had approximately 158 million unissued shares of stock authorized for issuance under our charter (although approximately 50 million of these shares are reserved for issuance under our equity compensation plans, dividend reinvestment and stock purchase plan, ATM offering program, and outstanding convertible notes and exchangeable notes). The number of our unissued shares of stock authorized for issuance establishes a limit on the amount of capital we can raise through issuances of shares of stock or securities convertible into, or exchangeable for, shares of stock, unless we seek and receive approval from our shareholders to increase the authorized number of our shares in our charter. Also, certain stock change of ownership tests may limit our ability to raise significant amounts of equity capital or could limit our future use of tax losses to offset income tax obligations if we raise significant amounts of equity capital.

In addition, we may not be able to raise capital at times when we need capital or see opportunities to invest capital. Many of the same factors that could make the pricing for investments in real estate loans and securities attractive, such as the availability of assets from distressed owners who need to liquidate them at reduced prices, and uncertainty about credit risk, housing, and the economy, may limit investors' and lenders' willingness to provide us with additional capital on terms that are favorable to us, if at all. There may be other reasons we are not able to raise capital and, as a result, may not be able to finance growth in our business and in our portfolio of assets. If we are unable to raise capital and expand our business and our portfolio of investments, our growth may be limited, we may have to forgo attractive business and investment opportunities, and our general and administrative expenses may increase significantly relative to our capital base. Alternatively, we may need to raise capital on unfavorable terms, which may lead to greater dilution of existing shareholders, higher interest costs, or higher transaction costs.

To the extent we have capital that is available for investment, we have broad discretion over how to invest that capital and our shareholders and other investors will be relying on the judgment of our management regarding its use. To the extent we invest capital in our business or in portfolio assets, we may not be successful in achieving favorable returns.

Conducting our business in a manner so that we are exempt from registration under, and in compliance with, the Investment Company Act may reduce our flexibility and could limit our ability to pursue certain opportunities. At the same time, failure to continue to qualify for exemption from the Investment Company Act could adversely affect us.

Under the Investment Company Act, an investment company is required to register with the SEC and is subject to extensive restrictive and potentially adverse regulations relating to, among other things, operating methods, management, capital structure, dividends, and transactions with affiliates. However, companies primarily engaged in the business of acquiring mortgages and other liens on and interests in real estate are generally exempt from the requirements of the Investment Company Act. We believe that we have conducted our business so that we are not subject to the registration requirements of the Investment Company Act. In order to continue to do so, however, Redwood and each of our subsidiaries must either operate so as to fall outside the definition of an investment company under the Investment Company Act or satisfy its own exclusion under the Investment Company Act. For example, to avoid being defined as an investment company, an entity may limit its ownership or holdings of investment securities to less than 40% of its total assets. In order to satisfy an exclusion from being defined as an investment company, other entities, among other things, maintain at least 55% of their assets in certain qualifying real estate assets (the 55% Requirement) and also maintain an additional 25% of their assets in such qualifying real estate assets or certain other types of real estate-related assets (the 25% Requirement). Rapid changes in the values of assets we own, however, can disrupt prior efforts to conduct our business to meet these requirements.

If Redwood or one of our subsidiaries fell within the definition of an investment company under the Investment Company Act and failed to qualify for an exclusion or exemption, including, for example, if it was required to and failed to meet the 55% Requirement or the 25% Requirement, it could, among other things, be required either (i) to change the manner in which it conducts operations to avoid being required to register as an investment company or (ii) to register as an investment company, either of which could adversely affect us by, among other things, requiring us to dispose of certain assets or to change the structure of our business in ways that we may not believe to be in our best interests. Legislative or regulatory changes relating to the Investment Company Act or which affect our efforts to qualify for exclusions or exemptions, including our ability to comply with the 55% Requirement and the 25% Requirement, could also result in these adverse effects on us.

If we were deemed an unregistered investment company, we could be subject to monetary penalties and injunctive relief and we could be unable to enforce contracts with third parties and third parties could seek to obtain rescission of transactions undertaken during the period we were deemed an unregistered investment company, unless the court found that under the circumstances, enforcement (or denial of rescission) would produce a more equitable result than no enforcement (or grant of rescission) and would not be inconsistent with the Investment Company Act.

Provisions in our charter and bylaws and provisions of Maryland law may limit a change in control or deter a takeover that might otherwise result in a premium price being paid to our shareholders for their shares in Redwood.

In order to maintain our status as a REIT, not more than 50% in value of our outstanding capital stock may be owned, actually or constructively, by five or fewer individuals (defined in the Internal Revenue Code to include certain entities). In order to protect us against the risk of losing our status as a REIT due to concentration of ownership among our shareholders and for other reasons, our charter generally prohibits any single shareholder, or any group of affiliated shareholders, from beneficially owning more than 9.8% of the outstanding shares of any class of our stock, unless our Board of Directors waives or modifies this ownership limit. This limitation may have the effect of precluding an acquisition of control of us by a third party without the consent of our Board of Directors. Our Board of Directors has granted a limited number of waivers to institutional investors to own shares in excess of this 9.8% limit, which waivers are subject to certain terms and conditions. Our Board of Directors may amend these existing waivers to permit additional share ownership or may grant waivers to additional shareholders at any time.

Certain other provisions contained in our charter and bylaws and in the Maryland General Corporation Law (“MGCL”) may have the effect of discouraging a third party from making an acquisition proposal for us and may therefore inhibit a change in control. For example, our charter includes provisions granting our Board of Directors the authority to issue preferred stock from time to time and to establish the terms, preferences, and rights of the preferred stock without the approval of our shareholders. Provisions in our charter and the MGCL also restrict our shareholders’ ability to remove directors and fill vacancies on our Board of Directors and restrict unsolicited share acquisitions. These provisions and others may deter offers to acquire our stock or large blocks of our stock upon terms attractive to our shareholders, thereby limiting the opportunity for shareholders to receive a premium for their shares over then-prevailing market prices.

The ability to take action against our directors and officers is limited by our charter and bylaws and provisions of Maryland law and we may (or, in some cases, are obligated to) indemnify our current and former directors and officers against certain losses relating to their service to us.

Our charter limits the liability of our directors and officers to us and to shareholders for pecuniary damages to the fullest extent permitted by Maryland law. In addition, our charter and bylaws together require us to indemnify our officers and directors (and those of our subsidiaries and affiliates) to the maximum extent permitted by Maryland law in the defense of any proceeding to which he or she is made, or threatened to be made, a party because of his or her service to us. In addition, we have entered into, and may in the future enter into, indemnification agreements with our directors and certain of our officers and the directors and certain of the officers of certain of our subsidiaries and affiliates which obligate us to indemnify them against certain losses relating to their service to us and the related costs of defense.

Other Risks Related to Ownership of Our Common Stock

Investing in our common stock may involve a high degree of risk. Investors in our common stock may experience losses, volatility, and poor liquidity, and we may reduce our dividends in a variety of circumstances.

An investment in our common stock may involve a high degree of risk, particularly when compared to other types of investments. Risks related to the economy, the financial markets, our industry, our investing activity, our other business activities, our financial results, the amount of dividends we distribute, the manner in which we conduct our business, and the way we have structured our operations could result in a reduction in, or the elimination of, the value of our common stock. The level of risk associated with an investment in our common stock may not be suitable for the risk tolerance of many investors. Investors may experience volatile returns and material losses. In addition, the trading volume of our common stock (i.e., its liquidity) may be insufficient to allow investors to sell their common stock when they want to or at a price they consider reasonable.

Our earnings, cash flows, book value, and dividends can be volatile and difficult to predict. Investors in our common stock should not rely on our estimates, projections, or predictions, or on management's beliefs about future events. In particular, the sustainability of our earnings and our cash flows will depend on numerous factors, including our level of business and investment activity, our access to debt and equity financing, the returns we earn, the amount and timing of credit losses, prepayments, the expense of running our business, and other factors, including the risk factors described herein. As a consequence, although we seek to pay a regular common stock dividend that is sustainable, we may reduce our regular dividend rate, or stop paying dividends, in the future for a variety of reasons. We may not provide public warnings of dividend reductions prior to their occurrence. Although we have paid special dividends in the past, we have not paid a special dividend since 2007 and we may not do so in the future. Changes to the amount of dividends we distribute may result in a reduction in the value of our common stock.

A limited number of institutional shareholders own a significant percentage of our common stock, which could have adverse consequences to other holders of our common stock.

As of February 16, 2021, based on filings of Schedules 13D and 13G with the SEC, we believe that three institutional shareholders each owned approximately 5% or more of our outstanding common stock (and we believe one of these shareholders owned approximately 18% of our outstanding common stock) and we believe based on data obtained from other public sources that, overall, institutional shareholders owned, in the aggregate, more than 75% of our outstanding common stock. Furthermore, one or more of these investors or other investors could significantly increase their ownership of our common stock, including through the conversion of outstanding convertible or exchangeable notes into shares of common stock. Significant ownership stakes held by these individual institutions or other investors could have adverse consequences for other shareholders because each of these shareholders will have a significant influence over the outcome of matters submitted to a vote of our shareholders, including the election of our directors and transactions involving a change in control. In addition, should any of these significant shareholders determine to liquidate all or a significant portion of their holdings of our common stock, it could have an adverse effect on the market price of our common stock.

Although, under our charter, shareholders are generally precluded from beneficially owning more than 9.8% of our outstanding common stock, our Board of Directors may amend existing ownership-limitation waivers or grant waivers to other shareholders in the future, in each case in a manner which may allow for increases in the concentration of the ownership of our common stock held by one or more shareholders.

Future sales of our common stock by us or by our officers and directors may have adverse consequences for investors.

We may issue additional shares of common stock, or securities convertible into, or exchangeable for, shares of common stock, in public offerings or private placements, and holders of our outstanding convertible notes or exchangeable securities may convert those securities into shares of common stock. In addition, we may issue additional shares of common stock to participants in our direct stock purchase and dividend reinvestment plan and to our directors, officers, and employees under our employee stock purchase plan, our incentive plan, or other similar plans, including upon the exercise of, or in respect of, distributions on equity awards previously granted thereunder. We are not required to offer any such shares to existing shareholders on a preemptive basis. Therefore, it may not be possible for existing shareholders to participate in future share issuances, which may dilute existing shareholders' interests in us. In addition, if market participants buy shares of common stock, or securities convertible into, or exchangeable for, shares of common stock, in issuances by us in the future, it may reduce or eliminate any purchases of our common stock they might otherwise make in the open market, which in turn could have the effect of reducing the volume of shares of our common stock traded in the marketplace, which could have the effect of reducing the market price and liquidity of our common stock.

At February 17, 2021, our directors and executive officers beneficially owned, in the aggregate, approximately 2% of our common stock. Sales of shares of our common stock by these individuals are generally required to be publicly reported and are tracked by many market participants as a factor in making their own investment decisions. As a result, future sales by these individuals could negatively affect the market price of our common stock.

Dividend distributions on our common stock may not be declared or paid or dividends may decrease over time. Dividends may be paid in shares of common stock, cash or a combination of shares of common stock and cash. Changes in the amount and timing of dividend distributions we pay or in the tax characterization of dividend distributions we pay may adversely affect the market price of our common stock or may result in holders of our common stock being taxed on dividend distributions at a higher rate than initially expected.

Our dividend distributions are driven by a variety of factors, including our minimum dividend distribution requirements under the REIT tax laws and our REIT taxable income as calculated pursuant to the Internal Revenue Code. We are generally required to distribute to our stockholders at least 90% of our REIT taxable income, although our reported financial results for GAAP purposes may differ materially from our REIT taxable income.

In the year ended December 31, 2019, we paid \$129.5 million of cash dividends on our common stock, representing cumulative dividends of \$1.20 per share. For 2020, as a result of the impact of the pandemic on our business, we reduced cash dividend payments on our common stock to \$84.0 million, representing cumulative dividends of \$0.725 per share.

Our ability to continue to pay quarterly dividends in the future may be adversely affected by a number of factors, including the risk factors described in this Annual Report on Form 10-K for the year ended December 31, 2020. Further, we may consider paying future dividends, if at all, in shares of common stock, cash, or a combination of shares of common stock and cash. Any decision regarding the composition of such dividends would be made following an analysis and review of our liquidity, including our cash balances and cash flows, at the time of payment of the dividend. For example, we may determine to distribute shares of common stock in lieu of cash, or in combination with cash, in respect of our dividend obligations, which, among other things, could result in dilution to existing stockholders.

To the extent we determine that future dividends would represent a return of capital to investors or would not be required under applicable REIT tax laws and regulations, rather than the distribution of income, we may determine to discontinue dividend payments until such time that dividends would again represent a distribution of income or be required under applicable REIT tax laws and regulations. Any reduction or elimination of our payment of dividend distributions would not only reduce the amount of dividends you would receive as a holder of our common stock, but could also have the effect of reducing the market price of our common stock and our ability to raise capital in future securities offerings.

In addition, the rate at which holders of our common stock are taxed on dividends we pay and the characterization of our dividend — be it ordinary income, capital gains, or a return of capital — could have an impact on the market price of our common stock. After we announce the expected characterization of dividend distributions we have paid, the actual characterization (and, therefore, the rate at which holders of our common stock are taxed on the dividend distributions they have received) could vary from our expectations, including due to errors, changes made in the course of preparing our corporate tax returns, or changes made in response to an audit by the IRS, with the result that holders of our common stock could incur greater income tax liabilities than expected.

We may pay taxable dividends in our common stock and cash, in which case stockholders may sell shares of our common stock to pay tax on such dividends, placing downward pressure on the market price of our common stock.

We may satisfy the REIT 90% distribution test with taxable distributions of our common stock. The IRS has issued Revenue Procedure 2017-45 authorizing elective cash/stock dividends to be made by “publicly offered REITs.” Pursuant to Revenue Procedure 2017-45, as modified by Revenue Procedure 2020-19, the IRS will treat the distribution of stock pursuant to an elective cash/stock dividend as a distribution of property under Section 301 of the Internal Revenue Code (i.e., a dividend), as long as at least 20% of the total dividend (or 10% for dividends declared after April 1, 2020 and before December 31, 2020) is available in cash and certain other parameters detailed in the Revenue Procedure are satisfied.

If we make a taxable dividend payable in cash and common stock, taxable stockholders receiving such dividends will be required to include the full amount of the dividend as ordinary income to the extent of our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. As a result, stockholders may be required to pay income tax with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the common stock that it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our common stock at the time of the sale. Furthermore, with respect to certain non-U.S. stockholders, we may be required to withhold U.S. federal income tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in common stock. If we make a taxable dividend payable in cash and our common stock and a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock.

The market price of our common stock could be negatively affected by various factors, including broad market fluctuations.

The market price of our common stock may be negatively affected by various factors, which change from time to time. Some of these factors are:

- Our actual or anticipated financial condition, performance, and prospects and those of our competitors.
- The market for similar securities issued by other REITs and other competitors of ours.
- Changes in the manner that investors and securities analysts who provide research to the marketplace on us analyze the value of our common stock.
- Changes in recommendations or in estimated financial results published by securities analysts who provide research to the marketplace on us, our competitors, or our industry.
- General economic and financial market conditions, including, among other things, actual and projected interest rates, prepayments, and credit performance and the markets for the types of assets we hold or invest in.
- Proposals to significantly change the manner in which financial markets, financial institutions, and related industries, or financial products are regulated under applicable law, or the enactment of such proposals into law or regulation.
- Other events or circumstances which undermine confidence in the financial markets or otherwise have a broad impact on financial markets, such as the sudden instability or collapse of large financial institutions or other significant corporations (whether due to fraud or other factors), terrorist attacks, natural or man-made disasters, the outbreak of pandemic or epidemic disease, or threatened or actual armed conflicts.

Furthermore, these fluctuations do not always relate directly to the financial performance of the companies whose stock prices may be affected. As a result of these and other factors, investors who own our common stock could experience a decrease in the value of their investment, including decreases unrelated to our financial results or prospects.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal executive and administrative office is located in Mill Valley, California and we have additional offices, including at the locations listed below. We do not own any properties and lease the space we utilize for our offices. Additional information on our leases is included in *Note 16* to the Financial Statements within this Annual Report on Form 10-K. The following table presents the locations and remaining lease terms of our primary offices.

Executive and Administrative Office Locations and Lease Expirations

<u>Location</u>	<u>Lease Expiration</u>
One Belvedere Place, Suite 300 Mill Valley, CA 94941	2028
8310 South Valley Highway, Suite 425 Englewood, CO 80112	2031
4 Park Plaza, Suite 900 Irvine, CA 92614	2024
650 Fifth Avenue, Suite 2120 New York, NY 10019	2023

ITEM 3. LEGAL PROCEEDINGS

For information on our legal proceedings, see *Note 16* to the Financial Statements within this Annual Report on Form 10-K under the heading "Loss Contingencies - Litigation, Claims and Demands."

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed and traded on the NYSE under the symbol RWT. At February 17, 2021, our common stock was held by approximately 583 holders of record and the total number of beneficial stockholders holding stock through depository companies was approximately 31,056. At February 22, 2021, there were 112,090,006 shares of common stock outstanding.

The cash dividends declared on our common stock for each full quarterly period during 2020 and 2019 were as follows:

	Common Dividends Declared			
	Record Date	Payable Date	Per Share	Dividend Type
<u>Year Ended December 31, 2020</u>				
Fourth Quarter	12/17/2020	12/29/2020	\$ 0.14	Regular
Third Quarter	9/22/2020	9/29/2020	\$ 0.14	Regular
Second Quarter	6/22/2020	6/29/2020	\$ 0.125	Regular
First Quarter	3/16/2020	3/30/2020	\$ 0.32	Regular
<u>Year Ended December 31, 2019</u>				
Fourth Quarter	12/16/2019	12/30/2019	\$ 0.30	Regular
Third Quarter	9/16/2019	9/30/2019	\$ 0.30	Regular
Second Quarter	6/14/2019	6/28/2019	\$ 0.30	Regular
First Quarter	3/15/2019	3/29/2019	\$ 0.30	Regular

All dividend distributions are made with the authorization of the board of directors at its discretion and will depend on such items as our GAAP net income, REIT taxable income, financial condition, maintenance of REIT status, and other factors that the board of directors may deem relevant from time to time. The holders of our common stock share proportionally on a per share basis in all declared dividends on common stock. As reported on our Current Report on Form 8-K on January 28, 2021, for dividend distributions made in 2020, we expect our dividends paid in 2020 to be characterized as 100% return of capital. None of the dividend distributions made in 2020 are expected to be characterized for federal income tax purposes as ordinary income, long-term capital gains, or qualified dividends.

During the year ended December 31, 2020, we did not sell any equity securities that were not registered under the Securities Act of 1933, as amended. In February 2018, our Board of Directors approved an authorization for the repurchase of our common stock, increasing the total amount authorized for repurchases of common stock to \$100 million, and also authorized the repurchase of outstanding debt securities, including convertible and exchangeable debt. This authorization increased the previous share repurchase authorization approved in February 2016 and has no expiration date. This repurchase authorization does not obligate us to acquire any specific number of shares or securities. Under this authorization, shares or securities may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended. During the year ended December 31, 2020, we repurchased 3,047,335 shares of our common stock pursuant to this authorization for \$22 million. At December 31, 2020, \$78 million of this current total authorization remained available for repurchases of shares of our common stock.

The following table contains information on the shares of our common stock that we purchased or otherwise acquired during the three months ended December 31, 2020.

(In Thousands, except Per Share Data)	Total Number of Shares Purchased or Acquired	Average Price per Share Paid	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or approximate dollar value) of Shares that May Yet be Purchased under the Plans or Programs
October 1, 2020 - October 31, 2020	— ⁽¹⁾	\$ 7.52	—	\$ —
November 1, 2020 - November 30, 2020	—	\$ —	—	\$ —
December 1, 2020 - December 31, 2020	—	\$ —	—	\$ 78,369
Total	—	\$ 7.52	—	\$ 78,369

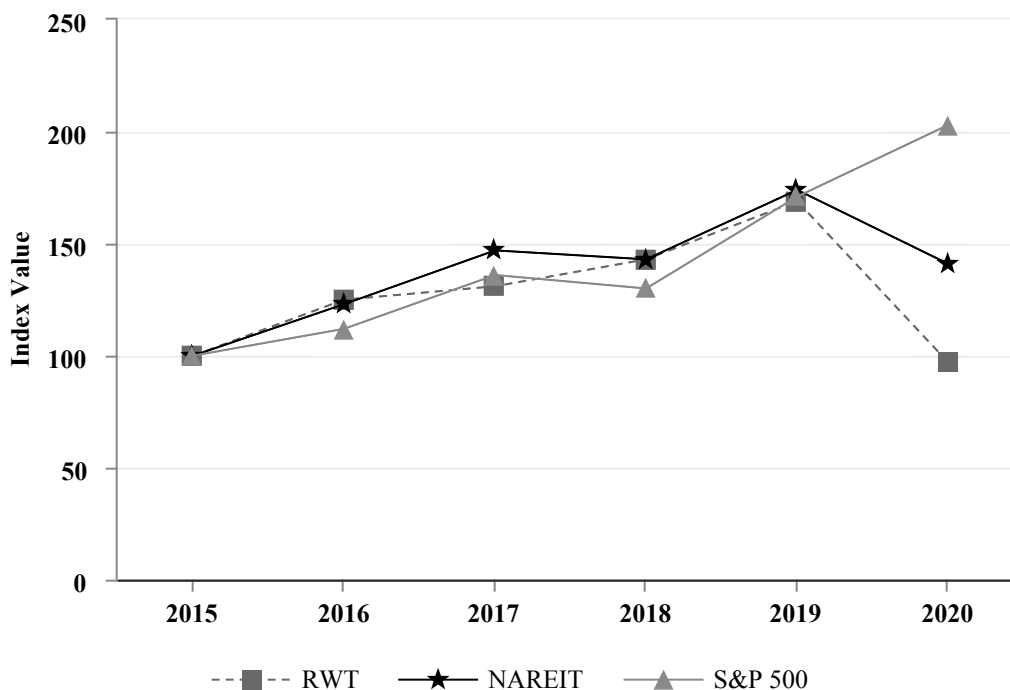
(1) Represents fewer than 1,000 shares reacquired to satisfy tax withholding requirements related to the vesting of restricted shares.

Information with respect to compensation plans under which equity securities of the registrant are authorized for issuance is set forth in Part II, Item 12 of this Annual Report on Form 10-K.

Performance Graph

The following graph presents a cumulative total return comparison of our common stock, over the last five years, to the S&P Composite-500 Stock Index and the National Association of Real Estate Investment Trusts, Inc. (“NAREIT”) Mortgage REIT index. The total returns reflect stock price appreciation and the reinvestment of dividends for our common stock and for each of the comparative indices, assuming that \$100 was invested in each on December 31, 2015. The information has been obtained from sources believed to be reliable; but neither its accuracy nor its completeness is guaranteed. The total return performance shown on the graph is not necessarily indicative of future performance of our common stock.

**Five Year - Cumulative Total Return Comparison
December 31, 2015 through December 31, 2020**



	2015	2016	2017	2018	2019	2020
Redwood Trust, Inc.	100	125	131	143	169	97
FTSE NAREIT Mortgage REIT Index	100	123	147	143	174	141
S&P Composite-500 Index	100	112	136	130	171	203

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

INTRODUCTION

Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) is intended to provide a reader of our financial statements with a narrative from the perspective of our management on our financial condition, results of operations, liquidity and certain other factors that may affect our future results. Our MD&A is presented in six main sections:

- Overview
- Results of Operations
- Liquidity and Capital Resources
- Off Balance Sheet Arrangements and Contractual Obligations
- Critical Accounting Policies and Estimates
- New Accounting Standards

Our MD&A should be read in conjunction with the Consolidated Financial Statements and related Notes included in Part II, Item 8, Financial Statements and Supplementary Data of this Annual Report on Form 10-K. References herein to “Redwood,” the “company,” “we,” “us,” and “our” include Redwood Trust, Inc. and its consolidated subsidiaries, unless the context otherwise requires. The discussion in this MD&A contains forward-looking statements that involve substantial risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, such as those discussed in the Cautionary Statement in Part 1, Item 1, *Business* and in Part 1, Item 1A, *Risk Factors* of this Annual Report on Form 10-K.

OVERVIEW

Our Business

Redwood Trust, Inc., together with its subsidiaries, is a specialty finance company focused on several distinct areas of housing credit. Our goal is to provide attractive returns to shareholders through a stable and growing stream of earnings and dividends, capital appreciation, and a commitment to technological innovation that facilitates risk-minded scale. We operate our business in three segments: Residential Lending, Business Purpose Lending, and Third-Party Investments. Our segments are based on our organizational and management structure, which aligns with how our results are monitored and performance is assessed.

Our primary sources of income are net interest income from our investments and non-interest 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 is generated through the acquisition and origination of loans and their subsequent sale, securitization, or transfer to our investment portfolios.

Redwood Trust, Inc. has elected to be taxed 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.”

For additional information on our business, refer to Part I, Item 1, *Business* of this Annual Report on Form 10-K.

Business Update

During the fourth quarter of 2020, our Residential Lending business locked a record \$3.78 billion in loans (unadjusted for pipeline fallout), an 81% increase from the third quarter. And our Business Purpose Lending ("BPL") business logged \$448 million of originations – an increase of 71% from the third quarter driven by strong single-family rental ("SFR") loan originations. We have allocated additional capital to these businesses, reflecting our expectation of continuing borrower demand for our loan programs. This deployment includes further investments in the financial assets created by our platforms, investments we expect to drive sustainably higher net interest income as we progress through 2021.

Overall credit performance in our investment portfolio remains strong, as delinquencies have continued to decrease since their peak in the summer and strong home price appreciation has kept actual credit losses low. As a result, we continue to see an opportunity for further valuation increases on these investments. Coupled with positive credit trends, high prepayment speeds have begun to provide additional valuation improvements on most of our credit investments held at a discount to par. As prepayments rise and principal pays down on the collateral securing our Sequoia and CoreVest securitization transactions, the call rights we own within these structures are also becoming more valuable. Based on current prepayment trends, we expect up to \$600 million of loans collateralizing these securitizations to become redeemable in 2021, well below their estimated fair values.

We believe the impact of the COVID-19 pandemic on how Americans are thinking about their housing needs has further validated our core investment thesis, as demand for single-family detached housing has grown significantly. We expect much of that demand to be sustainable, as families choose to move away from dense urban areas, and more people can work remotely out of their homes regardless of proximity to the workplace. This has already caused continuing and spreading effects across both the residential and commercial property sectors, especially in major metropolitan areas.

This is why our primary focus for 2021 will remain on our residential consumer and business purpose lending platforms. The operating capital we allocate to these businesses is currently expected to generate attractive returns at levels very difficult to match when sourcing third-party investments in the current market environment. Most importantly, these businesses serve large and growing markets not covered by government lending programs, and as such are positioned to generate scalable and repeatable sources of future earnings, even in a less favorable interest rate environment. Since the earnings from these platforms are generated within our taxable subsidiary, these earnings can also be retained to provide a steady stream of internally sourced capital that can be deployed to further grow earnings and book value.

Speed and disruption are strategic priorities in 2021 across the Redwood enterprise. Our goal is not simply to grow volume, or issue more securitizations. We want to fundamentally change how the non-Agency mortgage finance sector operates. That entails more speed and automation, and keeping technology at the forefront of our strategic plans. In December 2020, our residential team launched a new technology initiative, Redwood Rapid Funding, with strong initial demand from our counterparties. At CoreVest, we are working to consolidate our technology advantage in speed to market, client service, and our use of data to optimize lead generation.

But internal innovation is only part of our strategy. In January 2021, we launched RWT Horizons, an investment initiative focused on early-stage technology companies with business plans focused on innovations that can disrupt the mortgage finance landscape. The amount of capital deployed through this new platform will likely be small at first, however the investments are designed to have an impact on how our businesses operate. This strategy is premised on extracting value at more points along the mortgage value chain, thereby making us a more meaningful partner to the broad network of market constituents to whom we provide liquidity, and building relationships designed to benefit all parties.

In sum, we believe we are positioned to generate sustainable margins and attractive assets that we expect will result in high-quality earnings in 2021. Our Business Purpose Lending team continues to generate strong origination volumes, supported by growing consumer demand for single-family homes for rent and investor demand for access to this asset class. We believe the size of this market opportunity is \$3 trillion and growing, and with CoreVest's competitive advantages we believe our market share has continued to expand. The securitization market and investor demand for our CoreVest securitizations also continues to be strong, with new alternative funding vehicles already being implemented to diversify our funding channels. We expect to continue to maintain a secure position in our line of credit and build-to-rent bridge products, with an opportunity to delve deeper into these markets.

Our Residential team continues to report strong momentum, with favorable lock volume forecasts in January 2021. While the yield curve has room to steepen with the prospect of another round of fiscal stimulus (and therefore mortgage rates have room to rise), we expect refinancing opportunities with respect to existing jumbo loans will remain attractive in 2021. Additionally, our recent volumes have been almost exclusively from Select loans, with some of the strongest borrower credit profiles we've seen since the Great Financial Crisis of 2008. This leaves a significant opportunity to again diversify our purchase mix into Redwood Choice expanded prime and non-QM products. These loans have represented as much as 40% of our quarterly lock activity in recent years.

Redwood remains committed to all our stakeholders, including our shareholders, our employees, and our communities. We're proud to stand behind our core values, including an earnest focus on diversity, equity and inclusion, and a commitment to strong corporate citizenship, both socially and environmentally. Caring for our employees has never been as important, as we continue to support our team members and their families through the impacts of COVID-19. Investment in our employee programs and stewardship of our culture remain strategic priorities, and we're proud of the work that we've done to engage, develop, and retain our workforce over the past year. Our commitment to our larger communities through volunteerism and charitable giving have also remained in sharp focus for us, particularly as our shared humanity has been amplified by the COVID-19 pandemic.

2020 Financial Overview

This section includes an overview of our 2020 financial results. A detailed discussion of our results of operations is presented in the next section of this MD&A. The following table presents selected financial highlights from 2020 and 2019.

Table 1 – Key Earnings and Return Metrics

(In Thousands, except per Share Data)	Years Ended December 31,	
	2020	2019
Net (loss) income	\$ (581,847)	\$ 169,183
Earnings (loss) per share (diluted EPS)	\$ (5.12)	\$ 1.46
Book value per share	\$ 9.91	\$ 15.98
REIT taxable (loss) income per share	\$ (0.05)	\$ 1.28
Dividends per share	\$ 0.725	\$ 1.20

We entered 2020 building on the strong momentum gained during 2019. Record monthly loan volumes in January and February and a sense of optimism quickly shifted as the spread of the novel coronavirus accelerated into a global pandemic in mid-March, creating significant dislocations in the financial markets and resulting in one of the fastest market declines in history. Despite the overall strong credit quality and underlying performance of our residential and business purpose loan assets, uncertainty related to the pandemic and its impact on the economy triggered a collapse in liquidity for any sector not explicitly supported by the federal government, and during the first quarter our balance sheet sustained heavy realized and unrealized losses, ultimately driving net a loss and a reduction in our book value for the full year of 2020.

The declines in asset prices in our sector were driven by widespread panic among market participants and the systematic repricing of mortgage-related assets financed by large financial institutions – in particular, assets of the type we owned, which were not explicitly supported by the federal government. In response to these market conditions, we repositioned our investment portfolio and our debt structure, generating significant liquidity and reducing our overall debt as well as our marginable debt. In aggregate, over the course of 2020, our recourse debt declined from \$5.15 billion at December 31, 2019 to \$1.39 billion at December 31, 2020, and our recourse leverage ratio (the ratio of our recourse debt to tangible shareholders' equity) declined from 3.1x to 1.3x, respectively. Additionally, marginable debt (that portion of recourse debt subject to daily market-value based margin calls), declined to \$97 million at December 31, 2020, from \$4.12 billion at December 31, 2019. While we realized substantial losses on loans and securities we sold during the early part of the year, a significant portion of the unrealized losses incurred in the first quarter of 2020 were ultimately recovered through the end of the year. Additionally, the actions we took to successfully generate liquidity, meet all our margin calls, and reduce debt, allowed us to avoid the need to raise any dilutive capital when markets were disrupted.

Additionally, as a result of the general market disruptions, both our mortgage banking operations (residential and business purpose) were also impacted, and we experienced a significant reduction in acquisition and origination activities during the first half of the year. The impact to these businesses in the first quarter was acute and resulted in us writing off all the goodwill we had recorded in association with the 5 Arches and CoreVest business purpose lending platforms we acquired in 2019. Additionally, in April we implemented a reduction in force, reducing our overall workforce by approximately 35%. The markets began to stabilize in the spring, and our operating businesses began to see a swift recovery. We repositioned these businesses during the spring and into summer, resetting our underwriting guidelines and re-engaging with loan sellers and with borrowers, and experienced significant growth in production volumes in the third and fourth quarters of 2020, which drove very strong returns for these operations in the second half of the year.

While 2020 was a very challenging year for the world and for our company, we are happy to have finished the year in a position of strength, with over \$460 million of cash on hand, an attractive investment portfolio with improving credit trends, and operating businesses on track to continue growing volumes of loan purchases and originations and generate strong returns.

Table 2 – Key Operational Metrics

(In Thousands)	Years Ended December 31,	
	2020	2019
Capital Deployed	\$ 386,945	\$ 1,085,994
Residential Loans Purchased	\$ 4,483,477	\$ 5,901,802
Business Purpose Loans Originated	\$ 1,431,437	\$ 1,015,157

As discussed above, we made significant changes to our capital structure as a result of the pandemic. In the first half of 2020, we generated significant liquidity through asset sales and then, as our business stabilized in the summer, we began to re-deploy capital back into our investment portfolio – primarily into investments created organically through our mortgage banking platforms, including subordinate securities retained from Sequoia residential and CoreVest single-family securitizations and bridge loans originated by CoreVest.

While our residential mortgage banking business experienced an overall decrease in loan purchases in 2020 due to the effects of the pandemic, we saw loan purchase commitments for this business surge in the third quarter and reach record levels in the fourth quarter of 2020. Given a lag between when loans are locked and purchased, we expect an increase in residential loan purchases to carry into 2021. In 2020, through our Sequoia platform, we completed five Select securitizations and one Choice securitization.

Our business purpose loan originations increased in 2020, benefiting from a full year of operations at our now-combined 5 Arches and CoreVest platforms. We saw sequential increases in loan origination volumes in the third and fourth quarters of 2020 and believe the business is positioned to further increase origination volumes in 2021. In 2020, we completed five single-family rental securitizations through our CoreVest platform.

RESULTS OF OPERATIONS

Within this *Results of Operations* section, we provide commentary that compares results year-over-year for 2020, 2019, and 2018. Most tables include "changes" columns that show the amounts by which the year's results are greater or less than the results from the prior year. Unless otherwise specified, references in this section to increases or decreases in 2020 refer to the change in results from 2019 to 2020, and increases or decreases in 2019 refer to the change in results from 2018 to 2019.

Consolidated Results of Operations

The following table presents the components of our net income for the years ended December 31, 2020, 2019, and 2018.

Table 3 – Net Income (Loss)

(In Thousands)	Years Ended December 31,			Changes	
	2020	2019	2018	'20/'19	'19/'18
Net Interest Income	\$ 123,911	\$ 142,473	\$ 139,678	\$ (18,562)	\$ 2,795
Non-interest Income					
Mortgage banking activities, net	78,472	87,266	59,566	(8,794)	27,700
Investment fair value changes, net	(588,438)	35,500	(25,689)	(623,938)	61,189
Other income	4,188	19,257	13,070	(15,069)	6,187
Realized gains, net	30,424	23,821	27,041	6,603	(3,220)
Total non-interest (loss) income, net	(475,354)	165,844	73,988	(641,198)	91,856
General and administrative expenses	(115,204)	(108,737)	(75,298)	(6,467)	(33,439)
Loan acquisition costs	(11,023)	(9,935)	(7,484)	(1,088)	(2,451)
Other expenses	(108,785)	(13,022)	(196)	(95,763)	(12,826)
Net income before income taxes	(586,455)	176,623	130,688	(763,078)	45,935
Benefit from (provision) for income taxes	4,608	(7,440)	(11,088)	12,048	3,648
Net (Loss) Income	\$ (581,847)	\$ 169,183	\$ 119,600	\$ (751,030)	\$ 49,583

Net Interest Income

Net interest income decreased in 2020, primarily due to lower average asset balances relative to 2019 resulting from portfolio repositioning, including significant asset sales in the first half of 2020 related to the COVID-19 pandemic, as well as higher borrowing costs associated with non-marginable and non-recourse debt facilities we entered into during 2020.

Net interest income increased in 2019, as higher net capital deployment towards multifamily, third party, and business purpose lending investments improved net interest income. This improvement was partially offset by a decrease in net interest income from residential loans held-for-sale at our residential lending segment, as the average balance of loans in inventory awaiting sale or securitization declined in 2019 as compared with 2018. Additionally, higher interest expense on long-term debt in 2019 from a higher average balance of convertible debt further offset the increase from net capital deployment.

Additional detail on net interest income is provided in the "*Net Interest Income*" section that follows.

Mortgage Banking Activities, Net

Income from mortgage banking activities, net includes results from both our residential and business purpose mortgage banking operations. The \$9 million decrease in 2020 was predominantly due to a decrease in loan acquisition volumes at our residential mortgage banking business as a result of pandemic-related market disruptions. These decreases were partially offset by an increase in mortgage banking income from our business purpose mortgage banking operations, which benefited from a full year of income after our acquisitions of 5 Arches and CoreVest in March and October of 2019, respectively.

The \$28 million increase in 2019 was due to a \$40 million increase from business purpose mortgage banking, partially offset by a \$12 million decrease from residential mortgage banking. The increase from business purpose mortgage banking resulted from our acquisitions of 5 Arches and CoreVest and the income generated from those operations. The decrease from residential mortgage banking was primarily due to lower gross margins on slightly higher loan purchase commitments in 2019, relative to 2018.

A more detailed analysis of the changes in this line item is included in the “*Results of Operations by Segment*” section that follows.

Investment Fair Value Changes, Net

Investment fair value changes, net, is primarily comprised of the change in fair values of our portfolio investments accounted for under the fair value option and interest rate hedges associated with these investments.

The negative investment fair value changes recorded during 2020 were primarily driven by realized losses incurred on assets sales and derivative settlements that occurred in March and April of the year, as we repositioned our portfolio in response to the pandemic. Approximately \$360 million of losses were realized from such sales. The remaining net losses for the year were primarily associated with assets we retained that experienced a significant decline in value during the first quarter of 2020 and had not fully recovered their value through the end of the year, as well as a negative fair value changes on our interest only securities resulting from lower benchmark interest rates and higher prepayment speeds during 2020. During 2019, the positive investment fair value changes primarily resulted from tightening credit spreads in several investment classes.

Additional detail on our investment fair value changes is included in the “*Results of Operations by Segment*” section that follows.

Other Income

The \$15 million decrease in Other income in 2020 was primarily the result of losses on our MSR investments, which were driven primarily by increased prepayment speeds, resulting from declines in interest rates during 2020. The \$6 million increase in Other income in 2019 primarily resulted from \$4 million of business purpose loan administration fee income earned at 5 Arches, as well as a \$2 million gain associated with the re-measurement of our initial minority investment and purchase option in 5 Arches upon its acquisition. This increase was partially offset by a decrease in income from our MSR investments as the notional balance of these investments continued to pay down. Details on the composition of Other income is included in *Note 20* in Part II, Item 8 of this Annual Report on Form 10-K.

Realized Gains, Net

For 2020, we realized gains of \$30 million, including \$25 million of gains from the repurchase of \$125 million of convertible debt and \$5 million of net gains from the sale of \$55 million of AFS securities. For 2019, we realized gains of \$24 million, primarily from the sale of \$110 million of AFS securities and the call of a seasoned Sequoia securitization in the first quarter. For 2018, we realized gains of \$27 million, primarily from the sale of \$144 million of AFS securities. Of note, all of the gains from extinguishment of debt were excluded from our diluted earnings per share for the year ended December 31, 2020, in accordance with GAAP. See *Note 17* in Part II, Item 8 of this Annual Report on Form 10-K for additional information on this calculation.

General and Administrative Expenses

The \$6 million increase in general and administrative expenses in 2020 primarily resulted from \$14 million of additional expenses at our Business Purpose Lending segment, driven by a full year of operations at our now-combined 5 Arches and CoreVest platforms. This increase was partially offset by a \$9 million decrease in general and administrative expenses at our Residential Lending segment, driven by a decrease in loan acquisition activity at our residential mortgage banking business as well as a workforce reduction we implemented in April 2020.

The \$33 million increase in general and administrative expenses in 2019 primarily resulted from \$24 million of additional expenses from the operations of 5 Arches and CoreVest. The remainder of the increase was primarily due to \$7 million in higher compensation expense at the Redwood parent entity (exclusive of 5 Arches and CoreVest), as well as higher systems, consulting, accounting, and legal costs, driven mostly by the acquisition-related expenses associated with 5 Arches and CoreVest. The higher compensation expense at the Redwood parent entity was primarily driven by higher variable compensation, commensurate with improved results in 2019, as well as a higher average employee count in 2019.

Loan Acquisition Costs

The increase in loan acquisition costs for 2020 resulted from an increase in origination activity at our business purpose mortgage banking operations, primarily as a result of the acquisition of CoreVest, and was partially offset by a reduction in expenses from lower acquisition volumes at our residential mortgage banking operations in 2020.

Other Expenses

In the first quarter of 2020, we recorded an \$89 million goodwill impairment expense at our Business Purpose Lending segment that resulted from the onset of the pandemic. Exclusive of this amount, other expenses in 2020 and 2019 primarily consisted of amortization expense from intangible assets and contingent consideration we recorded in connection with the acquisitions of 5 Arches and CoreVest in 2019.

Provision for Income Taxes

Our provision for income taxes is almost entirely related to activity at our taxable REIT subsidiaries, which primarily includes our mortgage banking activities and MSR investments, as well as certain other investment and hedging activities.

The change to a benefit from income taxes in 2020 from a provision for income taxes in the prior year was the result of GAAP losses at our TRS in 2020. The full benefit from income taxes in 2020 was partially offset by a valuation allowance recorded against our federal net ordinary deferred tax assets.

The decrease in the provision for income taxes for 2019 was driven primarily by lower GAAP income earned at our TRS. Additionally, the provision for 2019 included a \$2 million tax benefit resulting from the purchase of 5 Arches. For additional detail on income taxes, see the “*Tax Provision and Taxable Income*” section that follows.

Net Interest Income

The following tables present the components of net interest income for the years ended December 31, 2020, 2019, and 2018.

Table 4 – Net Interest Income

(Dollars in Thousands)	Years Ended December 31,								
	2020			2019			2018		
	Interest Income/(Expense)	Average Balance ⁽¹⁾	Yield	Interest Income/(Expense)	Average Balance ⁽¹⁾	Yield	Interest Income/(Expense)	Average Balance ⁽¹⁾	Yield
Interest Income									
Residential loans, held-for-sale	\$ 19,985	\$ 538,580	3.7 %	\$ 39,355	\$ 888,690	4.4 %	\$ 51,330	\$ 1,129,810	4.5 %
Residential loans - HFI at Redwood ⁽²⁾	21,000	494,097	4.3 %	92,340	2,321,288	4.0 %	94,361	2,345,219	4.0 %
Residential loans - HFI at Legacy Sequoia ⁽²⁾	9,059	316,844	2.9 %	17,640	453,563	3.9 %	20,029	577,175	3.5 %
Residential loans - HFI at Sequoia Choice ⁽²⁾	87,093	1,883,855	4.6 %	108,778	2,273,514	4.8 %	69,645	1,452,784	4.8 %
Residential loans - HFI at Freddie Mac SLST ⁽²⁾	85,609	2,209,182	3.9 %	57,840	1,531,361	3.8 %	4,453	109,231	4.1 %
Business purpose loans	80,667	1,220,589	6.6 %	30,733	446,077	6.9 %	4,333	50,962	8.5 %
Single-family rental loans - HFI at CAFL	136,950	2,544,738	5.4 %	23,072	439,165	5.3 %	—	—	— %
Multifamily loans - HFI at Freddie Mac K-Series	54,813	1,404,068	3.9 %	132,600	3,373,743	3.9 %	21,322	532,020	4.0 %
Trading securities	33,940	286,382	11.9 %	70,359	1,119,220	6.3 %	71,350	1,016,613	7.0 %
Available-for-sale securities	15,665	140,783	11.1 %	21,463	182,251	11.8 %	33,728	302,134	11.2 %
Other interest income	27,135	775,386	3.5 %	28,101	605,863	4.6 %	8,166	211,651	3.9 %
Total interest income	571,916	11,814,504	4.8 %	622,281	13,634,735	4.6 %	378,717	7,727,599	4.9 %
Interest Expense									
Short-term debt facilities	(44,454)	1,188,487	(3.7)%	(73,558)	1,973,542	(3.7)%	(52,832)	1,513,497	(3.5)%
Short-term debt - servicer advance financing	(6,441)	201,175	(3.2)%	(11,952)	219,307	(5.4)%	(971)	17,271	(5.6)%
Short-term debt - convertible notes, net	—	—	— %	(10,996)	174,433	(6.3)%	(5,114)	97,035	(5.3)%
ABS issued - Legacy Sequoia ⁽²⁾	(5,945)	312,351	(1.9)%	(14,418)	445,342	(3.2)%	(16,519)	567,908	(2.9)%
ABS issued - Sequoia Choice ⁽²⁾	(73,643)	1,681,490	(4.4)%	(93,354)	2,052,697	(4.5)%	(59,769)	1,317,645	(4.5)%
ABS issued - Freddie Mac SLST ⁽²⁾	(66,859)	1,897,194	(3.5)%	(42,574)	1,237,205	(3.4)%	(3,156)	89,172	(3.5)%
ABS issued - Freddie Mac K-Series	(51,521)	1,324,678	(3.9)%	(126,948)	3,184,441	(4.0)%	(19,985)	497,524	(4.0)%
ABS issued - CAFL	(101,740)	2,363,624	(4.3)%	(17,172)	401,467	(4.3)%	—	—	— %
Long-term debt facilities	(45,318)	708,611	(6.4)%	(2,105)	49,988	(4.2)%	—	—	— %
Long-term debt - FHLBC	(10,411)	589,269	(1.8)%	(48,999)	1,999,999	(2.4)%	(41,360)	1,999,999	(2.1)%
Long-term debt - corporate	(41,673)	693,838	(6.0)%	(37,732)	626,290	(6.0)%	(39,333)	791,196	(5.0)%
Total interest expense	(448,005)	10,960,717	(4.1)%	(479,808)	12,364,711	(3.9)%	(239,039)	6,891,247	(3.5)%
Net Interest Income	\$ 123,911			\$ 142,473			\$ 139,678		

- (1) Average balances for residential loans held-for-sale, residential loans held-for-investment, business purpose loans, multifamily loans held-for-investment, and trading securities are calculated based upon carrying values, which represent estimated fair values. Average balances for available-for-sale securities and debt are calculated based upon amortized historical cost, except for ABS issued, which is based upon fair value.
- (2) Interest income from residential loans held-for-investment ("HFI") at Redwood exclude loans HFI at consolidated Sequoia or Freddie Mac SLST entities. Interest income from residential loans - HFI at Legacy Sequoia and the interest expense from ABS issued - Legacy Sequoia represent activity from our consolidated Legacy Sequoia entities. Interest income from residential loans - HFI at Sequoia Choice and the interest expense from ABS issued - Sequoia Choice represent activity from our consolidated Sequoia Choice entities. Interest income from residential loans - HFI at Freddie Mac SLST and the interest expense from ABS issued - Freddie Mac SLST represent activity from our consolidated Freddie Mac SLST entities.

The following table details how net interest income changed on a consolidated basis as a result of changes in average investment balances (“volume”) and changes in interest yields (“rate”).

Table 5 – Net Interest Income - Volume and Rate Changes

(In Thousands)	Change in Net Interest Income For the Years Ended December 31,					
	2020			2019		
	Volume	Rate	Total	Volume	Rate	Total
Net Interest Income for the Beginning of the Year			\$ 142,473			\$ 139,678
Impact of Changes in Interest Income						
Residential loans - HFS	\$ (15,504)	\$ (3,866)	(19,370)	\$ (10,955)	\$ (1,020)	(11,975)
Residential loans - HFI at Redwood	(72,684)	1,346	(71,338)	(963)	(1,058)	(2,021)
Residential loans - HFI at Legacy Sequoia	(5,317)	(3,264)	(8,581)	(4,290)	1,901	(2,389)
Residential loans - HFI at Sequoia Choice	(18,644)	(3,041)	(21,685)	39,345	(212)	39,133
Residential loans - HFI at Freddie Mac SLST	25,602	2,167	27,769	57,976	(4,589)	53,387
Business purpose loans	53,363	(3,430)	49,933	33,593	(7,193)	26,400
Single-family rental loans - HFI at CAFL	110,619	3,259	113,878	23,072	—	23,072
Multifamily loans - HFI at Freddie Mac K-Series	(77,415)	(372)	(77,787)	113,889	(2,611)	111,278
Trading securities	(52,356)	15,937	(36,419)	7,201	(8,192)	(991)
Available-for-sale securities	(4,884)	(914)	(5,798)	(13,383)	1,118	(12,265)
Other interest income	7,863	(8,830)	(967)	15,209	4,726	19,935
Net changes in interest income	(49,357)	(1,008)	(50,365)	260,694	(17,130)	243,564
Impact of Changes in Interest Expense						
Short-term debt facilities	29,260	(157)	29,103	(16,060)	(4,666)	(20,726)
Short-term debt - servicer advance financing	988	4,523	5,511	(11,359)	378	(10,981)
Short-term debt - convertible notes, net	10,996	—	10,996	(4,079)	(1,803)	(5,882)
ABS issued - Legacy Sequoia	4,306	4,167	8,473	3,565	(1,464)	2,101
ABS issued - Sequoia Choice	16,882	2,829	19,711	(33,342)	(243)	(33,585)
ABS issued - Freddie Mac SLST	(22,711)	(1,574)	(24,285)	(40,632)	1,214	(39,418)
ABS issued - Freddie Mac K-Series	74,140	1,287	75,427	(107,934)	971	(106,963)
ABS issued - CAFL	(83,927)	(640)	(84,567)	(17,172)	—	(17,172)
Long-term debt facilities	(27,735)	(15,478)	(43,213)	(2,105)	—	(2,105)
Long-term debt - FHLBC	34,562	4,026	38,588	—	(7,639)	(7,639)
Long-term debt - corporate	(4,070)	129	(3,941)	1,533	68	1,601
Net changes in interest expense	32,691	(888)	31,803	(227,585)	(13,184)	(240,769)
Net changes in interest income and expense	(16,666)	(1,896)	(18,562)	33,109	(30,314)	2,795
Net Interest Income for the Year Ended			<u>\$ 123,911</u>			<u>\$ 142,473</u>

The following table presents the components of net interest income by segment for the years ended December 31, 2020, 2019, and 2018.

Table 6 – Net Interest Income by Segment

(In Thousands)	Years Ended December 31,			Changes	
	2020	2019	2018	'20/'19	'19/'18
Net Interest Income by Segment					
Residential Lending	\$ 43,535	\$ 97,440	\$ 110,534	\$ (53,905)	\$ (13,094)
Business Purpose Lending	61,598	22,140	2,990	39,458	19,150
Third-Party Investments	57,262	68,389	67,082	(11,127)	1,307
Corporate/Other	(38,484)	(45,496)	(40,928)	7,012	(4,568)
Net Interest Income	<u>\$ 123,911</u>	<u>\$ 142,473</u>	<u>\$ 139,678</u>	<u>\$ (18,562)</u>	<u>\$ 2,795</u>

Residential Lending

The \$54 million reduction in net interest income for the residential lending segment in 2020 was primarily driven by the liquidation of our FHLB-financed jumbo loan investment portfolio during the first half of 2020, as well as a lower average balance of retained Sequoia securities during the year resulting from sales in the first half of 2020. In both cases, asset sales were associated with the repositioning of our portfolio in response to the pandemic. The \$13 million decline in 2019 was primarily due to higher interest costs on our variable-rate long-term FHLB borrowings from higher benchmark interest rates in 2019, as well as a lower average balance of retained Sequoia securities in 2019 resulting from asset sales.

Business Purpose Lending

The \$39 million increase in net interest income for the business purpose lending segment in 2020 was primarily driven by the acquisition of CoreVest and its in-place investment portfolio in the fourth quarter of 2019. The \$19 million increase in 2019 was primarily due to the acquisition of 5 Arches in the second quarter of 2019, through which we increased our originations of business purpose loans that were held as earning assets during the year.

Third-party Investments

The \$11 million decrease in net interest income for the third-party investments segment in 2020 was primarily driven by a lower average balance of securities during the year, resulting from the sale of a significant amount of securities in the first quarter of 2020 as we repositioned our portfolio in response to the pandemic. The \$1 million increase in 2019 was primarily due to higher net interest income from a higher average balance of both multifamily and re-performing loan investments in 2019, partially offset by a lower average balance of other third-party RMBS investments.

Corporate/Other

The Corporate/Other line item in the table above includes net interest income from consolidated Legacy Sequoia entities and interest expense on our convertible debt and trust-preferred securities. The \$7 million increase in net interest income from Corporate/Other during 2020 was primarily due to a lower average balance of long-term debt as compared to 2019, as we repaid \$201 million of our convertible debt in November 2019 and repurchased \$125 million of convertible debt during the second quarter of 2020. The \$5 million decrease in net interest income from Corporate/Other during 2019 was primarily due to a higher average balance of long-term debt as compared to 2018, as we issued \$200 million of convertible debt in June 2018.

Results of Operations by Segment

Overview

We report on our business using three distinct segments: Residential Lending, Business Purpose Lending, and Third-Party Investments. Our segments are based on our organizational and management structure, which aligns with how our results are monitored and performance is assessed. For additional information on our segments, refer to *Note 23* in Part II, Item 8 and Part I, Item 1 of this Annual Report on Form 10-K. The following table presents the segment contribution from our four segments reconciled to our consolidated net income for the years ended December 31, 2020, 2019, and 2018.

Table 7 – Segment Results Summary

(In Thousands)	Years Ended December 31,			Changes	
	2020	2019	2018	'20/'19	'19/'18
Segment Contribution from:					
Residential Lending	\$ (129,044)	\$ 100,020	\$ 128,460	\$ (229,064)	\$ (28,440)
Business Purpose Lending	(95,115)	20,670	307	(115,785)	20,363
Third-Party Investments	(291,439)	149,295	76,639	(440,734)	72,656
Corporate/Other	(66,249)	(100,802)	(85,806)	34,553	(14,996)
Net (Loss) Income	\$ (581,847)	\$ 169,183	\$ 119,600	\$ (751,030)	\$ 49,583

Residential Lending

The \$229 million decrease in net contribution from our residential lending segment in 2020 was primarily driven by negative fair value changes and lower net interest income on our investments in 2020, in both cases associated with pandemic-related asset sales in the first half of the year, as well as lower mortgage banking income in the first half of the year. The "*Residential Lending*" section that follows provides additional detail on the activity and results from this segment during 2020.

The \$28 million reduction in net contribution from this segment in 2019 was primarily driven by higher negative investment fair value changes and lower mortgage banking income in 2019. The negative investment fair value changes in 2019 primarily resulted from interest rate volatility, which adversely impacted valuations, net of associated hedges. Mortgage banking income decreased due to a lower average balance of loans carried during 2019, which resulted in lower net interest income, as well as lower mortgage banking activities income resulting from lower profit margins. See the previous section for a further description of the changes in net interest income for this segment.

Business Purpose Lending

The \$116 million decrease in net contribution from our business purpose lending segment in 2020 was primarily driven by an \$89 million charge related to the impairment of our entire goodwill balance for this segment in the first quarter of 2020, as well as from negative investment fair value changes in 2020, triggered by the pandemic. These amounts were offset by an increase in mortgage banking income, as we benefited from a full year of operations from the acquisitions of 5 Arches and CoreVest in 2019. The "*Business Purpose Lending*" section that follows provides additional detail on the activity and results from this segment during 2020.

The \$20 million increase in net contribution from this segment in 2019 primarily resulted from our acquisitions of 5 Arches and CoreVest in 2019 and the increase in business purpose loans held-for-investment through the acquisitions, as well as through originations post-acquisition. Prior to 2019, we did not have significant investments in business purpose loans.

Third-Party Investments

The \$441 million decrease in net contribution from our third-party investments segment in 2020 was primarily driven by negative investment fair value changes in 2020, as well as lower net interest income, in both cases associated with pandemic-related asset sales in the first half of 2020. The "*Third-Party Investments*" section that follows provides additional detail on the activity and results from this segment during 2020.

The \$73 million increase in net contribution from this segment in 2019 was primarily associated with positive investment fair value changes in 2019. The positive investment fair value changes in 2019 were primarily driven by tightening credit spreads on our multifamily securities, as well as our re-performing loan securities and other third-party RMBS during that year. See the previous section for a further description of the changes in net interest income for this segment.

Corporate/Other

The \$35 million decrease in net expense from Corporate/Other in 2020 was primarily due to a \$25 million gain associated with the repurchase of \$125 million of convertible debt in the second quarter of 2020 and the associated reduction in interest expense from the repurchase. The \$15 million increase in net expense from Corporate/Other in 2019 primarily resulted from a \$9 million increase in corporate general and administrative expenses, as well as \$3 million of contingent consideration expense associated with our acquisition of 5 Arches, recorded in Other expenses. These increases were partially offset by a \$2 million gain associated with the re-measurement of our initial minority investment and purchase option in 5 Arches. The increase in corporate general and administrative expenses in 2019 was primarily due to \$7 million in higher compensation expense, driven mostly by higher variable compensation commensurate with improved results in 2019, as well as higher systems, consulting, accounting, and legal costs, driven mostly by the acquisitions of 5 Arches and CoreVest.

The following sections provide a further discussion of our three business segments and their results of operations.

Residential Lending Segment

Overview

Our Residential Lending segment primarily consists of a mortgage loan conduit that acquires residential loans from third-party originators for subsequent sale, securitization, or transfer to our investment portfolio, as well as the investments we retain from these activities. We typically acquire prime, jumbo mortgages and the related mortgage servicing rights on a flow basis from our network of loan sellers and distribute those loans through our Sequoia private-label securitization program or to institutions that acquire pools of whole loans. Our investments in this segment primarily consist of residential mortgage-backed securities ("RMBS") retained from our Sequoia securitizations (some of which we consolidate for GAAP purposes), as well as MSRs retained from jumbo whole loans we sold.

Our Residential Lending segment incurred a \$129 million net loss during 2020, driven largely by \$153 million of negative investment fair value changes primarily associated with losses on assets we sold to reposition our investment portfolio in response to the pandemic. Additionally, we incurred a \$9 million net loss from mortgage banking operations for the full year, as losses incurred in the first half of the year were not fully offset by positive results in the second half of the year.

Mortgage Banking

The following table provides the activity of residential loans held in inventory for sale at our mortgage banking business during the years ended December 31, 2020 and 2019.

Table 8 – Loan Inventory for Residential Mortgage Banking Operations — Activity

(In Thousands)	Years Ended December 31,	
	2020	2019
Balance at beginning of period	\$ 536,385	\$ 1,048,801
Acquisitions	4,483,477	5,862,533
Sales	(5,007,990)	(5,132,465)
Transfers between portfolios ⁽¹⁾	263,172	(1,145,977)
Principal repayments	(85,790)	(103,209)
Changes in fair value, net	(12,613)	6,702
Balance at End of Period	\$ 176,641	\$ 536,385

(1) Represents the net transfers of loans from held-for-investment to held-for-sale within our Residential Lending investment portfolio.

The following table provides the fair value changes of our residential loan purchase and forward sale commitments during the years ended December 31, 2020 and 2019.

Table 9 – Residential Loan Purchase and Forward Sale Commitments and Associated Gains

(In Thousands)	Years Ended December 31,	
	2020	2019
Loan purchase commitments entered into	\$ 4,817,150	\$ 7,012,962
Market valuation gains, net	\$ 56,761	\$ 60,260

Income from mortgage banking activities is comprised of mark-to-market adjustments on loans from the time they are purchased to when they are sold, mark-to-market adjustments on new and outstanding loan purchase commitments, gains/losses from associated hedges, and other miscellaneous income/expenses (see *Note 19* in Part II, Item 8 of this Annual Report on Form 10-K).

During the year ended December 31, 2020, our residential mortgage loan conduit entered into loan purchase commitments (adjusted for expected pipeline fallout) of \$4.82 billion, purchased \$4.48 billion of prime residential jumbo loans, sold \$5.01 billion of loans to third parties, and securitized \$2.50 billion of loans. At December 31, 2020, we had identified \$3.09 billion of loans for purchase (gross loan locks outstanding, unadjusted for fallout) and had outstanding forward sale agreements for \$1.00 billion of loans.

We utilize a combination of capital and our residential loan warehouse facilities to manage our inventory of residential loans held-for-sale. At December 31, 2020, we had residential warehouse facilities outstanding with four different counterparties, with \$1.30 billion of total capacity and \$1.16 billion of available capacity. These included non-marginable (i.e., not subject to margin calls based on the market value of the underlying collateral) facilities with \$600 million of total capacity and marginable facilities with \$700 million of total capacity.

Investment Portfolio

The following table presents details of our Residential Lending investment portfolio at December 31, 2020 and December 31, 2019.

Table 10 – Residential Lending Investments

(In Thousands)	December 31, 2020	December 31, 2019
Residential loans at Redwood ⁽¹⁾	\$ —	\$ 2,111,897
Residential securities at Redwood ⁽²⁾	155,501	229,074
Residential securities at consolidated Sequoia Choice entities ⁽³⁾	217,965	254,265
Other investments	8,815	42,224
Total Segment Investments	\$ 382,281	\$ 2,637,460

(1) Excludes Sequoia Choice loans held at VIEs that we consolidate for GAAP purposes.

(2) Excludes \$5 million of trading securities that are designated as hedges for our mortgage banking operations and are not considered part of our investment portfolio.

(3) Represents our retained economic investment in the consolidated Sequoia Choice securitization VIEs. For GAAP purposes, we consolidated \$1.57 billion of loans and \$1.35 billion of ABS issued associated with these investments at December 31, 2020.

The following table presents the components of investment fair value changes for our Residential Lending segment by investment type for the years ended December 31, 2020, 2019, and 2018.

Table 11 – Investment Fair Value Changes, Net from Residential Lending

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Investment Fair Value Changes, Net			
Changes in fair value of:			
Residential loans held-for-investment, at Redwood	\$ (93,314)	\$ 58,891	\$ (29,573)
Trading securities	(53,976)	(14,675)	(3,281)
Net investments in Sequoia Choice entities ⁽¹⁾	(13,244)	6,947	443
Risk-sharing and other investments	(3,556)	(166)	(434)
Risk management derivatives, net	10,735	(78,917)	11,159
Impairments on AFS securities	(33)	—	—
Investment Fair Value Changes, Net	\$ (153,388)	\$ (27,920)	\$ (21,686)

(1) Includes changes in fair value for loan purchase and forward sale commitments.

As a result of the economic and financial market impacts of the pandemic, the terms of our FHLBC facility evolved and in March 2020 we began entering into transactions to sell several pools of residential whole loans financed through this facility with the objective to pay down our FHLBC borrowings. During the second and third quarters of 2020, we completed the sale of all of our residential loans previously financed at the FHLBC, and repaid all but \$1 million of borrowings under this facility. The losses of \$93 million recorded in 2020 in association with these loans was effectively realized through their sale.

During 2020, we sold \$112 million of securities from our residential lending investment portfolio and retained \$37 million of investment securities from five Sequoia securitizations we completed during the year. Investment fair value changes in 2020 included approximately \$18 million of realized losses associated with these securities sales. The remaining net losses on our securities investments for 2020 were primarily associated with interest-only securities and resulted from lower interest rates and higher prepayment speeds during 2020, as well as from assets we retained that experienced a significant decline in value during the first quarter of 2020 and had not fully recovered their value through the end of the year.

The decrease in Other investments during 2020 primarily represents a decrease in our MSR investments, as the notional balance of these investments paid down significantly in 2020 as a result of lower interest rates and higher prepayment speeds.

The \$11 million of gains from risk management derivatives in 2020 were realized in the first quarter, when we settled all of the hedges for this portfolio.

See the "Investments" section that follows for additional details on investments at this segment and their associated borrowings.

Business Purpose Lending Segment

Overview

Our Business Purpose Lending segment consists of a platform that originates business purpose loans for subsequent securitization or transfer into our investment portfolio, as well as the investments we retain from these activities. These activities are performed through our wholly-owned CoreVest subsidiary, which we acquired in 2019. In 2019 we also acquired another business purpose loan originator, 5 Arches, which was combined with CoreVest during 2020. We typically originate single-family rental and bridge loans and distribute most of our single-family loans through our CoreVest American Finance Lender ("CAFL") private-label securitization program and hold our bridge loans for investment. Single-family rental loans are business purpose mortgage loans to investors in single-family rental properties. Bridge loans are business purpose mortgage loans to investors rehabilitating and reselling or renting residential and small-balance multifamily properties. Our investments in this segment primarily consist of securities retained from CAFL securitizations (which we consolidate for GAAP purposes), and bridge loans.

Our Business Purpose Lending segment incurred a \$95 million net loss during 2020, driven largely by an \$89 million charge related to the full impairment of its goodwill, and \$81 million of negative investment fair value changes on its investment portfolio. The goodwill impairment charge was recorded in the first quarter of 2020 and was triggered by the onset of the pandemic and economic downturn that ensued. Investment fair value changes are discussed further below.

Mortgage Banking

The following table provides the business purpose loans origination activity at Redwood during the years ended December 31, 2020 and 2019.

Table 12 – Business Purpose Loans — Origination Activity

(In Thousands)	Year Ended December 31, 2020			Year Ended December 31, 2019		
	Single-Family Rental	Bridge ⁽¹⁾	Total	Single-Family Rental	Bridge ⁽¹⁾	Total
Fair value at beginning of period	\$ 331,565	\$ —	\$ 331,565	\$ 28,460	\$ —	\$ 28,460
Originations	979,883	451,554	1,431,437	513,802	501,355	1,015,157
Acquisitions	—	—	—	426,654	—	426,654
Sales	(110,836)	(25,151)	(135,987)	(20,426)	(56,485)	(76,911)
Transfers between portfolios ⁽²⁾	(1,000,165)	(423,487)	(1,423,652)	(632,650)	(449,388)	(1,082,038)
Principal repayments	(54,395)	—	(54,395)	(2,991)	—	(2,991)
Changes in fair value, net	99,342	(2,916)	96,426	18,716	4,518	23,234
Fair Value at End of Period	\$ 245,394	\$ —	\$ 245,394	\$ 331,565	\$ —	\$ 331,565

- (1) Our bridge loans are generally originated at our TRS and the majority are transferred to our REIT and a smaller portion sold. Origination fees and any mark-to-market changes on these loans prior to transfer are recognized as mortgage banking income. The loans held at our REIT are classified as held-for-investment, with subsequent fair value changes recorded through Investment fair value changes, net on our consolidated statements of income (loss). For the carrying value and activity of our bridge loans held-for-investment, see the "Investments" section that follows.
- (2) For single-family rental loans, amounts represent transfers of loans from held-for-sale to held-for-investment, including when loans are securitized (and consolidated for GAAP purposes) or transferred from our TRS to our REIT with the intent to hold for long-term investment. For bridge loans, represents the transfer of loans from our TRS to our REIT as described in preceding footnote.

During the year ended December 31, 2020, we funded \$980 million of single-family rental loans, sold \$111 million of such loans to third parties and securitized \$1.21 billion of loans. All of our outstanding SFR loans are held as inventory in our mortgage banking business and classified as held-for-sale. During the year ended December 31, 2020, we funded \$452 million of bridge loans, sold \$25 million of loans to a third party and transferred the remaining loans to our BPL investment portfolio.

We utilize a combination of capital and loan warehouse facilities to manage our inventory of single-family rental loans that we hold for sale. At December 31, 2020, we had business purpose warehouse facilities outstanding with four different counterparties, with \$1.00 billion of total capacity (used for both SFR and bridge loans) and \$785 million of available capacity. All of these facilities are non-marginable (i.e., not subject to margin calls based on the market value of the underlying collateral).

Investment Portfolio

The following table presents details of our Business Purpose Lending investment portfolio at December 31, 2020 and December 31, 2019.

Table 13 – Business Purpose Lending Investments

(In Thousands)	December 31, 2020	December 31, 2019
Single-family rental loans at Redwood ⁽¹⁾	\$ —	\$ 237,620
Bridge loans at Redwood	641,765	745,006
Single-family rental securities at consolidated CAFL entities ⁽²⁾	238,630	191,301
Other investments	21,627	21,002
Total Segment Investments	\$ 902,022	\$ 1,194,929

- (1) Excludes loans held at VIEs that we consolidate for GAAP purposes.
- (2) Represents our economic investment in securities issued by consolidated CAFL securitization VIEs. For GAAP purposes, we consolidated \$3.25 billion of loans and \$3.01 billion of ABS issued associated with these investments at December 31, 2020.

The following table presents the components of investment fair value changes for our Business Purpose Lending segment by investment type for the years ended December 31, 2020, 2019 and 2018.

Table 14 – Investment Fair Value Changes, Net from Business Purpose Lending

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Investment Fair Value Changes, Net			
Single-family rental loans held-for-investment	\$ (20,806)	\$ 272	\$ —
Bridge loans held-for-investment	(10,377)	(2,139)	(29)
REO	(494)	(1,045)	—
Net investments in CAFL entities ⁽¹⁾	(36,754)	(3,636)	—
Other	(1,011)	(174)	—
Risk management derivatives, net	(11,600)	—	—
Investment Fair Value Changes, Net	\$ (81,042)	\$ (6,722)	\$ (29)

(1) Includes changes in fair value of the loans held-for-investment and the ABS issued at the entities, which netted together represent the change in value of our investments (subordinate securities) at the consolidated VIEs.

During 2020, we funded \$452 million of business purpose bridge loans and received principal payments of \$510 million. Additionally, we retained \$104 million of securities from five single-family rental securitizations we completed during 2020. See the "Investments" section that follows for additional details on investments at this segment and their associated borrowings.

The negative investment fair value changes across our business purpose lending investment portfolio were generally triggered by the pandemic. Fair value declines for bridge loans were primarily driven by declines in values of performing loans as well as unrealized losses on delinquent loans, in both cases triggered by the pandemic. Losses on net investments in CAFL entities were primarily driven by spread widening on the securities we own in these entities and higher delinquencies in the loan pools underlying the securitizations. The \$12 million of losses on risk management derivatives were realized in the first quarter when we settled all our hedges for this portfolio.

Third-Party Investments Segment

Overview

Our Third-Party Investments segment consists of investments in RMBS issued by third parties, investments in Freddie Mac SLST and K-Series securitizations (both of which we consolidate for GAAP purposes), our servicer advance investments, and other residential and multifamily credit investments not generated through our Residential Lending or Business Purpose Lending segments.

Our Third-Party Investments segment incurred a \$291 million net loss during 2020, driven largely by \$352 million of negative investment fair value changes primarily associated with losses on assets we sold to reposition our investment portfolio in response to the pandemic.

Investment Portfolio

The following table presents details of the investments in our Third-Party Investments segment at December 31, 2020 and December 31, 2019.

Table 15 – Third-Party Investments

(In Thousands)	December 31, 2020	December 31, 2019
Residential securities at Redwood	\$ 134,090	\$ 466,672
Residential securities at consolidated Freddie Mac SLST entities ⁽¹⁾	428,179	448,893
Multifamily securities at Redwood	49,255	404,128
Multifamily securities at consolidated Freddie Mac K-Series entities ⁽²⁾	28,255	252,285
Other investments ⁽³⁾	43,398	32,248
Total Segment Investments	\$ 683,177	\$ 1,604,226

- (1) Represents our economic investment in securities issued by consolidated Freddie Mac SLST securitization entities. For GAAP purposes, we consolidated \$2.22 billion of loans and \$1.79 billion of ABS issued associated with these investments at December 31, 2020.
- (2) Represents our economic investment in securities issued by consolidated Freddie Mac K-Series securitization entities. For GAAP purposes, we consolidated \$492 million of loans and \$464 million of ABS issued associated with these investments at December 31, 2020.
- (3) Other investments includes our servicer advance investments, which for purposes of this table are presented net of \$208 million of non-recourse short-term securitization debt, secured by servicing advances at December 31, 2020.

The following table presents the components of investment fair value changes for our Third-Party Investments segment by investment type for the years ended December 31, 2020, 2019, and 2018.

Table 16 – Investment Fair Value Changes, Net from Third-Party Investments

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Investment Fair Value Changes, Net			
Changes in fair value of:			
Trading securities	\$ (172,221)	\$ 70,721	\$ (4,774)
Servicer advance investments	(8,901)	3,001	(701)
Excess MSRs	(8,302)	(3,260)	1,823
Shared home appreciation options	(1,884)	842	—
Net investments in Freddie Mac SLST entities ⁽¹⁾	(21,160)	27,206	1,271
Net investments in Freddie Mac K-Series entities ⁽¹⁾	(81,039)	21,430	931
Risk management derivatives, net	(58,158)	(48,181)	(1,439)
Other	16	—	—
Impairments on AFS securities	(355)	—	(89)
Investment Fair Value Changes, Net	\$ (352,004)	\$ 71,759	\$ (2,978)

- (1) Includes changes in fair value of the loans held-for-investment and the ABS issued at the entities, which netted together represent the change in value of our investments (subordinate securities) at the consolidated VIEs.

During 2020, we retained \$56 million of multifamily securities from two securitizations issued through our multifamily joint venture, purchased \$25 million of third-party investments, and sold \$547 million of third-party investments. Investment fair value changes in 2020 included approximately \$207 million of realized losses associated with these sales, which included trading securities we held on balance sheet and securities we owned in the consolidated Freddie Mac K-series entities.

The sales of the subordinate securities issued by four Freddie Mac sponsored K-Series multifamily securitizations resulted in the deconsolidation of \$3.86 billion of multifamily loans and other assets, and \$3.72 billion of ABS issued and other liabilities associated with these investments. At December 31, 2020, we held subordinate securities in three such securitizations, one of which we consolidated.

The negative investment fair value changes across our third-party investment portfolio were generally triggered by the pandemic. In addition to the sales noted above, in 2020, losses on risk management derivatives were realized when we settled all of our hedges for this portfolio in the first quarter, losses on investments in Freddie Mac SLST entities and servicing advance investments were primarily driven by higher delinquencies in the underlying loan pools, and losses on excess MSR were primarily driven by higher prepayments speeds resulting from lower interest rates during 2020.

See the "Investments" section that follows for additional details on these investments.

Investments

This section presents additional details on our investment assets and their activity during 2020 and 2019.

Residential Loans at Residential Lending Investment Portfolio

The following table provides the activity of residential loans at our Residential Lending investment portfolio during the years ended December 31, 2020 and 2019.

Table 17 – Residential Loans at Residential Lending Investment Portfolio - Activity

(In Thousands)	Years Ended December 31,	
	2020	2019
Fair value at beginning of period	\$ 2,111,897	\$ 2,383,932
Acquisitions	—	39,269
Sales	(1,254,935)	(9,421)
Transfers between portfolios ⁽¹⁾	(533,612)	69,431
Principal repayments	(229,818)	(430,205)
Changes in fair value, net	(93,532)	58,891
Fair Value at End of Period	\$ —	\$ 2,111,897

(1) Represents the net transfers of loans into or out of our investment portfolio and their reclassification between held-for-sale to held-for-investment.

During 2020, we sold all of our residential loans previously held for investment and financed at our FHLBC facility, and repaid all but \$1 million of borrowings under this facility. We do not expect to increase borrowings under our FHLBC facility above the existing \$1 million of borrowings outstanding.

Single-Family Rental Loans at Business Purpose Lending Investment Portfolio

The following table provides the activity of single-family rental loans at our Business Purpose Lending investment portfolio during the years ended December 31, 2020 and 2019.

Table 18 – Single-Family Rental Loans at Business Purpose Lending Investment Portfolio - Activity

(In Thousands)	Years Ended December 31,	
	2020	2019
Fair value at beginning of period	\$ 237,620	\$ —
Acquisitions	—	—
Sales	—	—
Transfers between portfolios	(215,417)	238,144
Principal repayments	(1,397)	(796)
Changes in fair value, net	(20,806)	272
Fair Value at End of Period	\$ —	\$ 237,620

During the second quarter of 2020, we transferred all of our single-family rental loans previously financed at the FHLBC and held for investment to non-marginable warehouse facilities, repaid our associated FHLBC debt, and reclassified these loans as held-for-sale as part of our business purpose mortgage banking loan inventory.

Bridge Loans Held-for-Investment at Redwood

The following table provides the activity of bridge loans held-for-investment at Redwood during the years ended December 31, 2020 and 2019.

Table 19 – Bridge Loans Held-for-Investment at Redwood - Activity

(In Thousands)	Years Ended December 31,	
	2020	2019
Fair value at beginning of period	\$ 745,006	\$ 112,798
Acquisitions	—	384,986
Transfers between portfolios ⁽¹⁾	423,351	449,388
Transfers to REO	(6,111)	(7,775)
Principal repayments	(510,446)	(192,255)
Changes in fair value, net	(10,035)	(2,136)
Fair Value at End of Period	\$ 641,765	\$ 745,006

(1) All of our bridge loans are originated at our TRS then transferred to our REIT. Origination fees and any mark-to-market changes on these loans prior to transfer are recognized as mortgage banking income. Once the loans are transferred to our REIT, they are classified as held-for-investment, with subsequent fair value changes recorded through Investment fair value changes, net on our consolidated statements of income (loss).

Our \$642 million of bridge loans held-for-investment at December 31, 2020 were comprised of first-lien, fixed-rate, interest-only loans with a weighted average coupon of 8.09% and original maturities of six to 24 months. At origination, the weighted average FICO score of borrowers backing these loans was 738 and the weighted average LTV ratio of these loans was 67%. At December 31, 2020, of the 1,725 loans in this portfolio, 31 of these loans with an aggregate fair value of \$34 million and an unpaid principal balance of \$39 million were greater than 90 days delinquent, of which 25 loans with an aggregate fair value of \$33 million and an aggregate unpaid principal balance of \$39 million were in foreclosure.

During 2020, we entered into new non-recourse facilities and new non-marginable (i.e., not subject to margin calls based on the market value of the underlying collateral) recourse facilities to finance business purpose bridge loans. While our new non-marginable and non-recourse financing facilities have reduced our contingent liquidity risks, they generally have higher interest costs, which marginally impacted our net interest income. Our non-recourse facility financing bridge loans with \$252 million of borrowings outstanding at December 31, 2020 and an interest rate equal to one-month LIBOR plus 7.50% is prepayable in June 2021. We expect to refinance this debt when it becomes prepayable in June, and based on current market rates, expect a reduction in our borrowing costs.

Real Estate Securities Portfolio

The following table sets forth our real estate securities activity by collateral type for the years ended December 31, 2020 and 2019.

Table 20 – Real Estate Securities Activity by Collateral Type

Year Ended December 31, 2020 (In Thousands)	Residential			Multifamily	Total
	Senior	Mezzanine	Subordinate	Mezzanine	
Beginning fair value	\$ 175,859	\$ 151,797	\$ 368,090	\$ 404,128	\$ 1,099,874
Acquisitions					
Sequoia securities	49,090	—	4,187	—	53,277
Third-party securities	23,229	2,000	27,950	59,446	112,625
Sales					
Sequoia securities	(33,375)	(31,334)	(6,394)	—	(71,103)
Third-party securities	(115,354)	(93,728)	(91,054)	(287,483)	(587,619)
Gains on sales and calls, net	3,357	400	2,487	(1,604)	4,640
Effect of principal payments ⁽¹⁾	(4,464)	(1,015)	(6,803)	(9,625)	(21,907)
Change in fair value, net	(69,878)	(22,457)	(37,720)	(115,607)	(245,662)
Ending Fair Value ⁽²⁾	\$ 28,464	\$ 5,663	\$ 260,743	\$ 49,255	\$ 344,125
Year Ended December 31, 2019 (In Thousands)	Residential			Multifamily	Total
	Senior	Mezzanine	Subordinate	Mezzanine	
Beginning fair value	\$ 246,285	\$ 218,147	\$ 558,983	\$ 429,079	\$ 1,452,494
Transfers ⁽³⁾	—	—	—	(4,951)	(4,951)
Acquisitions					
Sequoia securities	8,882	—	4,848	—	13,730
Third-party securities	45,063	70,169	81,559	148,611	345,402
Sales					
Sequoia securities	—	(55,312)	(6,362)	—	(61,674)
Third-party securities	(68,661)	(86,754)	(308,350)	(181,752)	(645,517)
Gains on sales and calls, net	9,453	3,059	11,175	134	23,821
Effect of principal payments ⁽¹⁾	(33,855)	(10,594)	(15,678)	(20,444)	(80,571)
Change in fair value, net	(31,308)	13,082	41,915	33,451	57,140
Ending Fair Value	\$ 175,859	\$ 151,797	\$ 368,090	\$ 404,128	\$ 1,099,874

(1) The effect of principal payments reflects the change in fair value due to principal payments, which is calculated as the cash principal received on a given security during the period multiplied by the prior quarter ending price or acquisition price for that security.

(2) At December 31, 2020, excludes \$218 million and \$239 million of securities retained from our consolidated Sequoia Choice and CAFL securitizations, respectively, as well as \$428 million and \$28 million of securities we owned that were issued by consolidated Freddie Mac SLST and Freddie Mac K-Series securitizations, respectively.

(3) Represents the derecognition of mezzanine securities we owned in Freddie Mac K-Series securitizations when we began to consolidate the securitizations upon the acquisition of subordinate interests in these entities.

During the year ended December 31, 2020, we sold \$659 million of securities, including \$540 million of securities we sold in the first quarter of 2020 to reposition our portfolio in response to the pandemic.

At December 31, 2020, our securities consisted of fixed-rate assets (83%), adjustable-rate assets (14%), hybrid assets that reset within the next year (2%), and hybrid assets that reset between 12 and 36 months (1%). For the portions of our securities portfolio that are sensitive to changes in interest rates, we seek to minimize this interest rate risk by using various derivative instruments.

We directly finance our holdings of real estate securities with a combination of capital and collateralized debt in the form of repurchase (or “repo”) financing. The following table presents the fair value of our residential securities that were financed with repurchase debt at December 31, 2020.

Table 21 – Real Estate Securities Financed with Repurchase Debt

December 31, 2020 (Dollars in Thousands, except Weighted Average Price)	Real Estate Securities ⁽¹⁾	Repurchase Debt	Allocated Capital	Weighted Average Price ⁽²⁾	Financing Haircut ⁽³⁾
Residential Securities					
Mezzanine ⁽⁴⁾	\$ 63,105	\$ (48,108)	\$ 14,997	\$ 102	24 %
Total Residential Securities	63,105	(48,108)	14,997	102	24 %
Multifamily Securities ⁽⁵⁾	51,448	(29,667)	21,781	72	42 %
Total Securities	\$ 114,553	\$ (77,775)	\$ 36,778		

(1) Amounts represent carrying value of securities, which are held at GAAP fair value.

(2) GAAP fair value per \$100 of principal. Weighted average price excludes IO securities.

(3) Allocated capital divided by GAAP fair value.

(4) Includes \$63 million of securities we owned that were issued by consolidated Sequoia Choice securitizations, which we consolidate in accordance with GAAP.

(5) Includes \$28 million of securities we owned that were issued by consolidated Freddie Mac K-Series securitizations, which we consolidate in accordance with GAAP.

At December 31, 2020, we had short-term debt incurred through repurchase facilities of \$78 million with three different counterparties, which was secured by \$115 million of real estate securities (including securities owned in consolidated securitization entities).

At December 31, 2020, real estate securities with a fair value of \$363 million (including securities owned in consolidated Sequoia Choice and CAFL securitization entities), were financed with long-term, non-mark-to-market recourse debt through our subordinate securities financing facilities. Additionally, at December 31, 2020, we had \$428 million of re-performing loan securities financed with \$205 million of non-recourse securitization debt. The remaining \$351 million of our securities, including certain securities we own that were issued by consolidated securitization entities, were financed with capital.

The following table presents our real estate securities at December 31, 2020 and December 31, 2019, categorized by portfolio vintage (the years the securities were issued), and by priority of cash flows (senior, mezzanine, and subordinate). Within the following table, we have additionally separated securities issued through our Sequoia platform or by third parties, including the Agencies.

Table 22 – Real Estate Securities by Vintage and Type

December 31, 2020						
(In Thousands)	Sequoia 2012-2020	Third Party 2013-2020	Third Party ≤2008	Total Residential Securities	Multifamily 2019-2020	Total Real Estate Securities
Senior ⁽¹⁾	\$ 17,333	\$ 11,128	\$ 3	\$ 28,464	\$ —	\$ 28,464
Mezzanine ⁽²⁾	3,649	2,014	—	5,663	—	5,663
Subordinate ⁽¹⁾	136,475	117,994	6,274	260,743	49,255	309,998
Total Securities ⁽³⁾	\$ 157,457	\$ 131,136	\$ 6,277	\$ 294,870	\$ 49,255	\$ 344,125
December 31, 2019						
(In Thousands)	Sequoia 2012-2019	Third Party 2013-2019	Third Party ≤2008	Total Residential Securities	Multifamily 2016-2019	Total Real Estate Securities
Senior ⁽¹⁾	\$ 48,765	\$ 101,297	\$ 25,797	\$ 175,859	\$ —	\$ 175,859
Mezzanine ⁽²⁾	43,980	107,817	—	151,797	404,128	555,925
Subordinate ⁽¹⁾	136,329	220,825	10,936	368,090	—	368,090
Total Securities ⁽³⁾	\$ 229,074	\$ 429,939	\$ 36,733	\$ 695,746	\$ 404,128	\$ 1,099,874

- (1) At December 31, 2020 and December 31, 2019, senior Sequoia and third-party securities included \$28 million and \$64 million of IO securities, respectively. At December 31, 2020 and December 31, 2019, subordinate third-party securities included \$11 million and \$6 million of IO securities, respectively. Our interest-only securities included \$13 million and \$36 million of A-IO-S securities at December 31, 2020 and December 31, 2019, respectively, that we retained from certain of our Sequoia securitizations. These securities represent certificated servicing strips and therefore may be negatively impacted by the operating and funding costs related to servicing the associated securitized mortgage loans.
- (2) Mezzanine includes securities initially rated AA through BBB- and issued in 2012 or later.
- (3) At December 31, 2020, excluded \$218 million, \$428 million, \$28 million, and \$239 million of securities we owned that were issued by consolidated Sequoia Choice, Freddie Mac SLST, Freddie Mac K-Series, and CAFL securitizations, respectively. At December 31, 2019, excluded \$254 million, \$449 million, \$252 million, and \$191 million of securities we owned that were issued by consolidated Sequoia Choice, Freddie Mac SLST, Freddie Mac K-Series, and CAFL securitizations, respectively. For GAAP purposes we consolidated \$7.53 billion of loans and \$6.62 billion of non-recourse ABS debt associated with these retained securities.

The following tables present the components of the interest income we earned on AFS securities for the years ended December 31, 2020, 2019, and 2018.

Table 23 – Interest Income — AFS Securities

Year Ended December 31, 2020					Yield as a Result of		
(Dollars in Thousands)	Interest Income	Discount (Premium) Amortization	Total Interest Income	Average Amortized Cost	Interest Income	Discount (Premium) Amortization	Total Interest Income
Residential							
Senior	\$ 221	\$ 529	\$ 750	\$ 3,355	6.59 %	15.77 %	22.36 %
Mezzanine	120	14	134	2,936	4.09 %	0.48 %	4.57 %
Subordinate	8,786	5,995	14,781	134,492	6.53 %	4.46 %	10.99 %
Total AFS Securities	\$ 9,127	\$ 6,538	\$ 15,665	\$ 140,783	6.48 %	4.64 %	11.12 %

Year Ended December 31, 2019					Yield as a Result of		
(Dollars in Thousands)	Interest Income	Discount (Premium) Amortization	Total Interest Income	Average Amortized Cost	Interest Income	Discount (Premium) Amortization	Total Interest Income
Residential							
Senior	\$ 2,082	\$ 3,214	\$ 5,296	\$ 29,555	7.04 %	10.87 %	17.91 %
Mezzanine	692	249	941	17,143	4.04 %	1.45 %	5.49 %
Subordinate	10,768	4,458	15,226	135,553	7.94 %	3.29 %	11.23 %
Total AFS Securities	\$ 13,542	\$ 7,921	\$ 21,463	\$ 182,251	7.43 %	4.35 %	11.78 %

Year Ended December 31, 2018					Yield as a Result of		
(Dollars in Thousands)	Interest Income	Discount (Premium) Amortization	Total Interest Income	Average Amortized Cost	Interest Income	Discount (Premium) Amortization	Total Interest Income
Residential							
Senior	\$ 6,290	\$ 8,174	\$ 14,464	\$ 106,304	5.92 %	7.69 %	13.61 %
Mezzanine	1,999	838	2,837	47,414	4.22 %	1.77 %	5.99 %
Subordinate	11,341	5,086	16,427	148,416	7.64 %	3.43 %	11.07 %
Total AFS Securities	\$ 19,630	\$ 14,098	\$ 33,728	\$ 302,134	6.50 %	4.67 %	11.16 %

Tax Provision and Taxable Income

Tax Provision under GAAP

For the years ended December 31, 2020, 2019, and 2018, we recorded a tax benefit of \$5 million and tax provisions of \$7 million and \$11 million, respectively. Our tax provision is primarily derived from GAAP net income or loss at our TRS, as we do not book a material tax provision associated with income generated at our REIT. Our TRS income is generally earned from our mortgage banking activities, MSRs, and other non-REIT eligible security investments.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") was enacted into law. The CARES Act, among other things, provided tax relief to businesses, including the deferral of certain payroll taxes, relief for retaining employees, and other income tax provisions. Based on our review of the CARES Act, we concluded that this new legislation did not have a material impact on our tax provision for the year ended December 31, 2020.

Taxable Income

The following table summarizes our taxable income and distributions to shareholders for the years ended December 31, 2020, 2019, and 2018. For each of these periods, we had no undistributed REIT taxable income, after the application of net operating loss carryforwards.

Table 24 – Taxable Income

(In Thousands except per Share Data)	Years Ended December 31,		
	2020 est. ⁽¹⁾	2019	2018
REIT taxable (loss) income	\$ (7,342)	\$ 136,060	\$ 110,161
Taxable REIT subsidiary income	68,003	(1,481)	58,551
Total Taxable Income	\$ 60,661	\$ 134,579	\$ 168,712
REIT taxable (loss) income per share	\$ (0.05)	\$ 1.28	\$ 1.38
Total taxable income per share	\$ 0.56	\$ 1.27	\$ 2.13
Distributions to shareholders	\$ 82,478	\$ 126,139	\$ 94,134
Distributions to shareholders per share	\$ 0.725	\$ 1.20	\$ 1.18

(1) Our tax results for the year ended December 31, 2020 are estimates until we file tax returns for 2020.

In accordance with Internal Revenue Code rules applicable to disaster losses, \$59 million of losses incurred in 2020 at our TRS were recognized in 2019 for federal income tax purposes, resulting in higher TRS taxable income for the year ended December 31, 2020 and lower TRS taxable income for the year ended December 31, 2019.

Taxable Income Distribution Requirement

As a REIT, we are required to distribute at least 90% of our REIT taxable income, taking into account the application of available federal net operating loss carryforwards ("NOLs"), to our shareholders. For 2020, we incurred an estimated REIT taxable loss of \$7 million; therefore, our minimum dividend distribution requirement was zero. The following table details our federal NOLs and capital loss carryforwards available as of December 31, 2020.

Table 25 - Federal Net Operating and Capital Loss Carryforwards

(In Thousands)	Loss Carryforward Expiration by Period					Total
	1 to 3 Years	3 to 5 Years	5 to 15 Years	After 15 Years	No Expiration	
REIT Loss Carryforwards						
Net operating loss	\$ —	\$ —	\$ (28,684)	\$ —	\$ (7,342)	\$ (36,026)
Capital loss	—	(327,999)	—	—	—	(327,999)
Total REIT Loss Carryforwards	\$ —	\$ (327,999)	\$ (28,684)	\$ —	\$ (7,342)	\$ (364,025)
TRS Loss Carryforwards						
Net operating loss	\$ —	\$ —	\$ —	\$ (213)	\$ (570)	\$ (783)
Capital loss	—	—	—	—	—	—
Total TRS Loss Carryforwards	\$ —	\$ —	\$ —	\$ (213)	\$ (570)	\$ (783)

At December 31, 2019, we maintained \$29 million of NOLs at the REIT level. Federal income tax rules require the dividends paid deduction to be applied to reduce REIT taxable income before the applicability of NOLs is considered; therefore, REIT taxable income must exceed our dividend distribution for us to utilize a portion of our NOL and any remaining NOL amount will carry forward into future years. Since annual REIT taxable income, exclusive of the dividends paid deduction, was a taxable loss of \$7 million in 2020, the NOL will be increased by this amount. Federal NOLs at the REIT level do not begin to expire until 2029.

The Tax Act created a limitation on the annual usage of REIT NOLs to 80% of REIT taxable income, effective with respect to NOLs arising in taxable years beginning after December 31, 2017. However, under the CARES Act, this 80% limitation only applies to NOLs used in taxable years beginning after December 31, 2020. We do not expect this to materially impact our REIT.

Our TRS NOL carryforwards were acquired in the 5 Arches acquisition. A portion of these NOLs were generated after December 31, 2017 and therefore carry forward indefinitely. These NOLs are subject to the Separate Return Limitation Year ("SRLY") rules, which can limit the usage of the NOLs. Due to uncertainty regarding the utilization of these NOLs, we recorded a valuation allowance against the associated deferred tax asset.

Tax Characteristics of Distributions to Shareholders

For the year ended December 31, 2020, we declared and distributed four regular quarterly dividends totaling \$82 million (\$0.725 per share). Under the federal income tax rules applicable to REITs, the taxable portion of any distribution to shareholders is determined by (i) taxable income of the REIT, exclusive of the dividends paid deduction and NOLs; and (ii) net capital gains recognized by the REIT, exclusive of capital loss carryforwards. The income or loss generated at our TRS does not directly affect the tax characterization of our dividends.

Under the federal income tax rules applicable to REITs, our 2020 dividend distributions are expected to be characterized for federal income tax purposes as 100% return of capital, which in general is non-taxable (provided it does not exceed a shareholder's basis in Redwood shares) and reduces a shareholder's basis in Redwood shares (but not below zero). To the extent such distributions exceed a shareholder's basis in Redwood shares, such excess amount would be taxable as capital gain. None of our 2020 dividend distributions are expected to be characterized for federal income tax purposes as ordinary income, qualified dividends, or long-term capital gain dividends.

Individual taxpayers may generally deduct 20% of their ordinary REIT dividends from taxable income. This results in a maximum federal effective tax rate of 29.6% on an individual taxpayer's ordinary REIT dividends, compared to the highest marginal rate of 37%. This deduction does not apply to REIT dividends classified as qualified dividend income or long-term capital gains dividends, as those dividends are taxed at a maximum rate of 20% for individuals.

Differences between Estimated Total Taxable Income and GAAP Income

Differences between estimated taxable income and GAAP income are largely due to the following: (i) we cannot establish loss reserves for future anticipated events for tax but we can for GAAP, as realized credit losses are expensed when incurred for tax and these losses can be anticipated through lower yields on assets or through loss provisions for GAAP; (ii) the timing, and possibly the amount, of some expenses (e.g., certain compensation expenses) are different for tax than for GAAP; (iii) since amortization and impairments differ for tax and GAAP, the tax and GAAP gains and losses on sales may differ, resulting in differences in realized gains on sale; (iv) at the REIT and certain TRS entities, unrealized gains and losses on market valuation adjustments of loans, securities and derivatives are not recognized for tax until the instrument is sold or extinguished; (v) for tax, basis may not be assigned to mortgage servicing rights retained when whole loans are sold resulting in lower tax gain on sale; (vi) for tax, we do not consolidate securitization entities as we do under GAAP; and, (vii) dividend distributions to our REIT from our TRS are included in REIT taxable income, but not GAAP income. As a result of these differences in accounting, our estimated taxable income can vary significantly from our GAAP income during certain reporting periods.

The tax basis in assets and liabilities at the REIT was \$2.69 billion and \$1.34 billion, respectively, at December 31, 2020. The GAAP basis in assets and liabilities at the REIT was \$9.13 billion and \$8.02 billion, respectively, at December 31, 2020. The primary difference in both the tax and GAAP assets and liabilities is attributable to securitization entities that are consolidated for GAAP reporting purposes but not for tax purposes.

The tables below reconcile our estimated total taxable income to our GAAP income for the years ended December 31, 2020, 2019, and 2018.

Table 26 – Differences between Estimated Total Taxable Income and GAAP Net Income

(In Thousands, except per Share Data)	Year Ended December 31, 2020				
	REIT (Est.)	TRS (Est.)	Total Tax (Est.)	GAAP	Differences
Interest income	\$ 212,324	\$ 38,762	\$ 251,086	\$ 571,916	\$ (320,830)
Interest expense	(103,566)	(48,115)	(151,681)	(448,005)	296,324
Net interest income	108,758	(9,353)	99,405	123,911	(24,506)
Realized credit losses	(2,326)	—	(2,326)	—	(2,326)
Mortgage banking activities, net	—	146,697	146,697	78,472	68,225
Investment fair value changes, net	(94,253)	(1,573)	(95,826)	(588,438)	492,612
Other income	8,300	13,386	21,686	4,188	17,498
Realized gains, net	17,463	6,445	23,908	30,424	(6,516)
General and administrative expenses	(43,222)	(65,969)	(109,191)	(115,204)	6,013
Loan acquisition costs	(2,040)	(8,983)	(11,023)	(11,023)	—
Other expenses	—	(12,473)	(12,473)	(108,785)	96,312
Benefit from (provision for) income taxes	(22)	(174)	(196)	4,608	(4,804)
Net Income (Loss)	\$ (7,342)	\$ 68,003	\$ 60,661	\$ (581,847)	\$ 642,508
Income (loss) per basic common share	\$ (0.05)	\$ 0.61	\$ 0.56	\$ (5.12)	\$ 5.68

(In Thousands, except per Share Data)	Year Ended December 31, 2019				
	REIT	TRS	Total Tax	GAAP	Differences
Interest income	\$ 261,666	\$ 60,172	\$ 321,838	\$ 622,281	\$ (300,443)
Interest expense	(130,326)	(54,300)	(184,626)	(479,808)	295,182
Net interest income	131,340	5,872	137,212	142,473	(5,261)
Realized credit losses	(534)	—	(534)	—	(534)
Mortgage banking activities, net	—	21,246	21,246	87,266	(66,020)
Investment fair value changes, net	(1,661)	8,435	6,774	35,500	(28,726)
Other income	10,042	10,210	20,252	19,257	995
Realized gains, net	43,756	19,073	62,829	23,821	39,008
General and administrative expenses	(44,215)	(54,833)	(99,048)	(108,737)	9,689
Loan acquisition costs	(1,623)	(8,312)	(9,935)	(9,935)	—
Other expenses	(667)	(2,684)	(3,351)	(13,022)	9,671
Provision for income taxes	(378)	(488)	(866)	(7,440)	6,574
Net Income	\$ 136,060	\$ (1,481)	\$ 134,579	\$ 169,183	\$ (34,604)
Income per basic common share	\$ 1.28	\$ (0.01)	\$ 1.27	\$ 1.63	\$ (0.36)

Year Ended December 31, 2018

(In Thousands, except per Share Data)	REIT	TRS	Total Tax	GAAP	Differences
Interest income	\$ 212,522	\$ 52,878	\$ 265,400	\$ 378,717	\$ (113,317)
Interest expense	(96,126)	(43,021)	(139,147)	(239,039)	99,892
Net interest income	116,396	9,857	126,253	139,678	(13,425)
Realized credit losses	(1,738)	—	(1,738)	—	(1,738)
Mortgage banking activities, net	—	57,212	57,212	59,566	(2,354)
Investment fair value changes, net	5,513	(586)	4,927	(25,689)	30,616
Other income	1,762	15,822	17,584	13,070	4,514
Realized gains, net	30,001	13,098	43,099	27,041	16,058
General and administrative expenses	(38,823)	(31,715)	(70,538)	(75,298)	4,760
Loan acquisition costs	(2,242)	(5,242)	(7,484)	(7,484)	—
Other expenses	(409)	344	(65)	(196)	131
Provision for income taxes	(299)	(239)	(538)	(11,088)	10,550
Net Income	\$ 110,161	\$ 58,551	\$ 168,712	\$ 119,600	\$ 49,112
Income per basic common share	\$ 1.38	\$ 0.75	\$ 2.13	\$ 1.47	\$ 0.66

Potential Taxable Income Volatility

We expect period-to-period volatility in our estimated taxable income. A description of the factors that can cause this volatility is provided below.

Recognition of Gains and Losses on Sale

Since the computation of amortization and impairments on assets may differ for tax and GAAP and many of our assets held for investment purposes are marked-to-market for GAAP, but not for tax, the tax and GAAP basis on assets sold or called may differ, resulting in differences in gains and losses on sale or call. In addition, capital losses in excess of capital gains are generally disallowed and carry forward to future tax years. Subsequent capital gains realized for tax may be offset by prior capital losses and, thus, not affect taxable income. At December 31, 2020, we had \$328 million of capital loss carryforwards at the REIT and none at the TRS level.

Prepayments on Securities

We own Sequoia, CAFL, and third-party IO securities. Our tax basis in these securities was \$181 million at December 31, 2020. The return on IOs is sensitive to prepayments and, to the extent prepayments vary period to period, income from these IOs will vary. Typically, fast prepayments reduce yields and slow prepayments increase yields. We are not permitted to recognize a negative yield under tax accounting rules, so during periods of fast prepayments our periodic premium expense for tax purposes can be relatively low and the tax cost basis for these securities may not be significantly reduced. Currently, our tax basis is above the fair values for these IOs in the aggregate. If a securitization is called, the remaining tax basis in the IO is expensed, creating an ordinary loss at the call date.

Prepayments also affect the taxable income recognition on other securities we own. For tax purposes, we are required to use particular prepayment assumptions for the remaining lives of each security. As actual prepayment speeds vary, the yield we recognize for tax purposes will be adjusted accordingly. Thus, to the extent actual prepayments differ from our long-term assumptions or vary from period to period, the yield recognized will also vary and this difference could be material.

Credit Losses on Securities and Loans

To determine estimated taxable income, we are generally not permitted to anticipate, or reserve for, credit losses on investments which are generally purchased at a discount. For tax purposes, we accrue the entire purchase discount on a security into taxable income over the expected life of the security. Estimated taxable income is reduced when actual credit losses occur. As we have no credit reserves or allowances for tax, any future credit losses on securities or loans will have a more significant impact on tax earnings than on GAAP earnings and may create significant taxable income volatility to the extent the level of credit losses fluctuates during reporting periods. Credit losses are based on our tax basis, which differs from our basis for GAAP purposes. We anticipate an additional \$20 million of credit losses for tax on securities, based on our projection of principal balance losses and assuming a similar tax basis as we have recently experienced, although the timing of actual losses is difficult to accurately project.

Our estimated total taxable income for the years ended December 31, 2020, 2019, and 2018 included \$2 million, \$1 million, and \$2 million, respectively, in realized credit losses on investments.

Compensation Expense

The total tax expense for equity award compensation is dependent upon varying factors such as the timing of payments of dividend equivalent rights, the distribution of deferred stock units and performance stock units, and the cash deferrals to and withdrawals from our Executive Deferred Compensation Plan. For GAAP purposes, the total expense associated with an equity award is determined at the award date and is recognized over the vesting period. For tax, the total expense is recognized at the date of distribution or exercise, not the award date. In addition, some compensation may not be deductible for tax if it exceeds certain levels. Thus, the total amount of compensation expense, as well as the timing, could be significantly different for tax than for GAAP.

As an example, for GAAP we expense the grant date fair value of performance stock units (PSUs) granted over the vesting term of those PSUs (regardless of the degree to which the performance conditions for vesting are ultimately satisfied, if at all), whereas for tax the value of the PSUs that actually vest in accordance with the performance conditions of those awards and are subsequently distributed to the award recipient is recorded as an expense on the date of distribution. For example, if no PSUs under a particular grant ultimately vest, due to the failure to satisfy the performance conditions, no tax expense will be recorded for those PSUs, even though we would have already recorded expense for GAAP equal to the grant date fair value of the PSU awards. Conversely, for example, if performance is such that a number of shares of common stock equal to 200% of the PSU award ultimately vest and are delivered to the award recipient, expense for tax will equal the common stock value on the date of distribution of 200% of the number of PSUs originally granted. This expense for tax could significantly exceed the recorded expense for GAAP.

In addition, since the timing of distributions of deferred stock units, performance stock units, or cash out of the Executive Deferred Compensation Plan is based on employees' deferral elections, it can be difficult to project when the tax expense will occur.

Mortgage Servicing Rights

For GAAP purposes, we recognize MSR assets through the direct acquisition of servicing rights from third parties or through the retention of MSR assets associated with residential loans that we have acquired and subsequently sold to non-consolidated securitization entities or to third parties. For tax purposes, basis in our MSR assets is recognized through the direct acquisition of servicing rights from third parties, or to the extent that a retained MSR entitles us to receive a servicing fee in excess of so-called normal servicing (or the right to receive reasonable compensation for services to be performed under the mortgage servicing contract). Tax basis in our normal MSR assets is not recognized when MSR assets are retained from sales of loans to non-consolidated securitization entities or to third parties, thereby creating a favorable temporary GAAP to tax difference from sale of the loans. No material tax basis in MSR assets was recognized in 2020.

For GAAP purposes, mortgage servicing fee income, net of servicing expense, as well as changes in the estimated fair value of our MSR assets, is recognized on our consolidated statements of income over the life of the MSR asset. For tax purposes, only mortgage servicing fee income, net of servicing expense is recognized as taxable income. Any MSR where basis is recognized for tax purposes through acquisition is amortized as a tax expense over a finite life.

Periodic changes in the market values of MSR assets are recorded through the income statement for GAAP purposes, but not for tax purposes. Only when MSR assets are sold will a tax gain or loss be recognized. As tax basis is not recognized for retained MSR assets and the rules for writing-off tax basis of purchased MSR assets are restrictive, the tax gain from the sale of MSR assets can be substantial.

LIQUIDITY AND CAPITAL RESOURCES

Summary

In addition to the proceeds from equity and debt capital-raising transactions, our principal sources of cash consist of borrowings under mortgage loan warehouse facilities, securities repurchase agreements, payments of principal and interest we receive from our investment portfolios, proceeds from the sale of portfolio assets, and cash generated from our operating activities. Our most significant uses of cash are to purchase and originate mortgage loans for our mortgage banking operations, to purchase investment securities and make other investments, to repay principal and interest on our debt, to meet margin calls associated with our debt and other obligations, to make dividend payments on our capital stock, and to fund our operations.

At December 31, 2020, our total capital was \$1.76 billion and included \$1.11 billion of equity capital and \$0.65 billion of convertible notes and long-term debt on our consolidated balance sheet, including \$199 million of convertible debt due in 2023, \$150 million of convertible debt due in 2024, \$172 million of exchangeable debt due in 2025, and \$140 million of trust-preferred securities due in 2037.

As of December 31, 2020, our unrestricted cash was \$461 million. While we believe our available cash is sufficient to fund our operations, we may raise equity or debt capital from time to time to increase our unrestricted cash and liquidity, to repay existing debt, to make long-term portfolio investments, to fund strategic acquisitions and investments, or for other purposes. To the extent we seek to raise additional capital, our approach will continue to be based on what we believe to be in the best interests of the company.

In the discussion that follows and throughout this document, we distinguish between marginable and non-marginable debt. When we refer to non-marginable debt and marginable debt, we are referring to whether such debt is subject to market value-based margin calls on underlying collateral that is non-delinquent. If a mortgage loan is financed under a marginable warehouse facility, to the extent the market value of the loan declines (which market value is generally determined by the counterparty under the facility), we will be subject to a margin call, meaning we will be required to either immediately reacquire the loan or meet a margin requirement to pledge additional collateral, such as cash or additional residential loans, in an amount at least equal to the decline in value. Non-marginable debt may be subject to a margin call due to delinquency of the mortgage or security being financed, or a decline in the value of the underlying asset securing the collateral. For example, we could be subject to a margin call on non-marginable debt if an appraisal or broker price opinion indicates a decline in the value of the property securing the mortgage loan that is financed by us under a loan warehouse facility.

We also distinguish between recourse and non-recourse debt. When we refer to non-recourse debt, we mean debt that is payable solely from the assets pledged to secure such debt, and under which debt no creditor or lender has direct or indirect recourse to us, or any other entity or person (except for customary exceptions for fraud, acts of insolvency, or other "bad acts"), if such assets are inadequate or unavailable to pay off such debt.

We are subject to risks relating to our liquidity and capital resources, including risks relating to incurring debt under residential loan warehouse facilities, securities repurchase facilities, and other short- and long-term debt facilities and other risks relating to our use of derivatives. A further discussion of these risks is set forth below under the heading "*Risks Relating to Debt Incurred under Short- and Long-Term Borrowing Facilities*" and in Part I, Item 1A - Risk Factors of this Annual Report on Form 10-K.

Cash Flows and Liquidity for the Year Ended December 31, 2020

Cash flows from our mortgage banking activities and our investments can be volatile from quarter to quarter depending on many factors, including the timing and amount of securities acquisitions, sales and repayments, the profitability of mortgage banking activities, as well as changes in interest rates, prepayments, and credit losses. Therefore, cash flows generated in the current period are not necessarily reflective of the long-term cash flows we will receive from these investments or activities.

During 2020, in response to the pandemic, we sold a significant amount of investments and repaid a significant amount of debt, which allowed us to reposition and de-lever our balance sheet and generate additional liquidity. Additionally, we entered into several new financing agreements that are non-marginable (i.e., not subject to margin calls based on the market value of the underlying, non-delinquent collateral) and non-recourse, and have longer dated maturities than agreements they replaced that were marginable and recourse to us. While the asset sales and pay-down of debt, along with these new financing agreements, strengthened our liquidity and capital position by removing sources of contingent liquidity risk (from potential market value-based margin calls on non-delinquent collateral), they have also reduced our overall amount of earning assets and in some cases have increased our borrowing costs. In the near-term, while we maintain a higher balance of cash, this will reduce our cash flows from operations. However, given our significant cash position, we believe we are positioned well to meet our near-term liquidity needs.

Cash Flows from Operating Activities

Cash flows from operating activities were negative \$505 million in 2020. This amount includes the net cash utilized during the period from the purchase and sale of residential mortgage loans and the origination and sale of our business purpose loans associated with our mortgage banking activities. Purchases of loans are financed to a large extent with short-term and long-term debt, for which changes in cash are included as a component of financing activities. Excluding cash flows from the purchase, origination, sale, and principal payments of loans classified as held-for-sale, cash flows from operating activities were positive \$91 million in 2020, negative \$76 million in 2019, and positive \$100 million in 2018.

As a result of the pandemic, in late March we determined that our hedges were no longer effectively managing the risks associated with certain of our assets and liabilities and we settled nearly all of our outstanding derivative positions. As a result of these settlements and other hedging activity during the quarter, we made \$187 million of cash payments. Additionally, during the six months ended June 30, 2020, our margin receivable (which was primarily associated with our hedges), decreased by \$207 million, resulting in an increase to our cash flows from operations. These changes in operating cash flows resulted from actions taken in response to the pandemic that we would generally not expect to recur at such a magnitude in subsequent periods. Additionally, during the six months ended June 30, 2020, we received \$38 million in cash related to FHLBC stock that was transferred back to the FHLBC, upon the repayment of substantially all of our borrowings from the FHLBC.

Cash Flows from Investing Activities

During 2020, our net cash provided by investing activities was \$4.07 billion and primarily resulted from proceeds from sales of loans and real estate securities, as well as principal payments on loans. Although we generally intend to hold our loans and investment securities as long-term investments, we may sell certain of these assets in order to manage our liquidity needs and interest rate risk, to meet other operating objectives, and to adapt to market conditions.

Because many of our investment securities and loans are financed through various borrowing agreements, a significant portion of the proceeds from any sales or principal payments of these assets are generally used to repay balances under these financing sources. Similarly, all or a significant portion of cash flows from principal payments of loans at consolidated securitization entities would generally be used to repay ABS issued by those entities.

As presented in the "*Supplemental Noncash Information*" subsection of our consolidated statements of cash flows, during 2020, 2019, and 2018, we transferred residential loans between held-for-sale and held-for-investment classification, retained securities from Sequoia and CAFL securitizations we sponsored, consolidated certain multifamily and re-performing residential securitization trusts, and deconsolidated certain multifamily securitization trusts, which represent significant non-cash transactions that were not included in cash flows from investing activities.

Cash Flows from Financing Activities

During 2020, our net cash used in financing activities was \$3.31 billion. This primarily resulted from \$1.81 billion of net repayments of short-term debt and \$2.97 billion of repayments of long-term debt, including repayments of \$2.00 billion of FHLBC borrowings, which were associated with the sales of a significant amount of assets noted in the investing activities section above. Additionally, we paid \$97 million to purchase and retire \$125 million of our convertible debt in the second quarter of 2020, and repurchased \$22 million of stock in the third quarter. These outflows of cash were partially offset by \$191 million of net proceeds from the issuance and settlements of ABS issued. Additionally, during the year ended December 31, 2020, we had cash inflows of \$1.47 billion related to borrowings under three new non-marginable facilities that were generally used to repay existing borrowings from marginable facilities.

During the year ended December 31, 2020, we declared dividends of \$0.725 per common share. On December 7, 2020, the Board of Directors declared a regular dividend of \$0.14 per share for the fourth quarter of 2020, which was paid on December 29, 2020 to shareholders of record on December 17, 2020.

In accordance with the terms of our outstanding deferred stock units and restricted stock units, which are stock-based compensation awards, each time we declare and pay a dividend on our common stock, we are required to make a dividend equivalent payment in that same per share amount on each outstanding deferred stock unit, cash-settled deferred stock unit, and restricted stock unit.

Repurchase Authorization

In February 2018, our Board of Directors approved an authorization for the repurchase of our common stock, increasing the total amount authorized for repurchases of common stock to \$100 million, and also authorized the repurchase of outstanding debt securities, including convertible and exchangeable debt. This authorization increased the previous share repurchase authorization approved in February 2016 and has no expiration date. This repurchase authorization does not obligate us to acquire any specific number of shares or securities. Under this authorization, shares or securities may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended. During the year ended December 31, 2020, we repurchased 3,047,335 shares of our common stock pursuant to this authorization for \$22 million. At December 31, 2020, \$78 million of the current authorization remained available for the repurchase of shares of our common stock and we also continued to be authorized to repurchase outstanding debt securities. Like other investments we may make, any repurchases of our common stock or debt securities under this authorization would reduce our available capital and unrestricted cash described above.

Leverage

Our debt-to-equity leverage ratio decreased during 2020, as we repositioned our debt structure and substantially decreased our balance of recourse debt. Additionally, our leverage ratio is impacted by the amount of loans we hold for sale at our mortgage banking businesses and our amount of undeployed capital available for investment.

In the second half of 2020, our acquisitions and purchase commitments of loans in our residential mortgage banking operations and origination volumes in our business purpose mortgage banking operations grew significantly and may continue to grow in 2021. We use short-term recourse debt to finance our loan inventory at both our mortgage banking operations and, all other factors being equal, as the balance of our loan inventory grows our overall leverage will also increase.

At December 31, 2020, we estimate we had approximately \$200 million of capital available for investment. As this capital is deployed, our leverage ratio is expected to increase, all other factors being equal, as we generally make investments in loans, securities, and other assets with a combination of capital and borrowings secured by the assets we invest in. In general, higher leverage creates greater liquidity risk as the amount of our equity relative to borrowings decreases, including liquidity risks of the types described in Part I, Item 1A of this Annual Report on Form 10-K under the heading "*Risk Factors*," and in Part II, Item 7A of this Annual Report on Form 10-K under the heading "*Market Risks*."

Leverage Used in our Mortgage Banking Activities

We generally use loan warehouse facilities to finance the residential loans we acquire and the business purpose loans we originate in our mortgage banking operations while we aggregate the loans for sale or securitization. These facilities may be designated as short-term or long-term for financial reporting purposes, depending on the remaining maturity of the facility or the amount of time individual borrowings may remain outstanding on a facility.

At December 31, 2020, we had residential loan warehouse facilities outstanding with four different counterparties, with \$1.30 billion of total capacity and \$1.16 billion of available capacity. These included non-marginable facilities with \$600 million of total capacity and marginable facilities with \$700 million of total capacity.

At December 31, 2020, we had business purpose loan warehouse facilities outstanding with four different counterparties, with \$1.00 billion of total capacity and \$785 million of available capacity. All of these facilities are non-marginable.

While we had significant available capacity under our residential warehouse facilities at December 31, 2020, given our large pipeline of residential loans identified for purchase at year-end, we may need to establish new facilities or increase our capacity on existing facilities to accommodate higher loan purchase volumes in 2021. Additionally, because several of our warehouse facilities are uncommitted, at any given time we may not be able to obtain additional financing under them when we need it, exposing us to, among other things, liquidity risks. Additional information regarding risks related to the debt we use to finance our mortgage banking operations can be found under the heading "*Risks Relating to Debt Incurred under Short- and Long-Term Borrowing Facilities*" that follows within this section.

Leverage Used in our Investment Portfolio

We use various forms of secured recourse and non-recourse debt to finance assets in our investment portfolio. We distinguish our debt between recourse and non-recourse, as our non-recourse debt is mostly comprised of ABS issued, which has unique characteristics that differentiate it in important ways from our recourse debt. When we refer to non-recourse debt, we mean debt that is payable solely from the assets pledged to secure such debt, and under which debt no creditor or lender has direct or indirect recourse to us, or any other entity or person (except for customary exceptions for fraud, acts of insolvency, or other "bad acts"), if such assets are inadequate or unavailable to pay off such debt.

ABS issued represents debt of securitization entities that we consolidate for GAAP reporting purposes. Our exposure to these entities is primarily through the financial interests we have purchased or retained from these entities (typically subordinate securities and interest only securities). 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. As the debt issued by these entities is not a direct obligation of Redwood, and since the debt generally can remain outstanding for the full term of the loans it is financing within each securitization, this debt effectively provides permanent financing for these assets.

Separately, we use non-recourse debt in the form of non-marginable term facilities to finance a portion of our business purpose bridge loan portfolio. While this debt is non-recourse to Redwood, it does have fixed terms with prepayment options that allows us to refinance this debt or ultimately repay it upon maturity.

The remainder of the debt we use to finance our investments is recourse debt. For securities we have financed, the majority of our financing is in the form of recourse non-marginable secured term debt, with the smaller remaining amount being marginable securities repurchase debt. Additionally, a portion of our business purpose bridge loan portfolio is financed with recourse non-marginable secured term debt.

At December 31, 2020, in aggregate, we had \$1.39 billion of secured recourse debt outstanding, financing our investment portfolio, of which \$97 million was marginable and \$1.29 billion was non-marginable.

Corporate Leverage

In addition to secured recourse and non-recourse leverage we use specifically in association with our mortgage banking operations and within our investment portfolio, we also use unsecured recourse debt to finance our overall operations. This is generally in the form of convertible debt securities we issue in the public markets and also includes trust preferred securities.

Short-Term Debt

In the ordinary course of our business, we use recourse debt through several different types of borrowing facilities and use cash borrowings under these facilities to, among other things, fund the acquisition of residential loans (including those we acquire and originate in anticipation of securitization), finance investments in securities and other investments, and otherwise fund our business and operations. During 2020, the highest balance of our short-term debt outstanding was \$3.23 billion.

See *Note 13* in Part II, Item 8 of this Annual Report on Form 10-K for additional information on our short-term debt.

Long-Term Debt

FHLBC Borrowings

In July 2014, our FHLB-member subsidiary entered into a borrowing agreement with the Federal Home Loan Bank of Chicago. Under this agreement, our subsidiary incurred borrowings, also referred to as "advances," from the FHLB secured by eligible collateral, including residential mortgage loans. Under a final rule published by the Federal Housing Finance Agency in January 2016, our FHLB-member subsidiary's membership in the FHLBC terminated in February 2021. Our FHLB-member subsidiary's existing \$1 million of FHLB debt, which matures beyond this transition period, is permitted to remain outstanding until its stated maturity. Advances under this agreement incur interest charges based on a specified margin over the FHLBC's 13-week discount note rate, which resets every 13 weeks.

At December 31, 2020, \$1 million of advances were outstanding under our FHLBC borrowing agreement, with a weighted average interest rate of 0.30%. These borrowings mature in 2026. At December 31, 2019, \$2.00 billion of advances were outstanding under this agreement, which were classified as long-term debt, with a weighted average interest rate of 1.88% and a weighted average maturity of six years. During the year ended December 31, 2020, we repaid \$2.00 billion of our FHLBC borrowings. At December 31, 2020, total advances under this agreement were secured by \$1 million of restricted cash. We do not expect to increase borrowings under our FHLBC borrowing agreement above the existing \$1 million of advances outstanding. This agreement also requires our subsidiary to purchase and hold stock in the FHLBC in an amount equal to a specified percentage of outstanding advances. At December 31, 2020, our subsidiary held \$5 million of FHLBC stock that is included in Other assets in our consolidated balance sheets.

Recourse Subordinate Securities Financing Facilities

In 2019, a subsidiary of Redwood entered into a repurchase agreement providing non-marginable (e.g., not subject to margin calls based on the market value of the underlying collateral) recourse debt financing of certain Sequoia securities as well as securities retained from our consolidated Sequoia Choice securitizations. The financing is fully and unconditionally guaranteed by Redwood, with an interest rate of approximately 4.21% through September 2022. The financing facility may be terminated, at our option, in September 2022, and has a final maturity in September 2024, provided that the interest rate on amounts outstanding under the facility increases between October 2022 and September 2024. At December 31, 2020, we had borrowings under this facility totaling \$178 million and \$1 million of unamortized deferred issuance costs, for a net carrying value of \$177 million. At December 31, 2020, the fair value of real estate securities pledged as collateral under this long-term debt facility was \$249 million and included Sequoia securities and securities retained from our Sequoia Choice securitizations.

In the first quarter of 2020, a subsidiary of Redwood entered into a second repurchase agreement with similar terms to provide non-marginable recourse debt financing of certain securities retained from our consolidated CAFL securitizations. The financing is fully and unconditionally guaranteed by Redwood, with an interest rate of approximately 4.21% through February 2023. The financing facility may be terminated, at our option, in February 2023, and has a final maturity in February 2025, provided that the interest rate on amounts outstanding under the facility increases between March 2023 and February 2025. At December 31, 2020, we had borrowings under this facility totaling \$103 million and \$1 million of unamortized deferred issuance costs, for a net carrying value of \$102 million. At December 31, 2020, the fair value of real estate securities pledged as collateral under this long-term debt facility was \$114 million and included securities retained from our consolidated CAFL securitizations.

Non-Recourse Business Purpose Loan Financing Facilities

In the third quarter of 2020, a subsidiary of Redwood entered into a repurchase agreement providing non-marginable, non-recourse financing primarily for business purpose bridge loans. Borrowings under this facility accrue interest at a per annum rate equal to one-month LIBOR plus 3.85% (with a 0.50% LIBOR floor) through July 2022. We do not have the ability to increase borrowings under this borrowing facility above the existing amounts outstanding. At December 31, 2020, we had borrowings under this facility totaling \$115 million and \$1 million of unamortized deferred issuance costs, for a net carrying value of \$114 million. At December 31, 2020, \$186 million of bridge loans were pledged as collateral under this facility.

In the second quarter of 2020, a subsidiary of Redwood entered into a repurchase agreement providing non-marginable, non-recourse financing primarily for business purpose bridge loans. Borrowings under this facility accrue interest at a per annum rate equal to one-month LIBOR plus 7.50% (with a 1.50% LIBOR floor) through June 2022. This facility is fully callable in June 2021. At December 31, 2020, this facility had an aggregate maximum borrowing capacity of \$372 million, which consisted of a term facility of \$197 million and a revolving facility of \$175 million. The revolving period ends in June 2021, and amounts borrowed under the term and revolving facilities are due in full in June 2022. At December 31, 2020, we had borrowings under this facility totaling \$252 million and \$2 million of unamortized deferred issuance costs, for a net carrying value of \$249 million. At December 31, 2020, \$338 million of bridge loans and \$21 million of other BPL investments were pledged as collateral under this facility.

Recourse Business Purpose Loan Financing Facilities

In the third quarter of 2020, a subsidiary of Redwood entered into a repurchase agreement providing non-marginable financing for business purpose bridge loans and single-family rental loans. Borrowings under this facility accrue interest at a per annum rate equal to three-month LIBOR plus 3.00% through September 2023 and are recourse to Redwood. This facility has an aggregate maximum borrowing capacity of \$250 million. At December 31, 2020, we had borrowings under this facility totaling \$80 million and \$0.2 million of unamortized deferred issuance costs, for a net carrying value of \$80 million. At December 31, 2020, \$106 million of single-family rental loans were pledged as collateral under this facility.

In the second quarter of 2020, a subsidiary of Redwood entered into a repurchase agreement providing non-marginable financing for business purpose bridge loans and single-family rental loans. Borrowings under this facility accrue interest at a per annum rate equal to three-month LIBOR plus 3.00% to 3.50% (with a 1.00% LIBOR floor) through May 2022 and are recourse to Redwood. This facility has an aggregate maximum borrowing capacity of \$350 million. At December 31, 2020, we had borrowings under this facility totaling \$52 million and \$0.5 million of unamortized deferred issuance costs, for a net carrying value of \$51 million. At December 31, 2020, \$24 million of bridge loans and \$49 million of single-family rental loans were pledged as collateral under this facility.

Recourse Revolving Debt Facility

In the first quarter of 2020, a subsidiary of Redwood entered into a secured revolving debt facility agreement collateralized by MSRs and certificated mortgage servicing rights. Borrowings under this facility accrue interest at a per annum rate equal to one-month LIBOR plus 3.00% through January 2021, with an increase in rate between February 2021 and the maturity of the facility in January 2022. This facility has an aggregate maximum borrowing capacity of \$50 million. We had no borrowings outstanding under this facility at December 31, 2020.

Convertible Notes

In September 2019, one of our taxable subsidiaries issued \$201 million principal amount of 5.75% exchangeable senior notes due 2025. After deducting the underwriting discount and offering costs, we received approximately \$195 million of net proceeds. Including amortization of deferred debt issuance costs, the weighted average interest expense yield on these exchangeable notes is approximately 6.3% per annum. During the second quarter of 2020, we repurchased \$29 million par value of these notes at a discount and recorded a gain on extinguishment of \$6 million in Realized gains, net on our consolidated statements of income (loss). At December 31, 2020, the outstanding principal amount of these notes was \$172 million and the accrued interest payable balance on this debt was \$2 million.

In June 2018, we issued \$200 million principal amount of 5.625% convertible senior notes due 2024 at an issuance price of 99.5%. After deducting the issuance discount, the underwriting discount and offering costs, we received approximately \$194 million of net proceeds. Including amortization of deferred debt issuance costs and the debt discount, the weighted average interest expense yield on these convertible notes is approximately 6.2% per annum. During the second quarter of 2020, we repurchased \$50 million par value of these notes at a discount and recorded a gain on extinguishment of \$9 million in Realized gains, net on our consolidated statements of income (loss). At December 31, 2020, the outstanding principal amount of these notes was \$150 million and the accrued interest payable on this debt was \$4 million.

In August 2017, we issued \$245 million principal amount of 4.75% convertible senior notes due 2023. After deducting the underwriting discount and issuance costs, we received approximately \$238 million of net proceeds. Including amortization of deferred debt issuance costs, the weighted average interest expense yield on these convertible notes is approximately 5.3% per annum. During the second quarter of 2020, we repurchased \$46 million par value of these notes at a discount and recorded a gain on extinguishment of \$10 million in Realized gains, net on our consolidated statements of income (loss). At December 31, 2020, the outstanding principal amount of these notes was \$199 million and the accrued interest payable balance on this debt was \$4 million.

Trust Preferred Securities and Subordinated Notes

At December 31, 2020, we had trust preferred securities and subordinated notes outstanding of \$100 million and \$40 million, respectively, issued by us in 2006 and 2007. This debt requires quarterly interest payments at a floating rate equal to three-month LIBOR plus 2.25% and must be redeemed no later than 2037.

Asset-Backed Securities Issued

ABS Issued represents asset-backed securities issued to third parties by securitization entities that we consolidate in accordance with GAAP. See *Note 4* in Part II, Item 8 of this Annual Report on Form 10-K, for additional information on our principals of consolidation and *Note 14* in Part II, Item 8 of this Annual Report on Form 10-K, for additional information on our asset-backed securities issued. The following discusses significant activity within our ABS issued during 2020.

During the first quarter of 2020, we sold subordinate securities issued by four Freddie Mac K-Series securitization trusts we previously consolidated and determined that we should derecognize the associated assets and liabilities of each of these entities for financial reporting purposes. As a result, during the first quarter of 2020, we deconsolidated \$3.86 billion of multifamily loans and other assets and \$3.72 billion of multifamily ABS issued.

During the year ended December 31, 2020, we issued \$1.64 billion of ABS through our consolidated securitization entities. This included \$1.19 billion and \$249 million of CAFL and Sequoia Choice ABS issued, respectively, as well as \$205 million of ABS issued through a re-securitization entity sponsored by us during the year ended December 31, 2020.

Other Commitments and Contingencies

For additional information on commitments and contingencies that could impact our liquidity and capital resources, see *Note 16* in Part II, Item 8 of this Annual Report on Form 10-K.

COVID-19 Pandemic-Related Mortgage Payment Forbearances

In response to the personal financial impacts of the pandemic, many residential mortgage borrowers have sought, or are seeking, forbearance with respect to monthly mortgage payment obligations. We are exposed to the negative financial impact of COVID-19 related payment forbearances with respect to loans securitized in Sequoia transactions, loans held for investment or sale, and a variety of other investments, including third-party issued mortgage-backed securities, mortgage servicing rights and related cash flows, and re-performing residential mortgage loans. Business purpose mortgage loan borrowers may also seek payment forbearances. In addition, transactions we have entered into, including to finance loans with warehouse financing providers and to sell whole loans to third parties, may be negatively impacted by COVID-19 related payment forbearances, including by reducing our proceeds from these transactions or if we are required to repurchase impacted loans.

Mortgage Servicing Advance Obligations

Redwood's liquidity exposure to advancing obligations associated with residential mortgage servicing rights ("MSRs") is primarily related to our Sequoia private-label residential mortgage backed securities ("RMBS"). The residential mortgage loans backing our Sequoia securities were generally originated as prime quality residential mortgage loans with strong credit characteristics. These loans were sourced from our residential mortgage platform through our network of loan sellers, including banks and independent mortgage companies, and were acquired after undergoing our review and underwriting process.

We outsource our residential mortgage servicing activity to third-party sub-servicers and do not directly service residential mortgage loans. We carry out a servicing oversight function and, in some cases, are obligated to reimburse our sub-servicers when they fund advances of principal and interest ("P&I"), taxes and insurance ("T&I"), and certain other amounts related to securitized mortgage loans.

As of December 31, 2020, we had \$0.4 million of servicing advances outstanding related to principal and interest on Sequoia securitized loans for which we had servicing advance funding obligations.

Risks Relating to Debt Incurred under Short- and Long-Term Borrowing Facilities

As described above under the heading "*Results of Operations*," in the ordinary course of our business, we use debt financing obtained through several different types of borrowing facilities to, among other things, finance the acquisition and origination of residential and business purpose mortgage loans (including those we acquire and originate in anticipation of sale or securitization), and finance investments in securities and other investments. We may also use short- and long-term borrowings to fund other aspects of our business and operations, including the repurchase of shares of our common stock. Debt incurred under these facilities is generally either the direct obligation of Redwood Trust, Inc., or the direct obligation of subsidiaries of Redwood Trust, Inc. and guaranteed by Redwood Trust, Inc.

Residential and Business Purpose Loan Warehouse Facilities. One source of our debt financing is secured borrowings under loan warehouse facilities. These facilities may be designated as short-term or long-term for financial reporting purposes, depending on the remaining maturity of the facility or the amount of time individual borrowings may remain outstanding on a facility. Residential loan warehouse facilities were in place with four different financial institution counterparties as of December 31, 2020. In addition, as of December 31, 2020, we had business purpose loan warehouse facilities secured by single-family rental loans and bridge loans, in place with four financial institution counterparties. Under the four residential loan warehouse facilities, we had an aggregate borrowing limit of \$1.30 billion at December 31, 2020, and under the five business purpose loan warehouse facilities we had an aggregate borrowing limit of \$1.19 billion at December 31, 2020. However, several of these facilities are uncommitted, which means that any request we make to borrow funds under these facilities may be declined for any reason, even if at the time of the borrowing request we have then-outstanding borrowings that are less than the borrowing limits under these facilities. Financing for residential or business purpose mortgage loans is obtained under these facilities by our transfer of mortgage loans to the counterparty in exchange for cash proceeds (in an amount less than 100% of the principal amount of the transferred mortgage loans), and our covenant to reacquire those loans from the counterparty for the same amount plus a financing charge.

In order to obtain financing for a residential or business purpose loan under these facilities, the loan must initially (and continuously while the financing remains outstanding) meet certain eligibility criteria, including, without limitation, that the loan is not in a delinquent status, except that certain loan facilities may allow a loan to continue to be financed if it becomes delinquent, if it meets specified conditions. In addition, under these warehouse facilities, residential or business purpose loans can only be financed for a maximum period, which period may be limited to 364 days for our short-term warehouse facilities. We generally intend to repay the financing of a loan under one of these facilities at or prior to the expiration of that financing with the proceeds of a securitization or other sale of that loan, through the proceeds of other short-term or long-term borrowings, or with other equity or long-term debt capital.

Our warehouse facilities may be marginable or non-marginable. When we refer to non-marginable debt and marginable debt, we are referring to whether such debt is subject to market value-based margin calls on underlying collateral that is non-delinquent. If a mortgage loan is financed under a marginable warehouse facility, to the extent the market value of the loan declines (which market value is generally determined by the counterparty under the facility), we will be subject to a margin call, meaning we will be required to either immediately reacquire the loan or meet a margin requirement to pledge additional collateral, such as cash or additional residential loans, in an amount at least equal to the decline in value. Some of our non-marginable warehouse facilities may be subject to a margin call due to delinquency of the mortgage or security being financed, or a decline in the value of the asset securing the collateral. For example, under certain agreements, we could be subject to a margin call on non-marginable debt if an appraisal or broker price opinion indicates a decline in the value of the property securing the mortgage loan that is financed by us under a loan warehouse facility. See further discussion below under the heading “*Margin Call Provisions Associated with Short-Term Debt and Other Debt Financing.*”

Because several of these warehouse facilities are uncommitted, at any given time we may not be able to obtain additional financing under them when we need it, exposing us to, among other things, liquidity risks of the types described in Part I, Item 1A of this Annual Report on Form 10-K under the heading “*Risk Factors,*” and in Part II, Item 7A of this Annual Report on Form 10-K under the heading “*Market Risks.*” In addition, with respect to residential or business purpose loans that at any given time are already being financed through these warehouse facilities, we are exposed to market, credit, liquidity, and other risks of the types described in Part I, Item 1A of this Annual Report on Form 10-K under the heading “*Risk Factors,*” and in Part II, Item 7A of this Annual Report on Form 10-K under the heading “*Market Risks,*” if and when those loans become ineligible to be financed, decline in value, or have been financed for the maximum term permitted under the applicable facility.

Under our residential and business purpose loan warehouse facilities, we also make various representations and warranties and have agreed to certain covenants, events of default, and other terms that if breached or triggered can result in our being required to immediately repay all outstanding amounts borrowed under these facilities and these facilities being unavailable to use for future financing needs. In particular, the terms of these facilities include financial covenants, cross-default provisions, judgment default provisions, and other events of default (such as, for example, events of default triggered by one of the following: a change in control over Redwood, regulatory investigation or enforcement action against Redwood, Redwood’s failure to continue to qualify as a REIT for tax purposes, or Redwood’s failure to maintain the listing of its common stock on the New York Stock Exchange). Under a cross-default provision, an event of default is triggered (and the warehouse facility becomes unavailable and outstanding amounts borrowed thereunder become due and payable) if an event of default or similar event occurs under another borrowing or credit facility we maintain in excess of a specified amount. Under a judgment default provision, an event of default is triggered (and the warehouse facility becomes unavailable and outstanding amounts borrowed thereunder become due and payable) if a judgment for damages in excess of a specified amount is entered against us in any litigation and we are unable to promptly satisfy the judgment. Financial covenants included in these warehouse facilities are further described below under the heading “*Financial Covenants Associated with Short-Term Debt and Other Debt Financing.*”

These residential and business purpose loan warehouse facilities could also become unavailable and outstanding amounts borrowed thereunder could become immediately due and payable if there is a material adverse change in our business. If we breach or trigger the representations and warranties, covenants, events of default, or other terms of our warehouse facilities, we are exposed to liquidity and other risks, including of the type described in Part I, Item 1A of this Annual Report on Form 10-K under the heading “*Risk Factors,*” and in Part II, Item 7A of this Annual Report on Form 10-K under the heading “*Market Risks.*”

In addition to the residential and business purpose loan warehouse facilities described above, in the ordinary course of business we may seek to establish additional warehouse facilities that may be of a similar or greater size and may have similar or more restrictive terms. In the event a counterparty to one or more of our warehouse facilities becomes insolvent or unable or unwilling to perform its obligations under the facility, we may be unable to access short-term financing we need or fail to recover the full value of our mortgage loans financed.

Securities Repurchase Facilities. Another source of short-term debt financing is through securities repurchase facilities we have established with various different financial institution counterparties. Under these facilities we do not have an aggregate borrowing limit; however, these facilities are uncommitted, which means that any request we make to borrow funds under these facilities may be declined for any reason. Short-term financing for securities is obtained under these facilities by our transfer of securities to the counterparty in exchange for cash proceeds (in an amount less than 100% of the fair value of the transferred securities), and our covenant to reacquire those securities from the counterparty for the same amount plus a financing charge.

Under these securities repurchase facilities, securities are financed for a fixed period, which would not generally exceed 90 days. We generally intend to repay the short-term financing of a security under one of these facilities through a renewal of that financing with the same counterparty, through a sale of the security, or with other equity or long-term debt capital. While a security is financed under a securities repurchase facility, to the extent the value of the security declines (which value is generally determined by the counterparty under the facility), we are required to either immediately reacquire the security or meet a margin requirement to pledge additional collateral, such as cash or U.S. Treasury securities, in an amount at least equal to the decline in value. See further discussion below under the heading “*Margin Call Provisions Associated with Short-Term Debt and Other Debt Financing.*”

At the end of the fixed period applicable to the financing of a security under a securities repurchase facility, if we intend to continue to obtain financing for that security we would typically request the same counterparty to renew the financing for an additional fixed period. If the same counterparty does not renew the financing, it may be difficult for us to obtain financing for that security under one of our other securities repurchase facilities, due to the fact that the financial institution counterparties to our securities repurchase facilities generally only provide financing for securities that we purchased from them or one of their affiliates.

Because our securities repurchase facilities are uncommitted, at any given time we may not be able to obtain additional financing under them when we need it, exposing us to, among other things, liquidity risks of the types described in Part I, Item 1A of this Annual Report on Form 10-K under the heading “*Risk Factors,*” and in Part II, Item 7A of this Annual Report on Form 10-K under the heading “*Market Risks.*” In addition, with respect to securities that at any given time are already being financed through our securities repurchase facilities, we are exposed to market, credit, liquidity, and other risks of the types described in Part I, Item 1A of this Annual Report on Form 10-K under the heading “*Risk Factors,*” and in Part II, Item 7A of this Annual Report on Form 10-K under the heading “*Market Risks,*” if and when those securities decline in value, or have been financed for the maximum term permitted under the applicable facility.

Under our securities repurchase facilities, we also make various representations and warranties and have agreed to certain covenants, events of default, and other terms (including of the type described above under the heading “*Residential and Business Purpose Loan Warehouse Facilities*”) that if breached or triggered can result in our being required to immediately repay all outstanding amounts borrowed under these facilities and these facilities being unavailable to use for future financing needs. In particular, the terms of these facilities include financial covenants, cross-default provisions, judgment default provisions, and other events of default (including of the type described above under the heading “*Residential and Business Purpose Loan Warehouse Facilities*”). Financial covenants included in our repurchase facilities are further described below under the heading “*Financial Covenants Associated with Short-Term Debt and Other Debt Financing.*”

Our securities repurchase facilities could also become unavailable and outstanding amounts borrowed thereunder could become immediately due and payable if there is a material adverse change in our business. If we breach or trigger the representations and warranties, covenants, events of default, or other terms of our securities repurchase facilities, we are exposed to liquidity and other risks, including of the type described in Part I, Item 1A of this Annual Report on Form 10-K under the heading “*Risk Factors,*” and in Part II, Item 7A of this Annual Report on Form 10-K under the heading “*Market Risks.*”

In the ordinary course of business we may seek to establish additional securities repurchase facilities that may have similar or more restrictive terms. In the event a counterparty to one or more of our securities repurchase facilities becomes insolvent or unable or unwilling to perform its obligations under the facility, we may be unable to access the short-term financing we need or fail to recover the full value of our securities financed.

Other Short-Term Debt Facility. We also maintain a \$10 million committed line of short-term credit from a bank, which is secured by our pledge of certain mortgage-backed securities we own. This bank line of credit is an additional source of short-term financing for us. Similar to the uncommitted warehouse and securities repurchase facilities described herein, under this committed line we make various representations and warranties and have agreed to certain covenants, events of default, and other terms that if breached or triggered can result in our being required to immediately repay all outstanding amounts borrowed under this facility and this facility being unavailable to use for future financing needs. The margin call provisions and financial covenants included in this committed line are further described below under the headings “*Margin Call Provisions Associated with Short-Term Debt and Other Debt Financing*” and “*Financial Covenants Associated with Short-Term Debt and Other Debt Financing.*” When we use this committed line to incur short-term debt we are exposed to the market, credit, liquidity, and other types of risks described above with respect to residential loan warehouse and securities repurchase facilities.

Servicer Advance Financing. In connection with our servicer advance investments, we consolidate an entity that was formed to finance servicing advances and for which we, through our control of an affiliated entity majority owned by Redwood (the "SA Buyer") formed to invest in servicer advance investments and excess MSR, are the primary beneficiary. The servicer advance financing consists of non-recourse short-term securitization debt, secured by servicer advances. We consolidate the securitization entity that issued the debt, but the securitization entity is independent of Redwood and the assets and liabilities are not owned by and are not legal obligations of Redwood.

SA Buyer has agreed to purchase all future arising servicer advances under certain residential mortgage servicing agreements. SA Buyer relies, in part, on its members to make committed capital contributions in order to pay the purchase price for future servicer advances. A failure by any or all of the members to make such capital contributions for amounts required to fund servicer advances could result in an event of default under our servicer advance financing and a complete loss of our investment in SA Buyer and its servicer advance investments and excess MSR. Additionally, to the extent that the servicer of the underlying mortgage loans (who is unaffiliated with us except through its co-investment in SA Buyer and the securitization entity) fails to recover the servicer advances in which we have invested, or takes longer than we expect to recover such advances, the value of our investment could be adversely affected and we could fail to achieve our expected return and suffer losses.

The outstanding balance of servicer advances securing the financing is not likely to be repaid on or before the maturity date of such financing arrangement. We expect to request the same counterparty or another one of our financing sources to renew or refinance the financing for an additional fixed period; however, there can be no assurance that we will be able to extend the financing arrangement upon the expiration of its stated term, which subjects us to a number of risks. A financing source that elects to extend or refinance may charge higher interest rates and impose more onerous terms upon us, including without limitation, lowering the amount of financing that can be extended against the servicer advances being financed. If we are unable to renew or refinance the servicer advance financing, the securitization entity will be required to repay the outstanding balance of the financing on the related maturity date. Additionally, there may be substantial increases in the interest rates under the financing arrangement if the debt is not repaid, extended or refinanced prior to the expected repayment date, which may be before the related maturity date. If the securitization entity is unable to pay the outstanding balance of the notes, the financing counterparty may foreclose on the servicer advances pledged as collateral.

Under this servicer advance financing, SA Buyer and the securitization entity, along with the servicer, make various representations and warranties and have agreed to certain covenants, events of default, and other terms that if breached or triggered can result in acceleration of all outstanding amounts borrowed under this facility and this facility being unavailable to use for future financing needs. We do not have the direct ability to control the servicer’s compliance with such covenants and tests and the failure of SA Buyer, the securitization entity, or the servicer to satisfy any such covenants or tests could result in a partial or total loss on our investment. The financial covenants of SA Buyer included in this servicer advance financing are further described below under the heading “*Financial Covenants Associated with Short-Term Debt and Other Debt Financing.*”

FHLB Borrowing Facility. Our wholly-owned subsidiary, RWT Financial, LLC, is a party to a secured borrowing facility with the Federal Home Loan Bank of Chicago (FHLBC) that was put into place in July 2014. Borrowings under this facility, also referred to as “advances,” are required to be secured by eligible collateral including, but not limited to, residential and business purpose mortgage loans and residential mortgage-backed securities. As a result of the economic and financial market impacts of the pandemic, the terms of our FHLBC facility evolved and we transferred or sold nearly all of our residential loans previously financed at the FHLBC, and repaid all but \$1 million of borrowings under this facility. Additionally, pursuant federal regulations adopted in January 2016 by the Federal Housing Finance Agency, RWT Financial’s membership in the FHLBC terminated in February 2021. Our FHLB-member subsidiary’s existing \$1 million of FHLB debt, which matures beyond this transition period, is permitted to remain outstanding until stated maturity. At December 31, 2020, \$1 million of advances were outstanding under this facility. FHLBC facility above the existing \$1 million of borrowings outstanding.

Subordinate Securities Financing Facilities. Another source of long-term debt financing is through subordinate securities financing facilities providing non-mark-to-market recourse debt financing on a portfolio of subordinate securities. Financing for the securities was obtained under these facilities by our transfer of securities to the counterparty in exchange for cash proceeds (in an amount less than 100% of the fair value of the transferred *securities*), and our covenant to reacquire those securities from the counterparty for the same amount plus a financing charge. These financing facilities are fully and unconditionally guaranteed by Redwood.

One financing facility may be terminated, at our option, in September 2022, and has a final maturity in September 2024, provided that the interest rate on amounts outstanding under the facility increases between October 2022 and September 2024. At December 31, 2020, we had borrowings under this facility totaling \$178 million and \$1 million of unamortized deferred issuance costs, for a net carrying value of \$177 million. At December 31, 2020, the fair value of real estate securities pledged as collateral under this long-term debt facility was \$249 million and included Sequoia securities and securities retained from our Sequoia Choice securitizations.

Another financing facility may be terminated, at our option, in February 2023, and has a final maturity in February 2025, provided that the interest rate on amounts outstanding under the facility increases between March 2023 and February 2025. At December 31, 2020, we had borrowings under this facility totaling \$103 million and \$1 million of unamortized deferred issuance costs, for a net carrying value of \$102 million. At December 31, 2020, the fair value of real estate securities pledged as collateral under this long-term debt facility was \$114 million and included securities retained from our consolidated CAFL securitizations.

In addition to the subordinate securities financing facilities described above, in the ordinary course of business we may seek to establish additional long-term securities repurchase facilities that may be of a similar or greater size and may have similar or more restrictive terms.

Similar to the uncommitted warehouse and securities repurchase facilities described herein, under these facilities we make various representations and warranties and have agreed to certain covenants, events of default, and other terms that if breached or triggered can result in our being required to immediately repay all outstanding amounts borrowed under this facility and this facility being unavailable to use for future financing needs. In particular, outstanding amounts borrowed under this facility could become immediately due and payable if there is a failure to pay any amounts due under the facility, the failure to repurchase the securities by the final maturity date, or upon the insolvency of Redwood, as guarantor. If we breach or trigger the representations and warranties, covenants, events of default, or other terms of this subordinate securities financing facility, we are exposed to liquidity and other risks, including of the type described in Part I, Item 1A of this Annual Report on Form 10-K under the heading “*Risk Factors*,” and in Part II, Item 7A of this Annual Report on Form 10-K under the heading “*Market Risks*.”

Financial Covenants Associated With Short-Term Debt and Other Debt Financing

Set forth below is a summary of the financial covenants associated with our short-term debt and other debt financing facilities.

- Residential and Business Purpose Loan Warehouse Facilities. As noted above, one source of our debt financing is secured borrowings under residential and business purpose loan warehouse facilities we have established and, as of December 31, 2020, were in place with several different financial institution counterparties. Financial covenants included in these warehouse facilities are as follows and at December 31, 2020, and through the date of this Annual Report on Form 10-K, we were in compliance with each of these financial covenants:
 - Maintenance of a minimum dollar amount of stockholders' equity/tangible net worth at Redwood.
 - Maintenance of a minimum dollar amount of cash and cash equivalents at Redwood.
 - Maintenance of a maximum ratio of consolidated recourse indebtedness to stockholders' equity and tangible net worth at Redwood.
 - With respect to residential loan warehouse facilities, maintenance of uncommitted residential loan warehouse facilities with a specified level of available borrowing capacity.
- Securities Repurchase Facilities. As noted above, another source of our short-term debt financing is through secured borrowings under securities repurchase facilities we have established with various financial institution counterparties. Financial covenants included in these securities repurchase facilities are as follows and at December 31, 2020, and through the date of this Annual Report on Form 10-K, we were in compliance with each of these financial covenants:
 - Maintenance of a minimum dollar amount of stockholders' equity/tangible net worth at Redwood.
 - Maintenance of a minimum dollar amount of cash and cash equivalents at Redwood.
 - Maintenance of a maximum ratio of consolidated recourse indebtedness to consolidated adjusted tangible net worth at Redwood.
- Committed Line of Credit. As noted above, we also maintain a \$10 million committed line of short-term credit from a bank, which is secured by our pledge of certain mortgage-backed securities we own. The types of financial covenants included in this bank line of credit are a subset of the covenants summarized above.
- Servicer Advance Financing. As noted above, servicer advance financing consists of non-recourse short-term securitization debt, secured by servicing advances. Financial covenants associated with this financing facility are as follows and at December 31, 2020, and through the date of this Annual Report on Form 10-K, we were in compliance with each of these financial covenants:
 - Maintenance of a minimum dollar amount of stockholders' equity/tangible net worth at SA Buyer.
 - Maintenance of a minimum dollar amount of cash and cash equivalents at SA Buyer.

As noted above, at December 31, 2020, and through the date of this Annual Report on Form 10-K, we were in compliance with the financial covenants associated with our short-term debt and other debt financing facilities. In particular, with respect to: (i) financial covenants that require us to maintain a minimum dollar amount of stockholders' equity or tangible net worth at Redwood, at December 31, 2020 our level of stockholders' equity and tangible net worth resulted in our being in compliance with these covenants by more than \$200 million; and (ii) financial covenants that require us to maintain recourse indebtedness below a specified ratio at Redwood, at December 31, 2020 our level of recourse indebtedness resulted in our being in compliance with these covenants at a level such that we could incur at least \$600 million in additional recourse indebtedness.

Margin Call Provisions Associated With Short-Term Debt and Other Debt Financing

- Residential and Business Purpose Loan Warehouse Facilities. As noted above, one source of our debt financing is secured borrowings under residential and business purpose loan warehouse facilities we have established and, as of December 31, 2020, were in place with several different financial institution counterparties. These warehouse facilities include the margin call provisions described below and during the twelve months ended December 31, 2020, and through the date of this Annual Report on Form 10-K, we complied with any margin calls received from creditors under these warehouse facilities:

- Under our marginable residential warehouse facilities, if at any time the market value (as determined by the creditor) of any residential mortgage loan financed under a facility declines, then the creditor may demand that we transfer additional collateral to the creditor (in the form of cash, U.S. Treasury obligations (in certain cases), or additional residential mortgage loans) with a value equal to the amount of the decline. If we receive any such demand, (i) under one of our residential loan warehouse facilities, we would generally be required to transfer the additional collateral on the same day (although demands received after a certain time would only require the transfer of additional collateral on the following business day) and (ii) under one of our residential loan warehouse facilities, we would generally be required to transfer the additional collateral on the following business day. The value of additional residential and business purpose mortgage loans transferred as additional collateral is determined by the creditor.
- Under certain non-marginable residential and business purpose warehouse facilities, if the value of the asset securing the mortgage loan financed under a facility declines (as determined by an appraisal or broker price opinion), then the creditor may demand that we transfer additional collateral to the creditor (in the form of cash, U.S. Treasury obligations (in certain cases), or additional mortgage loans) with a value equal to the amount of the decline. The conditions precedent to which the creditor may request updated valuation reports varies by agreement, including, for example, based on the number of days the loan has been financed under such facility. If we receive any such demand as a result of a margin deficit based on an updated valuation report, we would generally be required to transfer the additional collateral within one to five business days depending on the terms of the agreement. The value of additional residential and business purpose mortgage loans transferred as additional collateral is determined by the creditor.
- Securities Repurchase Facilities. Another source of our short-term debt financing is through secured borrowings under securities repurchase facilities we have established with various financial institution counterparties. These repurchase facilities include the margin call provisions described below and during the twelve months ended December 31, 2020, and through the date of this Annual Report on Form 10-K, we complied with any margin calls received from creditors under these repurchase facilities:
 - If at any time the market value (as determined by the creditor) of any securities financed under a facility declines, then the creditor may demand that we transfer additional collateral to the creditor (in the form of cash, U.S. Treasury obligations, or additional securities) with a value equal to the amount of the decline. If we receive any such demand, we would generally be required to transfer the additional collateral on the same day. The value of additional securities transferred as additional collateral is determined by the creditor.
- Committed Line of Credit. As noted above, we also maintain a \$10 million committed line of short-term credit from a bank, which is secured by our pledge of certain mortgage-backed securities we own. Margin call provisions included in this bank line of credit are as follows and during the twelve months ended December 31, 2020, and through the date of this Annual Report on Form 10-K, we complied with any margin calls received from this creditor under this line of credit:
 - If at any time the total market value (as determined by two broker-dealers) of the securities that are pledged as collateral under this facility declines to a value less than the outstanding amount of borrowings under this facility, then the creditor may demand that we transfer additional collateral to the creditor (in the form of cash, U.S. Treasury obligations, or additional securities) with a value equal to the amount of the difference. If we receive any such demand, we would generally be required to transfer the additional collateral within two business days. The value of additional collateral pledged is determined by the creditor.

OFF BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

In the normal course of business, we engage in financial transactions that may not be recorded on the balance sheet. For additional information on our commitments and contingencies, refer to *Note 16* in Part II, Item 8 of this Annual Report.

The following table presents our contractual obligations and commitments at December 31, 2020, as well as the obligations of the securitization entities that we consolidate for financial reporting purposes.

Table 27 – Contractual Obligations and Commitments

December 31, 2020 (In Millions)	Payments Due or Commitment Expiration by Period				
	Less Than 1 Year	1 to 3 Years	3 to 5 Years	After 5 Years	Total
Obligations of Redwood					
Short-term debt	\$ 315	\$ —	\$ —	\$ —	\$ 315
Convertible notes	—	199	322	—	521
Anticipated interest payments on convertible notes	28	56	28	—	112
Other long-term debt	—	780	—	141	921
Anticipated interest payments on other long-term debt	53	65	19	105	242
Accrued interest payable	14	—	—	—	14
Operating leases	3	6	4	7	20
Total Redwood Obligations and Commitments	\$ 413	\$ 1,106	\$ 373	\$ 253	\$ 2,145
Obligations of Consolidated Securitization Entities for Financial Reporting Purposes					
Consolidated ABS ⁽¹⁾	\$ —	\$ —	\$ —	\$ 6,638	\$ 6,638
Anticipated interest payments on ABS ⁽²⁾	251	469	386	958	2,064
Non-recourse short-term debt	208	—	—	—	208
Accrued interest payable	21	—	—	—	21
Total Obligations of Securitization Entities Consolidated for Financial Reporting Purposes	480	469	386	7,596	8,931
Total Consolidated Obligations and Commitments	\$ 893	\$ 1,575	\$ 759	\$ 7,849	\$ 11,076

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

(2) The anticipated interest payments on consolidated ABS issued is calculated based on the contractual maturity of the ABS and therefore assumes no prepayments of the principal outstanding at December 31, 2020.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates. A discussion of critical accounting policies and the possible effects of changes in estimates on our consolidated financial statements is included in *Note 2 — Basis of Presentation and Note 3 — Summary of Significant Accounting Policies* included in Part II, Item 8 of this Annual Report on Form 10-K. Management discusses the ongoing development and selection of these critical accounting policies with the audit committee of the board of directors.

We expect quarter-to-quarter GAAP earnings volatility from our business activities. This volatility can occur for a variety of reasons, including the timing and amount of purchases, sales, calls, and repayment of consolidated assets, changes in the fair values of consolidated assets and liabilities, increases or decreases in earnings from mortgage banking activities, and certain non-recurring events. In addition, the amount or timing of our reported earnings may be impacted by technical accounting issues and estimates, some of which are described below.

Changes in the Fair Value of Loans Held at Fair Value

We have elected the fair value option for our residential loans held-for-sale, residential loans, business purpose loans, and multifamily loans. As such, these loans are carried on our consolidated balance sheets at their estimated fair value and changes in the fair values of these loans are recorded in Mortgage banking activities, net or Investment fair value changes, net on our consolidated statements of income in the period in which the valuation change occurs. Periodic fluctuations in the values of these investments are inherently volatile and thus can lead to significant period-to-period GAAP earnings volatility.

The fair value of loans is affected by, among other things, changes in interest rates, credit performance, prepayments, and market liquidity. To the extent interest rates change or market liquidity and or credit conditions materially change, the value of these loans could decline, which could have a material effect on reported earnings.

Changes in Fair Values of Securities

Our securities are classified as either trading or AFS securities, and in both cases are carried on our consolidated balance sheets at their estimated fair values. In addition, we invest in securities of certain securitization entities that we are required to consolidate for GAAP reporting purposes. We have elected to account for these entities as collateralized financing entities and use the fair value of the ABS issued by these entities (which we determined to be more observable) to determine the fair value of the loans held at these entities. For trading securities and collateralized financing entities, changes in fair values are recorded in Investment fair value changes, net on our consolidated statements of income in the period in which the valuation change occurs. Periodic fluctuations in the values of these investments are inherently volatile and thus can lead to significant period-to-period GAAP earnings volatility.

For AFS securities, cumulative unrealized gains and losses are recorded as a component of Accumulated other comprehensive income in our consolidated balance sheets. Unrealized gains are not credited to current earnings and unrealized losses are not charged against current earnings to the extent they are temporary in nature. Certain factors may require us, however, to recognize a decline in the value of AFS securities as an allowance for credit losses recorded through our current earnings. Factors that determine other-than-temporary-impairment include a change in our ability or intent to hold AFS securities, adverse changes to projected cash flows of assets, or the likelihood that declines in the fair values of assets would not return to their previous levels within a reasonable time. Loss reserves on AFS securities can lead to significant period-to-period GAAP earnings volatility. In addition, sales of securities in large unrealized gain or loss positions that are not impaired can lead to significant period-to-period GAAP earnings volatility.

Changes in Fair Values of Servicer Advance Investments

Servicer advance investments are carried on our consolidated balance sheets at their estimated fair values, with changes in fair values recorded in our consolidated statements of income in Investment fair value changes, net. Periodic fluctuations in the values of our servicer advance investments can be caused by changes in the actual and anticipated balance of servicing advances outstanding, actual and anticipated prepayments on the underlying loans, and changes in the discount rate assumptions used to value servicer advance investments. Periodic fluctuations in the values of these investments are inherently volatile and can lead to significant period-to-period GAAP earnings volatility.

Changes in Fair Values of Excess MSRs

Excess MSRs are carried on our consolidated balance sheets at their estimated fair values, with changes in fair values recorded in our consolidated statements of income in Investment fair value changes, net. Periodic fluctuations in the values of our excess MSRs can be caused by actual prepayments on the underlying loans, changes in assumptions regarding future projected prepayments on the underlying loans, actual or anticipated changes in delinquencies, and changes in the discount rate assumptions used to value excess MSRs. Periodic fluctuations in the values of these investments are inherently volatile and can lead to significant period-to-period GAAP earnings volatility.

Changes in Fair Values of Shared Home Appreciation Options

Shared home appreciation options are carried on our consolidated balance sheets at their estimated fair values, with changes in fair values recorded in our consolidated statements of income in Investment fair value changes, net. Periodic fluctuations in the values of our shared home appreciation options can be caused by changes in the discount rate assumptions used to value shared home appreciation options, changes in assumptions regarding future projected home values, and changes in assumptions regarding future projected prepayment rates. Periodic fluctuations in the values of these investments are inherently volatile and can lead to significant period-to-period GAAP earnings volatility.

Changes in Fair Values of Derivative Financial Instruments

We generally use derivatives as part of our mortgage banking activities (e.g., to manage risks associated with loans we plan to acquire and subsequently sell or securitize), in relation to our residential investments (to manage risks associated with our securities, MSRs, and held-for-investment loans), and to manage variability in debt interest expense indexed to adjustable rates, and cash flows on assets and liabilities that have different coupon rates (fixed rates versus floating rates, or floating rates based on different indices). The nature of the instruments we use and the accounting treatment for the specific assets, liabilities, and derivatives may therefore lead to volatility in our periodic earnings, even when we are meeting our hedging objectives.

Some of our derivatives are accounted for as trading instruments with all associated changes in value recorded through our consolidated statements of income. Changes in value of the assets and liabilities we manage by using derivatives may not be accounted for similarly. This could lead to reported income and book values in specific periods that do not necessarily reflect the economics of our risk management strategy. Even when the assets and liabilities are similarly accounted for as trading instruments, periodic changes in their values may not coincide as other market factors (e.g., supply and demand) may affect certain instruments and not others at any given time.

Changes in Fair Values of Intangible Assets

In connection with our acquisitions of CoreVest and 5 Arches, a portion of the purchase price of each acquisition was allocated to goodwill and intangible assets. During 2020, we impaired our entire balance of goodwill associated with these acquisitions. Accounting standards require that we routinely assess intangible assets for indicators of impairment, and if indicators are present, we must review them for impairment. The assessments to determine if intangible assets are impaired requires significant judgement to develop assumptions and estimates. If we determine intangible assets are impaired, we will be required to write down the value of these assets, up to their entire balance. Any write-down would have a negative effect on our consolidated financial statements.

Changes in Mortgage Banking Income

The amount of income that can be earned from mortgage banking activities is primarily dependent on the volume of loans we are able to acquire and any potential profit we earn upon the sale or securitization of these loans. Our ability to acquire loans and the volume of loans we acquire is dependent on many factors that are beyond our control, including general economic conditions and changes in interest rates, loan origination volumes industry-wide and at the sellers we purchase our loans from, increased regulation, and competition from other financial institutions. Our profitability from mortgage banking activities is also dependent on many factors, including our ability to effectively hedge certain risks related to changes in interest rates and other factors that are beyond our control, including changes in market credit risk pricing. Additionally, our income from mortgage banking activities is generally generated over the period from when we identify a loan for purchase until we subsequently sell or securitize the loan. This income may encompass positive or negative market valuation adjustments on loans, hedging gains or losses associated with related risk management activities, and any other related transaction expenses, and may be realized unevenly over the course of one or more quarters for financial reporting purposes. Additional factors that could impact our profitability are discussed in Part I, Item 1A - *Risk Factors* of this Annual Report on Form 10-K and above, under the headings “*Changes in the Fair Value of Loans Held at Fair Value*” and “*Changes in Fair Values of Derivative Financial Instruments.*” Changes in the volumes of loans acquired or originated in connection with our mortgage banking activities and our profitability on these activities can lead to significant period-to-period GAAP earnings volatility.

Changes in Yields for Securities

The yields we project on available-for-sale real estate securities can have a significant effect on the periodic interest income we recognize for financial reporting purposes. Yields can vary as a function of credit results, prepayment rates, and interest rates. If estimated future credit losses are less than our prior estimate, credit losses occur later than expected, or prepayment rates are faster than expected (meaning the present value of projected cash flows is greater than previously expected for assets acquired at a discount to principal balance), the yield over the remaining life of the security may be adjusted upwards. If estimated future credit losses exceed our prior expectations, credit losses occur more quickly than expected, or prepayments occur more slowly than expected (meaning the present value of projected cash flows is less than previously expected for assets acquired at a discount to principal balance), the yield over the remaining life of the security may be adjusted downward.

Changes in the actual maturities of real estate securities may also affect their yields to maturity. Actual maturities are affected by the contractual lives of the associated mortgage collateral, periodic payments of principal, and prepayments of principal. Therefore, actual maturities of AFS securities are generally shorter than stated contractual maturities. Stated contractual maturities are generally greater than 10 years. There is no assurance that our assumptions used to estimate future cash flows or the current period’s yield for each asset will not change in the near term, and any change could be material.

Changes in Loss Contingency Reserves

We may be exposed to various loss contingencies, including, without limitation, those described in *Note 16* to the consolidated financial statements included in Part II, Item 8 of this Annual Report on Form 10-K. In accordance with FASB guidance on accounting for contingencies, we review the need for any loss contingency reserves and establish them when, in the opinion of management, it is probable that a matter would result in a liability, and the amount of loss, if any, can be reasonably estimated. The establishment of a loss contingency reserve, the subsequent increase in a reserve or release of reserves previously established, or the recognition of a loss in excess of previously established reserves, can occur as a result of various factors and events that affect management’s opinion of whether the standard for establishing, increasing, or continuing to maintain, a reserve has been met. Changes in the loss contingency reserves can lead to significant period-to-period GAAP earnings volatility.

Changes in Provision for Taxes

Our provision for income taxes is primarily the result of GAAP income or losses generated at our TRS. Deferred tax assets/liabilities are generated by temporary differences in GAAP income and taxable income at our taxable subsidiaries and are a significant component of our GAAP provision for income taxes. 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 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 and associated valuation allowances could change in future periods to the extent that actual or revised estimates of future taxable income during the carry-forward periods change from current expectations, causing significant period-to-period GAAP earnings volatility.

Market Risks

We seek to manage risks inherent in our business — including but not limited to credit risk, interest rate risk, prepayment risk, liquidity risk, and fair value risk — in a prudent manner designed to enhance our earnings and dividends and preserve our capital. In general, we seek to assume risks that can be quantified from historical experience, to actively manage such risks, and to maintain capital levels consistent with these risks. Information concerning the risks we are managing, how these risks are changing over time, and potential GAAP earnings and taxable income volatility we may experience as a result of these risks is discussed under the caption “*Risk Factors*” of this Annual Report on Form 10-K, under the caption “*Risks Relating to Debt Incurred under Short- and Long-Term Borrowing Facilities*” within this MD&A, and under the caption “*Quantitative and Qualitative Disclosures About Market Risk*” of this Annual Report on Form 10-K.

Other Risks

In addition to the market and other risks described above, our business and results of operations are subject to a variety of types of risks and uncertainties, including, among other things, those described under the caption “*Risk Factors*” of this Annual Report on Form 10-K.

NEW ACCOUNTING STANDARDS

A discussion of new accounting standards and the possible effects of these standards on our consolidated financial statements is included in *Note 3 — Summary of Significant Accounting Policies* included in Part II, Item 8 of this Annual Report on Form 10-K.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risks

We seek to manage risks inherent in our business - including but not limited to credit risk, interest rate risk, prepayment risk, inflation risk, and fair value and liquidity risk - in a prudent manner designed to enhance our earnings and dividends and preserve our capital. In general, we seek to assume risks that can be quantified from historical experience, to actively manage such risks, and to maintain capital levels consistent with these risks. This section presents a general overview of these risks. Additional information concerning the risks we are managing, how these risks are changing over time, and potential GAAP earnings and taxable income volatility we may experience as a result of these risks is further discussed in Part I, Item 1A and Part II, Item 7 of this Annual Report on Form 10-K.

Credit Risk

Integral to our business is assuming credit risk through our ownership of real estate loans, securities and other investments as well as through our reliance on the creditworthiness of business counterparties. We believe the securities and loans we purchase are priced to generate an expected return that compensates us for the underlying credit risk associated with these investments. Nevertheless, there may be significant credit losses associated with these investments should they perform worse than we expect on a credit basis. For additional details, refer to Part I, Item 1A of this Annual Report on Form 10-K and see the risk factor titled *“The nature of the assets we hold and the investments we make expose us to credit risk that could negatively impact the value of those assets and investments, our earnings, dividends, cash flows, and access to liquidity, or otherwise negatively affect our business.”*

We manage our credit risks by analyzing the extent of the risk we are taking and reviewing whether we believe the appropriate underwriting criteria are met, and we utilize systems and staff to monitor the ongoing credit performance of our loans and securities. To the extent we find the credit risks on specific assets are changing adversely, we may be able to take actions, such as selling the affected investments, to mitigate potential losses. However, we may not always be successful in analyzing risks, reviewing underwriting criteria, foreseeing adverse changes in credit performance or in effectively mitigating future credit losses and the ability to sell an asset may be limited due to the structure of the asset or the absence of a liquid market for the asset.

Residential Loans and Securities

Our residential loans (including business purpose loans) and securities backed by residential loans are generally secured by real property. Credit losses on real estate loans and securities can occur for many reasons, including: poor origination practices; fraud; poor underwriting; poor servicing practices; weak economic conditions; increases in payments required to be made by borrowers; declines in the value of real estate; natural disasters, the effects of climate change (including flooding, drought, and severe weather) and other natural events; uninsured property loss; over-leveraging of the borrower; costs of remediation of environmental conditions, such as indoor mold; acts of war or terrorism; changes in legal protections for lenders and other changes in law or regulation; and personal events affecting borrowers, such as reduction in income, job loss, divorce, or health problems. In addition, if the U.S. economy or the housing market were to weaken (and that weakening was in excess of what we anticipated), credit losses could increase beyond levels that we have anticipated.

Credit losses on business purpose real estate loans can occur for many of the reasons noted above for residential real estate loans. Moreover, these types of real estate loans may not be fully amortizing and, therefore, the borrower’s ability to repay the principal when due may depend upon the ability of the borrower to refinance or sell the property at maturity. Business purpose real estate loans are particularly sensitive to conditions in the rental housing market, including declining or delinquent rents, and to demand for rental residential properties.

With respect to most of the legacy Sequoia securitization entities sponsored by us that we consolidate and for a portion of the loans underlying residential loan securities we have acquired from securitizations sponsored by others, the interest rate is adjustable. Accordingly, when short-term interest rates rise, required monthly payments from homeowners may rise under the terms of these loans, and this may increase borrowers’ delinquencies and defaults that can lead to additional credit losses.

We may also own some securities backed by loans that are not prime quality such as re-performing and non-performing loans, Alt-A quality loans, and subprime loans, that have substantially higher credit risk characteristics than prime-quality loans. Consequently, we can expect these lower credit-quality loans to have higher rates of delinquency and loss, and if such losses differ from our assumptions, we could incur credit losses. In addition, we may invest in riskier loan types with the potential for higher delinquencies and losses as compared to regular amortization loans, but believe these securities offer us the opportunity to generate

attractive risk-adjusted returns as a result of attractive pricing and the manner in which these securitizations are structured. Nevertheless, there remains substantial uncertainty about the future performance of these assets.

Additionally, we own residential mortgage credit risk transfer (or "CRT") securities issued by Fannie Mae and Freddie Mac ("the Agencies"), for which we assume credit risk both on the residential loans that the securities reference, as well as corporate credit risk from the Agencies, as our investments in the securities are not secured by the reference loans.

Multifamily Loans and Securities

Multifamily loans we may acquire, invest in, or originate are generally secured by real property. The multifamily securities we invest in are primarily subordinate positions in securitizations sponsored by Freddie Mac that are comprised of loans collateralized by multifamily properties. We also own and may continue to invest in other third-party sponsored multifamily mortgage-backed securities. Credit losses on these real estate loans and securities can occur for many of the reasons noted above for residential and business-purpose real estate loans, including: poor origination practices; fraud; faulty appraisals; documentation errors; poor underwriting; legal errors; poor servicing practices; weak economic conditions; decline in the value of properties; declining rents on single and multifamily residential rental properties; special hazards; earthquakes and other natural events; over-leveraging of the borrower or on the property; reduction in market rents and occupancies and poor property management practices; and changes in legal protections for lenders. In addition, if the U.S. economy or were to weaken (and that weakening was in excess of what we anticipated), credit losses could increase beyond levels that we have anticipated. Moreover, the principal balance of multifamily loans may be significantly larger than the residential and business-purpose real estate loans we own.

Counterparties

We are also exposed to credit risk with respect to our business and lender counterparties. For example, counterparties we acquire loans from, lend to, or invest in, make representations and warranties and covenants to us, and may also indemnify us against certain losses. To the extent we have suffered a loss and are entitled to enforce those agreements to recover damages, if our counterparties are insolvent or unable or unwilling to comply with these agreements we would suffer a loss due to the credit risk associated with our counterparties. As an example, under short-term borrowing facilities and certain swap and other derivative agreements, we sometimes transfer assets as collateral to our counterparties. To the extent a counterparty is not able to return this collateral to us if and when we are entitled to its return, we could suffer a loss due to the credit risk associated with that counterparty.

In addition, because we rely on the availability of credit under committed and uncommitted borrowing facilities to fund our business and investments, our counterparties' willingness and ability to extend credit to us under these facilities is a significant counterparty risk (and is discussed further below under the heading "Fair Value and Liquidity Risks").

In connection with our servicer advance investments, the partnership entity (the "SA Buyer") formed to invest in servicer advance investments and excess MSR, has agreed to purchase all future arising servicer advances under certain residential mortgage servicing agreements. SA Buyer relies, in part, on its members to make committed capital contributions in order to pay the purchase price for future servicer advances. A failure by any or all of the members to make such capital contributions for amounts required to fund servicer advances could result in an event of default under our servicer advance financing and a complete loss of our investment in SA Buyer and its servicer advance investments and excess MSR.

The outstanding balance of servicer advances securing the financing is not likely to be repaid on or before the maturity date of such financing arrangement. We expect to request the same counterparty or another one of our financing sources to renew or refinance the financing for an additional fixed period, however, there can be no assurance that we will be able to extend the financing arrangement upon the expiration of its stated term, which subjects us to a number of risks. A financing source that elects to extend or refinance may charge higher interest rates and impose more onerous terms upon us, including without limitation, lowering the amount of financing that can be extended against the servicer advances being financed. If we are unable to renew or refinance the servicer advance financing, the securitization entity will be required to repay the outstanding balance of the financing on the related maturity date. Additionally, there may be substantial increases in the interest rates under the financing arrangement if the notes are not repaid, extended or refinanced prior to the expected repayment date, which may be before the related maturity date. If the securitization entity is unable to pay the outstanding balance of the notes, the financing counterparty may foreclose on the servicer advances pledged as collateral.

Under our servicer advance financing, the consolidated partnership (SA Buyer) and the securitization entity, along with the servicer (who is unaffiliated with us except through their co-investment in SA Buyer and the securitization entity), make various representations and warranties and have agreed to certain covenants, events of default, and other terms that if breached or triggered can result in acceleration of all outstanding amounts borrowed under this facility and this facility being unavailable to use for future financing needs. We do not have the direct ability to control the servicer's compliance with such covenants and tests and the failure of SA Buyer, the securitization entity, or the servicer to satisfy any such covenants or tests could result in a partial or total loss on our investment.

Interest Rate Risk

Changes in interest rates and the shape of the yield curve can affect the cash flows and fair values of our assets, liabilities, and derivative financial instruments and, consequently, affect our earnings and reported equity. Our general strategy with respect to interest rates is to maintain an asset/liability posture (including hedges) that assumes some interest rate risks but not to such a degree that the achievement of our long-term goals would likely be adversely affected by changes in interest rates. Accordingly, we are willing to accept short-term volatility of earnings and changes in our reported equity in order to accomplish our goal of achieving attractive long-term returns. For additional details, refer to Part I, Item 1A of this Annual Report on Form 10-K and see the risk factor titled *"Interest rate fluctuations can have various negative effects on us and could lead to reduced earnings and increased volatility in our earnings."*

We invest in securities, residential loans, business purpose loans, multifamily loans, and other mortgage-related assets, which all expose us to interest rate risk. Additionally, we acquire and originate residential and business purpose loans, then sell or securitize these assets. We are exposed to interest rate risk during the "accumulation" period - the period from when we enter into agreements to purchase the loans with the intention of selling or securitizing them at a future date.

To mitigate this interest rate risk, we use derivative financial instruments for risk management purposes. We may also use derivative financial instruments in an effort to maintain a close match between pledged assets and debt. However, we generally do not attempt to completely hedge changes in interest rates, and at times, we may be subject to more interest rate risk than we generally desire in the long term. Changes in interest rates will have an impact on the values and cash flows of our assets and corresponding liabilities.

Prepayment Risk

Prepayment risks exist in many of the assets on our consolidated balance sheets. In general, discount securities benefit from faster prepayment rates on the underlying real estate loans while premium securities (such as certain IOs we own), and mortgage servicing assets benefit from slower prepayments on the underlying loans. In addition, loans held for investment at premiums also benefit from slower prepayments whereas loans held at discounts benefit from faster prepayments. For additional details, refer to Part I, Item 1A of this Annual Report on Form 10-K and see the risk factor titled *"Changes in prepayment rates of mortgage loans could reduce our earnings, dividends, cash flows, and access to liquidity."*

When we make investments that are subject to prepayment risk, we apply a reasonable baseline prepayment range in determining expected returns. If actual prepayment rates deviate from our baseline expectations, it could have an adverse change to our expected returns. In order to mitigate this risk, we may use derivative financial instruments. We caution that prepayment rates are difficult to predict or anticipate, and adverse changes in the rate of prepayment could reduce our cash flows, earnings, and dividends.

Inflation Risk

Virtually all of our consolidated assets and liabilities are financial in nature. As a result, changes in interest rates and other factors drive our performance more directly than does inflation. That said, changes in interest rates generally correlate with inflation rates or changes in inflation rates, and therefore adverse changes in inflation or changes in inflation expectations can lead to lower returns on our investments than originally anticipated.

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

Fair Value and Liquidity Risks

To fund our assets we may use a variety of debt alternatives in addition to equity capital that present us with fair value and liquidity risks. We seek to manage these risks, including by maintaining what we believe to be adequate cash and capital levels.

We acquire and originate residential and business purpose loans and then sell or securitize them as part of our mortgage banking operations. Changes in the fair value of the loans, once sold or securitized, do not have an impact on our liquidity. However, changes in fair values during the accumulation period (while these loans are typically funded with short-term debt before they are sold or securitized) may impact our liquidity. We would be exposed to liquidity risk to the extent the values of these loans decline and/or the counterparties we use to finance these investments adversely change our borrowing requirements. We attempt to mitigate our liquidity risk from short-term financing facilities by setting aside adequate capital, in addition to amounts required by our financing counterparties.

Some of the securities we acquire are funded with a combination of our capital and short-term debt facilities. For the securities we acquire with a combination of capital and short-term debt, we would be exposed to liquidity risk to the extent the values of these investments decline and/or the counterparties we use to finance these investments adversely change our borrowing requirements. We attempt to mitigate our liquidity risk from short-term financing facilities by setting aside adequate capital.

Under our borrowing facilities, interest rate swaps and other derivatives agreements, we pledge assets as security for our payment obligations and make various representations and warranties and agree to certain covenants, events of default, and other terms. In addition, our borrowing facilities are generally uncommitted, meaning that each time we request a new borrowing under a facility the lender has the option to decline to extend credit to us. The terms of these facilities and agreements typically include financial covenants (such as covenants to maintain a minimum amount of tangible net worth or stockholders' equity and/or a minimum amount of liquid assets and/or a maximum amount of recourse debt to equity), margin requirements (which typically require us to pledge additional collateral if and when the value of previously pledged collateral declines), operating covenants (such as covenants to conduct our business in accordance with applicable laws and regulations and covenants to provide notice of certain events to creditors), representations and warranties (such as representations and warranties relating to characteristics of pledged collateral, our exposure to litigation and/or regulatory enforcement actions and the absence of material adverse changes to our financial condition, our operations, or our business prospects), and events of default (such as a breach of covenant or representation/warranty and cross-defaults, under which an event of default is triggered under a credit facility if an event of default or similar event occurs under another credit facility). For additional details, refer to Part II, Item 7 of this Annual Report on Form 10-K and see the discussion titled "*Risks Relating to Debt Incurred under Short- and Long-Term Borrowing Facilities*."

Business, Operational, Regulatory, and Other Risks

In addition to the financial risks described above, we are subject to a variety of other risks in the ordinary conduct of our business, including risks related to our business and industry (such as economic, competitive, and strategic risks), operational risks (including cybersecurity and technology risks), risks related to legislative and regulatory compliance matters, and risks related to our REIT status and our status under the Investment Company Act of 1940, among others. The effective management of these risks is of critical importance to the overall success of our business. These risks are further discussed in Part I, Item 1A Risk Factors of this Annual Report on Form 10-K.

Quantitative Information on Market Risk

Our future earnings are sensitive to a number of market risk factors and changes in these factors may have a variety of secondary effects that, in turn, will also impact our earnings and equity. To supplement the discussion above of the market risks we face, the following table incorporates information that may be useful in analyzing certain market risks that may affect our consolidated balance sheet at December 31, 2020. The table presents principal cash flows and related average interest rates for material interest rate sensitive assets and liabilities by year of repayment. The forward curve (future interest rates as implied by the yield structure of debt markets) at December 31, 2020, was used to project the average coupon rates for each year presented. The timing of principal cash flows includes assumptions on the prepayment speeds of assets based on their recent prepayment performance and future prepayment performance consistent with the forward curve. Our future results depend greatly on the credit performance of the underlying loans (this table assumes no credit losses), future interest rates, prepayments, and our ability to invest our existing cash and future cash flow.

Quantitative Information on Market Risk

(Dollars in Thousands)		Principal Amounts Maturing and Effective Rates During Period						December 31, 2020	
		2021	2022	2023	2024	2025	Thereafter	Principal Balance	Fair Value
Interest Rate Sensitive Assets ⁽¹⁾									
Residential Loans - HFS ⁽²⁾									
Adjustable Rate	Principal	\$ 49	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 49	\$ 37
	Interest Rate	2.00 %	N/A	N/A	N/A	N/A	N/A		
Fixed Rate	Principal	171,729	—	—	—	—	—	171,729	175,626
	Interest Rate	3.13 %	N/A	N/A	N/A	N/A	N/A		
Hybrid	Principal	970	—	—	—	—	—	970	978
	Interest Rate	4.38 %	N/A	N/A	N/A	N/A	N/A		
Residential Loans - HFI at Sequoia									
Adjustable Rate	Principal	98,041	75,415	58,218	45,225	35,081	21,494	333,474	285,935
	Interest Rate	1.89 %	1.94 %	2.07 %	2.19 %	2.37 %	2.37 %		
Fixed Rate	Principal	530,017	344,645	225,206	147,997	97,870	204,719	1,550,454	1,565,322
	Interest Rate	4.99 %	4.99 %	4.99 %	4.98 %	4.98 %	4.98 %		
Residential Loans - HFI at Freddie Mac SLST									
Fixed Rate	Principal	161,086	157,542	147,546	138,093	129,290	1,514,214	2,247,771	2,221,153
	Interest Rate	4.08 %	4.27 %	4.27 %	4.26 %	4.26 %	4.26 %		
Business Purpose Loans - HFS									
Fixed Rate	Principal	234,475	—	—	—	—	—	234,475	245,394
	Interest Rate	4.84 %	N/A	N/A	N/A	N/A	N/A		
Business Purpose Loans - HFI at Redwood									
Fixed Rate	Principal	510,570	138,962	—	—	—	—	649,532	641,765
	Interest Rate	8.19 %	7.68 %	N/A	N/A	N/A	N/A		
Single-Family Rental Loans - HFI at CAFL									
Fixed Rate	Principal	41,071	43,363	45,783	48,338	51,036	2,787,546	3,017,137	3,249,194
	Interest Rate	5.44 %	5.44 %	5.44 %	5.44 %	5.44 %	5.44 %		
Multifamily Loans - HFI at Freddie Mac K-Series									
Fixed Rate	Principal	7,639	7,975	8,326	8,638	430,230	—	462,808	492,221
	Interest Rate	4.20 %	4.21 %	4.21 %	4.22 %	3.55 %	N/A		

Quantitative Information on Market Risk

(Dollars in Thousands)		Principal Amounts Maturing and Effective Rates During Period						December 31, 2020		
		2021	2022	2023	2024	2025	Thereafter	Principal Balance	Fair Value	
Interest Rate Sensitive Assets										
(continued)										
Residential Senior Securities										
Fixed Rate ⁽³⁾	Principal	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 28,464
	Interest Rate	0.21 %	0.21 %	0.20 %	0.19 %	0.18 %	0.15 %			
Residential Subordinate Securities										
Adjustable Rate	Principal	24	19	14	11	1,252	2,096	3,416	3,141	
	Interest Rate	1.91 %	1.97 %	2.03 %	2.03 %	2.08 %	1.50 %			
Fixed Rate	Principal	9,435	5,856	3,330	5,965	8,071	414,900	447,557	252,446	
	Interest Rate	3.34 %	3.72 %	3.65 %	3.65 %	3.69 %	3.15 %			
Hybrid	Principal	2,355	1,937	1,511	1,176	914	11,901	19,794	10,819	
	Interest Rate	2.72 %	2.54 %	2.51 %	2.57 %	2.68 %	2.84 %			
Multifamily Securities										
Adjustable Rate	Principal	19,924	17,487	6,139	—	—	3,601	47,151	49,255	
	Interest Rate	2.82 %	2.41 %	1.79 %	7.72 %	7.90 %	7.90 %			
Interest Rate Sensitive Liabilities										
Asset-Backed Securities Issued										
Sequoia Entities										
Adjustable Rate	Principal	79,943	62,283	48,301	37,624	28,215	72,673	329,039	282,326	
	Interest Rate	1.00 %	0.89 %	0.96 %	1.05 %	1.24 %	1.24 %			
Fixed Rate	Principal	512,167	331,933	196,001	109,480	57,864	102,512	1,309,957	1,347,357	
	Interest Rate	4.11 %	4.18 %	4.05 %	3.51 %	1.67 %	1.67 %			
Freddie Mac SLST Entities										
Fixed Rate	Principal	150,087	139,280	113,831	99,436	92,954	1,066,042	1,661,630	1,793,620	
	Interest Rate	3.14 %	3.15 %	3.15 %	3.15 %	3.15 %	3.15 %			
Freddie Mac K-Series Entities										
Fixed Rate	Principal	7,639	7,975	8,326	8,638	383,761	—	416,339	463,966	
	Interest Rate	2.62 %	2.62 %	2.62 %	2.63 %	2.23 %	N/A			
CAFL Entities										
Fixed Rate	Principal	150,759	244,908	257,961	512,569	462,789	1,087,439	2,716,425	3,013,093	
	Interest Rate	2.97 %	2.87 %	2.68 %	2.59 %	2.50 %	2.50 %			
Short-Term Debt	Principal	522,609	—	—	—	—	—	522,609	522,609	
	Interest Rate	2.39 %	N/A	N/A	N/A	N/A	N/A			

Quantitative Information on Market Risk

(Dollars in Thousands)	Principal Amounts Maturing and Effective Rates During Period						December 31, 2020		
	2021	2022	2023	2024	2025	Thereafter	Principal Balance	Fair Value	
Interest Rate Sensitive Liabilities (continued)									
Long-Term Debt									
Convertible Notes	Principal	\$ —	\$ —	\$198,629	\$150,200	\$172,092	\$ —	\$ 520,921	\$ 499,865
	Interest Rate	5.89 %	5.89 %	5.89 %	6.25 %	6.30 %	N/A		
Trust Preferred Securities and Subordinated Notes									
	Principal	—	—	—	—	—	139,500	139,500	80,910
	Interest Rate	6.21 %	6.21 %	6.21 %	6.21 %	6.21 %	6.21 %		
Other Long-Term Debt									
	Principal	—	596,919	182,991	—	—	—	779,910	783,570
	Interest Rate	5.63 %	5.63 %	3.79 %	N/A	N/A	N/A		
Interest Rate Agreements									
Interest Rate Swaps									
(Purchased)	Notional Amount	—	—	—	—	—	42,000	42,000	224
	Receive Strike Rate	0.18 %	0.22 %	0.36 %	0.62 %	0.90 %	1.47 %		
	Pay Strike Rate	0.86 %	0.86 %	0.86 %	0.86 %	0.86 %	0.86 %		

- (1) For the key assumptions and sensitivity analysis for assets retained from securitizations, refer to *Note 4* in Part II, Item 8 of this Annual Report.
- (2) As we generally expect our residential loans held-for-sale to be sold within one year, we have only presented principal amounts and effective rates through 2020.
- (3) The fair value of fixed-rate senior securities includes \$28 million interest-only securities, for which there is no principal at December 31, 2020.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Consolidated Financial Statements of Redwood Trust, Inc. and Notes thereto, together with the Reports of Independent Registered Public Accounting Firm thereon, are set forth on pages F-1 through F-116 of this Annual Report on Form 10-K and incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

We have adopted and maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed on our reports under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized, and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms and that the information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) of the Exchange Act, we have carried out an evaluation, under the supervision and with the participation of management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the quarter covered by this report. Based on the foregoing, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level.

Management of Redwood Trust, Inc., together with its consolidated subsidiaries (the Company, or Redwood), is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed under the supervision of our chief executive officer and chief financial officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our consolidated financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles (GAAP).

As of the end of our 2020 fiscal year, management conducted an assessment of the effectiveness of our internal control over financial reporting based on the framework established in Internal Control - Integrated Framework released by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2013. Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2020, was effective.

There have been no changes in our internal control over financial reporting during the fourth quarter of 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures are being made only in accordance with authorizations of management and the board of directors of Redwood; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our consolidated financial statements.

The Company's internal control over financial reporting as of December 31, 2020, has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in their report appearing on page F-4, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2020.

ITEM 9B. OTHER INFORMATION

The Company's Board of Directors has set May 20, 2021 as the date for the 2021 annual meeting of stockholders. The meeting will be held at 8:30 a.m. (Pacific) as a "virtual" Annual Meeting of Stockholders via a live webcast, as an alternative to an in-person meeting. Stockholders of record as of March 24, 2021 will be entitled to vote at that meeting.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 is incorporated herein by reference to the definitive Proxy Statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated herein by reference to the definitive Proxy Statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 is incorporated herein by reference to the definitive Proxy Statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is incorporated herein by reference to the definitive Proxy Statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Item 14 is incorporated herein by reference to the definitive Proxy Statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

Documents filed as part of this report:

- (1) Consolidated Financial Statements and Notes thereto
- (2) Schedules to Consolidated Financial Statements: Schedule IV - Mortgage Loans on Real Estate

All other Consolidated Financial Statements schedules not included have been omitted because they are either inapplicable or the information required is provided in the Company's Consolidated Financial Statements and Notes thereto, included in Part II, Item 8, of this Annual Report on Form 10-K.

- (3) Exhibits:

<u>Exhibit Number</u>	<u>Exhibit</u>
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- | | |
|--------|--|
| 3.1 | Articles of Amendment and Restatement of the Registrant, effective July 6, 1994 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1, filed on August 6, 2008) |
| 3.1.1 | Articles Supplementary of the Registrant, effective August 10, 1994 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.1, filed on August 6, 2008) |
| 3.1.2 | Articles Supplementary of the Registrant, effective August 11, 1995 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.2, filed on August 6, 2008) |
| 3.1.3 | Articles Supplementary of the Registrant, effective August 9, 1996 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.3, filed on August 6, 2008) |
| 3.1.4 | Certificate of Amendment of the Registrant, effective June 30, 1998 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.4, filed on August 6, 2008) |
| 3.1.5 | Articles Supplementary of the Registrant, effective April 7, 2003 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.5, filed on August 6, 2008) |
| 3.1.6 | Articles of Amendment of the Registrant, effective June 12, 2008 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.6, filed on August 6, 2008) |
| 3.1.7 | Articles of Amendment of the Registrant, effective May 19, 2009 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on May 21, 2009) |
| 3.1.8 | Articles of Amendment of the Registrant, effective May 24, 2011 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on May 20, 2011) |
| 3.1.9 | Articles of Amendment of the Registrant, effective May 18, 2012 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on May 21, 2012) |
| 3.1.10 | Articles of Amendment of the Registrant, effective May 16, 2013 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on May 21, 2013) |
| 3.1.11 | Articles of Amendment of the Registrant, effective May 15, 2019 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on May 17, 2019) |
| 3.1.12 | Articles of Amendment of the Registrant, effective June 15, 2020 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on June 15, 2020) |
| 3.2.1 | Amended and Restated Bylaws of the Registrant, as adopted on March 5, 2008 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on March 11, 2008) |
| 3.2.2 | First Amendment to Amended and Restated Bylaws of the Registrant, as adopted on May 17, 2012 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.2, filed on May 21, 2012) |
| 3.2.3 | Second Amendment to Amended and Restated Bylaws of the Registrant, as adopted on May 22, 2018 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on May 23, 2018) |
| 4.1 | Description of Redwood Trust, Inc. Common Stock (filed herewith) |

<u>Exhibit Number</u>	<u>Exhibit</u>
4.2	Form of Common Stock Certificate (incorporated by reference to the Registrant's Registration Statement on Form S-11 (No. 333-08363), Exhibit 4.3, filed on August 6, 1996)
4.3	Indenture dated as of October 1, 2001 between Sequoia Mortgage Trust 5 and Bankers Trust Company of California, N.A., as Trustee (incorporated by reference to Sequoia Mortgage Funding Corporation's Current Report on Form 8-K, Exhibit 99.1, filed on November 15, 2001)
4.4	Indenture dated as April 1, 2002 between Sequoia Mortgage Trust 6 and Deutsche Bank National Trust Company, as Trustee (incorporated by reference to Sequoia Mortgage Funding Corporation's Current Report on Form 8-K, Exhibit 99.1, filed on May 13, 2002)
4.5	Junior Subordinated Indenture dated as of December 12, 2006 between the Registrant and The Bank of New York Trust Company, National Association, as Trustee (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 1.4, filed on December 12, 2006)
4.6	Amended and Restated Trust Agreement dated December 12, 2006 among the Registrant, The Bank of New York Trust Company, National Association, The Bank of New York (Delaware), the Administrative Trustees (as named therein) and the several holders of the Preferred Securities from time to time (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 1.3, filed on December 12, 2006)
4.7	Purchase Agreement dated December 12, 2006 among the Registrant, Redwood Capital Trust I and Merrill Lynch International (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 1.1, filed on December 12, 2006)
4.8	Purchase Agreement dated December 12, 2006 among the Registrant, Redwood Capital Trust I and Bear, Stearns & Co. Inc. (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 1.2, filed on December 12, 2006)
4.9	Subordinated Indenture dated as of May 23, 2007 between the Registrant and Wilmington Trust Company (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 1.2, filed on May 23, 2007)
4.10	Purchase Agreement dated May 23, 2007 between the Registrant and Obsidian CDO Warehouse, LLC (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 1.1, filed on May 23, 2007)
4.11	Indenture, dated March 6, 2013, between Redwood Trust, Inc. and Wilmington Trust, National Association, as Trustee (incorporated by reference to the Registrant's Current Report on Form 8-K/A, Exhibit 4.1, filed on March 6, 2013)
4.12	Second Supplemental Indenture, dated August 18, 2017, between Redwood Trust, Inc. and Wilmington Trust, National Association, as Trustee (including the form of 4.75% Convertible Senior Note due 2023) (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 4.2, filed on August 18, 2017)
4.13	Third Supplemental Indenture, dated June 25, 2018, between Redwood Trust, Inc. and Wilmington Trust, National Association, as Trustee (including the form of 5.625% Convertible Senior Note due 2024) (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 4.2, filed on June 25, 2018)
4.14	Indenture, by and among Redwood Trust, Inc., RWT Holdings, Inc., and Wilmington Trust, National Association, as Trustee, dated as of September 24, 2019 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 99.1, filed on September 25, 2019)
9.1	Waiver Agreement dated as of November 15, 2007 between the Registrant and Davis Selected Advisors, L.P. (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 9.1, filed on March 5, 2008)
9.2	Amendment of Waiver Agreement dated as of January 16, 2008 between Registrant and Davis Selected Advisors, L.P. (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 9.2, filed on March 5, 2008)
10.1*	Amended and Restated 2014 Incentive Award Plan, as amended through December 16, 2020 (filed herewith)
10.2*	Form of Restricted Stock Unit Award Agreement under 2014 Incentive Plan (2020 Form of Award Agreement) (filed herewith)
10.3*	Form of Deferred Stock Unit Award Agreement under 2014 Incentive Plan (2020 Form of Award Agreement) (incorporate by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on December 18, 2020)

<u>Exhibit Number</u>	<u>Exhibit</u>
10.4*	Form of Performance Stock Unit Award Agreement under 2014 Incentive Plan (2020 Form of Award Agreement) (incorporate by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.3, filed on December 18, 2020)
10.5*	Form of Cash Settled Deferred Stock Unit Award Agreement under 2014 Incentive Plan (2020 Form of Award Agreement) (incorporate by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.2, filed on December 18, 2020)
10.6*	Form of Performance Award Agreement (Cash – Performance Vesting) under 2014 Incentive Plan (2020 Form) (incorporate by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.4, filed on August 7, 2020)
10.7*	Form of Performance Award Agreement (Cash – Time Vesting) under 2014 Incentive Plan (2020 Form) (incorporate by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.5, filed on August 7, 2020)
10.8*	Form of Performance Stock Unit Award Agreement under 2014 Incentive Plan (2019 Form of Award Agreement) (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on December 13, 2019)
10.9*	Form of Restricted Stock Unit Award Agreement (2018 Form of Award Agreement) (incorporated by reference to the Registrant's Annual Report on Annual 10-K, Exhibit 10.23, filed on March 1, 2019)
10.10*	Form of Deferred Stock Unit Award Agreement under 2014 Incentive Plan (2018 Form of Award Agreement) (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on December 17, 2018)
10.11*	Form of Performance Stock Unit Award Agreement under 2014 Incentive Plan (2018 Form of Award Agreement) (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.2, filed on December 17, 2018)
10.12*	Form of Letter Agreement Amendment to Equity Awards Under 2014 Incentive Plan (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.3, filed on December 17, 2018)
10.13*	Form of Redwood Trust, Inc. Restricted Stock Award Agreement under 2014 Incentive Award Plan (2014) (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.4, filed on August 8, 2014)
10.14*	Form of Redwood Trust, Inc. Deferred Stock Unit Award Agreement under 2014 Incentive Award Plan (2014) (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.2, filed on August 8, 2014)
10.15*	2002 Redwood Trust, Inc. Employee Stock Purchase Plan, as amended through May 15, 2019 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on May 17, 2019)
10.16*	Executive Deferred Compensation Plan, as amended and restated on December 10, 2008 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on January 14, 2009)
10.17*	First Amendment to Amended and Restated Executive Deferred Compensation Plan, effective as of November 23, 2013 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.15, filed on February 26, 2014)
10.18*	Second Amendment to Amended and Restated Executive Deferred Compensation Plan (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.1, filed on November 8, 2018)
10.19*	Direct Stock Purchase and Dividend Reinvestment Plan (incorporated by reference to the Plan text included in the Registrant's Prospectus Supplement filed on May 9, 2019)
10.20*	Summary of the Registrant's Compensation Arrangements for Non-Employee Directors (incorporated by reference to the "Director Compensation" section of the Registrant's Definitive Proxy Statement filed on April 27, 2020)
10.21*	Revised Form of Indemnification Agreement for Directors and Executive Officers (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 99.3, filed on November 16, 2009)
10.22*	Fifth Amended and Restated Employment Agreement, dated as of November 6, 2020, by and between Christopher J. Abate and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.1, filed on November 6, 2020)

**Exhibit
Number**

Exhibit

- 10.23* Third Amended and Restated Employment Agreement, dated as of November 6, 2020, by and between Dashiell I. Robinson and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.2, filed on November 6, 2020)
- 10.24* Fifth Amended and Restated Employment Agreement, dated as of November 6, 2020, by and between Andrew P. Stone and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.3, filed on November 6, 2020)
- 10.25* Employment Agreement, dated as of November 6, 2020, by and between Sasha G. Macomber and the Registrant (filed herewith)
- 10.26* Letter Agreement, between Collin L. Cochrane and the Registrant, dated as of February 28, 2020 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.77, filed on March 2, 2020)
- 10.27 Office Building Lease, effective as of and dated as of June 1, 2012 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.1, filed November 3, 2011)
- 10.28 First Amendment to Lease, effective as of May 25, 2017, between AG-SKB Belvedere Owner, L.P. and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.1, filed on August 4, 2017)
- 10.29 Second Amendment to Lease, effective as of December 27, 2017, between AG-SKB Belvedere Owner, L.P. and the Registrant (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.30, filed on February 28, 2018)
- 10.30 Lease Agreement, dated as of January 11, 2013, between MG-Point, LLC, as Landlord, and the Registrant, as Tenant (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.22, filed on February 26, 2013)
- 10.31 First Amendment to Lease, effective as of June 27, 2013, between MG-Point, LLC, as Landlord, and the Registrant, as Tenant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.4, filed August 8, 2013)
- 10.32 Second Amendment to Lease, effective as of June 23, 2014, between MG-Point, LLC, as Landlord, and the Registrant, as Tenant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.7, filed August 8, 2014)
- 10.33 Third Amendment to Lease, effective as of January 22, 2020, between ARTIS HRA Inverness Point, LP (successor-in-interest to MG-Point, LLC), as Landlord, and the Registrant, as Tenant (filed herewith)
- 10.34 Fourth Amendment to Lease Agreement, dated as of April 20, 2020, between ARTIS HRA Inverness Point, LP, as Landlord, and the Registrant, as Tenant (incorporate by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.2, filed on August 7, 2020)
- 10.35 Fifth Amendment to Lease Agreement, dated as of July 23, 2020, between ARTIS HRA Inverness Point, LP, as Landlord, and the Registrant, as Tenant (incorporate by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.3, filed on August 7, 2020)
- 10.36 Lease, between SRI Nine Main Plaza LLC and CoreVest American Finance Lender LLC (formerly known as Colony American Finance Lender, LLC), dated as of October 7, 2015 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.3, filed on November 8, 2019)
- 10.37 First Amendment to Lease, between Broadway Michelson LLC (as successor to SRI Nine Main Plaza LLC) and CoreVest American Finance Lender LLC, dated as of May 21, 2018 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.4, filed on November 8, 2019)
- 10.38 Lease, between Jamboree Center 4 LLC and Redwood Trust, Inc., dated as of December 18, 2020 (filed herewith)
- 10.39 Distribution Agreement by and among Redwood Trust, Inc., Wells Fargo Securities, LLC, J.P. Morgan Securities LLC, Credit Suisse Securities (USA) LLC, Goldman Sachs & Co. LLC, and JMP Securities LLC, dated November 14, 2018 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 1.1, filed on November 15, 2018)
- 10.40 Amendment No. 1 to the Distribution Agreement by and among Wells Fargo Securities, LLC, J.P. Morgan Securities LLC, Credit Suisse Securities (USA) LLC, Goldman Sachs & Co. LLC and JMP Securities LLC, dated May 9, 2019 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 1.1, filed on May 10, 2019)

<u>Exhibit Number</u>	<u>Exhibit</u>
10.41	Amendment No. 2 to the Distribution Agreement by and among Wells Fargo Securities, LLC, J.P. Morgan Securities LLC, Credit Suisse Securities (USA) LLC, Goldman Sachs & Co. LLC and JMP Securities LLC, dated March 4, 2020 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 1.1, filed on March 6, 2020)
10.42	Advances, Collateral Pledge, and Security Agreement between the Federal Home Loan Bank of Chicago and RWT Financial, LLC, dated as of July 16, 2014 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.8, filed on August 8, 2014)
10.43	Financial Covenant Supplement to Advances, Collateral Pledge, and Security Agreement between the Federal Home Loan Bank of Chicago and RWT Financial, LLC, dated as of July 16, 2014 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.9, filed on August 8, 2014)
10.44	Guaranty, dated July 16, 2014, given by Redwood Trust, Inc. in favor of the Federal Home Loan Bank of Chicago (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.10, filed on August 8, 2014)
10.45	Second Supplement to Advances, Collateral Pledge and Security Agreement between the Federal Home Loan Bank of Chicago and RWT Financial, LLC, dated as of February 19, 2015 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.53, filed on February 25, 2015)
10.46	Amendment to Advances, Collateral Pledge, and Security Agreement between the Federal Home Loan Bank of Chicago and RWT Financial, LLC, dated as of October 31, 2017 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.3, filed on November 7, 2017)
21	List of Subsidiaries (filed herewith)
23	Consent of Grant Thornton LLP (filed herewith)
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)
101	Pursuant to Rule 405 of Regulation S-T, the following financial information from the Registrant's Annual Report on Form 10-K for the period ended December 31, 2020, is filed in XBRL-formatted interactive data files: <ul style="list-style-type: none"> (i) Consolidated Balance Sheets at December 31, 2020 and 2019; (ii) Consolidated Statements of Income (Loss) for the years ended December 31, 2020, 2019, and 2018; (iii) Statements of Consolidated Comprehensive Income (Loss) for the years ended December 31, 2020, 2019, and 2018; (iv) Consolidated Statements of Changes in Equity for the years ended December 31, 2020, 2019, and 2018; (v) Consolidated Statements of Cash Flows for the years ended December 31, 2020, 2019, and 2018; and (vi) Notes to Consolidated Financial Statements.
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)

* Indicates exhibits that include management contracts or compensatory plan or arrangements.

ITEM 16. FORM 10-K SUMMARY

Not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

REDWOOD TRUST, INC.

Date: February 26, 2021

By: /s/ CHRISTOPHER J. ABATE

Christopher J. Abate
Chief Executive Officer

Pursuant to the requirements the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ CHRISTOPHER J. ABATE</u> Christopher J. Abate	Director and Chief Executive Officer (Principal Executive Officer)	February 26, 2021
<u>/s/ COLLIN L. COCHRANE</u> Collin L. Cochrane	Chief Financial Officer (Principal Financial and Accounting Officer)	February 26, 2021
<u>/s/ RICHARD D. BAUM</u> Richard D. Baum	Director, Chairman of the Board	February 26, 2021
<u>/s/ GREG H. KUBICEK</u> Greg H. Kubicek	Director, Vice Chairman of the Board	February 26, 2021
<u>/s/ DOUGLAS B. HANSEN</u> Douglas B. Hansen	Director	February 26, 2021
<u>/s/ DEBORA D. HORVATH</u> Debora D. Horvath	Director	February 26, 2021
<u>/s/ GEORGE W. MADISON</u> George W. Madison	Director	February 26, 2021
<u>/s/ JEFFREY T. PERO</u> Jeffrey T. Pero	Director	February 26, 2021
<u>/s/ GEORGANNE C. PROCTOR</u> Georganne C. Proctor	Director	February 26, 2021

REDWOOD TRUST, INC.

**CONSOLIDATED FINANCIAL STATEMENTS,
REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
For Inclusion in Annual Report on Form 10-K Filed With
Securities and Exchange Commission
December 31, 2020**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES
REDWOOD TRUST, INC.**

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Redwood Trust, Inc.

Opinion on the financial statements

We have audited the accompanying consolidated balance sheets of Redwood Trust, Inc. (a Maryland corporation) and subsidiaries (the "Company") as of December 31, 2020 and 2019, the related consolidated statements of income (loss), comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2020, and the related notes and financial statement schedule included under Item 15(a) (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2020, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 31, 2020, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), and our report dated February 26, 2021 expressed an unqualified opinion.

Basis for opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical audit matters

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinions on the critical audit matter or on the accounts or disclosures to which it relates.

Fair value measurements of certain real estate securities, and beneficial interests in consolidated Sequoia Choice and Freddie Mac Seasoned Loans Structured Transaction ("SLST") securitization entities holding residential loans, consolidated CoreVest American Finance Lender ("CAFL") securitization entities holding business purpose loans, and consolidated Freddie Mac K-Series securitization entities holding multifamily loans.

As described further in Note 5 to the consolidated financial statements, the Company owns real estate securities, which are recorded at fair value on a recurring basis. Some of these real estate securities result in the consolidation of the underlying securitization entities as required by ASC 810, *Consolidation*. The Company has elected to account for consolidated securitization entities as Collateralized Finance Entities ("CFEs") and has elected to measure the financial assets of its CFEs using the fair value of the financial liabilities issued by those entities, which management has determined to be more observable. The real estate securities and beneficial interests in consolidated securitization entities, are priced individually by the Company utilizing market comparable pricing and discounted cash flow analysis valuation techniques.

We identified the fair value measurements of certain investment securities, specifically certain subordinate securities, as well the beneficial interests in consolidated Sequoia Choice and SLST securitization entities holding residential loans, consolidated CAFL securitization entities holding business purpose loans, and consolidated Freddie Mac K-Series securitization entities holding multifamily loans (together, “Investments”) as a critical audit matter.

The principal considerations for our determination that the fair value measurement of these Investments was a critical audit matter are as follows. There is limited observable market data available for these Investments as they trade infrequently and, as such, the fair value measurement requires management to make complex judgments in order to identify and select the significant assumptions, which include the discount rate, prepayment rate, default rate and loss severity. In addition, the fair value measurements of the Investments are highly sensitive to changes in the significant assumptions and underlying market conditions and are material to the consolidated financial statements. As a result, obtaining sufficient appropriate audit evidence related to the fair value measurements required significant auditor subjectivity.

Our audit procedures related to the fair value measurements of these Investments included the following, among others. We tested the design and operating effectiveness of relevant controls including, among others, management’s validation of the inputs to the valuations, and management’s review of the significant assumptions against available market data. Further, we involved firm valuation specialists to independently determine the fair value measurement for a sample of the Investments and compared them to management’s fair value measurement for reasonableness.

/s/ GRANT THORNTON LLP

We have served as the Company's auditor since 2005.

Newport Beach, California
February 26, 2021

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Redwood Trust, Inc.

Opinion on internal control over financial reporting

We have audited the internal control over financial reporting of Redwood Trust, Inc. (a Maryland corporation) and subsidiaries (the "Company") as of December 31, 2020, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2020, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated financial statements of the Company as of and for the year ended December 31, 2020, and our report dated February 26, 2021 expressed an unqualified opinion on those financial statements.

Basis for opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and limitations of internal control over financial reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ GRANT THORNTON LLP

Newport Beach, California
February 26, 2021

REDWOOD TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In Thousands, except Share Data)	December 31, 2020	December 31, 2019
ASSETS ⁽¹⁾		
Residential loans, held-for-sale, at fair value	\$ 176,641	\$ 536,385
Residential loans, held-for-investment, at fair value	4,072,410	7,178,465
Business purpose loans, held-for-sale, at fair value	245,394	331,565
Business purpose loans, held-for-investment, at fair value	3,890,959	3,175,178
Multifamily loans, held-for-investment, at fair value	492,221	4,408,524
Real estate securities, at fair value	344,125	1,099,874
Other investments	348,175	358,130
Cash and cash equivalents	461,260	196,966
Restricted cash	83,190	93,867
Goodwill and intangible assets	56,865	161,464
Derivative assets	53,238	35,701
Other assets	130,588	419,321
Total Assets	\$ 10,355,066	\$ 17,995,440
LIABILITIES AND EQUITY ⁽¹⁾		
Liabilities		
Short-term debt	\$ 522,609	\$ 2,329,145
Derivative liabilities	16,072	163,424
Accrued expenses and other liabilities	179,340	206,893
Asset-backed securities issued (includes \$6,900,362 and \$10,515,475 at fair value), net	7,100,661	10,515,475
Long-term debt, net	1,425,485	2,953,272
Total liabilities	9,244,167	16,168,209
Commitments and Contingencies (see <i>Note 16</i>)		
Equity		
Common stock, par value \$0.01 per share, 395,000,000 and 270,000,000 shares authorized; 112,090,006 and 114,353,036 issued and outstanding	1,121	1,144
Additional paid-in capital	2,264,874	2,269,617
Accumulated other comprehensive (loss) income	(4,221)	41,513
Cumulative earnings	997,277	1,579,124
Cumulative distributions to stockholders	(2,148,152)	(2,064,167)
Total equity	1,110,899	1,827,231
Total Liabilities and Equity	\$ 10,355,066	\$ 17,995,440

(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 Redwood Trust, Inc. or its affiliates. At December 31, 2020 and December 31, 2019, assets of consolidated VIEs totaled \$8,141,069 and \$11,931,869, respectively. At December 31, 2020 and December 31, 2019, liabilities of consolidated VIEs totaled \$7,148,414 and \$10,717,072, respectively. See *Note 4* for further discussion.

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

REDWOOD TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (LOSS)

(In Thousands, except Share Data)	Years Ended December 31,		
	2020	2019	2018
Interest Income			
Residential loans	\$ 222,746	\$ 315,953	\$ 239,818
Business purpose loans	217,617	53,805	4,333
Multifamily loans	54,813	132,600	21,322
Real estate securities	49,605	91,822	105,078
Other interest income	27,135	28,101	8,166
Total interest income	571,916	622,281	378,717
Interest Expense			
Short-term debt	(50,895)	(96,506)	(58,917)
Asset-backed securities issued	(299,708)	(294,466)	(99,429)
Long-term debt	(97,402)	(88,836)	(80,693)
Total interest expense	(448,005)	(479,808)	(239,039)
Net Interest Income	123,911	142,473	139,678
Non-interest (Loss) Income			
Mortgage banking activities, net	78,472	87,266	59,566
Investment fair value changes, net	(588,438)	35,500	(25,689)
Other income	4,188	19,257	13,070
Realized gains, net	30,424	23,821	27,041
Total non-interest income, net	(475,354)	165,844	73,988
General and administrative expenses	(115,204)	(108,737)	(75,298)
Loan acquisition costs	(11,023)	(9,935)	(7,484)
Other expenses	(108,785)	(13,022)	(196)
Net (Loss) Income before Benefit from (Provision for) Income Taxes	(586,455)	176,623	130,688
Benefit from (provision for) income taxes	4,608	(7,440)	(11,088)
Net (Loss) Income	\$ (581,847)	\$ 169,183	\$ 119,600
Basic (loss) earnings per common share	\$ (5.12)	\$ 1.63	\$ 1.47
Diluted (loss) earnings per common share	\$ (5.12)	\$ 1.46	\$ 1.34
Basic weighted average shares outstanding	113,935,605	101,120,744	78,724,912
Diluted weighted average shares outstanding	113,935,605	136,780,594	110,027,770

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

REDWOOD TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Net (Loss) Income	\$ (581,847)	\$ 169,183	\$ 119,600
Other comprehensive (loss) income:			
Net unrealized (loss) gain on available-for-sale securities	(3,951)	17,077	(7,298)
Reclassification of unrealized gain on available-for-sale securities to net income	(12,165)	(19,967)	(25,561)
Net unrealized (loss) gain on interest rate agreements	(32,806)	(16,894)	8,908
Reclassification of unrealized loss on interest rate agreements to net income	3,188	—	—
Total other comprehensive loss	(45,734)	(19,784)	(23,951)
Total Comprehensive (Loss) Income	\$ (627,581)	\$ 149,399	\$ 95,649

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

REDWOOD TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

For the Year Ended December 31, 2020

(In Thousands, except Share Data)	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Cumulative Earnings	Cumulative Distributions to Stockholders	Total
	Shares	Amount					
December 31, 2019	114,353,036	\$ 1,144	\$ 2,269,617	\$ 41,513	\$ 1,579,124	\$ (2,064,167)	\$ 1,827,231
Net loss	—	—	—	—	(581,847)	—	(581,847)
Other comprehensive loss	—	—	—	(45,734)	—	—	(45,734)
Issuance of common stock	350,088	3	5,544	—	—	—	5,547
Employee stock purchase and incentive plans	434,217	4	(3,956)	—	—	—	(3,952)
Non-cash equity award compensation	—	—	15,298	—	—	—	15,298
Share repurchases	(3,047,335)	(30)	(21,629)	—	—	—	(21,659)
Common dividends declared (\$0.725 per share)	—	—	—	—	—	(83,985)	(83,985)
December 31, 2020	<u>112,090,006</u>	<u>\$ 1,121</u>	<u>\$ 2,264,874</u>	<u>\$ (4,221)</u>	<u>\$ 997,277</u>	<u>\$ (2,148,152)</u>	<u>\$ 1,110,899</u>

For the Year Ended December 31, 2019

(In Thousands, except Share Data)	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income	Cumulative Earnings	Cumulative Distributions to Stockholders	Total
	Shares	Amount					
December 31, 2018	84,884,344	\$ 849	\$ 1,811,422	\$ 61,297	\$ 1,409,941	\$ (1,934,715)	\$ 1,348,794
Net income	—	—	—	—	169,183	—	169,183
Other comprehensive loss	—	—	—	(19,784)	—	—	(19,784)
Issuance of common stock	28,724,645	288	441,884	—	—	—	442,172
Direct stock purchase and dividend reinvestment plan	399,838	4	6,303	—	—	—	6,307
Employee stock purchase and incentive plans	344,209	3	(4,949)	—	—	—	(4,946)
Non-cash equity award compensation	—	—	14,957	—	—	—	14,957
Common dividends declared (\$1.20 per share)	—	—	—	—	—	(129,452)	(129,452)
December 31, 2019	<u>114,353,036</u>	<u>\$ 1,144</u>	<u>\$ 2,269,617</u>	<u>\$ 41,513</u>	<u>\$ 1,579,124</u>	<u>\$ (2,064,167)</u>	<u>\$ 1,827,231</u>

For the Year Ended December 31, 2018

(In Thousands, except Share Data)	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income	Cumulative Earnings	Cumulative Distributions to Stockholders	Total
	Shares	Amount					
December 31, 2017	76,599,972	\$ 766	\$ 1,673,845	\$ 85,248	\$ 1,290,341	\$ (1,837,913)	\$ 1,212,287
Net income	—	—	—	—	119,600	—	119,600
Other comprehensive loss	—	—	—	(23,951)	—	—	(23,951)
Issuance of common stock:	8,738,319	88	142,140	—	—	—	142,228
Dividend reinvestment & stock purchase plans	113,004	1	1,705	—	—	—	1,706
Employee stock purchase and incentive plans	473,878	4	(4,470)	—	—	—	(4,466)
Non-cash equity award compensation	—	—	13,736	—	—	—	13,736
Share repurchases	(1,040,829)	(10)	(15,534)	—	—	—	(15,544)
Common dividends declared (\$1.18 per share)	—	—	—	—	—	(96,802)	(96,802)
December 31, 2018	<u>84,884,344</u>	<u>\$ 849</u>	<u>\$ 1,811,422</u>	<u>\$ 61,297</u>	<u>\$ 1,409,941</u>	<u>\$ (1,934,715)</u>	<u>\$ 1,348,794</u>

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

REDWOOD TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Cash Flows From Operating Activities:			
Net (loss) income	\$ (581,847)	\$ 169,183	\$ 119,600
Adjustments to reconcile net (loss) income to net cash used in operating activities:			
Amortization of premiums, discounts, and debt issuance costs, net	8,550	(5,066)	(13,687)
Depreciation and amortization of non-financial assets	17,365	10,133	1,308
Originations of held-for-sale loans	(1,004,058)	(569,915)	—
Purchases of held-for-sale loans	(4,431,468)	(5,823,547)	(7,162,131)
Proceeds from sales of held-for-sale loans	4,776,469	5,198,089	5,383,313
Principal payments on held-for-sale loans	62,736	106,183	66,892
Net settlements of derivatives	(201,036)	(66,059)	51,115
Non-cash equity award compensation expense	15,298	14,957	13,736
Goodwill impairment expense	88,675	—	—
Market valuation adjustments	541,399	(97,006)	(24,069)
Realized gains, net	(30,424)	(23,821)	(27,041)
Net change in:			
Accrued interest receivable and other assets	301,381	(83,210)	(41,849)
Accrued interest payable, deferred tax liabilities, and accrued expenses and other liabilities	(68,507)	4,502	21,080
Net cash used in operating activities	(505,467)	(1,165,577)	(1,611,733)
Cash Flows From Investing Activities:			
Originations of loans held-for-investment	(426,404)	(448,189)	—
Purchases of loans held-for-investment	—	(49,489)	(147,523)
Proceeds from sales of loans held-for-investment	1,574,160	9,422	—
Principal payments on loans held-for-investment	2,256,196	1,751,303	781,063
Purchases of real estate securities	(112,626)	(345,403)	(609,568)
Purchases of residential securities held in consolidated securitization trust	—	(193,212)	(227,649)
Purchases of multifamily securities held in consolidated securitization trusts	—	(99,221)	(107,411)
Sales of multifamily securities held in consolidated securitization trusts	142,990	—	—
Proceeds from sales of real estate securities	658,899	707,357	582,331
Principal payments on real estate securities	27,210	84,303	84,495
Purchases of servicer advance investments	(179,419)	(69,610)	(395,813)
Principal repayments from servicer advance investments	107,527	203,876	94,644
Acquisition of 5 Arches, net of cash acquired	—	(3,714)	(9,999)
Acquisition of CoreVest, net of cash acquired	—	(451,626)	—
Equity investment	40,226	(40,467)	—
Other investing activities, net	(18,345)	(29,468)	(57,322)
Net cash provided by (used in) investing activities	4,070,414	1,025,862	(12,752)

REDWOOD TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Cash Flows From Financing Activities:			
Proceeds from borrowings on short-term debt	5,496,761	6,452,566	6,975,965
Repayments on short-term debt	(7,303,543)	(7,193,677)	(6,711,264)
Proceeds from issuance of asset-backed securities	1,684,778	1,397,126	1,658,848
Repayments on asset-backed securities issued	(1,493,438)	(1,123,119)	(459,171)
Proceeds from issuance of long-term debt	1,473,590	387,053	199,000
Deferred debt issuance costs	(10,244)	(7,023)	(4,977)
Repayments on long-term debt	(2,974,795)	(1,137)	—
Net settlements of derivatives	(84,336)	—	—
Net proceeds from issuance of common stock	5,881	450,710	142,601
Net payments on repurchase of common stock	(21,659)	—	(16,315)
Taxes paid on equity award distributions	(4,286)	(5,471)	(4,839)
Dividends paid	(83,985)	(129,452)	(96,802)
Other financing activities, net	3,946	(2,105)	(291)
Net cash (used in) provided by financing activities	(3,311,330)	225,471	1,682,755
Net increase in cash and cash equivalents	253,617	85,756	58,270
Cash, cash equivalents and restricted cash at beginning of period ⁽¹⁾	290,833	205,077	146,807
Cash, cash equivalents and restricted cash at end of period ⁽¹⁾	\$ 544,450	\$ 290,833	\$ 205,077
Supplemental Cash Flow Information:			
Cash paid during the period for:			
Interest	\$ 456,147	\$ 452,216	\$ 207,014
Taxes	1,190	7,963	10,594
Supplemental Noncash Information:			
Real estate securities retained from loan securitizations	\$ 53,276	\$ 13,729	\$ 51,911
Retention of mortgage servicing rights from loan securitizations and sales	—	868	328
Consolidation of residential loans held in securitization trust	—	1,190,995	1,206,645
Consolidation of residential ABS issued	—	997,783	978,996
(Deconsolidation) consolidation of multifamily loans held in securitization trusts	(3,849,779)	2,162,385	2,099,916
(Deconsolidation) consolidation of multifamily ABS issued	(3,706,789)	2,058,214	1,975,324
Consolidation of single-family rental loans held in securitization trusts	—	1,829,281	—
Consolidation of single-family rental ABS issued	—	1,656,023	—
Transfers from loans held-for-sale to loans held-for-investment	1,868,656	1,801,560	2,062,809
Transfers from loans held-for-investment to loans held-for-sale	64,520	22,808	15,717
Transfers from residential loans to real estate owned	14,229	8,609	4,104
Operating lease right-of-use assets obtained in exchange for operating lease liabilities	7,862	13,094	—
Reduction in operating lease liabilities due to lease modification	1,722	—	—

(1) Cash, cash equivalents, and restricted cash at December 31, 2020 included cash and cash equivalents of \$461 million and restricted cash of \$83 million; at December 31, 2019 included cash and cash equivalents of \$197 million and restricted cash of \$94 million; and at December 31, 2018 included cash and cash equivalents of \$176 million and restricted cash of \$29 million.

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

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 1. Organization

Redwood Trust, Inc., together with its subsidiaries, is a specialty finance company focused on several distinct areas of housing credit. Our operating platforms occupy a unique position in the housing finance value chain, providing liquidity to growing segments of the U.S. housing market not served by government programs. We deliver customized housing credit investments to a diverse mix of investors, through our best-in-class securitization platforms; whole-loan distribution activities; and our publicly-traded shares. Our consolidated investment portfolio has evolved to incorporate a diverse mix of residential, business purpose and multifamily investments. Our goal is to provide attractive returns to shareholders through a stable and growing stream of earnings and dividends, capital appreciation, and a commitment to technological innovation that facilitates risk-minded scale. We operate our business in three segments: Residential Lending, Business Purpose Lending, and Third-Party Investments.

Our primary sources of income are net interest income from our investments and non-interest 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 is generated through the origination and acquisition of loans, and their subsequent sale, securitization, or transfer to our investment portfolios.

Redwood Trust, Inc. has elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended (the “Internal Revenue Code”), beginning with its taxable year ended December 31, 1994. 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 taxable REIT subsidiaries” or “TRS.”

Redwood was incorporated in the State of Maryland on April 11, 1994, and commenced operations on August 19, 1994. On March 1, 2019, Redwood completed the acquisition of 5 Arches, LLC (“5 Arches”), at which time 5 Arches became a wholly-owned subsidiary of Redwood. On October 15, 2019, Redwood acquired CoreVest American Finance Lender, LLC and certain affiliated entities (“CoreVest”), at which time CoreVest became wholly owned by Redwood. References herein to “Redwood,” the “company,” “we,” “us,” and “our” include Redwood Trust, Inc. and its consolidated subsidiaries, unless the context otherwise requires. In statements regarding qualification as a REIT, such terms refer solely to Redwood Trust, Inc. Refer to Item 1 - *Business* in this Annual Report on Form 10-K for additional information on our business.

Note 2. Basis of Presentation

The consolidated financial statements presented herein are at December 31, 2020 and December 31, 2019, and for the years ended December 31, 2020, 2019, and 2018. These consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) — as prescribed by the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Codification (“ASC”) — and the rules and regulations of the Securities and Exchange Commission (“SEC”). In the opinion of management, all normal and recurring adjustments to present fairly the financial condition of the Company at December 31, 2020 and 2019, and results of operations for all periods presented have been made.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 2. Basis of Presentation - (continued)

Principles of Consolidation

In accordance with GAAP, we 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 certain Sequoia securitization entities issued prior to 2012 where we maintain an ongoing involvement (“Legacy Sequoia”), as well as entities formed in connection with the securitization of Redwood Choice expanded-prime loans (“Sequoia Choice”). We also consolidate the assets and liabilities of certain Freddie Mac K-Series and Freddie Mac Seasoned Loans Structured Transaction (“SLST”) securitizations in which we have invested. Finally, we consolidated the assets and liabilities of certain CoreVest American Finance Lender (“CAFL”) securitizations beginning in the fourth quarter of 2019, in connection with our acquisition of CoreVest. 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 purchased or retained, although for the consolidated Sequoia and CAFL entities we are exposed to certain financial risks associated with our role as a sponsor, servicing administrator, 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 owned at the consolidated Sequoia and Freddie Mac SLST entities are shown under Residential loans held-for-investment at fair value, the underlying loans at the consolidated Freddie Mac K-Series are shown under Multifamily loans held-for-investment, at fair value, and the underlying single-family rental loans at the consolidated CAFL entities are shown under Business purpose loans held-for-investment, at fair value, 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 (loss), we recorded interest income on the loans owned at these entities and interest expense on the ABS issued by these entities as well as other income and expenses associated with these entities' activities. See *Note 14* for further discussion on ABS issued.

During the first quarter of 2020, we sold subordinate securities (and transferred directing certificate holder status as a result of these sales) issued by four of these Freddie Mac K-Series securitization trusts and determined that we should derecognize the associated assets and liabilities of each of these entities for financial reporting purposes. We deconsolidated \$3.86 billion of multifamily loans and other assets and \$3.72 billion of multifamily ABS issued and other liabilities, for which we realized market valuation losses of \$72 million, which were recorded through Investment fair value changes, net on our consolidated statements of income (loss) for the three months ended March 31, 2020.

We also consolidate two partnerships (“Servicing Investment” entities) through which we have invested in servicing-related assets. We maintain an 80% ownership interest in each entity and have determined that we are the primary beneficiary of these partnerships.

Beginning in the first quarter of 2019, we consolidated 5 Arches, an originator of business purpose loans, pursuant to the exercise of our purchase option and the acquisition of the remaining equity in the company. In the fourth quarter of 2019, we acquired and consolidated CoreVest, an originator and portfolio manager of business purpose loans.

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

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 periods. 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.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 2. Basis of Presentation - (continued)

Acquisitions

In May 2018, Redwood acquired a 20% minority interest in 5 Arches, an originator of business purpose loans, for \$10 million in cash, with a one-year option to purchase all remaining equity in the company. On March 1, 2019, we completed the acquisition of the remaining 80% interest in 5 Arches. At closing, we paid approximately \$13 million of cash, with the remaining \$27 million in consideration to be paid in a mix of cash and Redwood common stock over a two-year period.

A liability resulting from the contingent consideration arrangement with 5 Arches was initially recorded at its acquisition-date fair value of \$25 million as part of total consideration for the acquisition of 5 Arches. The contingent earn-out payments were classified as a contingent consideration liability and carried at fair value prior to March 31, 2020. During the three months ended March 31, 2020, we made a cash payment of \$11 million and granted \$3 million of Redwood common stock in connection with the first anniversary of the purchase date. Additionally, as a result of an amendment to the agreement, we reclassified the contingent liability to a deferred liability, as the remaining payments became payable on a set timetable without any remaining contingencies. At December 31, 2020, the carrying value of this deferred liability was \$15 million and was recorded as a component of Accrued expenses and other liabilities on our consolidated balance sheets. During the years ended December 31, 2020 and 2019, we recorded \$0.2 million and \$3 million of contingent consideration expense, respectively, through Other expenses on our consolidated statements of income (loss). See *Note 16* for additional information on our contingent consideration liability.

In October 2019, we acquired CoreVest, an originator and portfolio manager of business purpose loans. Aggregate consideration for this acquisition totaled approximately \$492 million, net of in-place financing on existing assets. The consideration consisted of \$482 million of cash and \$10 million of restricted stock awards issued to the CoreVest management team. Based on the terms of the equity interest purchase agreement, we determined that the \$10 million of shares should be accounted for as compensation expense for post-combination services, and therefore, it is not included in the GAAP purchase price allocated to the assets and liabilities acquired. See *Note 21* for additional information related to the restricted stock awards issued in connection with the CoreVest acquisition.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 2. Basis of Presentation - (continued)

During 2019, we accounted for the acquisitions of 5 Arches and CoreVest under the acquisition method of accounting pursuant to ASC 805. We performed the purchase price allocations and recorded underlying assets acquired and liabilities assumed based on their estimated fair values using the information available as of each acquisition date, with the excess of the purchase price allocated to goodwill. Through December 31, 2020, there were no significant changes to our purchase price allocations, which are summarized in the following table.

Table 2.1 – Purchase Price Allocations

(In Thousands)	5 Arches		CoreVest	
Acquisition Date	March 1, 2019		October 15, 2019	
Purchase price:				
Cash	\$	12,575	\$	482,311
Contingent consideration, at fair value		24,621		—
Purchase option, at fair value		5,082		—
Equity method investment, at fair value		8,052		—
Total consideration	\$	50,330	\$	482,311
Allocated to:				
Business purpose loans, at fair value	\$	2,022	\$	2,610,490
Cash and cash equivalents		2,128		30,685
Restricted cash		9,082		—
Other assets		5,473		67,420
Goodwill		28,747		59,928
Intangible assets		24,800		56,500
Deferred tax asset		—		2,577
Total assets acquired		72,252		2,827,600
Asset-backed securities issued, at fair value		—		1,656,023
Short-term debt, net		3,800		663,275
Accrued expenses and other liabilities		13,920		25,991
Deferred tax liability		4,202		—
Total liabilities assumed		21,922		2,345,289
Total net assets acquired	\$	50,330	\$	482,311

Because we owned a 20% noncontrolling interest in 5 Arches immediately before obtaining full control, we remeasured our initial minority investment and purchase option at their acquisition-date fair values using the income approach, which resulted in a gain of \$2 million that was recorded in Other income on our consolidated statements of income during the three months ended March 31, 2019.

We recognized \$2 million of acquisition costs related our acquisitions of 5 Arches and CoreVest during the year ended December 31, 2019. These costs primarily related to accounting, consulting, and legal expenses and are included in our General and administrative expenses on our consolidated statements of income.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 2. Basis of Presentation - (continued)

In connection with the acquisitions of 5 Arches and CoreVest, we identified and recorded finite-lived intangible assets totaling \$25 million and \$57 million, respectively. The table below presents the amortization period and carrying value of our intangible assets, net of accumulated amortization at December 31, 2020 and December 31, 2019.

Table 2.2 – Intangible Assets – Activity

(Dollars in Thousands)	Intangible Assets at Acquisition	Accumulated Amortization at December 31, 2020	Carrying Value at December 31, 2020	Weighted Average Amortization Period (in years)
Borrower network	\$ 45,300	\$ (7,819)	\$ 37,481	7
Broker network	18,100	(6,637)	11,463	5
Non-compete agreements	9,500	(4,431)	5,069	3
Tradenames	4,000	(1,860)	2,140	3
Developed technology	1,800	(1,088)	712	2
Loan administration fees on existing loan assets	2,600	(2,600)	—	1
Total	\$ 81,300	\$ (24,435)	\$ 56,865	6

(Dollars in Thousands)	Intangible Assets at Acquisition	Accumulated Amortization at December 31, 2019	Carrying Value at December 31, 2019	Weighted Average Amortization Period (in years)
Borrower network	\$ 45,300	\$ (1,348)	\$ 43,952	7
Broker network	18,100	(3,017)	15,083	5
Non-compete agreements	9,500	(1,264)	8,236	3
Tradenames	4,000	(527)	3,473	3
Developed technology	1,800	(188)	1,612	2
Loan administration fees on existing loan assets	2,600	(2,167)	433	1
Total	\$ 81,300	\$ (8,511)	\$ 72,789	6

All of our intangible assets are amortized on a straight-line basis. For the years ended December 31, 2020 and 2019, we recorded intangible asset amortization expense of \$16 million and \$9 million, respectively. Estimated future amortization expense is summarized in the table below.

Table 2.3 – Intangible Asset Amortization Expense by Year

(In Thousands)	December 31, 2020
2021	\$ 15,304
2022	12,800
2023	10,091
2024	7,073
2025 and thereafter	11,597
Total Future Intangible Asset Amortization	\$ 56,865

We recorded total goodwill of \$89 million in 2019 as a result of the total consideration exceeding the fair value of the net assets acquired from 5 Arches and CoreVest. The goodwill was attributed to the expected business synergies and expansion into business purpose loan markets, as well as access to the knowledgeable and experienced workforces continuing to provide services to the business. Of the total goodwill recorded, \$75 million is deductible for tax purposes. For reporting purposes, we included the intangible assets and goodwill from these acquisitions within the Business Purpose Lending segment.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 2. Basis of Presentation - (continued)

During the first quarter of 2020, as a result of the deterioration in economic conditions caused by the spread of the COVID-19 pandemic (the "pandemic"), and its impact on our business, including a significant decline in the market price of our common stock, we determined that it was more likely than not that the fair value of our Business Purpose Lending reporting unit was lower than its carrying amount, including goodwill. Based on this analysis, we determined that an interim goodwill impairment test should be performed as of March 31, 2020 and prepared updated cash flow projections for the reporting unit, resulting in a reduction in the long-term forecasts of profitability for our Business Purpose Lending reporting unit as compared to the prior year forecasts. Using these projections, we concluded that the fair value of our Business Purpose Lending reporting unit was less than its carrying value, including goodwill. As a result of this evaluation, we recorded a non-cash \$89 million goodwill impairment expense through Other expenses on our consolidated statements of income (loss) during the three months ended March 31, 2020. In conjunction with our assessment of goodwill, we also assessed our intangible assets for impairment at March 31, 2020 and determined they were not impaired. On a quarterly basis, we evaluate our finite-lived intangible assets for impairment indicators and additionally evaluate the useful lives of our intangible assets to determine if revisions to the remaining periods of amortization are warranted. We reviewed our finite-lived intangible assets and determined that the estimated lives were appropriate and that there were no indicators of impairment at December 31, 2020.

The following unaudited pro forma financial information presents Net interest income, Non-interest income, and Net income of Redwood, 5 Arches, and CoreVest combined, for the year ended December 31, 2019, as if the acquisitions occurred as of January 1, 2018. These pro forma amounts have been adjusted to include the amortization of intangible assets and acquisition-related compensation expense for both periods, and to exclude the income statement impacts related to our equity method investment in 5 Arches. The unaudited pro forma financial information is not intended to represent or be indicative of the consolidated financial results of operations that would have been reported if the acquisitions had been completed as of January 1, 2018 and should not be taken as indicative of our future consolidated results of operations.

Table 2.4 – Unaudited Pro Forma Financial Information

(In Thousands)	Year Ended December 31, 2019
Supplementary pro forma information:	
Net interest income	\$ 167,680
Non-interest income	193,519
Net income	185,896

Note 3. Summary of Significant Accounting Policies

Significant Accounting Policies

Business Combinations

We use the acquisition method of accounting for business combinations, under which the purchase price is allocated to the fair values of the assets acquired and liabilities assumed at the acquisition date. The excess of the purchase price over the amount allocated to the assets acquired and liabilities assumed is recorded as goodwill. Acquisition-related costs are expensed as incurred.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

Fair Value Measurements

Our consolidated 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. 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 assets 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 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 for assets 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 loans, business purpose loans, interest-only ("IO") and certain subordinate securities, MSR, servicer advance investments, excess MSR, and certain of our other investments. We generally elect the fair value option for residential and single-family rental loans that are held-for-sale, due to our intent to sell or securitize the loans in the near-term. We elect the fair value option for our IO and certain subordinate securities, and MSR, for which we generally hedge market interest rate risk. As such, we seek to offset interest rate related changes in the values of these investments with changes in the values of their associated hedges through our consolidated statements of income. In addition, we elect the fair value option for the assets and liabilities of our consolidated Sequoia, Freddie Mac SLST, Freddie Mac K-Series, and CAFL entities in accordance with GAAP accounting for collateralized financing entities ("CFEs").

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

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

Real Estate Loans

Residential Loans - Held-for-Sale at Fair Value

Residential 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. We generally elect the fair value option for residential 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, at which point the loan is placed on nonaccrual status and any accrued interest is reversed against interest income. 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. Changes in fair value for these loans are recurring and are reported through our consolidated statements of income in Mortgage banking activities, net.

Residential Loans - Held-for-Investment At Fair Value

Certain loans that were originally purchased with the intent to sell as part of our residential mortgage banking operations, and for which we elected the fair value option at acquisition, were subsequently reclassified to held-for-investment ("HFI"). Coupon interest is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due, at which point the loan is placed on nonaccrual status and any accrued interest is reversed against interest income. 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. During 2020, we completed the sale of all of our residential loans previously held for investment and had no residential loans held-for-investment at Redwood at December 31, 2020.

In addition, we record residential loans held at consolidated Sequoia and Freddie Mac SLST entities at fair value. In accordance with accounting guidance for CFEs, we use the fair value of the ABS issued by these entities (which we determined to be more observable) to determine the fair value of the loans held at these entities. Coupon interest for these loans is recognized as revenue based on amounts expected to be paid to the securities issued by these entities.

Changes in fair value for these loans are recurring and are reported through our consolidated statements of income in Investment fair value changes, net.

Business Purpose Loans - Held-for-Sale at Fair Value

We originate business purpose loans, including single-family rental loans through our business purpose lending platform. Single-family rental loans are mortgage loans secured by residential real estate (primarily 1-4 unit) that the borrower owns as an investment property and rents to residential tenants. We classify single-family rental loans as held-for-sale at fair value when we originate these loans with the intent to transfer to securitization entities or sell to third parties.

Coupon interest for these loans is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due, at which point the loan is placed on nonaccrual status and any accrued interest is reversed against interest income. 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. Changes in fair value are recurring and reported through our consolidated statements of income in Mortgage banking activities, net.

Business Purpose Loans - Held-for-Investment at Fair Value

We also originate bridge loans through our business purpose lending platform. Business purpose bridge loans are mortgage loans generally secured by unoccupied residential or small-balance multifamily real estate that the borrower owns as an investment and that is being renovated, rehabilitated or constructed. Bridge loans are classified as held-for-investment at fair value if we intend to hold these loans to maturity.

Coupon interest for these loans is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due, at which point the loan is placed on nonaccrual status and any accrued interest is reversed against interest income. 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.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 3. Summary of Significant Accounting Policies - (continued)

In addition, we record residential loans held at consolidated CAFL entities at fair value. In accordance with accounting guidance for CFEs, we use the fair value of the ABS issued by these entities (which we determined to be more observable) to determine the fair value of the loans held at these entities. Coupon interest for these loans is recognized as revenue based on amounts expected to be paid to the securities issued by these entities.

Changes in fair value for these loans are recurring and reported through our consolidated statements of income in Investment fair value changes, net.

Multifamily Loans, Held-for-Investment at Fair Value

Multifamily loans are mortgage loans secured by multifamily properties, held in Freddie Mac-sponsored K-series securitization trusts that we consolidate. In accordance with accounting guidance for CFEs, we use the fair value of the ABS issued by the Freddie Mac K-Series entities (which we determined to be more observable) to determine the fair value of the loans held at these entities. Coupon interest for these loans is recognized as revenue based on amounts expected to be paid to the securities issued by these entities. Changes in fair value for the assets and liabilities of these trusts are recurring and are reported through our consolidated statements of income in Investment fair value changes, net.

Repurchase Reserves

We sell and have sold residential and business purpose mortgage loans to various parties, including (1) securitization trusts, and (2) banks and other financial institutions that purchase mortgage loans for investment or private label securitization. We may be required to repurchase mortgage loans we have sold, or loans associated with MSR we have purchased, in the event of a breach of specified contractual representations and warranties made in connection with these sales and purchases. Additionally, we generally have a direct obligation to repurchase residential whole loans we sell in the event of any early payment defaults (or EPDs) by the underlying mortgage borrowers within certain specified periods following the sales.

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 or MSR. However, in some cases, such as where loans or MSR were acquired from companies that have since become insolvent, we may have to bear the loss associated with a loan repurchase. Furthermore, even if we do not have to ultimately bear such a loss because we can recover from the company that sold us the loan or the MSR, there could be a delay in making that recovery.

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 reserve at the time loans are sold and MSR are purchased and continually update our reserve estimate during its life. The reserve 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 16* for further discussion on the residential repurchase reserves.

Real Estate Securities, at Fair Value

Our securities primarily consist of mortgage-backed securities ("MBS") collateralized by residential and multifamily mortgage loans. We classify our real estate securities as trading or available-for-sale securities.

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. Coupon interest is recognized as interest income when earned and deemed collectible. Changes in the fair value of securities designated as trading securities are reported in Investment fair value changes, net on our consolidated statements of income.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 3. Summary of Significant Accounting Policies - (continued)

Available-for-Sale Securities

AFS securities are carried at their estimated fair value with unrealized gains and losses excluded from earnings (except when an allowance for credit losses 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 and interest income recognized on these securities or in the recognition of an allowance for credit losses 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.

Upon adoption of ASU 2016-13, "Financial Instruments - Credit Losses" in the first quarter of 2020, we modified our policy for recording impairments on available-for-sale securities. This new guidance requires that credit impairments on our available-for-sale securities be recorded in earnings using an allowance for credit losses, with the allowance limited to the amount by which the security's fair value is less than its amortized cost basis. The allowance for credit losses is calculated using a discounted cash flow approach and is measured as the difference between the beneficial interest's amortized cost and the estimate of cash flows expected to be collected, discounted at the effective interest rate used to accrete the beneficial interest. Any allowance for credit losses in excess of the unrealized losses on the beneficial interests are accounted for as a prospective reduction of the effective interest rate. No allowance is recorded for beneficial interests in an unrealized gain position. Favorable changes in the discounted cash flows will result in a reduction in the allowance for credit losses, if any. Any reduction in allowance for credit losses is recorded in earnings. If the allowance for credit losses has been reduced to zero, the remaining favorable changes are reflected as a prospective increase to the effective interest rate. If we intend to sell or it is more likely than not that we will be required to sell the security before it recovers in value, the entire impairment amount will be recognized in earnings with a corresponding adjustment to the security's amortized cost basis.

See *Note 9* for further discussion on real estate securities.

Other Investments

Servicer Advance Investments

Our servicer advance investments are comprised of outstanding servicer advances receivable, the requirement to purchase all future servicer advances made with respect to a specified pool of residential mortgage loans and a fee component of the related MSR. We have elected to record these investments at fair value. We recognize income from our servicer advance investments when earned and deemed collectible and record the income as a component of Other interest income in our consolidated statements of income. Our servicer advance investments are marked-to-market on a recurring basis with changes in the fair value reported in Investment fair value changes, net on our consolidated statements of income.

See *Note 10* for further discussion on our servicer advance investments.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 3. Summary of Significant Accounting Policies - (continued)

MSRs

We recognize MSRs through the retention of servicing rights associated with residential mortgage loans that we acquired and subsequently transferred to third parties when the transfer meets the GAAP criteria for sale accounting, or through the direct acquisition of MSRs sold by third parties.

We contract with licensed sub-servicers 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 subsequently carried at their estimated fair values. Servicing fee income from MSRs is recorded on a cash basis when received. Net servicing income and changes in the estimated fair value of MSRs are reported in Other income on our consolidated statements of income.

See *Note 10* for further discussion on MSRs.

Excess MSRs

Our excess MSR investments represent the right to receive a portion of mortgage servicing cash flows in excess of amounts paid for the underlying mortgage loans to be serviced. As owners of excess MSRs, we are not required to be a licensed servicer, and we are not required to assume any servicing duties, advance obligations or liabilities associated with the loan pool underlying the MSR. We have elected to record these investments at fair value. We recognize income from Excess MSRs when it is earned and deemed collectible and record the income as a component of Other interest income in our consolidated statements of income. Changes in fair value are recurring and are reported through our consolidated statements of income in Investment fair value changes, net.

See *Note 10* for further discussion on excess MSRs.

Investment in Multifamily Loan Fund

In January 2019, we invested in a limited partnership created to acquire floating rate, light-renovation multifamily loans from Freddie Mac. At December 31, 2020, the carrying amount of our investment in the partnership was zero and we had no remaining funding obligations to the partnership. We accounted for our ownership interest in this partnership using the equity method of accounting as we were able to exert significant influence over but did not control the activities of the investee. We assessed our investment for impairment whenever events or changes in circumstances indicated that the carrying amount of our investment might not be recoverable. We elected to record our share of earnings or losses from this investment on a one-quarter lag, as a component of Other income on our consolidated statements of income.

See *Note 10* for further discussion on our investment in the multifamily loan fund.

Shared Home Appreciation Options

During 2019, we invested in shared home appreciation options that allow us to share in both home price appreciation and depreciation. We have elected to record these investments at fair value and report changes in fair value through Investment fair value changes, net on our consolidated statements of income.

See *Note 10* for further discussion on shared home appreciation options.

Cash and Cash Equivalents

Cash and cash equivalents include non-restricted cash and highly liquid investments with original maturities of three months or less and money market fund investments which are generally invested in U.S. government securities and are available to us on a daily basis. The Company maintains its cash and cash equivalents with major financial institutions. Accounts at these institutions are guaranteed by the Federal Deposit Insurance Corporation (“FDIC”) up to \$250,000 for each bank. The Company is exposed to credit risk for amounts held in excess of the FDIC limit. The Company does not anticipate nonperformance by these institutions.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 3. Summary of Significant Accounting Policies - (continued)

Restricted Cash

Restricted cash primarily includes cash held at our consolidated Servicing Investment entities, and cash associated with our risk-sharing transactions with Fannie Mae and Freddie Mac ("the Agencies"), as well as cash collateral for certain consolidated securitization entities.

Goodwill and Intangible Assets

Significant judgment is required to estimate the fair value of intangible assets and in assigning their estimated useful lives. Accordingly, we typically seek the assistance of independent third-party valuation specialists for significant intangible assets. The fair value estimates are based on available historical information and on future expectations and assumptions we deem reasonable. We generally use an income-based valuation method to estimate the fair value of intangible assets, which discounts expected future cash flows to present value using estimates and assumptions we deem reasonable.

Determining the estimated useful lives of intangible assets also requires judgment. Our assessment as to which intangible assets are deemed to have finite or indefinite lives is based on several factors including economic barriers of entry for the acquired business, retention trends, and our operating plans, among other factors. Finite-lived intangible assets are amortized over their estimated useful lives on a straight-line basis and reviewed for impairment if indicators are present. Additionally, useful lives are evaluated each reporting period to determine if revisions to the remaining periods of amortization are warranted.

Goodwill is tested for impairment annually or more frequently if indicators of impairment exist. We have elected to make the first day of our fiscal fourth quarter the annual impairment assessment date for goodwill. Pursuant to our adoption of ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment" in the first quarter of 2020, we modified our goodwill impairment testing policy. We first assess qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying value. If, based on that assessment, we believe it is more likely than not that the fair value of the reporting unit is less than its carrying value, we measure the fair value of reporting unit and record a goodwill impairment charge for the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of the goodwill. Any such impairment charges would be recorded through Other expenses on our consolidated statements of income (loss).

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"), interest rate lock commitments ("IRLCs"), 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 value 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 income if they are used to manage risks associated with our MSR investments, through Mortgage banking activities, net if they are used to manage risks associated with our mortgage banking activities, or through Investment fair value changes, net if they are used to manage risks associated with our investments. Valuation changes related to residential LPCs, IRLCs, and FSCs are included in Mortgage banking activities, net on our consolidated statements of income.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 3. Summary of Significant Accounting Policies - (continued)

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 hedge 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, 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. We enter into swap and swaptions 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.

Interest Rate Futures

Interest rate futures are futures contracts based on U.S. Treasury notes, U.S. dollar-denominated interest rate swaps, or U.S. dollar-denominated interest rate indices.

TBA Agreements

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

Interest Rate Lock Commitments

IRLCs are agreements we have made with third-party borrowers for single-family rental loans that will be originated and held for sale. IRLCs qualify as derivatives under GAAP and 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 11* for further discussion on derivative financial instruments.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 3. Summary of Significant Accounting Policies - (continued)

Deferred Tax Assets and Liabilities

Our deferred tax assets/liabilities are generated by temporary differences in GAAP and taxable income at our taxable REIT subsidiaries. These differences generally reflect differing accounting treatments for GAAP and tax, such as accounting for mortgage servicing rights, security discount and premium amortization, credit losses, 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 GAAP income in periods prior to when we recognize income for tax. When this occurs, we establish a deferred tax liability for GAAP. As the income is subsequently realized in future periods for tax, the deferred tax liability is reduced.

We may also record deferred tax assets/liabilities resulting from GAAP and tax basis differences of assets and liabilities acquired in a business combination at our taxable REIT subsidiaries. These deferred tax assets/liabilities generally do not affect our GAAP income at the time of establishment as the offsetting accounting entry is recorded in GAAP goodwill. They also do not generally affect GAAP income when they are subsequently realized as the deferred tax provision or benefit resulting from the realization is offset by a corresponding current tax benefit or provision.

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 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.

Other Assets and Other Liabilities

Other assets primarily consists of investment receivable, accrued interest receivable, operating lease right-of-use assets, margin receivable, FHLBC stock, pledged collateral, fixed assets and leasehold improvements, and REO. Other liabilities primarily consists of accrued interest payable, accrued compensation, payable to minority partner, guarantee obligations, operating lease liabilities, deferred tax liabilities, margin payable, and residential loan and MSR repurchase reserves. See *Note 12* for further discussion.

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.

Investment Receivable

Investment receivable primarily consists of amounts receivable from third-party servicers related to principal and interest receivable from business purpose loans and fees receivable from servicer advance investments.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 3. Summary of Significant Accounting Policies - (continued)

Margin Receivable and Payable

Margin receivable and payable result from margin calls between us and our derivatives, master repurchase agreements, and warehouse facilities counterparties, whereby we or the counterparty were required to post collateral.

Agency Risk-Sharing - Other Assets and Liabilities

During 2014 and 2015, we entered into various risk-sharing arrangements with Fannie Mae and Freddie Mac. Under these arrangements, we committed to assume the first 1.00% or 2.25% (depending on the arrangement) of losses realized on reference pools of conforming residential mortgage loans that we acquired and then sold to the Agencies. As part of these risk-sharing arrangements, during the 10-year term of our first Fannie Mae arrangement, we receive monthly cash payments from Fannie Mae based on the monthly outstanding unpaid principal balance of the reference pool of loans, and for our Freddie Mac and our subsequent Fannie Mae arrangements, the Agencies charged us a reduced guarantee fee for the reference loans we delivered to them in exchange for mortgage-backed securities, which we then sold.

Under these arrangements we are required to pledge assets to the Agencies to collateralize our risk-sharing commitments to them throughout the terms of the arrangements. These pledged assets are held by a third-party custodian for the benefit of the Agencies. To the extent approved losses are incurred, the custodian will transfer collateral to the Agencies. As a result of these transactions, we recorded restricted cash, "pledged collateral" in the other assets line item, and "guarantee obligations" in the other liabilities line item, on our consolidated balance sheets. In addition, for the first Fannie Mae transaction, we recorded a "guarantee asset" in the other assets line item on our consolidated balance sheets.

The guarantee obligations represent our commitments to assume losses under these arrangements. We amortize the guarantee obligations over the 10-year terms of the arrangements based primarily on changes in the outstanding unpaid principal balance of loans in the reference pools, with a portion of the liabilities treated as a credit reserve that is not amortized into income. In addition, each period we assess the need for a separate loss allowance related to these arrangements, based on our estimate of credit losses inherent in the reference pools of loans.

Income from cash payments received under the first Fannie Mae risk-sharing arrangement and income related to the amortization of the guarantee obligations of all three arrangements are recorded in Other income, and market valuation changes of the guarantee asset are recorded in Investment fair value changes, net on our consolidated statements of income.

Our consolidated balance sheets include assets of the special purpose entities ("SPEs") associated with these risk-sharing arrangements (i.e., the "pledged collateral" referred to above) that can only be used to settle obligations of these SPEs and liabilities of these SPEs for which the creditors of these SPEs (the Agencies) do not have recourse to Redwood Trust, Inc. or its affiliates. At December 31, 2020 and December 31, 2019, assets of such SPEs totaled \$46 million and \$48 million, respectively, and liabilities of such SPEs totaled \$10 million and \$14 million, respectively.

See *Note 16* for further discussion on loss contingencies — risk-sharing.

REO

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 Investment fair value changes, net on our consolidated statements of income.

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 and exchangeable debt. Interest on our FHLB borrowings is paid every 13 weeks. 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.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 3. Summary of Significant Accounting Policies - (continued)

Leases

Upon adoption of ASU 2016-02, "Leases," in 2019, we recorded operating lease liabilities and operating lease right-of-use assets on our consolidated balance sheets. The operating lease liabilities are equal to the present value of our remaining lease payments discounted at our incremental borrowing rate and the operating lease right-of-use assets are equal to the operating lease liabilities adjusted for our deferred rent liabilities at the adoption of this accounting standard. As lease payments are made, the operating lease liabilities are reduced to the present value of the remaining lease payments and the operating lease right-of-use assets are reduced by the difference between the lease expense (straight-lined over the lease term) and the theoretical interest expense amount (calculated using the incremental borrowing rate). See *Note 16* for further discussion on leases.

Contingent Consideration

In relation to our acquisition of 5 Arches, we recorded contingent consideration liabilities that represent the estimated fair value (at the date of acquisition) of our obligation to make certain earn-out payments that are contingent on 5 Arches loan origination volumes exceeding certain specified thresholds. These liabilities were carried at fair value and periodic changes in their estimated fair value were recorded through Other expenses on our consolidated statements of income. During the first quarter of 2020, we reclassified the contingent liability to a deferred liability, as the remaining payments became payable on a set timetable without any remaining contingencies.

See *Note 12* for further discussion on other assets and other liabilities.

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 are typically collateralized by cash, loans, or securities, and in some cases may be unsecured. 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. Short-term debt also includes non-recourse short-term borrowings used to finance servicer advance investments.

See *Note 13* for further discussion on short-term debt.

Asset-Backed Securities Issued

ABS issued represents asset-backed securities issued through the Legacy Sequoia, Sequoia Choice, Freddie Mac K-Series, Freddie Mac SLST, and CAFL securitization entities. Assets at these entities 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. In accordance with accounting guidance for CFEs, we account for the ABS issued under our consolidated entities at fair value, with periodic changes in fair value recorded in Investment fair value changes, net on our consolidated statements of income.

During the third quarter of 2020, we re-securitized subordinate securities we owned in our consolidated Freddie Mac SLST securitization trusts, through the transfer of these financial assets to a re-securitization trust that we sponsored. We account for the ABS issued by this re-securitization trust at amortized cost.

See *Note 14* for further discussion on ABS issued.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 3. Summary of Significant Accounting Policies - (continued)

Long-Term Debt

FHLBC Borrowings

FHLBC borrowings include amounts borrowed by our FHLB-member subsidiary, also referred to as “advances,” from the Federal Home Loan Bank of Chicago that are secured by eligible collateral, including, but not limited to, residential mortgage loans, single-family rental loans, and residential mortgage-backed securities. FHLBC borrowings are carried at their unpaid principal balance and interest on advances is paid every 13 weeks from when each respective advance is made. If the value (as determined by the FHLBC) 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 FHLBC may foreclose upon the collateral and pursue any outstanding debt amount from us.

Recourse Subordinate Securities Financing Facilities

Borrowings under our subordinate securities financing facilities are secured by real estate securities and carried at unpaid principal balance net of any unamortized deferred issuance costs. Interest on these facilities is paid monthly.

See *Note 15* for further discussion on our subordinate securities financing facilities.

Non-Recourse Business Purpose Loan Financing Facilities

Borrowings under our non-recourse business purpose loan financing facilities are secured by bridge loans and other Business Purpose Lending ("BPL") investments and carried at unpaid principal balance net of any unamortized deferred issuance costs. Interest on these facilities is paid monthly.

See *Note 15* for further discussion on our non-recourse business purpose loan financing facilities.

Recourse Business Purpose Loan Financing Facilities

Borrowings under our recourse business purpose loan financing facilities are secured by bridge loans and single-family rental loans and carried at unpaid principal balance net of any unamortized deferred issuance costs. Interest on these facilities is paid monthly.

See *Note 15* for further discussion on our recourse business purpose loan financing facilities.

Recourse Revolving Debt Facility

Borrowings under our recourse revolving debt facility are secured by MSRs and certificated mortgage servicing rights and carried at unpaid principal balance. Interest on this facility is paid monthly.

See *Note 15* for further discussion on our recourse revolving debt facility.

Convertible Notes

Convertible notes include unsecured convertible and exchangeable debt that are carried at their unpaid principal balance net of any unamortized deferred issuance costs. Interest on the notes is payable semiannually until such time the notes mature or are converted or exchanged into shares. If converted or exchanged by a holder, the holder of the notes would receive shares of our common stock.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 3. Summary of Significant Accounting Policies - (continued)

Trust Preferred Securities and Subordinated Notes

Trust preferred securities and subordinated notes are carried at their unpaid principal balance net of any unamortized deferred issuance costs. This long-term debt is unsecured and interest is paid quarterly until it is redeemed in whole or matures at a future date.

Deferred Debt Issuance Costs

Deferred debt issuance costs are expenses associated with the issuance of long-term debt. These expenses typically include underwriting, rating agency, legal, accounting, and other fees. Deferred debt issuance costs are included in the carrying value of the related long-term debt issued and are amortized as an adjustment to interest expense using the interest method, based upon the actual and estimated repayment schedules of the related long-term debt issued.

See *Note 15* for further discussion on long-term debt.

Equity

Accumulated Other Comprehensive Income (Loss)

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 stockholders' equity and our consolidated balance sheets. Net unrealized gains and losses on securities and interest rate agreements held by our taxable REIT 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 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. In addition, if the assumed conversion or exchange of convertible or exchangeable debt into common shares is dilutive, diluted EPS is adjusted by adding back the periodic interest expense (net of any tax effects) associated with dilutive convertible or exchangeable debt to net income and adding the shares issued in an assumed conversion or exchange to the diluted weighted average 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. GAAP defines vested and unvested share-based payment awards containing nonforfeitable rights to dividends or dividend equivalents as participating securities that are included in computing EPS under the two-class method.

See *Note 17* for further discussion on equity.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

Incentive Plans

In May 2020, our shareholders approved an amendment to the 2014 Redwood Trust, Inc. Incentive Plan (“Incentive Plan”) for executive officers, employees, and non-employee directors, which increased the number of shares available under the Incentive Plan. The Incentive Plan provides for the grant of restricted stock, deferred stock, deferred stock units, performance-based awards (including performance stock units), dividend equivalents, stock payments, restricted stock units, and other types of awards to eligible participants. 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. Deferred stock units, restricted stock units, and restricted stock awards have attached dividend equivalent rights, resulting in the payment of dividend equivalents each time we pay a common stock dividend. Non-employee directors are also provided annual awards under the Incentive Plan that generally vest immediately. The cost of the awards is generally amortized over the vesting period on a straight-line basis. Upon adoption of ASU 2016-09 in 2016, we elected to begin accounting for forfeitures on employee equity awards as they occur.

Employee Stock Purchase Plan

In 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 2018, our Board of Directors approved an amendment to our 2002 Executive Deferred Compensation Plan (“EDCP”) to increase the number of shares available to 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. Plan matching contributions made by the Company for the years ended December 31, 2020, 2019, and 2018 were \$1.1 million, \$0.7 million, and \$0.6 million, respectively. 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 matching contributions.

See *Note 18* for further discussion on equity compensation plans.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

Cash-Based Retention and Incentive Awards

During the third quarter of 2020, \$8 million of cash-based retention awards were granted to certain executive and non-executive employees that will vest and be paid over a three-year period, subject to continued employment through the vesting periods from 2021 through 2023. Additionally, during the third quarter of 2020, Long-Term Relative TSR Performance Vesting Cash Awards ("Cash Performance Awards"), with an aggregate granted award value of \$2 million, were granted to certain executive and non-executive employees that will vest between 0% to 400% of granted award value based on a relative total stockholder return measure, and are contingent on continued employment over a three-year service period. The value of the cash-based retention awards will be amortized into expense on a straight-line basis over each award's respective vesting period. The Cash Performance Awards are amortized on a straight-line basis over three years; however, they are remeasured at fair value each quarter-end and the cumulative straight-line expense is trued-up in respect to their updated value.

See *Note 21* for further discussion on cash-based retention and incentive awards.

Cash-Settled Deferred Stock Units

In December 2020, \$2 million of cash-settled deferred stock units were granted to certain executive officers that will vest over the next four years through 2024. These awards will be fully vested and payable in cash with a vested award value based on the closing market price of our common stock on December 15, 2024. These awards are classified as a liability in Accrued expenses and other liabilities on our consolidated balance sheets, and will be amortized over the vesting period on a straight-line basis, adjusted for changes in the value of our common stock at the end of each reporting period.

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 REIT subsidiaries) within the time frame set forth in the Internal Revenue 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 GAAP guidance on accounting for uncertain tax positions. We classify interest and penalties on material uncertain tax positions as interest expense and general and administrative expenses, respectively, in our consolidated statements of income.

See *Note 22* for further discussion on taxes.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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December 31, 2020

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

Recent Accounting Pronouncements

Newly Adopted Accounting Standards Updates ("ASUs")

In August 2018, the FASB issued ASU 2018-15, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract (a consensus of the FASB Emerging Issues Task Force)." This new guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). This new guidance is effective for fiscal years beginning after December 15, 2019. We adopted this guidance, as required, in the first quarter of 2020, which did not have a material impact on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement." This new guidance amends previous guidance by removing and modifying certain existing fair value disclosure requirements, while adding other new disclosure requirements. This new guidance is effective for fiscal years beginning after December 15, 2019. We adopted this new guidance, as required, in the first quarter of 2020, which did not have a material impact on our consolidated financial statements but impacted certain of our fair value footnote disclosures.

In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." This new guidance simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. This new guidance is effective for fiscal years beginning after December 15, 2019. We adopted this new guidance, as required, in the first quarter of 2020, which did not have a material impact on our consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses." This new guidance provides a new impairment model that is based on expected losses rather than incurred losses to determine the allowance for credit losses. This new guidance is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted for fiscal years beginning after December 15, 2018. In November 2018, the FASB issued ASU 2018-19, "Codification Improvements to Topic 326, Financial Instruments - Credit Losses," which clarifies the scope of the amendments in ASU 2016-13. In April 2019, the FASB issued ASU 2019-04, "Codification Improvements to Topic 326, Financial Instruments - Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments," which is intended to clarify this guidance. In May 2019, the FASB issued ASU 2019-05, "Financial Instruments - Credit Losses (Topic 326): Targeted Transition Relief," which provides an option to irrevocably elect the fair value option for certain financial assets previously measured at amortized cost. In November 2019, the FASB issued ASU 2019-11, "Codification Improvements to Topic 326, Financial Instruments - Credit Losses," which is intended to clarify Codification guidance. In February 2020, the FASB issued ASU 2020-02, "Financial Instruments - Credit Losses (Topic 326) and Leases (Topic 842) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842) (SEC Update)," and in March 2020, the FASB issued ASU 2020-03, "Codification Improvements to Financial Instruments." These updates amend certain sections of the guidance. We currently have only a small balance of loans receivable that are not carried at fair value and would be subject to this new guidance for allowance for credit losses. Separately, we accounted for our available-for-sale securities under the other-than-temporary impairment ("OTTI") model for debt securities prior to the issuance of this new guidance. This new guidance requires that credit impairments on our available-for-sale securities be recorded in earnings using an allowance for credit losses, with the allowance limited to the amount by which the security's fair value is less than its amortized cost basis. Subsequent reversals in credit loss estimates are recognized in income. We adopted this guidance, as required, in the first quarter of 2020, which did not have a material impact on our consolidated financial statements.

Other Recent Accounting Pronouncements

In October 2020, the FASB issued ASU 2020-10, "Codification Improvements." This new guidance updates various codification topics by clarifying or improving disclosure requirements. This new guidance is effective for fiscal years ending after December 15, 2020. Early adoption is permitted. We plan to adopt this new guidance by the required date and do not anticipate that this update will have a material impact on our consolidated financial statements.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

In October 2020, the FASB issued ASU 2020-09, "Debt (Topic 470): Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762." This new guidance aligns certain SEC paragraphs in the codification with new SEC rules issued in March 2020 related to changes to the disclosure requirements for registered debt securities. This new guidance is effective January 4, 2021. Early adoption is permitted. We plan to adopt this new guidance by the required date and do not anticipate that this update will have a material impact on our consolidated financial statements.

In October 2020, the FASB issued ASU 2020-08, "Codification Improvements to Subtopic 310-20, Receivables - Nonrefundable Fees and Other Costs." This new guidance clarifies that an entity should reevaluate whether a callable debt security is within the scope of paragraph 310-20-35-33 for each reporting period. This new guidance is effective for fiscal years ending after December 15, 2020. Early adoption is not permitted. We plan to adopt this new guidance by the required date and do not anticipate that this update will have a material update on our consolidated financial statements.

In August 2020, the FASB issued ASU 2020-06, "Debt - Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging - Contracts in Entity's Own Equity (Subtopic 815-40)." This new guidance simplifies the accounting for convertible debt by reducing the number of accounting models to separately present certain conversion features in equity. This new guidance is effective for fiscal years beginning after December 31, 2021. Early adoption is permitted. We plan to adopt this new guidance by the required date and do not anticipate that this update will have a material impact on our consolidated financial statements.

In March 2020, the FASB issued ASU 2020-04, "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting." This new guidance provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met. In January 2021, the FASB issued ASU 2021-01, "Reference Rate Reform (Topic 848): Scope." This new guidance clarifies that certain optional expedients and exceptions in Topic 848 for contract modifications and hedge accounting apply to derivatives that are affected by the discounting transition. This new guidance is effective for all entities as of March 12, 2020 through December 31, 2022. We are currently evaluating the impact the adoption of this standard would have on our consolidated financial statements. Through December 31, 2020, we have not elected to apply the optional expedients and exceptions to any of our existing contracts, hedging relationships, or other transactions.

In January 2020, the FASB issued ASU 2020-01, "Investments - Equity Securities (Topic 321), Investments - Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815)." This new guidance clarifies the interaction of the accounting for equity securities, equity method investments, and certain forward contracts and purchased options. This new guidance is effective for fiscal years beginning after December 15, 2020. Early adoption is permitted. We plan to adopt this new guidance by the required date and do not anticipate that this update will have a material impact on our consolidated financial statements.

In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes." This new guidance simplifies the accounting for income taxes by removing certain exceptions to the general principles in Topic 740 and by clarifying and amending existing guidance. This new guidance is effective for fiscal years beginning after December 15, 2020. Early adoption is permitted. We plan to adopt this new guidance by the required date and do not anticipate that this update will have a material impact on our consolidated financial statements.

Balance Sheet Netting

Certain of our derivatives and short-term debt 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.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

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 December 31, 2020 and December 31, 2019.

Table 3.1 – Offsetting of Financial Assets, Liabilities, and Collateral

December 31, 2020 (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⁾		Net Amount
				Financial Instruments	Cash Collateral (Received) Pledged	
Assets ⁽²⁾						
Interest rate agreements	\$ 19,951	\$ —	\$ 19,951	\$ —	\$ (7,769)	\$ 12,182
TBAs	18,260	—	18,260	(13,423)	(4,658)	179
Total Assets	\$ 38,211	\$ —	\$ 38,211	\$ (13,423)	\$ (12,427)	\$ 12,361
Liabilities ⁽²⁾						
TBAs	\$ (15,495)	\$ —	\$ (15,495)	\$ 13,423	\$ 1,061	\$ (1,011)
Loan warehouse debt	(137,269)	—	(137,269)	137,269	—	—
Security repurchase agreements	(77,775)	—	(77,775)	77,775	—	—
Total Liabilities	\$ (230,539)	\$ —	\$ (230,539)	\$ 228,467	\$ 1,061	\$ (1,011)

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

December 31, 2019 (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⁾		Net Amount
				Financial Instruments	Cash Collateral (Received) Pledged	
Assets ⁽²⁾						
Interest rate agreements	\$ 19,020	\$ —	\$ 19,020	\$ (14,178)	\$ (915)	\$ 3,927
TBAs	5,755	—	5,755	(5,755)	—	—
Futures	137	—	137	—	—	137
Total Assets	\$ 24,912	\$ —	\$ 24,912	\$ (19,933)	\$ (915)	\$ 4,064
Liabilities ⁽²⁾						
Interest rate agreements	\$ (148,765)	\$ —	\$ (148,765)	\$ 14,178	\$ 134,587	\$ —
TBAs	(13,359)	—	(13,359)	5,755	6,673	(931)
Loan warehouse debt	(432,126)	—	(432,126)	432,126	—	—
Security repurchase agreements	(1,096,578)	—	(1,096,578)	1,096,578	—	—
Total Liabilities	\$ (1,690,828)	\$ —	\$ (1,690,828)	\$ 1,548,637	\$ 141,260	\$ (931)

- (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 and TBAs are components of derivatives instruments on our consolidated balance sheets. Loan warehouse debt, which is secured by certain residential and business purpose loans, and security repurchase agreements are components of Short-term debt and 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 us and a counterparty are subject to a master netting arrangement or similar agreement with that counterparty that provides for individual transactions to be aggregated and 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. 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 agreement or similar agreement provides for settlement on a net basis. Any such settlement would 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. Such limitations 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 we sponsor and other transfers of financial assets should be treated as sales or financings, as well as whether any VIEs that we hold variable interests in – 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.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 4. Principles of Consolidation - (continued)

Analysis of Consolidated VIEs

At December 31, 2020, we consolidated Legacy Sequoia, Sequoia Choice, Freddie Mac SLST, Freddie Mac K-Series and CAFL securitization entities that we determined were VIEs and for which we determined we were the primary beneficiary. Each of these entities is independent of Redwood and of each other and the assets and liabilities of these entities are not owned by and are not legal obligations of ours. Our exposure to these entities is primarily through the financial interests we have retained, although for the consolidated Sequoia and CAFL entities we are exposed to certain financial risks associated with our role as a sponsor, servicing administrator, or depositor of these entities or as a result of our having sold assets directly or indirectly to these entities. At December 31, 2020, the estimated fair value of our investments in the consolidated Legacy Sequoia, Sequoia Choice, Freddie Mac SLST, Freddie Mac K-Series, and CAFL entities was \$5 million, \$220 million, \$430 million, \$28 million, and \$242 million, respectively.

During the first quarter of 2020, we sold subordinate securities (and transferred directing certificate holder status as a result of these sales) issued by four of these Freddie Mac K-Series securitization trusts and determined that we should derecognize the associated assets and liabilities of each of these entities for financial reporting purposes. We deconsolidated \$3.86 billion of multifamily loans and other assets and \$3.72 billion of multifamily ABS issued and other liabilities, for which we realized market valuation losses of \$72 million, which were recorded through Investment fair value changes, net on our consolidated statements of income (loss).

Beginning in 2018, we consolidated two Servicing Investment entities formed to invest in servicing-related assets that we determined were VIEs and for which we determined we were the primary beneficiary. At December 31, 2020, we held an 80% ownership interest in, and were responsible for the management of, each entity. See *Note 10* for a further description of these entities and the investments they hold and *Note 12* for additional information on the minority partner's interest. Additionally, beginning in 2018, we consolidated an entity that was formed to finance servicer advances, that we determined was a VIE and for which we, through our control of one of the aforementioned partnerships, were the primary beneficiary. The servicer advance financing consists of non-recourse short-term securitization debt, secured by servicer advances. We consolidate the securitization entity, but the securitization entity is independent of Redwood and the assets and liabilities are not owned by and are not legal obligations of Redwood. See *Note 13* for additional information on the servicer advance financing. At December 31, 2020, the estimated fair value of our investment in the Servicing Investment entities was \$68 million.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 4. Principles of Consolidation - (continued)

The following table presents a summary of the assets and liabilities of these VIEs.

Table 4.1 – Assets and Liabilities of Consolidated VIEs Accounted for as Collateralized Financing Entities

December 31, 2020								
(Dollars in Thousands)	Legacy Sequoia	Sequoia Choice	Freddie Mac SLST	Freddie Mac K-Series	CAFL	Servicing Investment	Total Consolidated VIEs	
Residential loans, held-for-investment	\$ 285,935	\$ 1,565,322	\$ 2,221,153	\$ —	\$ —	\$ —	\$ 4,072,410	
Business purpose loans, held-for-investment	—	—	—	—	3,249,194	—	3,249,194	
Multifamily loans, held-for-investment	—	—	—	492,221	—	—	492,221	
Other investments	—	—	—	—	—	251,773	251,773	
Cash and cash equivalents	—	—	—	—	—	11,579	11,579	
Restricted cash	148	—	—	—	—	23,220	23,368	
Accrued interest receivable	305	6,802	6,754	1,337	13,055	2,334	30,587	
Other assets	638	—	646	—	2,930	5,723	9,937	
Total Assets	\$ 287,026	\$ 1,572,124	\$ 2,228,553	\$ 493,558	\$ 3,265,179	\$ 294,629	\$ 8,141,069	
Short-term debt	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 208,375	\$ 208,375	
Accrued interest payable	141	4,697	4,846	1,177	10,278	135	21,274	
Accrued expenses and other liabilities	—	50	—	—	—	18,353	18,403	
Asset-backed securities issued	282,326	1,347,357	1,793,620	463,966	3,013,093	—	6,900,362	
Total Liabilities	\$ 282,467	\$ 1,352,104	\$ 1,798,466	\$ 465,143	\$ 3,023,371	\$ 226,863	\$ 7,148,414	
Number of VIEs	20	10	2	1	14	3	50	
December 31, 2019								
(Dollars in Thousands)	Legacy Sequoia	Sequoia Choice	Freddie Mac SLST	Freddie Mac K-Series	CAFL	Servicing Investment	Total Consolidated VIEs	
Residential loans, held-for-investment	\$ 407,890	\$ 2,291,463	\$ 2,367,215	\$ —	\$ —	\$ —	\$ 5,066,568	
Business purpose loans, held-for-investment	—	—	—	—	2,192,552	—	2,192,552	
Multifamily loans, held-for-investment	—	—	—	4,408,524	—	—	4,408,524	
Other investments	—	—	—	—	—	184,802	184,802	
Cash and cash equivalents	—	—	—	—	—	9,015	9,015	
Restricted cash	143	27	—	—	—	21,766	21,936	
Accrued interest receivable	655	9,824	7,313	13,539	9,572	4,869	45,772	
Other assets	460	—	445	—	1,795	—	2,700	
Total Assets	\$ 409,148	\$ 2,301,314	\$ 2,374,973	\$ 4,422,063	\$ 2,203,919	\$ 220,452	\$ 11,931,869	
Short-term debt	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 152,554	\$ 152,554	
Accrued interest payable	395	7,732	5,374	12,887	7,485	187	34,060	
Accrued expenses and other liabilities	—	27	—	—	—	14,956	14,983	
Asset-backed securities issued	402,465	2,037,198	1,918,322	4,156,239	2,001,251	—	10,515,475	
Total Liabilities	\$ 402,860	\$ 2,044,957	\$ 1,923,696	\$ 4,169,126	\$ 2,008,736	\$ 167,697	\$ 10,717,072	
Number of VIEs	20	9	2	5	10	3	49	

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 4. Principles of Consolidation - (continued)

The following tables present income (loss) from these VIEs for the years ended December 31, 2020 and 2019.

Table 4.2 – Income (Loss) from Consolidated VIEs Accounted for as Collateralized Financing Entities

(Dollars in Thousands)	Year Ended December 31, 2020						
	Legacy Sequoia	Sequoia Choice	Freddie Mac SLST	Freddie Mac K-Series	CAFL	Servicing Investment	Total Consolidated VIEs
Interest income	\$ 9,061	\$ 87,093	\$ 85,609	\$ 54,813	\$ 136,950	\$ 17,665	\$ 391,191
Interest expense	(5,945)	(73,643)	(62,483)	(51,521)	(105,732)	(6,441)	(305,765)
Net interest income	3,116	13,450	23,126	3,292	31,218	11,224	85,426
Non-interest income							
Investment fair value changes, net	(1,512)	(13,244)	(21,160)	(81,039)	(39,574)	(11,327)	(167,856)
Total non-interest income, net	(1,512)	(13,244)	(21,160)	(81,039)	(39,574)	(11,327)	(167,856)
General and administrative expenses	—	—	—	—	—	(867)	(867)
Other expenses	—	—	—	—	—	193	193
Income (Loss) from Consolidated VIEs	\$ 1,604	\$ 206	\$ 1,966	\$ (77,747)	\$ (8,356)	\$ (777)	\$ (83,104)
(Dollars in Thousands)	Year Ended December 31, 2019						
	Legacy Sequoia	Sequoia Choice	Freddie Mac SLST	Freddie Mac K-Series	CAFL	Servicing Investment	Total Consolidated VIEs
Interest income	\$ 17,649	\$ 108,798	\$ 57,840	\$ 132,600	\$ 23,072	\$ 14,511	\$ 354,470
Interest expense	(14,418)	(93,354)	(42,574)	(126,948)	(17,173)	(11,952)	(306,419)
Net interest income	3,231	15,444	15,266	5,652	5,899	2,559	48,051
Non-interest income							
Investment fair value changes, net	(1,545)	6,947	27,206	21,430	(3,636)	3,311	53,713
Total non-interest income, net	(1,545)	6,947	27,206	21,430	(3,636)	3,311	53,713
General and administrative expenses	—	—	—	—	—	(343)	(343)
Other expenses	—	—	—	—	—	(1,106)	(1,106)
Income from Consolidated VIEs	\$ 1,686	\$ 22,391	\$ 42,472	\$ 27,082	\$ 2,263	\$ 4,421	\$ 100,315

We consolidate the assets and liabilities of certain Sequoia and CAFL 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 and CAFL 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 and CAFL entities in accordance with GAAP.

We consolidate the assets and liabilities of certain Freddie Mac K-Series and SLST securitization trusts resulting from our investment in subordinate securities issued by these trusts and in the case of certain CAFL securitizations, resulting from securities acquired through our acquisition of CoreVest. Additionally, we consolidate the assets and liabilities of Servicing Investment entities from our investment in servicer advance investments and excess MSR. In each case, we maintain certain discretionary rights associated with the ownership of these investments that we determined reflected a controlling financial interest, as we have both the power to direct the activities that most significantly impact the economic performance of the VIEs and the right to receive benefits of and the obligation to absorb losses from the VIEs that could potentially be significant to the VIEs.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 4. Principles of Consolidation - (continued)

During the third quarter of 2020, we re-securitized subordinate securities we owned in our consolidated Freddie Mac SLST securitization trusts through the transfer of these financial assets to a re-securitization trust that we sponsored. We retain a subordinate investment in the re-securitization trust and maintain certain discretionary rights associated with the ownership of this investment that we determined reflected a controlling financial interest in the entity, as we have both the power to direct the activities that most significantly impact the performance of the VIE and the right to receive benefits of and the obligation to absorb losses from the VIE that could potentially be significant to the VIE. At securitization, we issued \$210 million of ABS and have elected to account for the ABS issued at amortized cost.

Analysis of Unconsolidated VIEs with Continuing Involvement

Since 2012, we have transferred residential loans to 53 Sequoia securitization entities sponsored by us that are still outstanding as of December 31, 2020 and accounted for these transfers as sales for financial reporting purposes, in accordance with ASC 860. 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 certain of these transfers to securitization entities, for the transferred loans where we held the servicing rights prior to the transfer and continued to hold the servicing rights following the transfer, we recorded MSR 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. Our continuing involvement in these securitizations is limited to customary servicing obligations associated with retaining servicing rights (which we retain a third-party sub-servicer to perform) and the receipt of interest income associated with the securities we retained.

During each of the years ended December 31, 2020 and 2019, we transferred residential loans to five Sequoia securitization entities sponsored by us, and accounted for these transfers as sales for financial reporting purposes. The following table presents information related to securitization transactions that occurred during the years ended December 31, 2020 and 2019.

Table 4.3 – Securitization Activity Related to Unconsolidated VIEs Sponsored by Redwood

(In Thousands)	Years Ended December 31,	
	2020	2019
Principal balance of loans transferred	\$ 2,223,462	\$ 1,872,910
Trading securities retained, at fair value	49,089	8,882
AFS securities retained, at fair value	4,187	4,847

The following table summarizes the cash flows during the years ended December 31, 2020 and 2019 between us and the unconsolidated VIEs sponsored by us and accounted for as sales since 2012.

Table 4.4 – Cash Flows Related to Unconsolidated VIEs Sponsored by Redwood

(In Thousands)	Years Ended December 31,	
	2020	2019
Proceeds from new transfers	\$ 2,276,521	\$ 1,912,334
MSR fees received	9,749	11,857
Funding of compensating interest, net	(405)	(368)
Cash flows received on retained securities	24,172	27,045

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 4. Principles of Consolidation - (continued)

The following table presents the key weighted average assumptions used to value securities retained at the date of securitization for securitizations completed during 2020 and 2019.

Table 4.5 – Assumptions Related to Assets Retained from Unconsolidated VIEs Sponsored by Redwood

At Date of Securitization	Year Ended December 31, 2020		Year Ended December 31, 2019	
	Senior IO Securities	Subordinate Securities	Senior IO Securities	Subordinate Securities
Prepayment rates	29 %	14 %	25 %	15 %
Discount rates	14 %	7 %	14 %	7 %
Credit loss assumptions	0.27 %	0.24 %	0.20 %	0.20 %

The following table presents additional information at December 31, 2020 and December 31, 2019, related to unconsolidated VIEs sponsored by Redwood and accounted for as sales since 2012.

Table 4.6 – Unconsolidated VIEs Sponsored by Redwood

(In Thousands)	December 31, 2020	December 31, 2019
On-balance sheet assets, at fair value:		
Interest-only, senior and subordinate securities, classified as trading	\$ 20,982	\$ 88,425
Subordinate securities, classified as AFS	136,475	140,649
Mortgage servicing rights	8,413	40,254
Maximum loss exposure ⁽¹⁾	<u>\$ 165,870</u>	<u>\$ 269,328</u>
Assets transferred:		
Principal balance of loans outstanding	\$ 7,728,432	\$ 10,299,442
Principal balance of loans 30+ days delinquent	138,029	41,809

(1) Maximum loss exposure from our involvement with unconsolidated VIEs pertains to the carrying value of our securities and MSRs 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.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 4. Principles of Consolidation - (continued)

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 December 31, 2020 and December 31, 2019.

Table 4.7 – Key Assumptions and Sensitivity Analysis for Assets Retained from Unconsolidated VIEs Sponsored by Redwood

December 31, 2020 (Dollars in Thousands)	MSRs	Senior Securities ⁽¹⁾	Subordinate Securities
Fair value at December 31, 2020	\$ 8,413	\$ 17,333	\$ 140,124
Expected life (in years) ⁽²⁾	2	3	8
Prepayment speed assumption (annual CPR) ⁽²⁾	37 %	31 %	33 %
Decrease in fair value from:			
10% adverse change	\$ 906	\$ 1,557	\$ 452
25% adverse change	2,058	3,754	2,298
Discount rate assumption ⁽²⁾	12 %	21 %	5 %
Decrease in fair value from:			
100 basis point increase	\$ 196	\$ 337	\$ 9,769
200 basis point increase	380	659	18,650
Credit loss assumption ⁽²⁾	N/A	0.41 %	0.41 %
Decrease in fair value from:			
10% higher losses	N/A	\$ —	\$ 2,409
25% higher losses	N/A	—	5,915
December 31, 2019 (Dollars in Thousands)	MSRs	Senior Securities ⁽¹⁾	Subordinate Securities
Fair value at December 31, 2019	\$ 40,254	\$ 48,765	\$ 180,309
Expected life (in years) ⁽²⁾	6	6	14
Prepayment speed assumption (annual CPR) ⁽²⁾	11 %	14 %	16 %
Decrease in fair value from:			
10% adverse change	\$ 1,643	\$ 1,908	\$ 205
25% adverse change	3,913	5,086	1,434
Discount rate assumption ⁽²⁾	11 %	12 %	5 %
Decrease in fair value from:			
100 basis point increase	\$ 1,447	\$ 1,079	\$ 18,127
200 basis point increase	2,795	2,482	33,630
Credit loss assumption ⁽²⁾	N/A	0.21 %	0.21 %
Decrease in fair value from:			
10% higher losses	N/A	\$ —	\$ 1,804
25% higher losses	N/A	—	4,520

- (1) Senior securities included \$17 million and \$49 million of interest-only securities at December 31, 2020 and December 31, 2019, respectively.
- (2) Expected life, prepayment speed assumption, discount rate assumption, and credit loss assumption presented in the tables above represent weighted averages.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 4. Principles of Consolidation - (continued)

Analysis of Unconsolidated Third-Party VIEs

Third-party VIEs are securitization entities in which we maintain an economic interest, but do not sponsor. Our economic interest may include several securities and other investments 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 December 31, 2020 and December 31, 2019, grouped by asset type.

Table 4.8 – Third-Party Sponsored VIE Summary

(In Thousands)	December 31, 2020	December 31, 2019
Mortgage-Backed Securities		
Senior	\$ 11,131	\$ 127,094
Mezzanine	2,014	508,195
Subordinate	173,523	235,510
Total Mortgage-Backed Securities	186,668	870,799
Excess MSR	14,133	16,216
Total Investments in Third-Party Sponsored VIEs	\$ 200,801	\$ 887,015

We determined that we are not the primary beneficiary of these third-party VIEs, 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 solely 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.

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.

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.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

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 December 31, 2020 and December 31, 2019.

Table 5.1 – Carrying Values and Fair Values of Assets and Liabilities

(In Thousands)	December 31, 2020		December 31, 2019	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Residential loans, held-for-sale at fair value	\$ 176,604	\$ 176,604	\$ 536,280	\$ 536,280
Residential loans, held-for-investment	4,072,410	4,072,410	7,178,465	7,178,465
Business purpose loans, held-for-sale	245,394	245,394	331,565	331,565
Business purpose loans, held-for-investment	3,890,959	3,890,959	3,175,178	3,175,178
Multifamily loans	492,221	492,221	4,408,524	4,408,524
Real estate securities	344,125	344,125	1,099,874	1,099,874
Servicer advance investments ⁽¹⁾	231,489	231,489	169,204	169,204
MSRs ⁽¹⁾	8,815	8,815	42,224	42,224
Excess MSRs ⁽¹⁾	34,418	34,418	31,814	31,814
Shared home appreciation options ⁽¹⁾	42,440	42,440	45,085	45,085
Cash and cash equivalents	461,260	461,260	196,966	196,966
Restricted cash	83,190	83,190	93,867	93,867
Derivative assets	53,238	53,238	35,701	35,701
REO ⁽²⁾	8,413	9,229	9,462	10,389
Margin receivable ⁽²⁾	4,758	4,758	209,776	209,776
FHLBC stock ⁽²⁾	5,000	5,000	43,393	43,393
Pledged collateral ⁽²⁾	1,177	1,177	32,945	32,945
Liabilities				
Short-term debt	\$ 522,609	\$ 522,609	\$ 2,329,145	\$ 2,329,145
Margin payable ⁽³⁾	—	—	1,700	1,700
Guarantee obligation ⁽³⁾	10,039	7,843	14,009	13,754
Contingent consideration ⁽³⁾	—	—	28,484	28,484
Derivative liabilities	16,072	16,072	163,424	163,424
ABS issued net				
Fair value	6,900,362	6,900,362	10,515,475	10,515,475
Amortized cost	200,299	204,892	—	—
FHLBC long-term borrowings	1,000	1,000	1,999,999	1,999,999
Other long-term debt, net	774,726	783,570	183,520	184,666
Convertible notes, net	511,085	499,865	631,125	661,985
Trust preferred securities and subordinated notes, net	138,674	80,910	138,628	99,045

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

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

(3) These liabilities are included in Accrued expenses and other liabilities on our consolidated balance sheets.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

During the years ended December 31, 2020 and 2019, we elected the fair value option for \$108 million and \$333 million of securities, respectively, \$4.37 billion and \$6.99 billion of residential loans (principal balance), respectively, \$1.40 billion and \$4.02 billion of business purpose loans (principal balance), respectively, zero and \$1.43 billion of multifamily loans (principal balance), respectively, \$179 million and \$70 million of servicer advance investments, respectively, \$11 million and \$8 million of excess MSR, respectively, and \$4 million and \$43 million of shared home appreciation options, respectively. We anticipate electing the fair value option for all future purchases of residential and business purpose loans that we intend to sell to third parties or transfer to securitizations, as well as for certain securities we purchase, including IO securities and fixed-rate securities rated investment grade or higher.

The following table presents the assets and liabilities that are reported at fair value on our consolidated balance sheets on a recurring basis at December 31, 2020 and December 31, 2019, as well as the fair value hierarchy of the valuation inputs used to measure fair value.

Table 5.2 – Assets and Liabilities Measured at Fair Value on a Recurring Basis

December 31, 2020 (In Thousands)	Carrying Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Assets				
Residential loans	\$ 4,249,014	\$ —	\$ —	\$ 4,249,014
Business purpose loans	4,136,353	—	—	4,136,353
Multifamily loans	492,221	—	—	492,221
Real estate securities	344,125	—	—	344,125
Servicer advance investments	231,489	—	—	231,489
MSRs	8,815	—	—	8,815
Excess MSRs	34,418	—	—	34,418
Shared home appreciation options	42,440	—	—	42,440
Derivative assets	53,238	18,260	19,951	15,027
Pledged collateral	1,177	1,177	—	—
FHLBC stock	5,000	—	5,000	—
Liabilities				
Derivative liabilities	\$ 16,072	\$ 15,495	\$ —	\$ 577
ABS issued	6,900,362	—	—	6,900,362

REDWOOD TRUST, INC. AND SUBSIDIARIES
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December 31, 2020

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

December 31, 2019 (In Thousands)	Carrying Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Assets				
Residential loans	\$ 7,714,745	\$ —	\$ —	\$ 7,714,745
Business purpose loans	3,506,743	—	—	3,506,743
Multifamily loans	4,408,524	—	—	4,408,524
Real estate securities	1,099,874	—	—	1,099,874
Servicer advance investments	169,204	—	—	169,204
MSRs	42,224	—	—	42,224
Excess MSRs	31,814	—	—	31,814
Shared home appreciation options	45,085	—	—	45,085
Derivative assets	35,701	6,531	19,020	10,150
Pledged collateral	32,945	32,945	—	—
FHLBC stock	43,393	—	43,393	—
Liabilities				
Contingent consideration	\$ 28,484	\$ —	\$ —	\$ 28,484
Derivative liabilities	163,424	13,368	148,766	1,290
ABS issued	10,515,475	—	—	10,515,475

The following table presents additional information about Level 3 assets and liabilities measured at fair value on a recurring basis for the years ended December 31, 2020 and December 31, 2019.

Table 5.3 – Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis

(In Thousands)	Assets								
	Residential Loans	Business Purpose Loans	Multifamily Loans	Trading Securities	AFS Securities	Servicer Advance Investments	MSRs	Excess MSRs	Shared Home Appreciation Options
Beginning balance - December 31, 2019	\$7,714,745	\$3,506,743	\$4,408,524	\$ 860,540	\$ 239,334	\$ 169,204	\$ 42,224	\$ 31,814	\$ 45,085
Acquisitions	4,483,473	—	—	108,249	57,652	179,419	—	10,906	3,517
Originations	—	1,431,251	—	—	—	—	—	—	—
Sales	(6,262,958)	(135,800)	—	(603,529)	(55,192)	—	—	—	—
Principal paydowns	(1,552,171)	(753,026)	(7,703)	(8,687)	(17,924)	(107,527)	—	—	(4,278)
Deconsolidations	—	—	(3,849,779)	—	—	—	—	—	—
Gains (losses) in net income (loss), net	(132,307)	99,590	(58,821)	(230,906)	10,792	(9,607)	(33,409)	(8,302)	(1,884)
Unrealized losses in OCI, net	—	—	—	—	(16,204)	—	—	—	—
Other settlements, net ⁽¹⁾	(1,768)	(12,405)	—	—	—	—	—	—	—
Ending balance - December 31, 2020	\$4,249,014	\$4,136,353	\$ 492,221	\$ 125,667	\$ 218,458	\$ 231,489	\$ 8,815	\$ 34,418	\$ 42,440

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

Table 5.3 – Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis (continued)

(In Thousands)	Liabilities		
	Derivatives ⁽²⁾	Contingent Consideration	ABS Issued
Beginning balance - December 31, 2019	\$ 8,860	\$ 28,484	\$ 10,515,475
Acquisitions	—	—	1,478,589
Principal paydowns	—	(13,353)	(1,487,958)
Deconsolidations	—	—	(3,706,789)
Gains (losses) in net income (loss), net	56,972	(446)	101,045
Other settlements, net ⁽¹⁾	(51,382)	(14,685)	—
Ending balance - December 31, 2020	\$ 14,450	\$ —	\$ 6,900,362

(In Thousands)	Assets								
	Residential Loans	Business Purpose Loans	Multifamily Loans	Trading Securities	AFS Securities	Servicer Advance Investments	MSRs	Excess MSRs	Shared Home Appreciation Options
Beginning balance - December 31, 2018	\$ 7,254,631	\$ 141,258	\$ 2,144,598	\$ 1,118,612	\$ 333,882	\$ 300,468	\$ 60,281	\$ 27,312	\$ —
Acquisitions	7,092,866	2,639,615	2,162,386	332,593	26,538	69,610	868	7,762	44,243
Originations	—	1,015,436	—	—	—	—	—	—	—
Sales	(5,141,886)	(76,909)	—	(597,122)	(110,070)	—	—	—	—
Principal paydowns	(1,609,220)	(213,655)	(28,543)	(44,600)	(39,702)	(203,876)	—	—	—
Gains (losses) in net income, net	119,132	7,423	130,083	56,008	24,580	3,002	(18,925)	(3,260)	842
Unrealized gains in OCI, net	—	—	—	—	4,106	—	—	—	—
Other settlements, net ⁽¹⁾	(778)	(6,425)	—	(4,951)	—	—	—	—	—
Ending balance - December 31, 2019	\$ 7,714,745	\$ 3,506,743	\$ 4,408,524	\$ 860,540	\$ 239,334	\$ 169,204	\$ 42,224	\$ 31,814	\$ 45,085

(In Thousands)	Liabilities		
	Derivatives ⁽²⁾	Contingent Consideration	ABS Issued
Beginning balance - December 31, 2018	\$ 2,181	\$ —	\$ 5,410,073
Acquisitions	—	25,267	6,098,462
Principal paydowns	—	—	(1,112,437)
Gains (losses) in net income, net	62,220	3,217	119,377
Other settlements, net ⁽¹⁾	(55,541)	—	—
Ending balance - December 31, 2019	\$ 8,860	\$ 28,484	\$ 10,515,475

- (1) Other settlements, net for residential and business purpose loans represents the transfer of loans to REO, and for derivatives, the settlement of forward sale commitments and the transfer of the fair value of loan purchase or interest rate lock commitments at the time loans are acquired to the basis of residential and single-family rental loans. Other settlements, net for contingent consideration reflects the reclassification from a contingent liability to a deferred liability during the period due to an amendment in the underlying agreement. See *Note 16* for further discussion. Other settlements, net for trading securities relates to the consolidation of Freddie Mac K-Series securitization entities.
- (2) For the purpose of this presentation, derivative assets and liabilities, which consist of loan purchase commitments, forward sale commitments, and interest rate lock commitments, are presented on a net basis.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 5. Fair Value of Financial Instruments - (continued)

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 December 31, 2020, 2019, and 2018. Gains or losses incurred on assets or liabilities sold, matured, called, or fully written down during the years ended December 31, 2020, 2019, and 2018 are not included in this presentation.

Table 5.4 – Portion of Net Gains (Losses) Attributable to Level 3 Assets and Liabilities Still Held at December 31, 2020, 2019, and 2018 Included in Net Income

(In Thousands)	Included in Net Income		
	Years Ended December 31,		
	2020	2019	2018
Assets			
Residential loans at Redwood	\$ 1,138	\$ 67,470	\$ (17,757)
Business purpose loans	9,420	14,603	445
Net investments in consolidated Sequoia entities ⁽¹⁾	(14,646)	4,529	(1,046)
Net investments in consolidated Freddie Mac SLST entities ⁽¹⁾	(21,220)	27,225	21,295
Net investments in consolidated Freddie Mac K-Series entities ⁽¹⁾	(9,309)	21,430	931
Net investments in consolidated CAFL entities ⁽¹⁾	(37,062)	(14,681)	—
Trading securities	(83,327)	18,865	(12,256)
Available-for-sale securities	(388)	—	(89)
Servicer advance investments	(8,902)	3,001	(702)
MSRs	(17,545)	(11,957)	1,942
Excess MSRs	(8,302)	(3,260)	1,824
Shared home appreciation options	(1,884)	842	—
Loan purchase and interest rate lock commitments	15,027	10,190	2,913
Liabilities			
Loan purchase commitments	\$ (577)	\$ (1,290)	\$ (732)
Contingent consideration	—	(3,217)	—

(1) Represents the portion of net gains or losses included in our consolidated statements of income (loss) related to loans and the associated ABS issued at our consolidated securitization entities held at December 31, 2020, 2019, and 2018, which netted together represent the change in value of our investments at the consolidated VIEs.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

The following table presents information on assets recorded at fair value on a non-recurring basis at December 31, 2020 and December 31, 2019. 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 consolidated balance sheets at December 31, 2020 and December 31, 2019.

Table 5.5 – Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

December 31, 2020 (In Thousands)	Carrying Value	Fair Value Measurements Using			Gain (Loss) for Year Ended
		Level 1	Level 2	Level 3	December 31, 2020
Assets					
REO	\$ 1,117	\$ —	\$ —	\$ 1,117	\$ (157)
December 31, 2019 (In Thousands)					
	Carrying Value	Fair Value Measurements Using			Gain (Loss) for Year Ended
		Level 1	Level 2	Level 3	December 31, 2019
Assets					
REO	\$ 4,051	\$ —	\$ —	\$ 4,051	\$ (1,363)

The following table presents the net market valuation gains and losses recorded in each line item of our consolidated statements of income for the years ended December 31, 2020, 2019, and 2018.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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December 31, 2020

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

Table 5.6 – Market Valuation Gains and Losses, Net

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Mortgage Banking Activities, Net			
Residential loans held-for-sale, at fair value	\$ (15,477)	\$ 3,267	\$ 23,144
Residential loan purchase and forward sale commitments	56,761	60,260	(1,336)
Single-family rental loans held-for-sale, at fair value	82,169	15,043	375
Single-family rental loan purchase and interest rate lock commitments	341	1,961	78
Bridge loans	(4,998)	4,518	—
Trading securities ⁽¹⁾	(4,535)	—	—
Risk management derivatives, net	(47,779)	(15,723)	34,739
Total mortgage banking activities, net ⁽²⁾	\$ 66,482	\$ 69,326	\$ 57,000
Investment Fair Value Changes, Net			
Residential loans held-for-investment at Redwood	\$ (93,314)	\$ 58,891	\$ (29,573)
Single-family rental loans held-for-investment	(20,806)	272	—
Bridge loans held-for-investment	(10,629)	(2,139)	(29)
Trading securities	(226,196)	56,046	(8,055)
Servicer advance investments	(8,901)	3,001	(701)
Excess MSR	(8,302)	(3,260)	1,823
Net investments in Legacy Sequoia entities ⁽³⁾	(1,513)	(1,545)	(1,016)
Net investments in Sequoia Choice entities ⁽³⁾	(13,244)	6,947	443
Net investments in Freddie Mac SLST entities ⁽³⁾	(21,160)	27,206	1,271
Net investments in Freddie Mac K-Series entities ⁽³⁾	(81,039)	21,430	931
Net investments in CAFL entities ⁽³⁾	(36,754)	(3,636)	—
Other investments	(7,050)	(544)	(434)
Risk management derivatives, net	(59,142)	(127,169)	9,740
Change in allowance for credit losses on AFS securities	(388)	—	(89)
Total investment fair value changes, net	\$ (588,438)	\$ 35,500	\$ (25,689)
Other Income			
MSRs	\$ (33,409)	\$ (18,856)	\$ (2,508)
Risk management derivatives, net	13,966	8,595	(4,734)
Gain on re-measurement of 5 Arches investment	—	2,441	—
Total other income ⁽⁴⁾	\$ (19,443)	\$ (7,820)	\$ (7,242)
Total Market Valuation (Losses) Gains, Net	\$ (541,399)	\$ 97,006	\$ 24,069

- (1) Represents fair value changes on trading securities that are being used along with risk management derivatives to manage the mark-to-market risks associated with our residential mortgage banking operations.
- (2) Mortgage banking activities, net presented above does not include fee income from loan originations or acquisitions, provisions for repurchases expense, and other expenses that are components of Mortgage banking activities, net presented on our consolidated statements of income (loss), as these amounts do not represent market valuation changes.
- (3) Includes changes in fair value of the residential loans held-for-investment, REO and the ABS issued at the entities, which netted together represent the change in value of our investments at the consolidated VIEs.
- (4) Other income presented above does not include net MSR fee income or provisions for repurchases for MSRs, as these amounts do not represent market valuation adjustments.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

Valuation Policy

We maintain policies that specify 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 groups using the valuation processes described below. 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 the methodology and 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, severities, 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.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

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.

Table 5.7 – Fair Value Methodology for Level 3 Financial Instruments

December 31, 2020 (Dollars in Thousands, except Input Values)	Fair Value	Unobservable Input	Input Values		Weighted Average ⁽¹⁾
Assets			Range		
Residential loans, at fair value:					
Jumbo fixed-rate loans	\$ 19,464	Prepayment rate (annual CPR)	20	-	20 %
		Whole loan spread to swap rate	305	-	305 bps
Jumbo loans committed to sell	157,140	Whole loan committed sales price	\$102.54	-	\$103.22
Loans held by Legacy Sequoia ⁽²⁾	285,935	Liability price			N/A
Loans held by Sequoia Choice ⁽²⁾	1,565,322	Liability price			N/A
Loans held by Freddie Mac SLST ⁽²⁾	2,221,153	Liability price			N/A
Business purpose loans:					
Single-family rental loans	245,394	Senior credit spread	120	-	190 bps
		Subordinate credit spread	160	-	1,650 bps
		Senior credit support	25	-	34 %
		IO discount rate	9	-	9 %
		Prepayment rate (annual CPR)	3	-	3 %
		Non-securitizable loan dollar price	\$ 86	-	\$ 105
Single-family rental loans held by CAFL	3,249,194	Liability price			N/A
Bridge loans	641,765	Discount rate	6	-	15 %
Multifamily loans held by Freddie Mac K-Series ⁽²⁾	492,221	Liability price			N/A
Trading and AFS securities	344,125	Discount rate	3	-	25 %
		Prepayment rate (annual CPR)	9	-	56 %
		Default rate	—	-	25 %
		Loss severity	—	-	50 %
		CRT dollar price	\$ 84	-	\$ 104
Servicer advance investments	231,489	Discount rate	3	-	4 %
		Prepayment rate (annual CPR)	8	-	14 %
		Expected remaining life ⁽³⁾	4	-	4 yrs
		Mortgage servicing income	—	-	16 bps
MSRs	8,815	Discount rate	12	-	12 %
		Prepayment rate (annual CPR)	10	-	100 %
		Per loan annual cost to service	\$ 97	-	\$ 97
Excess MSRs	34,418	Discount rate	15	-	19 %
		Prepayment rate (annual CPR)	14	-	27 %
		Excess mortgage servicing amount	9	-	16 bps

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

Table 5.7 – Fair Value Methodology for Level 3 Financial Instruments (continued)

December 31, 2020		Input Values		
(Dollars in Thousands, except Input Values)	Fair Value	Unobservable Input	Range	Weighted Average
Assets (continued)				
Shared home appreciation options	\$ 42,440	Discount rate	15 - 15 %	15 %
		Prepayment rate (annual CPR)	10 - 24 %	18 %
		Home price appreciation	3 - 3 %	3 %
REO	1,117	Loss severity	1 - 46 %	21 %
Residential loan purchase commitments, net	14,450	Committed sales price	\$100.94 - \$103.22	\$ 102.25
		Pull-through rate	17 - 100 %	65 %
		Whole loan spread to TBA price	\$ 2.50 - \$ 2.50	\$ 2.50
		Whole loan spread to swap rate - fixed rate	305 - 305 bps	305 bps
		Prepayment rate (annual CPR)	20 - 20 %	20 %
		MSR multiple	— - 3.9 x	3.0 x
Liabilities				
ABS issued ⁽²⁾				
At consolidated Sequoia entities	1,629,683	Discount rate	2 - 26 %	3 %
		Prepayment rate (annual CPR)	8 - 55 %	31 %
		Default rate	— - 41 %	3 %
		Loss severity	30 - 50 %	31 %
At consolidated Freddie Mac SLST entities	1,793,620	Discount rate	1 - 7 %	2 %
		Prepayment rate (annual CPR)	6 - 7 %	6 %
		Default rate	9 - 15 %	11 %
		Loss severity	35 - 35 %	35 %
At consolidated Freddie Mac K-Series entities ⁽⁴⁾	463,966	Discount rate	1 - 17 %	2 %
At consolidated CAFL entities ⁽⁴⁾	3,013,093	Discount rate	1 - 40 %	3 %
		Prepayment rate (annual CPR)	3 - 3 %	3 %
		Default rate	— - 18 %	10 %
		Loss severity	30 - 30 %	30 %

- (1) The weighted average input values for all loan types are based on the unpaid principal balance. The weighted average input values for all other assets and liabilities are based on relative fair value.
- (2) The fair value of the loans held by consolidated entities was based on the fair value of the ABS issued by these entities, including securities we own, which we determined were more readily observable, in accordance with accounting guidance for collateralized financing entities. At December 31, 2020, the fair value of securities we owned at the consolidated Sequoia, Freddie Mac SLST, Freddie Mac K-Series, and CAFL entities was \$222 million, \$428 million, \$28 million, and \$239 million, respectively.
- (3) Represents the estimated average duration of outstanding servicer advances at a given point in time (not taking into account new advances made with respect to the pool).
- (4) As a market convention, certain securities are priced to a no-loss yield and therefore do not include default and loss severity assumptions.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

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 rates, interest rates, or other valuation assumptions – in isolation would likely result in a significantly lower or higher fair value measurement.

Residential loans at Redwood

Estimated fair values for residential loans are determined using models that incorporate various observable inputs, including pricing information from whole loan sales and securitizations. Certain significant inputs in these models are considered unobservable and are therefore Level 3 in nature. Significant pricing inputs obtained from market whole loan transaction activity include indicative spreads to indexed TBA prices and indexed swap rates for fixed-rate loans and indexed swap rates for hybrid loans (Level 3). Significant pricing inputs obtained from market securitization activity include indicative spreads to indexed TBA prices for senior MBS and indexed swap rates for subordinate MBS, senior credit support levels, and assumed future prepayment rates (Level 3). These assets would generally decrease in value based upon an increase in the credit spread, prepayment speed, or credit support assumptions.

Residential loans, business purpose loans, and multifamily loans at consolidated entities

We have elected to account for our consolidated securitization entities as collateralized financing entities in accordance with GAAP. A CFE is a variable interest entity that holds financial assets and issues beneficial interests in those assets, and these beneficial interests have contractual recourse only to the related assets of the CFE. Accounting guidance for CFEs allows companies to elect to measure both the financial assets and financial liabilities of a CFE using the more observable of the fair value of the financial assets or fair value of the financial liabilities. Pursuant to this guidance, we use the fair value of the ABS issued by the CFEs (which we determined to be more observable) to determine the fair value of the loans held at these entities, whereby the net assets we consolidate in our financial statements related to these entities represent the estimated fair value of our retained interests in the CFEs.

Business purpose loans

Business purpose loans include single-family rental loans and bridge loans. Significant inputs in the valuation analysis for these assets are predominantly Level 3 in nature, due to the lack of readily available market quotes and related inputs.

Estimated fair values for our securitizable single-family rental loans are determined using models that incorporate various inputs, including pricing information from market comparable securitizations. Certain significant inputs in these models are considered unobservable and are therefore Level 3 in nature. Significant pricing inputs obtained from market activity include indicative spreads to indexed swap rates for senior and subordinate MBS, IO MBS discount rates, senior credit support levels, and assumed future prepayment rates (Level 3). These assets would generally decrease in value based upon an increase in the credit spread, prepayment speed, or credit support assumptions. Non-securitizable single-family rental loans are generally comprised of performing loans that cannot be securitized and certain delinquent loans, and are valued at a dollar price that is informed by various market data, including the estimated fair value of the collateral securing the loan, for which we typically receive third-party appraisals (Level 3).

Prices for our bridge loans are determined using discounted cash flow modeling, which incorporates a primary significant unobservable input of discount rate. Cash flows for performing loans are generally based on contractual loan terms, whereas cash flows for delinquent loans are generally based on the estimated fair value of the underlying collateral, for which we typically receive third-party appraisals (Level 3). These assets would generally decrease in value based upon an increase in the discount rate.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

Real estate securities

Real estate securities include residential, multifamily, and other mortgage-backed securities that are generally illiquid in nature and trade infrequently. Significant inputs in the valuation analysis for these assets 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 analysis include bid/ask spreads, the amount and timing of credit losses, interest rates, and collateral prepayment rates. 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 and loss severity. The estimated fair value of our securities would generally decrease based upon an increase in discount rate, default rates, loss severities, or a decrease in prepayment rates.

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 December 31, 2020, we received dealer price indications on 75% of our securities, representing 88% of our carrying value. In the aggregate, our internal valuations of the securities for which we received dealer price indications were within 3% of the aggregate average 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, interest rate futures, loan purchase commitments, and forward sale commitments. 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. Fair values of TBAs and interest rate futures are generally obtained using quoted 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, IRLC and FSC fair values for residential jumbo and single-family rental loans are estimated based on the estimated fair values of the underlying loans (as described in "*Residential loans at Redwood*" and "*Business purpose loans*" above). In addition, fair values for LPCs and IRLCs are estimated based on the probability that the mortgage loan will be purchased or originated (the "Pull-through rate") (Level 3).

Servicer advance investments

Estimated fair values for servicer advance investments are determined through internal pricing models that estimate future cash flows and utilize certain significant inputs that are considered unobservable and are therefore Level 3 in nature. Our estimations of cash flows include the combined cash flows of all of the components that comprise the servicer advance investments: existing advances, the requirement to purchase future advances, the recovery of advances, and the right to a portion of the associated mortgage servicing fee ("mortgage servicing income"). The valuation technique is based on discounted cash flows. Significant inputs used in the valuations included prepayment rate (of the loans underlying the investments), mortgage servicing income, servicer advance WAL (the weighted-average expected remaining life of servicer advances), and discount rate. These assets would generally decrease in value based upon an increase in prepayment rates, an increase in servicer advance WAL, or an increase in discount rate, or a decrease in mortgage servicing income.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

MSRs

MSRs include the rights to service jumbo 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. 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 future MSR income (Level 3). These discounted cash flow models utilize certain significant unobservable inputs including market discount rates, assumed future prepayment rates of serviced loans, and the market cost of servicing. An increase in these unobservable inputs would generally reduce the estimated fair value of the MSRs.

Excess MSRs

Estimated fair values for excess MSRs are determined through internal pricing models that estimate future cash flows and utilize certain significant inputs that are considered unobservable and are therefore Level 3 in nature. The valuation technique is based on discounted cash flows. Significant unobservable inputs used in the valuations include prepayment rate (of the loans underlying the investments), the amount of excess servicing income expected to be received ("excess mortgage servicing income"), and discount rate. These assets would generally decrease in value based upon an increase in prepayment rates or discount rate, or a decrease in excess mortgage servicing income.

Shared Home Appreciation Options

Estimated fair values for shared home appreciation options are determined through internal pricing models that estimate future cash flows and utilize certain significant unobservable inputs such as forecasted home price appreciation, prepayment rates, and discount rate, and are therefore Level 3 in nature. The valuation technique is based on discounted cash flows. An increase in discount rate, or a decrease in expected future home values combined with a decrease in prepayment rates, would generally reduce the estimated fair value of the shared home appreciation options.

FHLBC stock

Our Federal Home Loan Bank ("FHLB") member subsidiary is required to purchase FHLBC stock under a borrowing agreement between our FHLB-member subsidiary and the FHLBC. Under this agreement, the stock is redeemable at face value, which represents the carrying value and fair value of the stock (Level 2).

Pledged collateral

Pledged collateral consists of cash and U.S. Treasury securities held by a custodian in association with certain agreements we have entered into. Treasury securities are carried at their fair value, which is determined using quoted prices in active markets (Level 1).

Cash and cash equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less and money market fund investments which are generally invested in U.S. government securities and are available to us on a daily basis. Fair values equal carrying values (Level 1).

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

Restricted cash

Restricted cash primarily includes interest-earning cash balances related to risk-sharing transactions with the Agencies, cash held in association with borrowings from the FHLBC, cash held at Servicing Investment entities, and cash held at consolidated Sequoia 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).

Real estate owned

Real estate owned ("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 2).

Short-term debt

Short-term debt includes our credit facilities for residential and business purpose loans and real estate securities as well as non-recourse short-term borrowings used to finance servicer advance investments. As these borrowings are secured and subject to margin calls and as the rates on these borrowings reset frequently to market rates, we believe that carrying values approximate fair values (Level 2).

ABS issued

ABS issued includes asset-backed securities issued through the Legacy Sequoia, Sequoia Choice, and CAFL securitization entities, as well as securities issued by certain third-party Freddie Mac K-Series and SLST securitization entities that we consolidate. These instruments are generally illiquid in nature and trade infrequently. 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. For ABS issued, we utilize both market comparable pricing and discounted cash flow analysis valuation techniques. Relevant market indicators factored into the analysis include bid/ask spreads, the amount and timing of collateral credit losses, interest rates, and collateral prepayment rates. Estimated fair values incorporate market indicators as well as other significant unobservable inputs to generate discounted cash flows (Level 3). These cash flow models use significant unobservable inputs such as discount rate, prepayment rate, default rate, and loss severity. A decrease in credit losses or discount rates, or an increase in prepayment rates, would generally cause the fair value of the ABS issued to decrease (i.e., become a larger liability).

Financial Instruments Carried at Amortized Cost

Guarantee obligations

In association with our risk-sharing transactions with the Agencies, we have made certain guarantees which are carried on our balance sheet at amortized cost (Level 3).

ABS issued

We account for certain ABS issued by a re-securitization trust sponsored by Redwood at amortized cost (Level 3).

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

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

Subordinate securities financing facilities

Borrowings under our subordinate securities financing facilities are secured by real estate securities and carried at unpaid principal balance net of any unamortized deferred issuance costs (Level 3).

Non-Recourse Business Purpose Loan Financing Facilities

Borrowings under our non-recourse business purpose loans financing facilities are secured by bridge loans and other BPL investments and carried at unpaid principal balance net of any unamortized deferred issuance costs (Level 3).

Recourse Business Purpose Loan Financing Facilities

Borrowings under our recourse business purpose loan financing facilities are secured by bridge loans and single-family rental loans and carried at unpaid principal balance net of any unamortized deferred issuance costs (Level 3).

Recourse Revolving Debt Facility

Borrowings under our recourse revolving debt facility are secured by MSRs and certificated mortgage servicing rights and carried at unpaid principal balance (Level 3).

Convertible notes

Convertible notes include unsecured convertible and exchangeable senior notes that are carried at their unpaid principal balance net of any unamortized deferred issuance costs. The fair value of the convertible notes is determined using quoted prices in generally active markets (Level 2).

Trust preferred securities and subordinated notes

Trust preferred securities and subordinated notes are carried at their unpaid principal balance net of any unamortized deferred issuance costs (Level 3).

Note 6. Residential Loans

We acquire residential loans from third-party originators and may sell or securitize these loans or hold them for investment. The following table summarizes the classifications and carrying values of the residential loans owned at Redwood and at consolidated Sequoia and Freddie Mac SLST entities at December 31, 2020 and December 31, 2019.

Table 6.1 – Classifications and Carrying Values of Residential Loans

December 31, 2020 (In Thousands)	Redwood	Legacy Sequoia	Sequoia Choice	Freddie Mac SLST	Total
Held-for-sale at fair value	\$ 176,641	\$ —	\$ —	\$ —	\$ 176,641
Held-for-investment at fair value	—	285,935	1,565,322	2,221,153	4,072,410
Total Residential Loans	\$ 176,641	\$ 285,935	\$ 1,565,322	\$ 2,221,153	\$ 4,249,051
December 31, 2019 (In Thousands)	Redwood	Legacy Sequoia	Sequoia Choice	Freddie Mac SLST	Total
Held-for-sale at fair value	\$ 536,385	\$ —	\$ —	\$ —	\$ 536,385
Held-for-investment at fair value	2,111,897	407,890	2,291,463	2,367,215	7,178,465
Total Residential Loans	\$ 2,648,282	\$ 407,890	\$ 2,291,463	\$ 2,367,215	\$ 7,714,850

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 6. Residential Loans - (continued)

At December 31, 2020, we owned mortgage servicing rights associated with \$172 million (principal balance) of residential loans owned at Redwood that were purchased from third-party originators. The value of these MSR's is included in the carrying value of the associated loans on our consolidated balance sheets. We contract with licensed sub-servicers that perform servicing functions for these loans.

Residential Loans Held-for-Sale

At Fair Value

The following table summarizes the characteristics of residential loans held-for-sale at December 31, 2020 and December 31, 2019.

Table 6.2 – Characteristics of Residential Loans Held-for-Sale

(Dollars in Thousands)	December 31, 2020		December 31, 2019	
Number of loans	198		669	
Unpaid principal balance	\$	172,748	\$	525,069
Fair value of loans	\$	176,641	\$	536,385
Market value of loans pledged as collateral under short-term borrowing agreements	\$	156,355	\$	201,949
Delinquency information				
Number of loans with 90+ day delinquencies	1		1	
Unpaid principal balance of loans with 90+ day delinquencies	\$	1,882	\$	747
Fair value of loans with 90+ day delinquencies	\$	1,223	\$	616
Number of loans in foreclosure	—		—	

The following table provides the activity of residential loans held-for-sale during the years ended December 31, 2020 and 2019.

Table 6.3 – Activity of Residential Loans Held-for-Sale

(In Thousands)	Year Ended December 31,	
	2020	2019
Principal balance of loans acquired	\$ 4,374,201	\$ 5,732,699
Principal balance of loans sold	6,463,741	6,069,518
Net market valuation gains (losses) recorded ⁽¹⁾	(15,477)	3,267

(1) Net market valuation gains (losses) on residential loans held-for-sale are recorded through Mortgage banking activities, net on our consolidated statements of income (loss).

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 6. Residential Loans - (continued)

Residential Loans Held-for-Investment at Fair Value

The following tables summarize the characteristics of the residential loans owned at Redwood and at consolidated Sequoia and Freddie Mac SLST entities at December 31, 2020 and December 31, 2019.

Table 6.4 – Characteristics of Residential Loans Held-for-Investment

December 31, 2020 (Dollars in Thousands)	Redwood	Legacy Sequoia	Sequoia Choice	Freddie Mac SLST
Number of loans	—	1,908	2,177	13,605
Unpaid principal balance	\$ —	\$ 333,474	\$ 1,550,454	\$ 2,247,771
Fair value of loans	\$ —	\$ 285,935	\$ 1,565,322	\$ 2,221,153

Delinquency information				
Number of loans with 90+ day delinquencies ⁽¹⁾	—	52	94	2,110
Unpaid principal balance of loans with 90+ day delinquencies	\$ —	\$ 17,285	\$ 74,742	\$ 389,245
Fair value of loans with 90+ day delinquencies ⁽²⁾	\$ —	N/A	N/A	N/A
Number of loans in foreclosure	—	21	3	245
Unpaid principal balance of loans in foreclosure	\$ —	\$ 4,939	\$ 2,251	\$ 38,610

December 31, 2019 (Dollars in Thousands)	Redwood	Legacy Sequoia	Sequoia Choice	Freddie Mac SLST
Number of loans	2,940	2,198	3,156	14,502
Unpaid principal balance	\$ 2,052,778	\$ 424,829	\$ 2,240,679	\$ 2,428,035
Fair value of loans	\$ 2,111,897	\$ 407,890	\$ 2,291,463	\$ 2,367,215

Delinquency information				
Number of loans with 90+ day delinquencies ⁽¹⁾	2	39	9	587
Unpaid principal balance of loans with 90+ day delinquencies	\$ 1,585	\$ 9,803	\$ 6,755	\$ 134,680
Fair value of loans with 90+ day delinquencies ⁽²⁾	\$ 1,424	N/A	N/A	N/A
Number of loans in foreclosure	—	16	3	208
Unpaid principal balance of loans in foreclosure	\$ —	\$ 3,673	\$ 2,290	\$ 33,042

- (1) For loans held at consolidated entities, the number of loans greater than 90 days delinquent includes loans in foreclosure.
- (2) The fair value of the loans held by consolidated entities was based on the fair value of the ABS issued by these entities, including securities we own, which we determined were more readily observable, in accordance with accounting guidance for collateralized financing entities.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 6. Residential Loans - (continued)

The following table provides the activity of residential loans held-for-investment at Redwood during the years ended December 31, 2020 and 2019.

Table 6.5 – Activity of Residential Loans Held-for-Investment at Redwood

(In Thousands)	Year Ended December 31,	
	2020	2019
Principal balance of loans acquired	\$ —	\$ 39,194
Principal balance of loans sold	—	—
Fair value of loans transferred from HFS to HFI	13,258	68,703
Fair value of loans transferred from HFI to HFS	1,870,986	22,814
Net market valuation gains (losses) recorded ⁽¹⁾	(93,314)	58,891

(1) Subsequent to the transfer of these loans to our investment portfolio, net market valuation gains (losses) on residential loans held-for-investment at Redwood are recorded through Investment fair value changes, net on our consolidated statements of income (loss).

The following table provides the activity of residential loans held-for-investment at consolidated entities during the years ended December 31, 2020 and 2019.

Table 6.6 – Activity of Residential Loans Held-for-Investment at Consolidated Entities

(In Thousands)	Year Ended December 31, 2020			Year Ended December 31, 2019		
	Legacy	Sequoia	Freddie Mac	Legacy	Sequoia	Freddie Mac
	Sequoia	Choice	SLST	Sequoia	Choice	SLST
Fair value of loans transferred from HFS to HFI ⁽¹⁾	N/A	\$ 270,506	N/A	N/A	\$ 1,076,671	N/A
Net market valuation gains (losses) recorded ⁽²⁾	\$ (30,900)	\$ (30,356)	\$ 35,131	\$ 5,170	\$ (15,232)	\$ 63,583

(1) Represents the transfer of loans from held-for-sale to held-for-investment associated with Sequoia Choice securitizations.

(2) For loans held at our consolidated Legacy Sequoia, Sequoia Choice, and Freddie Mac SLST entities, market value changes are based on the estimated fair value of the associated ABS issued, pursuant to collateralized financing entity guidelines. The net impact to our income statement associated with our economic investments in these securitization entities is presented in *Note 5*.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 6. Residential Loans - (continued)

Residential Loan Characteristics

The following table presents the geographic concentration of residential loans recorded on our consolidated balance sheets at December 31, 2020 and December 31, 2019.

Table 6.7 – Geographic Concentration of Residential Loans

Geographic Concentration (by Principal)	December 31, 2020				
	Held-for-Sale	Held-for- Investment at Legacy Sequoia	Held-for- Investment at Sequoia Choice	Held-for- Investment at Freddie Mac SLST	Held-for- Investment at FVO
California	43 %	17 %	34 %	14 %	— %
Texas	10 %	5 %	10 %	3 %	— %
Washington	7 %	1 %	5 %	2 %	— %
Colorado	5 %	3 %	3 %	1 %	— %
Florida	3 %	14 %	6 %	10 %	— %
Illinois	3 %	3 %	2 %	5 %	— %
Maryland	2 %	2 %	1 %	5 %	— %
New Jersey	1 %	5 %	2 %	7 %	— %
New York	1 %	10 %	5 %	10 %	— %
Ohio	— %	5 %	— %	2 %	— %
Other states (none greater than 5%)	25 %	35 %	32 %	41 %	— %
Total	100 %	100 %	100 %	100 %	— %

Geographic Concentration (by Principal)	December 31, 2019				
	Held-for-Sale	Held-for- Investment at Legacy Sequoia	Held-for- Investment at Sequoia Choice	Held-for- Investment at Freddie Mac SLST	Held-for- Investment at FVO
California	36 %	18 %	35 %	14 %	45 %
Washington	7 %	1 %	7 %	2 %	5 %
Texas	6 %	6 %	9 %	3 %	8 %
Colorado	6 %	3 %	4 %	— %	4 %
Florida	4 %	14 %	5 %	10 %	5 %
New Jersey	2 %	4 %	2 %	7 %	2 %
New York	1 %	10 %	4 %	10 %	4 %
Other states (none greater than 5%)	38 %	44 %	34 %	54 %	27 %
Total	100 %	100 %	100 %	100 %	100 %

REDWOOD TRUST, INC. AND SUBSIDIARIES
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December 31, 2020

Note 6. Residential Loans - (continued)

The following table displays the loan product type and accompanying loan characteristics of residential loans recorded on our consolidated balance sheets at December 31, 2020 and December 31, 2019.

Table 6.8 – Product Types and Characteristics of Residential Loans

December 31, 2020

(In Thousands)

Loan Balance	Number of Loans	Interest Rate ⁽¹⁾	Maturity Date	Total Principal	30-89 Days DQ	90+ Days DQ
Held-for-Investment at Legacy Sequoia:						
ARM loans:						
\$ — to \$250	1,524	0.25 % to 5.63%	2020-10 - 2036-05	\$ 146,100	\$ 4,208	\$ 3,966
\$ 251 to \$500	251	0.50 % to 4.13%	2024-05 - 2035-11	86,676	1,908	4,392
\$ 501 to \$750	79	0.25 % to 4.13%	2027-05 - 2035-01	48,437	714	1,192
\$ 751 to \$1,000	27	0.75 % to 3.75%	2028-03 - 2036-03	21,875	—	3,175
over \$1,000	18	1.00 % to 2.38%	2028-05 - 2035-04	26,422	—	4,560
	<u>1,899</u>			<u>329,510</u>	<u>6,830</u>	<u>17,285</u>
Hybrid ARM loans:						
\$ — to \$250	2	2.63 % to 2.63%	2033-09 - 2033-10	439	—	—
\$ 251 to \$500	5	2.63 % to 4.00%	2033-07 - 2034-03	1,748	410	—
\$ 501 to \$750	1	2.75 % to 2.75%	2033-08 - 2033-08	556	—	—
over \$1,000	1	2.63 % to 2.63%	2033-09 - 2033-09	1,221	—	—
	<u>9</u>			<u>3,964</u>	<u>410</u>	<u>—</u>
Total HFI at Legacy Sequoia:	<u><u>1,908</u></u>			<u><u>\$ 333,474</u></u>	<u><u>\$ 7,240</u></u>	<u><u>\$ 17,285</u></u>
Held-for-Investment at Sequoia Choice:						
Hybrid ARM loans						
\$ — to \$250	3	5.50 % to 6.75%	2048-03 - 2048-10	\$ 607	\$ —	\$ —
\$ 251 to \$500	5	3.50 % to 3.63%	2046-11 - 2049-06	2,196	440	—
\$ 501 to \$750	19	3.25 % to 4.75%	2044-04 - 2049-09	12,214	682	671
\$ 751 to \$1,000	15	3.13 % to 5.00%	2043-12 - 2049-08	12,911	960	1,744
over \$1,000	12	3.50 % to 5.00%	2044-11 - 2050-02	15,716	—	—
	<u>54</u>			<u>43,644</u>	<u>2,082</u>	<u>2,415</u>
Fixed loans:						
\$ — to \$250	48	2.75 % to 5.50%	2029-04 - 2049-09	\$ 9,508	\$ —	\$ 191
\$ 251 to \$500	285	3.13 % to 6.13%	2033-06 - 2050-03	122,327	4,728	2,225
\$ 501 to \$750	1,004	3.00 % to 6.75%	2031-04 - 2050-04	617,488	15,214	24,842
\$ 751 to \$1,000	556	3.25 % to 6.50%	2036-12 - 2050-04	478,938	10,482	21,155
over \$1,000	230	3.15 % to 5.88%	2036-07 - 2050-04	278,549	4,868	23,914
	<u>2,123</u>			<u>1,506,810</u>	<u>35,292</u>	<u>72,327</u>
Total HFI at Sequoia Choice:	<u><u>2,177</u></u>			<u><u>\$ 1,550,454</u></u>	<u><u>\$ 37,374</u></u>	<u><u>\$ 74,742</u></u>

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 6. Residential Loans - (continued)

Table 6.8 – Product Types and Characteristics of Residential Loans (continued)

December 31, 2020

(In Thousands)

Loan Balance	Number of Loans	Interest Rate ⁽¹⁾	Maturity Date	Total Principal	30-89 Days DQ	90+ Days DQ
Held-for-Investment at Freddie Mac SLST:						
Fixed loans:						
\$ — to \$250	11,007	2.00 % to 11.00%	2020-12 - 2059-10	\$ 1,407,107	\$ 283,745	\$ 206,724
\$ 251 to \$500	2,545	2.00 % to 7.75%	2035-05 - 2059-01	811,191	143,195	172,995
\$ 501 to \$750	52	2.00 % to 6.75%	2043-08 - 2058-07	28,461	6,863	9,526
over \$1,000	1	4.00 % to 4.00%	2056-03 - 2056-03	1,012	1,012	—
Total HFI at Freddie Mac SLST:	13,605			\$ 2,247,771	\$ 434,815	\$ 389,245
Held-for-Sale:						
Hybrid ARM loans						
\$ — to \$250	1	2.00 % to 2.00%	2032-11 - 2032-11	\$ 49	\$ —	\$ —
\$ 751 to \$1,000	1	4.38 % to 4.38%	2047-10 - 2047-10	970	970	—
	<u>2</u>			<u>1,019</u>	<u>970</u>	<u>—</u>
Fixed loans						
\$ — to \$250	1	4.69 % to 4.69%	2044-03 - 2044-03	219	219	—
\$ 501 to \$750	75	2.50 % to 5.50%	2045-12 - 2051-01	48,933	1,127	—
\$ 751 to \$1,000	80	2.38 % to 4.63%	2050-04 - 2051-01	71,137	—	—
over \$1,000	40	2.38 % to 5.00%	2040-11 - 2051-01	51,440	1,046	1,882
	<u>196</u>			<u>171,729</u>	<u>2,392</u>	<u>1,882</u>
Total Held-for-Sale	198			\$ 172,748	\$ 3,362	\$ 1,882

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 6. Residential Loans - (continued)

Table 6.8 – Product Types and Characteristics of Residential Loans (continued)

December 31, 2019

(In Thousands)

Loan Balance	Number of Loans	Interest Rate⁽¹⁾	Maturity Date	Total Principal	30-89 Days DQ	90+ Days DQ
Held-for-Investment at Redwood:						
Hybrid ARM loans						
\$ — to \$250	12	3.50 % to 4.5%	2043-09 - 2046-01	\$ 2,423	\$ —	\$ —
\$ 251 to \$500	51	3.25 % to 5.63%	2041-01 - 2048-08	20,781	—	—
\$ 501 to \$750	97	2.88 % to 5.13%	2041-09 - 2048-08	61,708	1,364	—
\$ 751 to \$1,000	90	2.88 % to 6.00%	2043-12 - 2048-08	77,550	1,784	971
over \$1,000	49	3.00 % to 5.50%	2040-10 - 2048-09	64,937	1,428	—
	<u>299</u>			<u>227,399</u>	<u>4,576</u>	<u>971</u>
Fixed loans						
\$ — to \$250	38	2.90 % to 4.80%	2026-02 - 2047-12	6,549	223	—
\$ 251 to \$500	676	2.75 % to 6.00%	2026-01 - 2049-04	287,984	—	—
\$ 501 to \$750	1,091	2.80 % to 6.75%	2026-04 - 2049-05	669,159	2,325	614
\$ 751 to \$1,000	519	2.75 % to 6.63%	2026-01 - 2049-04	447,499	1,895	—
over \$1,000	317	3.00 % to 5.88%	2031-04 - 2049-05	414,188	3,202	—
	<u>2,641</u>			<u>1,825,379</u>	<u>7,645</u>	<u>614</u>
Total HFI at Redwood:	<u><u>2,940</u></u>			<u><u>\$ 2,052,778</u></u>	<u><u>\$ 12,221</u></u>	<u><u>\$ 1,585</u></u>
Held-for-Investment at Legacy Sequoia:						
ARM loans:						
\$ — to \$250	1,685	1.38 % to 6.00%	2020-01 - 2035-11	\$ 169,230	\$ 5,135	\$ 3,109
\$ 251 to \$500	345	1.25 % to 5.63%	2022-01 - 2036-05	120,260	6,149	3,835
\$ 501 to \$750	87	1.63 % to 4.38%	2027-04 - 2035-02	53,811	3,628	1,211
\$ 751 to \$1,000	45	1.63 % to 4.38%	2027-11 - 2036-03	37,756	827	1,648
over \$1,000	24	1.63 % to 4.00%	2027-12 - 2035-04	38,341	—	—
	<u>2,186</u>			<u>419,398</u>	<u>15,739</u>	<u>9,803</u>
Hybrid ARM loans:						
\$ — to \$250	2	4.25 % to 4.50%	2033-09 - 2033-10	465	—	—
\$ 251 to \$500	7	3.63 % to 5.13%	2033-07 - 2034-06	2,494	—	—
\$ 501 to \$750	2	4.50 % to 4.50%	2033-08 - 2033-08	1,181	—	—
over \$1,000	1	4.50 % to 4.50%	2033-09 - 2033-09	1,291	—	—
	<u>12</u>			<u>5,431</u>	<u>—</u>	<u>—</u>
Total HFI at Legacy Sequoia:	<u><u>2,198</u></u>			<u><u>\$ 424,829</u></u>	<u><u>\$ 15,739</u></u>	<u><u>\$ 9,803</u></u>
Held-for-Investment at Sequoia Choice:						
Fixed loans:						
\$ — to \$250	56	2.75 % to 5.50 %	2038-02 - 2049-07	\$ 10,743	\$ —	\$ —
\$ 251 to \$500	420	3.13 % to 6.13 %	2037-12 - 2049-09	184,455	2,282	—
\$ 501 to \$750	1,528	3.13 % to 6.75 %	2037-02 - 2049-09	940,914	13,020	2,366
\$ 751 to \$1,000	835	3.25 % to 6.50 %	2035-04 - 2049-09	719,609	7,856	3,297
over \$1,000	317	3.5 % to 5.88 %	2038-01 - 2049-09	384,958	1,108	1,092
	<u>3,156</u>			<u>2,240,679</u>	<u>24,266</u>	<u>6,755</u>
Total HFI at Sequoia Choice:	<u><u>3,156</u></u>			<u><u>\$ 2,240,679</u></u>	<u><u>\$ 24,266</u></u>	<u><u>\$ 6,755</u></u>

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 6. Residential Loans - (continued)

Table 6.8 – Product Types and Characteristics of Residential Loans (continued)

December 31, 2019

(In Thousands)

Loan Balance	Number of Loans	Interest Rate ⁽¹⁾	Maturity Date	Total Principal	30-89 Days DQ	90+ Days DQ
Held-for-Investment at Freddie Mac SLST:						
Fixed loans:						
\$ — to \$250	11,639	2.00 % to 11.00%	2019-11 - 2059-10	\$ 1,501,538	\$ 477,592	\$ 79,632
\$ 251 to \$500	2,805	2.00 % to 7.75%	2033-08 - 2058-11	894,126	297,732	52,920
\$ 501 to \$750	57	2.00 % to 6.75%	2043-08 - 2058-07	31,350	8,787	2,623
over \$1,000	1	4.00 % to 4.00%	2056-03 - 2056-03	1,021	1,021	—
Total HFI at Freddie Mac SLST:	14,502			2,428,035	785,132	135,175
Held-for-Sale:						
Hybrid ARM loans						
\$ — to \$250	7	5.20 % to 7.00%	2047-08 - 2048-12	\$ 1,254	\$ —	\$ —
\$ 251 to \$500	1	4.25 % to 4.25%	2049-08 - 2049-08	432	—	—
\$ 501 to \$750	52	3.00 % to 5.50%	2047-04 - 2049-12	33,611	—	—
\$ 751 to \$1,000	33	3.25 % to 4.88%	2047-04 - 2049-11	28,573	—	—
over \$1,000	22	3.25 % to 5.25%	2048-06 - 2049-11	28,013	—	—
	<u>115</u>			<u>91,883</u>	<u>—</u>	<u>—</u>
Fixed loans						
\$ — to \$250	2	3.88 % to 7.13%	2034-08 - 2049-07	481	—	—
\$ 251 to \$500	13	3.63 % to 6.50%	2048-01 - 2050-01	6,234	—	—
\$ 501 to \$750	301	3.20 % to 5.88%	2034-05 - 2050-01	186,251	—	747
\$ 751 to \$1,000	161	3.50 % to 6.50%	2034-07 - 2050-01	139,786	—	—
over \$1,000	77	3.20 % to 5.00%	2034-08 - 2050-01	100,293	1,650	—
	<u>554</u>			<u>433,045</u>	<u>1,650</u>	<u>747</u>
Total Held-for-Sale	<u>669</u>			<u>\$ 524,928</u>	<u>\$ 1,650</u>	<u>\$ 747</u>

(1) Rate is net of servicing fee for consolidated loans for which we do not own the MSR.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 7. Business Purpose Loans

We originate and invest in business purpose loans, including single-family rental ("SFR") loans and bridge loans. This origination activity commenced in connection with our acquisition of 5 Arches and CoreVest in 2019. The following table summarizes the classifications and carrying values of the business purpose loans owned at Redwood at December 31, 2020 and December 31, 2019.

Table 7.1 – Classifications and Carrying Values of Business Purpose Loans

December 31, 2020 (In Thousands)	Single-Family Rental		Residential	Total
	Redwood	CAFL	Bridge	
Held-for-sale at fair value	\$ 245,394	—	\$ —	\$ 245,394
Held-for-investment at fair value	—	3,249,194	641,765	3,890,959
Total Business Purpose Loans	\$ 245,394	\$ 3,249,194	\$ 641,765	\$ 4,136,353
December 31, 2019 (In Thousands)	Single-Family Rental		Residential	Total
	Redwood	CAFL	Bridge	
Held-for-sale at fair value	\$ 331,565	\$ —	\$ —	\$ 331,565
Held-for-investment at fair value	237,620	2,192,552	745,006	3,175,178
Total Business Purpose Loans	\$ 569,185	\$ 2,192,552	\$ 745,006	\$ 3,506,743

The following table provides the activity of business purpose loans during the years ended December 31, 2020 and 2019.

Table 7.2 – Activity of Business Purpose Loans

(Dollars in Thousands)	Year Ended December 31, 2020		Year Ended December 31, 2019	
	SFR at Redwood	Bridge	SFR at Redwood	Bridge
Principal balance of loans originated	\$ 979,696	\$ 451,554	\$ 513,725	\$ 501,355
Principal balance of loans sold to third parties ⁽¹⁾	(110,836)	(25,151)	20,426	56,484
Fair value of loans transferred from HFS to HFI ⁽²⁾	1,292,633	N/A	717,934	N/A
Mortgage banking activities income recorded ⁽³⁾	81,032	(2,916)	13,363	3,342
Investment fair value changes recorded ⁽⁴⁾	(20,806)	(10,629)	272	(2,139)

- (1) The remaining business purpose loans were transferred to our investment portfolio (bridge loans) or retained in our mortgage banking business (single-family rental loans) for future securitizations.
- (2) During the years ended December 31, 2020 and 2019, we transferred \$1.29 billion and \$394 million of single-family rental loans, respectively, from held-for-sale to held-for-investment associated with five and one CAFL securitizations, respectively.
- (3) Represents net market valuation changes from the time a loan is originated to when it is sold or transferred to or from our investment portfolio. Additionally, for the years ended December 31, 2020 and 2019, we recorded loan origination fee income of \$19 million and \$16 million, respectively, through Mortgage banking activities, net on our consolidated statements of income (loss).
- (4) Represents net market valuation changes while a loan is held for investment.

Bridge Loans Held-for-Investment

The outstanding bridge loans held-for-investment at December 31, 2020 were first lien, fixed-rate, interest-only loans with original maturities of six to 24 months. During the year ended December 31, 2020, we transferred five loans with a fair value of \$6 million to REO, which is included in Other assets on our consolidated balance sheets. At December 31, 2020, we had a \$216 million commitment to fund bridge loans. See *Note 16* for additional information on this commitment.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 7. Business Purpose Loans - (continued)

Single-Family Rental Loans Held-for-Investment at CAFL

In conjunction with our acquisition of CoreVest in the fourth quarter of 2019, we consolidated the single-family rental loans owned at certain CAFL securitization entities. The outstanding single-family rental loans held-for-investment at CAFL at December 31, 2020 were first-lien, fixed-rate loans with original maturities of five, seven, or ten years. The following table provides the activity of single-family rental loans held-for-investment at CAFL during the years ended December 31, 2020 and 2019.

Table 7.3 – Activity of Single-Family Rental Loans Held-for-Investment at CAFL

(In Thousands)	Year Ended December 31,	
	2020	2019
Net market valuation gains (losses) recorded ⁽¹⁾	\$ 32,331	\$ (14,681)

(1) For loans held at our consolidated CAFL entities, market value changes are based on the estimated fair value of the associated ABS issued, including securities we own, pursuant to collateralized financing entity guidelines. The net impact to our income statement associated with our economic investments in these securitization entities is presented in *Note 5*.

Business Purpose Loan Characteristics

The following tables summarize the characteristics of the business purpose loans owned at Redwood at December 31, 2020 and December 31, 2019.

Table 7.4 – Characteristics of Business Purpose Loans

December 31, 2020 (Dollars in Thousands)	Single-Family Rental at Redwood	Single-Family Rental at CAFL	Bridge
Number of loans	65	1,094	1,725
Unpaid principal balance	\$ 234,475	\$ 3,017,137	\$ 649,532
Fair value of loans	\$ 245,394	\$ 3,249,194	\$ 641,765
Weighted average coupon	4.84 %	5.44 %	8.09 %
Weighted average remaining loan term (years)	8	5	1
Market value of loans pledged as collateral under short-term debt facilities	\$ 34,098	N/A	\$ 92,931
Market value of loans pledged as collateral under long-term debt facilities	\$ 154,774	N/A	\$ 544,151

Delinquency information			
Number of loans with 90+ day delinquencies ⁽¹⁾	10	22	31
Unpaid principal balance of loans with 90+ day delinquencies	\$ 7,127	\$ 61,440	\$ 39,415
Fair value of loans with 90+ day delinquencies ⁽²⁾	\$ 6,143	N/A	\$ 33,605
Number of loans in foreclosure	—	10	25
Unpaid principal balance of loans in foreclosure	\$ —	\$ 24,745	\$ 38,552
Fair value of loans in foreclosure ⁽²⁾	\$ —	N/A	\$ 33,066

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 7. Business Purpose Loans - (continued)

December 31, 2019

(Dollars in Thousands)	Single-Family Rental at Redwood	Single-Family Rental at CAFL	Bridge
Number of loans	308	783	2,653
Unpaid principal balance	\$ 552,848	\$ 2,078,214	\$ 742,528
Fair value of loans	\$ 569,185	\$ 2,192,552	\$ 745,006
Weighted average coupon	4.96 %	5.70 %	8.11 %
Weighted average remaining loan term (years)	9	7	2
Market value of loans pledged as collateral under short-term debt facilities	\$ 504,237	N/A	\$ 694,964

Delinquency information

Number of loans with 90+ day delinquencies ⁽¹⁾	2	18	15
Unpaid principal balance of loans with 90+ day delinquencies	\$ 1,818	\$ 29,039	\$ 8,987
Fair value of loans with 90+ day delinquencies ⁽²⁾	\$ 1,818	N/A	\$ 6,917
Number of loans in foreclosure	1	5	31
Unpaid principal balance of loans in foreclosure	\$ 130	\$ 9,169	\$ 14,186
Fair value of loans in foreclosure ⁽²⁾	\$ 130	N/A	\$ 12,111

(1) The number of loans greater than 90 days delinquent includes loans in foreclosure.

(2) The fair value of the loans held by consolidated entities was based on the fair value of the ABS issued by these entities, including securities we own, which we determined were more readily observable, in accordance with accounting guidance for collateralized financing entities.

The following table presents the geographic concentration of business purpose loans recorded on our consolidated balance sheets at December 31, 2020.

Table 7.5 – Geographic Concentration of Business Purpose Loans

Geographic Concentration (by Principal)	December 31, 2020			
	Single-Family Rental Held-for-Sale	Single-Family Rental Held-for-Investment at Redwood	Single-Family Rental Held-for-Investment at CAFL	Residential Bridge
Texas	24 %	— %	15 %	4 %
New Jersey	17 %	— %	11 %	9 %
Georgia	12 %	— %	5 %	8 %
Florida	10 %	— %	8 %	11 %
Connecticut	8 %	— %	4 %	1 %
New York	5 %	— %	1 %	8 %
Arizona	5 %	— %	2 %	1 %
California	5 %	— %	5 %	13 %
Illinois	5 %	— %	4 %	7 %
Alabama	2 %	— %	3 %	6 %
Indiana	2 %	— %	3 %	5 %
Tennessee	— %	— %	3 %	6 %
Other states (none greater than 5%)	5 %	— %	36 %	21 %
Total	100 %	— %	100 %	100 %

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 7. Business Purpose Loans - (continued)

Geographic Concentration (by Principal)	December 31, 2019			
	Single-Family Rental Held-for-Sale	Single-Family Rental Held-for-Investment at Redwood	Single-Family Rental Held-for-Investment at CAFL	Residential Bridge
Texas	19 %	12 %	15 %	3 %
New Jersey	12 %	5 %	11 %	8 %
Georgia	8 %	— %	5 %	7 %
Arkansas	6 %	— %	2 %	— %
Maryland	6 %	— %	2 %	— %
Florida	5 %	— %	8 %	9 %
New York	5 %	1 %	1 %	6 %
Alabama	5 %	— %	4 %	4 %
Illinois	1 %	— %	5 %	3 %
California	2 %	1 %	7 %	21 %
Utah	— %	— %	— %	5 %
Other states (none greater than 5%)	31 %	81 %	40 %	34 %
Total	100 %	100 %	100 %	100 %

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 7. Business Purpose Loans - (continued)

The following table displays the loan product type and accompanying loan characteristics of business purpose loans recorded on our consolidated balance sheets at December 31, 2020.

Table 7.6 – Product Types and Characteristics of Business Purpose Loans

December 31, 2020
(In Thousands)

Loan Balance	Number of Loans	Interest Rate	Maturity Date	Total Principal	30-89 Days DQ	90+ Days DQ
Single-Family Rental Held-for-Investment at CAFL:						
Fixed loans:						
\$ — to \$250	5	5.77 % to 7.05%	2022-07 - 2030-08	\$ 1,016	\$ —	\$ —
\$ 251 to \$500	67	4.64 % to 6.96%	2021-07 - 2031-01	29,977	—	—
\$ 501 to \$750	212	4.12 % to 7.06%	2020-11 - 2030-12	130,665	—	1,752
\$ 751 to \$1,000	131	4.33 % to 7.23%	2021-01 - 2031-01	113,874	764	750
over \$1,000	679	3.93 % to 7.57%	2020-11 - 2031-01	2,741,605	3,867	58,938
Total SFR HFI at CAFL:	1,094			\$ 3,017,137	\$ 4,631	\$ 61,440
Single-Family Rental Held-for-Sale:						
Fixed loans:						
\$ — to \$250	8	6.25 % to 7.75%	2027-03 - 2050-03	\$ 1,060	\$ —	\$ 635
\$ 251 to \$500	1	5.97 % to 5.97%	2021-02 - 2021-02	483	—	—
\$ 501 to \$750	6	5.84 % to 6.75%	2026-01 - 2031-01	3,632	—	—
\$ 751 to \$1,000	10	5.15 % to 6.39%	2020-05 - 2031-01	8,936	—	1,815
over \$1,000	40	3.82 % to 5.95%	2020-07 - 2031-01	220,364	—	4,677
Total Single-Family Rental HFS:	65			\$ 234,475	\$ —	\$ 7,127
Bridge:						
Fixed loans:						
\$ — to \$250	1,440	5.75 % to 12.00%	2019-10 - 2022-12	\$ 128,596	\$ 6,530	\$ 1,668
\$ 251 to \$500	110	6.65 % to 13.00%	2020-05 - 2022-12	37,607	945	1,423
\$ 501 to \$750	39	6.99 % to 10.00%	2020-07 - 2021-10	23,783	—	540
\$ 751 to \$1,000	21	6.50 % to 9.50%	2020-10 - 2022-03	18,225	—	943
over \$1,000	115	6.04 % to 10.25%	2020-03 - 2022-12	441,321	—	34,841
Total Bridge:	1,725			\$ 649,532	\$ 7,475	\$ 39,415

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 7. Business Purpose Loans - (continued)

Table 7.6 – Product Types and Characteristics of Business Purpose Loans (continued)

December 31, 2019
(In Thousands)

Loan Balance	Number of Loans	Interest Rate	Maturity Date	Total Principal	30-89 Days DQ	90+ Days DQ
Single-Family Rental Held-for-Investment at Redwood:						
Fixed loans:						
\$ 251 to \$500	20	4.88 % to 7.47%	2024-02 - 2030-01	\$ 7,925	\$ —	\$ —
\$ 501 to \$750	26	4.45 % to 7.25%	2023-09 - 2030-01	15,620	—	—
\$ 751 to \$1,000	16	4.91 % to 6.58%	2023-11 - 2029-09	13,616	—	—
over \$1,000	45	3.93 % to 6.94%	2023-10 - 2030-01	194,050	—	—
Total SFR HFI at Redwood:	107			\$ 231,211	\$ —	\$ —
Single-Family Rental Held-for-Investment at CAFL:						
Fixed loans:						
\$ — to \$250	2	5.46 % to 5.80%	2019-11 - 2021-09	\$ 398	\$ —	\$ —
\$ 251 to \$500	56	4.92 % to 7.05%	2020-03 - 2029-10	25,643	1,306	—
\$ 501 to \$750	148	4.75 % to 7.31%	2020-03 - 2029-10	91,414	1,259	1,990
\$ 751 to \$1,000	98	4.62 % to 7.23%	2020-03 - 2029-10	85,472	1,639	879
over \$1,000	479	4.31 % to 7.57%	2019-12 - 2029-11	1,875,287	18,567	26,170
Total SFR HFI at CAFL:	783			\$ 2,078,214	\$ 22,771	\$ 29,039
Single-Family Rental Held-for-Sale:						
Fixed loans:						
\$ — to \$250	85	5.50 % to 7.63%	2027-03 - 2050-01	\$ 10,506	\$ —	\$ 130
\$ 251 to \$500	9	4.94 % to 6.00%	2024-11 - 2050-01	3,708	—	—
\$ 501 to \$750	21	4.55 % to 5.96%	2024-01 - 2030-01	13,335	—	—
\$ 751 to \$1,000	13	5.00 % to 5.93%	2024-01 - 2030-01	11,676	—	—
over \$1,000	73	4.35 % to 6.28%	2024-01 - 2030-01	282,412	—	1,688
Total Single-Family Rental HFS:	201			\$ 321,637	\$ —	\$ 1,818
Bridge:						
Fixed loans:						
\$ — to \$250	2,207	6.53 % to 12.00%	2019-07 - 2022-01	\$ 197,449	\$ 1,447	\$ 369
\$ 251 to \$500	198	6.99 % to 13.00%	2019-10 - 2022-01	71,361	2,811	675
\$ 501 to \$750	71	6.99 % to 9.99%	2019-11 - 2021-10	42,862	2,072	508
\$ 751 to \$1,000	40	7.28 % to 10.00%	2018-10 - 2022-01	34,646	1,771	2,443
over \$1,000	137	5.79 % to 10.25%	2019-11 - 2022-01	394,914	31,452	4,992
Total Bridge:	2,653			\$ 741,232	\$ 39,553	\$ 8,987

Note 8. Multifamily Loans

Since 2018, we have invested in multifamily subordinate securities issued by Freddie Mac K-Series securitization trusts and were required to consolidate the underlying multifamily loans owned at these entities for financial reporting purposes in accordance with GAAP. During the first quarter of 2020, we sold subordinate securities issued by four such Freddie Mac K-Series securitization trusts and deconsolidated \$3.85 billion of multifamily loans. See *Note 2* for further discussion.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 8. Multifamily Loans - (continued)

The following table summarizes the characteristics of the multifamily loans consolidated at Redwood at December 31, 2020 and December 31, 2019.

Table 8.1 – Characteristics of Multifamily Loans

(Dollars in Thousands)	December 31, 2020	December 31, 2019
Number of loans	28	279
Unpaid principal balance	\$ 462,808	\$ 4,195,000
Fair value of loans	\$ 492,221	\$ 4,408,524
Weighted average coupon	4.25 %	4.13 %
Weighted average remaining loan term (years)	5	6

Delinquency information

Number of loans with 90+ day delinquencies	—	—
Number of loans in foreclosure	—	—

The outstanding multifamily loans held-for-investment at the Freddie Mac K-Series entities at December 31, 2020 were first-lien, fixed-rate loans that were originated in 2015 and had original loan terms of ten years. The following table provides the activity of multifamily loans held-for-investment during the year months ended December 31, 2020 and 2019.

Table 8.2 – Activity of Multifamily Loans Held-for-Investment

(In Thousands)	Year Ended December 31,	
	2020	2019
Net market valuation gains (losses) recorded ⁽¹⁾	\$ (58,821)	\$ 130,083

(1) Net market valuation gains (losses) on multifamily loans held-for-investment are recorded through Investment fair value changes, net on our consolidated statements of income (loss). For loans held at our consolidated Freddie Mac K-Series entities, market value changes are based on the estimated fair value of the associated ABS issued, including securities we own, pursuant to collateralized financing entity guidelines. The net impact to our income statement associated with our economic investment in these securitization entities is presented in *Note 5*.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 8. Multifamily Loans - (continued)

Multifamily Loan Characteristics

The following table presents the geographic concentration of multifamily loans recorded on our consolidated balance sheets at December 31, 2020.

Table 8.3 – Geographic Concentration of Multifamily Loans

Geographic Concentration (by Principal)	December 31, 2020	December 31, 2019
California	13 %	11 %
Florida	13 %	10 %
North Carolina	9 %	— %
Oregon	7 %	— %
Hawaii	5 %	— %
Tennessee	5 %	— %
Texas	— %	13 %
Arizona	— %	6 %
Georgia	— %	6 %
Washington	— %	5 %
Colorado	— %	5 %
Other states (none greater than 5%)	48 %	44 %
Total	100 %	100 %

The following table displays the loan product type and accompanying loan characteristics of multifamily loans recorded on our consolidated balance sheets at December 31, 2020.

Table 8.4 – Product Types and Characteristics of Multifamily Loans

December 31, 2020
(In Thousands)

Loan Balance	Number of Loans	Interest Rate	Maturity Date	Total Principal	30-89 Days DQ	90+ Days DQ
Fixed loans:						
\$ 10,001 to \$20,000	24	4.25 % to 4.25%	2025-09 - 2025-09	\$ 370,934	\$ —	\$ —
\$ 20,001 to \$30,000	4	4.25 % to 4.25%	2025-09 - 2025-09	91,874	—	—
Total:	28			\$ 462,808	\$ —	\$ —

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 8. Multifamily Loans - (continued)

December 31, 2019
(In Thousands)

Loan Balance	Number of Loans	Interest Rate	Maturity Date	Total Principal	30-89 Days DQ	90+ Days DQ
Fixed loans:						
\$ 1,000 to \$10,000	114	3.29 % to 4.73%	2023-02 - 2029-10	\$ 674,666	\$ —	\$ —
\$ 10,001 to \$20,000	102	3.54 % to 4.94%	2023-09 - 2029-08	1,489,118	—	—
\$ 20,001 to \$30,000	32	3.54 % to 4.69%	2024-01 - 2026-12	750,712	—	—
\$ 30,001 to \$40,000	19	3.52 % to 4.79%	2025-05 - 2029-10	654,729	—	—
over \$40,000	12	3.55 % to 4.65%	2024-10 - 2026-09	625,775	—	—
Total:	<u>279</u>			<u>\$ 4,195,000</u>	<u>\$ —</u>	<u>\$ —</u>

Note 9. Real Estate Securities

We invest in real estate securities that we create and retain from our Sequoia securitizations or acquire from third parties. The following table presents the fair values of our real estate securities by type at December 31, 2020 and December 31, 2019.

Table 9.1 – Fair Values of Real Estate Securities by Type

(In Thousands)	December 31, 2020	December 31, 2019
Trading	\$ 125,667	\$ 860,540
Available-for-sale	218,458	239,334
Total Real Estate Securities	<u>\$ 344,125</u>	<u>\$ 1,099,874</u>

Our real estate securities include mortgage-backed securities, which 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. Mezzanine securities are interests that are generally subordinate to senior securities in their rights to receive cash flows, and have subordinate securities below them that are first to absorb losses. Many of our mezzanine classified securities were initially rated AA through BBB- and issued in 2012 or later. Subordinate securities are all interests below mezzanine. Excluding our re-performing loan securities, nearly all of our residential securities are supported by collateral that was designated as prime at the time of issuance.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 9. Real Estate Securities - (continued)

Trading Securities

We elected the fair value option for certain securities and classify them as trading securities. Our trading securities include both residential and multifamily mortgage-backed securities, and our residential securities also include securities backed by re-performing loans ("RPL"). The following table presents the fair value of trading securities by position and collateral type at December 31, 2020 and December 31, 2019.

Table 9.2 – Fair Value of Trading Securities by Position

(In Thousands)	December 31, 2020	December 31, 2019
Senior		
Interest-only securities ⁽¹⁾	\$ 28,464	\$ 64,010
RPL securities	—	39,337
Other third-party residential securities	—	46,720
Total Senior	28,464	150,067
Mezzanine		
Sequoia securities	3,649	39,660
Multifamily securities	—	395,256
Other third-party residential securities	—	103,573
Total Mezzanine	3,649	538,489
Subordinate		
RPL securities	47,448	76,102
Multifamily securities	5,592	—
Other third-party residential securities	40,514	95,882
Total Subordinate	93,554	171,984
Total Trading Securities	\$ 125,667	\$ 860,540

(1) Includes \$13 million and \$36 million of Sequoia certificated mortgage servicing rights as of December 31, 2020, and December 31, 2019, respectively.

The following table presents the unpaid principal balance of trading securities by position and collateral type at December 31, 2020 and December 31, 2019.

Table 9.3 – Unpaid Principal Balance of Trading Securities by Position

(In Thousands)	December 31, 2020	December 31, 2019
Senior ⁽¹⁾	\$ —	\$ 83,591
Mezzanine	3,577	536,831
Subordinate	242,278	301,908
Total Trading Securities	\$ 245,855	\$ 922,330

(1) Our senior trading securities include interest-only securities, for which there is no principal balance.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 9. Real Estate Securities - (continued)

The following table provides the activity of trading securities during the years ended December 31, 2020 and 2019.

Table 9.4 – Trading Securities Activity

(In Thousands)	Year Ended December 31,	
	2020	2019
Principal balance of securities acquired	\$ 79,921	\$ 366,848
Principal balance of securities sold	744,914	592,502
Net market valuation gains (losses) recorded ⁽¹⁾	(230,731)	56,046

(1) Net market valuation gains (losses) on trading securities are recorded through Investment fair value changes, net and Mortgage banking activities, net on our consolidated statements of income (loss).

AFS Securities

The following table presents the fair value of our available-for-sale securities by position and collateral type at December 31, 2020 and December 31, 2019.

Table 9.5 – Fair Value of Available-for-Sale Securities by Position

(In Thousands)	December 31, 2020	December 31, 2019
Senior		
Other third-party residential securities	\$ —	\$ 25,792
Total Senior	—	25,792
Mezzanine		
Sequoia securities	—	4,320
Multifamily securities	—	5,123
Other third-party residential securities	2,014	4,244
Total Mezzanine	2,014	13,687
Subordinate		
Sequoia securities	136,475	136,330
Multifamily securities	43,663	3,749
Other third-party residential securities	36,306	59,776
Total Subordinate	216,444	199,855
Total AFS Securities	<u>\$ 218,458</u>	<u>\$ 239,334</u>

The following table provides the activity of available-for-sale securities during the years ended December 31, 2020 and 2019.

Table 9.6 – Available-for-Sale Securities Activity

(In Thousands)	Year Ended December 31,	
	2020	2019
Fair value of securities acquired	\$ 57,652	\$ 26,538
Fair value of securities sold	55,192	110,070
Net realized gains recorded	4,635	17,582

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 9. Real Estate Securities - (continued)

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.

At December 31, 2020, we had \$41 million of AFS securities with contractual maturities less than five years, \$3 million with contractual maturities greater than five years but less than ten years, and the remainder of our AFS securities had contractual maturities greater than ten years.

The following table presents the components of carrying value (which equals fair value) of AFS securities at December 31, 2020 and December 31, 2019.

Table 9.7 – Carrying Value of AFS Securities

December 31, 2020				
(In Thousands)	Senior	Mezzanine	Subordinate	Total
Principal balance	\$ —	\$ 2,000	\$ 281,284	\$ 283,284
Credit reserve	—	—	(44,967)	(44,967)
Unamortized discount, net	—	—	(95,718)	(95,718)
Amortized cost	—	2,000	140,599	142,599
Gross unrealized gains	—	14	77,280	77,294
Gross unrealized losses	—	—	(1,047)	(1,047)
CECL credit allowance	—	—	(388)	(388)
Carrying Value	\$ —	\$ 2,014	\$ 216,444	\$ 218,458
December 31, 2019				
(In Thousands)	Senior	Mezzanine	Subordinate	Total
Principal balance	\$ 26,331	\$ 13,512	\$ 264,234	\$ 304,077
Credit reserve	(533)	—	(32,407)	(32,940)
Unamortized discount, net	(10,427)	(527)	(113,301)	(124,255)
Amortized cost	15,371	12,985	118,526	146,882
Gross unrealized gains	10,450	702	81,329	92,481
Gross unrealized losses	(29)	—	—	(29)
Carrying Value	\$ 25,792	\$ 13,687	\$ 199,855	\$ 239,334

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 9. Real Estate Securities - (continued)

The following table presents the changes for the years ended December 31, 2020 and 2019, in unamortized discount and designated credit reserves on residential AFS securities.

Table 9.8 – Changes in Unamortized Discount and Designated Credit Reserves on AFS Securities

(In Thousands)	Year Ended December 31, 2020		Year Ended December 31, 2019	
	Credit Reserve	Unamortized Discount, Net	Credit Reserve	Unamortized Discount, Net
Beginning balance	\$ 32,940	\$ 124,255	\$ 41,370	\$ 151,200
Amortization of net discount	—	(6,538)	—	(7,921)
Realized credit losses	(2,282)	—	(2,606)	—
Acquisitions	7,248	2,634	3,712	1,910
Sales, calls, other	(731)	(16,841)	(9,453)	(21,017)
Impairments	—	—	—	—
Transfers to (release of) credit reserves, net	7,792	(7,792)	(83)	83
Ending Balance	\$ 44,967	\$ 95,718	\$ 32,940	\$ 124,255

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 December 31, 2020 and December 31, 2019.

Table 9.9 – Components of Fair Value of AFS Securities by Holding Periods

(In Thousands)	Less Than 12 Consecutive Months			12 Consecutive Months or Longer		
	Amortized Cost	Unrealized Losses	Fair Value	Amortized Cost	Unrealized Losses	Fair Value
December 31, 2020	\$ 9,129	\$ (1,047)	\$ 7,920	\$ —	\$ —	\$ —
December 31, 2019	—	—	—	5,830	(29)	5,801

At December 31, 2020, after giving effect to purchases, sales, and extinguishment due to credit losses, our consolidated balance sheet included 96 AFS securities, of which five were in an unrealized loss position and zero were in a continuous unrealized loss position for 12 consecutive months or longer. At December 31, 2019, our consolidated balance sheet included 107 AFS securities, of which one was in an unrealized loss position and one was in a continuous unrealized loss position for 12 consecutive months or longer.

Evaluating AFS Securities for Credit Losses

Gross unrealized losses on our AFS securities were \$1 million at December 31, 2020. Pursuant to our adoption of ASU 2016-13, "Financial Instruments - Credit Losses" in the first quarter of 2020, we evaluate all securities in an unrealized loss position to determine if the impairment is credit-related (resulting in an allowance for credit losses recorded in earnings) or non-credit-related (resulting in an unrealized loss through other comprehensive income). At December 31, 2020, 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 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.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 9. Real Estate Securities - (continued)

At December 31, 2020, our allowance for credit losses related to our AFS securities was \$0.4 million. AFS securities for which an allowance 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 may consider 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 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 security credit losses.

The table below summarizes the weighted average of the significant credit quality indicators we used for the credit loss allowance on our AFS securities at December 31, 2020.

Table 9.10 – Significant Credit Quality Indicators

December 31, 2020	Subordinate Securities
Default rate	0.5%
Loss severity	23%

The following table details the activity related to the allowance for credit losses for AFS securities held at December 31, 2020.

Table 9.11 – Rollforward of Allowance for Credit Losses

(In Thousands)	Year Ended December 31, 2020
Beginning balance allowance for credit losses	\$ —
Transition impact from adoption of ASU 2016-13, "Financial Instruments - Credit Losses"	—
Additions to allowance for credit losses on securities for which credit losses were not previously recorded	1,864
Additional increases or decreases to the allowance for credit losses on securities that had an allowance recorded in a previous period	(1,476)
Allowance on purchased financial assets with credit deterioration	—
Reduction to allowance for securities sold during the period	—
Reduction to allowance for securities we intend to sell or more likely than not will be required to sell	—
Write-offs charged against allowance	—
Recoveries of amounts previously written off	—
Ending balance of allowance for credit losses	\$ 388

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 9. Real Estate Securities - (continued)

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 years ended December 31, 2020, 2019, and 2018.

Table 9.12 – Gross Realized Gains and Losses on AFS Securities

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Gross realized gains - sales	\$ 8,779	\$ 17,582	\$ 27,127
Gross realized gains - calls	5	6,239	43
Gross realized losses - sales	(4,144)	—	(129)
Total Realized Gains on Sales and Calls of AFS Securities, net	\$ 4,640	\$ 23,821	\$ 27,041

Note 10. Other Investments

Other investments at December 31, 2020 and December 31, 2019 are summarized in the following table.

Table 10.1 – Components of Other Investments

(In Thousands)	December 31, 2020	December 31, 2019
Servicer advance investments	\$ 231,489	\$ 169,204
Shared home appreciation options	42,440	45,085
Excess MSR	34,418	31,814
Mortgage servicing rights	8,815	42,224
Investment in multifamily loan fund	—	39,802
Other	31,013	30,001
Total Other Investments	\$ 348,175	\$ 358,130

Servicer advance investments

In 2018, we and a third-party co-investor, through two partnerships (“SA Buyers”) consolidated by us, purchased the outstanding servicer advances and excess MSR related to a portfolio of legacy residential mortgage-backed securitizations serviced by the co-investor (See *Note 4* for additional information regarding the transaction). During the year ended December 31, 2020, we funded additional purchases of outstanding servicer advances and excess MSR under the same partnership structure. At December 31, 2020, we had funded \$94 million of total capital to the SA Buyers (see *Note 16* for additional detail).

Our servicer advance investments (owned by the consolidated SA Buyers) are comprised of outstanding servicer advance receivables, the requirement to purchase all future servicer advances made with respect to a specified pool of residential mortgage loans, and a portion of the mortgage servicing fees from the underlying loan pool. A portion of the remaining mortgage servicing fees from the underlying loan pool are paid directly to the third-party servicer for the performance of servicing duties and a portion is paid to excess MSR that we own as a separate investment. We hold our servicer advance investments at our taxable REIT subsidiaries.

Servicer advances are non-interest bearing and are a customary feature of residential mortgage securitization transactions. Servicer advances are generally reimbursable cash payments made by a servicer when the borrower fails to make scheduled payments due on a residential mortgage loan or to support the value of the collateral property. Servicer advances typically fall into three categories:

- **Principal and Interest Advances:** cash payments made by the servicer to cover scheduled principal and interest payments on a residential mortgage loan that have not been paid on a timely basis by the borrower.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 10. Other Investments - (continued)

- Escrow Advances (Taxes and Insurance Advances): Cash payments made by the servicer to third parties on behalf of the borrower for real estate taxes and insurance premiums on the property that have not been paid on a timely basis by the borrower.
- Corporate Advances: Cash payments made by the servicer to third parties for the reimbursable costs and expenses incurred in connection with the foreclosure, preservation and sale of the mortgaged property, including attorneys' and other professional fees.

Servicer advances are generally permitted to be repaid from amounts received with respect to the related residential mortgage loan, including payments from the borrower or amounts received from the liquidation of the property securing the loan. Residential mortgage servicing agreements generally require a servicer to make advances in respect of serviced residential mortgage loans unless the servicer determines in good faith that the advance would not be ultimately recoverable from the proceeds of the related residential mortgage loan or the mortgaged property.

At December 31, 2020, our servicer advance investments had a carrying value of \$231 million and were associated with a portfolio of residential mortgage loans with an unpaid principal balance of \$9.14 billion. The outstanding servicer advance receivables associated with this investment were \$218 million at December 31, 2020, which were financed with short-term non-recourse securitization debt (see *Note 13* for additional detail on this debt). The servicer advance receivables were comprised of the following types of advances at December 31, 2020 and December 31, 2019:

Table 10.2 – Components of Servicer Advance Receivables

(In Thousands)	December 31, 2020	December 31, 2019
Principal and interest advances	\$ 110,923	\$ 15,081
Escrow advances (taxes and insurance advances)	79,279	96,732
Corporate advances	27,454	39,769
Total Servicer Advance Receivables	\$ 217,656	\$ 151,582

We account for our servicer advance investments at fair value and during the years ended December 31, 2020 and 2019, we recorded \$11 million of Other interest income associated with these investments for each of these periods, and recorded a net market valuation loss of \$9 million and a net market valuation gain of \$3 million, respectively, through Investment fair value changes, net in our consolidated statements of income.

Shared Home Appreciation Options

In the third quarter of 2019, we entered into a flow purchase agreement to acquire shared home appreciation options. Under this arrangement, our counterparty purchases an option to buy a fractional interest in a homeowner's ownership interest in residential property, and subsequently the counterparty sells the option contract to us. Pursuant to the terms of the option contract, we share in both home price appreciation and depreciation. At December 31, 2020, we had acquired \$47 million of shared home appreciation options under this flow purchase agreement. We account for these investments under the fair value option and during the years ended December 31, 2020 and 2019, we recorded a net market valuation loss of \$2 million and a net market valuation gain of \$1 million, respectively, related to these assets through Investment fair value changes, net on our consolidated statements of income.

Excess MSRs

In association with our servicer advance investments described above, we (through our consolidated SA Buyers) invested in excess MSRs associated with the same portfolio of legacy residential mortgage-backed securitizations. Additionally, we own excess MSRs associated with specified pools of multifamily loans. We account for our excess MSRs at fair value and during the years ended December 31, 2020 and 2019, we recognized \$12 million and \$8 million of Other interest income, respectively, and recorded net market valuation losses of \$8 million and \$3 million, respectively, through Investment fair value changes, net on our consolidated statements of income.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 10. Other Investments - (continued)

Mortgage Servicing Rights

We invest in mortgage servicing rights associated with residential mortgage loans and contract with licensed sub-servicers to perform all servicing functions for these loans. The majority of our investments in MSR were made through the retention of servicing rights associated with the residential jumbo mortgage loans that we acquired and subsequently transferred to third parties. We hold our MSR investments at our taxable REIT subsidiaries.

At December 31, 2020 and December 31, 2019, our MSRs had a fair value of \$9 million and \$42 million, respectively, and were associated with loans with an aggregate principal balance of \$2.59 billion and \$4.35 billion, respectively. During the years ended December 31, 2020 and 2019, including net market valuation gains and losses on our MSRs and related risk management derivatives, we recorded a net loss of \$10 million and income of \$4 million, respectively, through Other income on our consolidated statements of income (loss).

Investment in Multifamily Loan Fund

In January 2019, we invested in a limited partnership created to acquire floating rate, light-renovation multifamily loans from Freddie Mac. At December 31, 2020, the carrying amount of our investment in the partnership was zero and we had no remaining funding obligations to the partnership. During the year ended December 31, 2020, we acquired \$56 million of securities from the partnership's securitization transactions. During the years ended December 31, 2020 and 2019, we recorded income of \$1 million for each of these periods associated with this investment in Other income on our consolidated statements of income (loss).

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 11. Derivative Financial Instruments

The following table presents the fair value and notional amount of our derivative financial instruments at December 31, 2020 and December 31, 2019.

Table 11.1 – Fair Value and Notional Amount of Derivative Financial Instruments

(In Thousands)	December 31, 2020		December 31, 2019	
	Fair Value	Notional Amount	Fair Value	Notional Amount
Assets - Risk Management Derivatives				
Interest rate swaps	\$ 224	\$ 42,000	\$ 17,095	\$ 1,399,000
TBAs	18,260	3,520,000	5,755	2,445,000
Interest rate futures	—	—	777	213,700
Swaptions	19,727	1,585,000	1,925	1,065,000
Assets - Other Derivatives				
Loan purchase and interest rate lock commitments	15,027	2,617,254	10,149	1,537,162
Total Assets	\$ 53,238	\$ 7,764,254	\$ 35,701	\$ 6,659,862
Liabilities - Cash Flow Hedges				
Interest rate swaps	\$ —	\$ —	\$ (51,530)	\$ 139,500
Liabilities - Risk Management Derivatives				
Interest rate swaps	—	—	(97,235)	2,314,300
TBAs	(15,495)	3,105,000	(13,359)	4,160,000
Interest rate futures	—	—	(10)	12,300
Liabilities - Other Derivatives				
Loan purchase commitments	(577)	477,153	(1,290)	303,394
Total Liabilities	\$ (16,072)	\$ 3,582,153	\$ (163,424)	\$ 6,929,494
Total Derivative Financial Instruments, Net	\$ 37,166	\$ 11,346,407	\$ (127,723)	\$ 13,589,356

Risk Management Derivatives

To manage, to varying degrees, risks associated with certain assets and liabilities on our consolidated balance sheets, we may enter into derivative contracts. At December 31, 2020, we were party to swaps and swaptions with an aggregate notional amount of \$1.63 billion and TBA agreements with an aggregate notional amount of \$6.63 billion. At December 31, 2019, we were party to swaps with an aggregate notional amount of \$4.78 billion, TBA agreements with an aggregate notional amount of \$6.61 billion, and interest rate futures contracts with an aggregate notional amount of \$226 million.

For the years ended December 31, 2020, 2019, and 2018, risk management derivatives had a net market valuation loss of \$93 million, a net market valuation loss of \$134 million, and a net market valuation gain of \$40 million, respectively. These market valuation gains and losses are recorded in Mortgage banking activities, net, Investment fair value changes, net and Other income on our consolidated statements of income.

Loan Purchase and Interest Rate Lock Commitments

LPCs and IRLCs that qualify as derivatives are recorded at their estimated fair values. For the years ended December 31, 2020, 2019, and 2018, LPCs and IRLCs had a net market valuation gain of \$57 million, a net market valuation gain of \$62 million, and a net market valuation loss of \$1 million, respectively, that were recorded in Mortgage banking activities, net on our consolidated statements of income.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 11. Derivative Financial Instruments - (continued)

Derivatives Designated as Cash Flow Hedges

To manage the variability in interest expense related to portions of 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.

During the first quarter of 2020, we terminated and settled all of our outstanding derivatives that had been designated as cash flow hedges for our long-term debt, with a payment of \$84 million. For interest rate agreements previously designated as cash flow hedges, our total unrealized loss reported in Accumulated other comprehensive income was \$81 million and \$51 million at December 31, 2020 and December 31, 2019, respectively. We will amortize this loss into interest expense over the remaining term of the trust preferred securities and subordinated notes. As of December 31, 2020, we expect to amortize \$4 million of realized losses related to terminated cash flow hedges into interest expense over the next twelve months.

For the years ended December 31, 2020, 2019, and 2018, changes in the values of designated cash flow hedges were negative \$33 million, negative \$17 million, and positive \$9 million, respectively, and were recorded in Accumulated other comprehensive income, a component of equity.

The following table illustrates the impact on interest expense of our interest rate agreements accounted for as cash flow hedges for the years ended December 31, 2020, 2019, and 2018.

Table 11.2 – Impact on Interest Expense of Interest Rate Agreements Accounted for as Cash Flow Hedges

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Net interest expense on cash flows hedges	\$ (860)	\$ (2,847)	\$ (3,228)
Realized net losses reclassified from other comprehensive income	(3,188)	—	—
Total Interest Expense	\$ (4,048)	\$ (2,847)	\$ (3,228)

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 each quarter-end. At December 31, 2020, we assessed this risk as remote and did not record a specific valuation adjustment.

At December 31, 2020, we were in compliance with our derivative counterparty ISDA agreements.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 12. Other Assets and Liabilities

Other assets at December 31, 2020 and December 31, 2019 are summarized in the following table.

Table 12.1 – Components of Other Assets

(In Thousands)	December 31, 2020	December 31, 2019
Investment receivable	\$ 43,176	\$ 23,330
Accrued interest receivable	39,445	71,058
Operating lease right-of-use assets	15,012	11,866
REO	8,413	9,462
FHLBC stock	5,000	43,393
Margin receivable	4,758	209,776
Fixed assets and leasehold improvements ⁽¹⁾	4,203	4,901
Pledged collateral	1,177	32,945
Other	9,404	12,590
Total Other Assets	\$ 130,588	\$ 419,321

(1) Fixed assets and leasehold improvements had a basis of \$11 million and accumulated depreciation of \$6 million at December 31, 2020.

Accrued expenses and other liabilities at December 31, 2020 and December 31, 2019 are summarized in the following table.

Table 12.2 – Components of Accrued Expenses and Other Liabilities

(In Thousands)	December 31, 2020	December 31, 2019
Accrued interest payable	\$ 34,858	\$ 60,655
Accrued compensation	24,393	33,888
Payable to minority partner	16,941	13,189
Operating lease liabilities	16,687	13,443
Margin payable	14,728	1,700
Deferred consideration	14,579	—
Guarantee obligations	10,039	14,009
Residential loan and MSR repurchase reserve	8,631	4,268
Current accounts payable	6,455	5,468
Bridge loan holdbacks	5,708	10,682
Accrued taxes payable	5,614	5,268
Accrued operating expenses	5,509	4,358
Contingent consideration	—	28,484
Other	15,198	11,481
Total Accrued Expenses and Other Liabilities	\$ 179,340	\$ 206,893

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 12. Other Assets and Liabilities - (continued)

Investment Receivable

Investment receivable primarily consists of amounts receivable from third-party servicers related to principal and interest receivable from business purpose loans and fees receivable from servicer advance investments.

Margin Receivable and Payable

Margin receivable and payable resulted from margin calls between us and our counterparties under derivatives, master repurchase agreements, and warehouse facilities, whereby we or the counterparty posted collateral. Through December 31, 2020, we had met all margin calls due.

Operating Lease Right-of-Use Assets and Operating Lease Liabilities

The operating lease right-of-use assets and operating lease liabilities presented in the tables above resulted from our adoption of ASU 2016-02, "Leases," in the first quarter of 2019. The operating lease liabilities are equal to the present value of our remaining lease payments discounted at our incremental borrowing rate and the operating lease right-of-use assets are equal to the operating lease liabilities adjusted for our deferred rent liabilities. These balances are reduced as lease payments are made. See *Note 16* for additional information on leases.

FHLBC Stock

In accordance with our FHLB-member subsidiary's borrowing agreement with the FHLBC, our subsidiary is required to purchase and hold stock in the FHLBC. See *Note 3* and *Note 15* for additional information on this borrowing agreement.

Pledged Collateral and Guarantee Obligations

The pledged collateral and guarantee obligations presented in the tables above are related to our risk-sharing arrangements with Fannie Mae and Freddie Mac, as well as collateral pledged for certain interest rate agreements. In accordance with these arrangements, we are required to pledge collateral to secure our guarantee obligations and to meet margin requirements for our interest rate agreements. See *Note 3* and *Note 16* for additional information on our risk-sharing arrangements.

Deferred Consideration

The deferred consideration presented in the table above is related to our acquisition of 5 Arches in 2019. Prior to March 31, 2020, these earn-out payments were classified as a contingent consideration liability. As a result of an amendment to the agreement, we reclassified the contingent liability to a deferred liability, as the remaining payments became payable on a set timetable without any remaining contingencies.

Bridge Loan Holdbacks

Bridge loan holdbacks represent loan amounts payable to bridge loan borrowers subject to the completion of various phases of property rehabilitation.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 12. Other Assets and Liabilities - (continued)

REO

The following table summarizes the activity and carrying values of REO assets held at Redwood and at consolidated Legacy Sequoia, Freddie Mac SLST, and CAFL entities during the year ended December 31, 2020.

Table 12.3 – REO Activity

(In Thousands)	Year Ended December 31, 2020				
	Redwood Bridge	Legacy Sequoia	Freddie Mac SLST	CAFL	Total
Balance at beginning of period	\$ 6,887	\$ 460	\$ 445	\$ 1,670	\$ 9,462
Transfers to REO	6,111	532	1,319	6,157	14,119
Liquidations ⁽¹⁾	(8,830)	(243)	(1,178)	(4,371)	(14,622)
Changes in fair value, net	432	(111)	60	(927)	(546)
Balance at End of Period	\$ 4,600	\$ 638	\$ 646	\$ 2,529	\$ 8,413

(1) For the year ended December 31, 2020, REO liquidations resulted in \$1 million of realized losses, which were recorded in Investment fair value changes, net on our consolidated statements of income (loss).

The following table provides the detail of REO assets at Redwood and at consolidated Legacy Sequoia, Freddie Mac SLST, and CAFL entities at December 31, 2020 and December 31, 2019.

Table 12.4 – REO Assets

Number of REO assets	Redwood Bridge	Legacy Sequoia	Freddie Mac SLST	CAFL	Total
At December 31, 2020	3	3	9	2	17
At December 31, 2019	4	4	3	2	13

Legal and Repurchase Reserves

See *Note 16* for additional information on the legal and residential repurchase reserves.

Payable to Minority Partner

In 2018, Redwood and a third-party co-investor, through two partnership entities consolidated by Redwood, purchased servicer advances and excess MSRs related to a portfolio of residential mortgage loans serviced by the co-investor (see *Note 4* and *Note 10* for additional information on the partnership entities and associated investments). We account for the co-investor's interests in the entities as liabilities and at December 31, 2020, the carrying value of their interests was \$17 million, representing their current economic interest in the entities. Earnings from the partnership entities are allocated to the co-investors on a proportional basis and during the years ended December 31, 2020 and 2019, we allocated \$0.2 million of losses and \$1 million of gains, respectively, to the co-investors, which were recorded in Other expenses on our consolidated statements of income.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 13. 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 December 31, 2020, we had outstanding agreements with several counterparties and we were in compliance with all of the related covenants.

The table below summarizes our short-term debt, including the facilities that are available to us, the outstanding balances, the weighted average interest rate, and the maturity information at December 31, 2020 and December 31, 2019.

Table 13.1 – Short-Term Debt

December 31, 2020						
(Dollars in Thousands)	Number of Facilities	Outstanding Balance	Limit	Weighted Average Interest Rate	Maturity	Weighted Average Days Until Maturity
Facilities						
Residential loan warehouse ⁽¹⁾	4	\$ 137,269	\$1,300,000	2.45 %	1/2021-11/2021	268
Business purpose loan warehouse ⁽²⁾	2	99,190	500,000	3.37 %	5/2022-6/2022	521
Real estate securities repo ⁽¹⁾	3	77,775	—	2.24 %	1/2021-3/2021	36
Total Short-Term Debt Facilities	9	314,234				
Servicer advance financing	1	208,375	335,000	1.95 %	11/2021	334
Total Short-Term Debt		\$ 522,609				
December 31, 2019						
(Dollars in Thousands)	Number of Facilities	Outstanding Balance	Limit	Weighted Average Interest Rate	Maturity	Weighted Average Days Until Maturity
Facilities						
Residential loan warehouse ⁽¹⁾	4	\$ 185,894	\$1,425,000	3.23 %	1/2020-10/2020	69
Business purpose loan warehouse ⁽²⁾	8	814,118	1,475,000	4.11 %	12/2020-5/2022	489
Real estate securities repo ⁽¹⁾	10	1,176,579	—	2.94 %	1/2020-3/2020	23
Total Short-Term Debt Facilities	22	2,176,591				
Servicer advance financing	1	152,554	400,000	3.56 %	11/2020	335
Total Short-Term Debt		\$ 2,329,145				

(1) Borrowings under our facilities are generally charged interest based on a specified margin over the one-month LIBOR interest rate. At December 31, 2020 and December 31, 2019, all of these borrowings were under uncommitted facilities and were due within 364 days (or less) of the borrowing date.

(2) Due to the revolving nature of the borrowings under these facilities, we have classified these facilities as short-term debt at December 31, 2020 and December 31, 2019. Borrowings under these facilities will be repaid as the underlying loans mature or are sold to third parties or transferred to securitizations.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 13. Short-Term Debt - (continued)

The following table below presents the value of loans and securities pledged as collateral under our short-term debt facilities at December 31, 2020 and December 31, 2019.

Table 13.2 – Collateral for Short-Term Debt

(In Thousands)	December 31, 2020	December 31, 2019
Collateral Type		
Held-for-sale residential loans	\$ 156,355	\$ 201,949
Business purpose loans	127,029	988,179
Real estate securities		
On balance sheet	23,193	618,881
Sequoia Choice securitizations ⁽¹⁾	63,105	111,341
Freddie Mac SLST securitizations ⁽¹⁾	—	381,640
Freddie Mac K-Series securitizations ⁽¹⁾	28,255	252,284
CAFL securitizations ⁽¹⁾	—	127,840
Total real estate securities owned	114,553	1,491,986
Other assets ⁽²⁾	315	16,252
Total Collateral for Short-Term Debt	\$ 398,252	\$ 2,698,366

- (1) Represents securities we have retained from consolidated securitization entities. For GAAP purposes, we consolidate the loans and non-recourse ABS debt issued from these securitizations.
- (2) In addition to securities that serve as collateral for our securities repo borrowings, we had posted \$0.3 million of cash collateral as margin with our borrowing counterparties.

For the years ended December 31, 2020 and 2019, the average balances of our short-term debt facilities were \$1.19 billion and \$1.97 billion, respectively. At December 31, 2020 and December 31, 2019, accrued interest payable on our short-term debt facilities was \$1 million and \$6 million, respectively.

Servicer advance financing consists of non-recourse short-term securitization debt used to finance servicer advance investments. We consolidate the securitization entity that issued the debt, but the entity is independent of Redwood and the assets and liabilities are not owned by and are not legal obligations of Redwood. At December 31, 2020, the fair value of servicer advances, cash and restricted cash collateralizing the securitization financing was \$251 million. At December 31, 2020, the accrued interest payable balance on this financing was \$0.1 million and the unamortized capitalized commitment costs were \$1 million.

We also maintain a \$10 million committed line of credit with a financial institution that is secured by certain mortgage-backed securities with a fair market value of \$2 million at December 31, 2020. At both December 31, 2020 and December 31, 2019, we had no outstanding borrowings on this facility.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 13. Short-Term Debt - (continued)

Remaining Maturities of Short-Term Debt

The following table presents the remaining maturities of our secured short-term debt by the type of collateral securing the debt as well as our convertible notes at December 31, 2020.

Table 13.3 – Short-Term Debt by Collateral Type and Remaining Maturities

(In Thousands)	December 31, 2020			
	Within 30 days	31 to 90 days	Over 90 days	Total
Collateral Type				
Held-for-sale residential loans	\$ 3,918	\$ 14,801	\$ 118,550	\$ 137,269
Business purpose loans	—	—	99,190	99,190
Real estate securities	40,455	37,320	—	77,775
Total Secured Short-Term Debt	44,373	52,121	217,740	314,234
Servicer advance financing	—	—	208,375	208,375
Total Short-Term Debt	\$ 44,373	\$ 52,121	\$ 426,115	\$ 522,609

Note 14. Asset-Backed Securities Issued

The carrying values of ABS issued by our consolidated securitization entities at December 31, 2020 and December 31, 2019, along with other selected information, are summarized in the following table.

Table 14.1 – Asset-Backed Securities Issued

(Dollars in Thousands)	December 31, 2020					
	Legacy Sequoia	Sequoia Choice	Freddie Mac SLST⁽¹⁾	Freddie Mac K-Series	CAFL	Total
Certificates with principal balance	\$ 329,039	\$ 1,309,957	\$ 1,866,145	\$ 416,339	\$ 2,716,425	\$ 6,637,905
Interest-only certificates	1,092	4,591	23,335	13,026	162,934	204,978
Market valuation adjustments	(47,805)	32,809	104,439	34,601	133,734	257,778
ABS Issued, Net	\$ 282,326	\$ 1,347,357	\$ 1,993,919	\$ 463,966	\$ 3,013,093	\$ 7,100,661
Range of weighted average interest rates, by series	0.35% to 1.55%	2.25% to 5.04%	3.50% to 4.75%	3.39 %	2.68% to 5.42%	
Stated maturities	2024 - 2036	2047 - 2050	2028 - 2059	2025	2022 - 2052	
Number of series	20	10	3	1	14	

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 14. Asset-Backed Securities Issued - (continued)

December 31, 2019						
(Dollars in Thousands)	Legacy Sequoia	Sequoia Choice	Freddie Mac SLST	Freddie Mac K-Series	CAFL	Total
Certificates with principal balance	\$ 420,056	\$ 1,979,719	\$ 1,842,682	\$ 3,844,789	\$ 1,875,007	\$ 9,962,253
Interest-only certificates	1,282	16,514	30,291	217,891	90,134	356,112
Market valuation adjustments	(18,873)	40,965	45,349	93,559	36,110	197,110
ABS Issued, Net	\$ 402,465	\$ 2,037,198	\$ 1,918,322	\$ 4,156,239	\$ 2,001,251	\$ 10,515,475
Range of weighted average interest rates, by series	1.94% to 3.26%	4.40% to 5.05%	3.50 %	3.35% to 4.35%	3.25% to 5.36%	
Stated maturities	2024 - 2036	2047 - 2049	2028 - 2029	2025 - 2049	2022 - 2048	
Number of series	20	9	2	5	10	

(1) Includes \$205 million (principal balance) of ABS issued by a re-securitization trust sponsored by Redwood and accounted for at amortized cost.

During the third quarter of 2020, we transferred all of the subordinate securities we owned from two consolidated re-performing loan securitization VIEs sponsored by Freddie Mac SLST to a re-securitization trust, which we determined was a VIE and for which we determined we are the primary beneficiary. At issuance, we sold \$210 million (principal balance) of ABS issued to third parties and retained 100% of the remaining beneficial ownership interest in the trust through ownership of a subordinate security issued by the trust. The ABS was issued at a discount and we have elected to account for the ABS issued at amortized cost. At December 31, 2020, the carrying value of the ABS issued was \$200 million and the debt discount was \$4 million. The stated coupon of the ABS issued was 4.75% at issuance and the final stated maturity occurs in July 2059. The ABS issued is subject to optional redemption and interest rate step-ups prior to the stated maturity according to the terms of the respective governing agreements.

The actual maturity of each class of ABS issued is primarily determined by the rate of principal prepayments on the assets of the issuing entity. Each series is also subject to redemption prior to the stated maturity according to the terms of the respective governing documents of each ABS issuing entity. As a result, the actual maturity of ABS issued may occur earlier than its stated maturity. At December 31, 2020, the majority of the ABS issued and outstanding had contractual maturities beyond five years. See *Note 4* for detail on the carrying value components of the collateral for ABS issued and outstanding. The following table summarizes the accrued interest payable on ABS issued at December 31, 2020 and December 31, 2019. Interest due on consolidated ABS issued is payable monthly.

Table 14.2 – Accrued Interest Payable on Asset-Backed Securities Issued

(In Thousands)	December 31, 2020	December 31, 2019
Legacy Sequoia	\$ 141	\$ 395
Sequoia Choice	4,697	7,732
Freddie Mac SLST ⁽¹⁾	5,656	5,374
Freddie Mac K-Series	1,177	12,887
CAFL	10,122	7,298
Total Accrued Interest Payable on ABS Issued	\$ 21,793	\$ 33,686

(1) Includes accrued interest payable on ABS issued by a re-securitization trust sponsored by Redwood.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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December 31, 2020

Note 15. Long-Term Debt

FHLBC Borrowings

In July 2014, our FHLB-member subsidiary entered into a borrowing agreement with the Federal Home Loan Bank of Chicago. At December 31, 2020, under this agreement, our subsidiary could incur borrowings, also referred to as "advances," from the FHLB secured by eligible collateral, including residential mortgage loans. Under a final rule published by the Federal Housing Finance Agency in January 2016, our FHLB-member subsidiary was permitted to remain an FHLB member through the five-year transition period for captive insurance companies that ended in February 2021. Our FHLB-member's existing \$1 million of FHLB debt, which matures beyond this transition period, is permitted to remain outstanding until its stated maturity. Advances under this agreement incur interest charges based on a specified margin over the FHLBC's 13-week discount note rate, which resets every 13 weeks.

At December 31, 2020, \$1 million of advances were outstanding under our FHLBC borrowing agreement, with a weighted average interest rate of 0.30%. These borrowings mature in 2026. At December 31, 2019, \$2.00 billion of advances were outstanding under this agreement, which were classified as long-term debt, with a weighted average interest rate of 1.88% and a weighted average maturity of six years. During the year ended December 31, 2020, we repaid \$2.0 billion of our FHLBC borrowings. At December 31, 2020, total advances under this agreement were secured by \$1 million of restricted cash. We do not expect to increase borrowings under our FHLBC borrowing agreement above the existing \$1 million of advances outstanding. This agreement also requires our subsidiary to purchase and hold stock in the FHLBC in an amount equal to a specified percentage of outstanding advances. At December 31, 2020, our subsidiary held \$5 million of FHLBC stock that is included in Other assets in our consolidated balance sheets.

Recourse Subordinate Securities Financing Facilities

In 2019, a subsidiary of Redwood entered into a repurchase agreement providing non-marginable (i.e., not subject to margin calls based on the market value of the underlying collateral that is non-delinquent) recourse debt financing of certain Sequoia securities as well as securities retained from our consolidated Sequoia Choice securitizations. The financing is fully and unconditionally guaranteed by Redwood, with an interest rate of approximately 4.21% through September 2022. The financing facility may be terminated, at our option, in September 2022, and has a final maturity in September 2024, provided that the interest rate on amounts outstanding under the facility increases between October 2022 and September 2024. At December 31, 2020, we had borrowings under this facility totaling \$178 million and \$1 million of unamortized deferred issuance costs, for a net carrying value of \$177 million. At December 31, 2020, the fair value of real estate securities pledged as collateral under this long-term debt facility was \$249 million and included Sequoia securities and securities retained from our Sequoia Choice securitizations.

In the first quarter of 2020, a subsidiary of Redwood entered into a second repurchase agreement with similar terms to provide non-marginable recourse debt financing of certain securities retained from our consolidated CAFL securitizations. The financing is fully and unconditionally guaranteed by Redwood, with an interest rate of approximately 4.21% through February 2023. The financing facility may be terminated, at our option, in February 2023, and has a final maturity in February 2025, provided that the interest rate on amounts outstanding under the facility increases between March 2023 and February 2025. At December 31, 2020, we had borrowings under this facility totaling \$103 million and \$1 million of unamortized deferred issuance costs, for a net carrying value of \$102 million. At December 31, 2020, the fair value of real estate securities pledged as collateral under this long-term debt facility was \$114 million and included securities retained from our consolidated CAFL securitizations.

Non-Recourse Business Purpose Loan Financing Facilities

In the third quarter of 2020, a subsidiary of Redwood entered into a repurchase agreement providing non-marginable, non-recourse financing primarily for business purpose bridge loans. Borrowings under this facility accrue interest at a per annum rate equal to one-month LIBOR plus 3.85% (with a 0.50% LIBOR floor), through July 2022. We do not have the ability to increase borrowings under this borrowing facility above the existing amounts outstanding. At December 31, 2020, we had borrowings under this facility totaling \$115 million and \$1 million of unamortized deferred issuance costs, for a net carrying value of \$114 million. At December 31, 2020, \$186 million of bridge loans were pledged as collateral under this facility.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 15. Long-Term Debt - (continued)

In the second quarter of 2020, a subsidiary of Redwood entered into a repurchase agreement providing non-marginable, non-recourse financing primarily for business purpose bridge loans. Borrowings under this facility accrue interest at a per annum rate equal to one-month LIBOR plus 7.50% (with a 1.50% LIBOR floor), through June 2022 (facility is fully callable in June 2021). At December 31, 2020, this facility had an aggregate maximum borrowing capacity of \$372 million, which consisted of a term facility of \$197 million and a revolving facility of \$175 million. The revolving period ends in June 2021, and amounts borrowed under the term and revolving facilities are due in full in June 2022. At December 31, 2020, we had borrowings under this facility totaling \$252 million and \$2 million of unamortized deferred issuance costs, for a net carrying value of \$249 million. At December 31, 2020, \$338 million of bridge loans and \$21 million of other BPL investments were pledged as collateral under this facility.

Recourse Business Purpose Loan Financing Facilities

In the third quarter of 2020, a subsidiary of Redwood entered into a repurchase agreement providing non-marginable financing for business purpose bridge loans and single-family rental loans. Borrowings under this facility accrue interest at a per annum rate equal to three-month LIBOR plus 3.00% through September 2023 and are recourse to Redwood. This facility has an aggregate maximum borrowing capacity of \$250 million. At December 31, 2020, we had borrowings under this facility totaling \$80 million and \$0.2 million of unamortized deferred issuance costs, for a net carrying value of \$80 million. At December 31, 2020, \$106 million of single-family rental loans were pledged as collateral under this facility.

In the second quarter of 2020, a subsidiary of Redwood entered into a repurchase agreement providing non-marginable financing for business purpose bridge loans and single-family rental loans. Borrowings under this facility accrue interest at a per annum rate equal to three-month LIBOR plus 3.00% to 3.50% (with a 1.00% LIBOR floor) through May 2022 and are recourse to Redwood. This facility has an aggregate maximum borrowing capacity of \$350 million. At December 31, 2020, we had borrowings under this facility totaling \$52 million and \$0.5 million of unamortized deferred issuance costs, for a net carrying value of \$51 million. At December 31, 2020, \$24 million of bridge loans and \$49 million of single-family rental loans were pledged as collateral under this facility.

Recourse Revolving Debt Facility

In the first quarter of 2020, a subsidiary of Redwood entered into a secured revolving debt facility agreement collateralized by MSR and certificated mortgage servicing rights. Borrowings under this facility accrue interest at a per annum rate equal to one-month LIBOR plus 3.00% through January 2021, with an increase in rate between February 2021 and the maturity of the facility in January 2022. This facility has an aggregate maximum borrowing capacity of \$50 million. We had no borrowings outstanding under this facility at December 31, 2020.

Convertible Notes

In September 2019, RWT Holdings, Inc., a wholly-owned subsidiary of Redwood Trust, Inc., issued \$201 million principal amount of 5.75% exchangeable senior notes due 2025. These exchangeable notes require semi-annual interest payments at a fixed coupon rate of 5.75% until maturity or exchange, which will be no later than October 1, 2025. After deducting the underwriting discount and offering costs, we received \$195 million of net proceeds. Including amortization of deferred debt issuance costs, the weighted average interest expense yield on these exchangeable notes is approximately 6.3% per annum. At December 31, 2020, these notes were exchangeable at the option of the holder at an exchange rate of 55.2644 common shares per \$1,000 principal amount of exchangeable senior notes (equivalent to an exchange price of \$18.09 per common share). Upon exchange of these notes by a holder, the holder will receive shares of our common stock. During the second quarter of 2020, we repurchased \$29 million par value of these notes at a discount and recorded a gain on extinguishment of \$6 million in Realized gains, net on our consolidated statements of income (loss). At December 31, 2020, the outstanding principal amount of these notes was \$172 million. At December 31, 2020, the accrued interest payable balance on this debt was \$2 million and the unamortized deferred issuance costs were \$4 million.

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Note 15. Long-Term Debt - (continued)

In June 2018, we issued \$200 million principal amount of 5.625% convertible senior notes due 2024 at an issuance price of 99.5%. These convertible notes require semi-annual interest payments at a fixed coupon rate of 5.625% until maturity or conversion, which will be no later than July 15, 2024. After deducting the issuance discount, the underwriting discount and offering costs, we received \$194 million of net proceeds. Including amortization of deferred debt issuance costs and the debt discount, the weighted average interest expense yield on these convertible notes is approximately 6.2% per annum. These notes are convertible at the option of the holder at a conversion rate of 54.8317 common shares per \$1,000 principal amount of convertible senior notes (equivalent to a conversion price of \$18.24 per common share). Upon conversion of these notes by a holder, the holder will receive shares of our common stock. During the second quarter of 2020, we repurchased \$50 million par value of these notes at a discount and recorded a gain on extinguishment of \$9 million in Realized gains, net on our consolidated statements of income (loss). At December 31, 2020, the outstanding principal amount of these notes was \$150 million and the accrued interest payable on this debt was \$4 million. At December 31, 2020, the unamortized deferred issuance costs and debt discount were \$2 million and \$0.5 million, respectively.

In August 2017, we issued \$245 million principal amount of 4.75% convertible senior notes due 2023. These convertible notes require semi-annual interest payments at a fixed coupon rate of 4.75% until maturity or conversion, which will be no later than August 15, 2023. After deducting the underwriting discount and offering costs, we received \$238 million of net proceeds. Including amortization of deferred debt issuance costs, the weighted average interest expense yield on these convertible notes is approximately 5.3% per annum. At December 31, 2020, these notes were convertible at the option of the holder at a conversion rate of 54.4764 common shares per \$1,000 principal amount of convertible senior notes (equivalent to a conversion price of \$18.36 per common share). Upon conversion of these notes by a holder, the holder will receive shares of our common stock. During the second quarter of 2020, we repurchased \$46 million par value of these notes at a discount and recorded a gain on extinguishment of \$10 million in Realized gains, net on our consolidated statements of income (loss). At December 31, 2020, the outstanding principal amount of these notes was \$199 million. At December 31, 2020, the accrued interest payable balance on this debt was \$4 million and the unamortized deferred issuance costs were \$3 million.

Trust Preferred Securities and Subordinated Notes

At December 31, 2020, we had trust preferred securities and subordinated notes outstanding of \$100 million and \$40 million, respectively. This debt requires quarterly interest payments at a floating rate equal to three-month LIBOR plus 2.25% until the notes are redeemed. The \$100 million trust preferred securities will be redeemed no later than January 30, 2037, and the \$40 million subordinated notes will be redeemed no later than July 30, 2037. At both December 31, 2020 and December 31, 2019, the accrued interest payable balance on our trust preferred securities and subordinated notes was \$1 million.

Under the terms of this debt, we covenant, among other things, to use our best efforts to continue to qualify as a REIT. If an event of default were to occur in respect of this debt, we would generally be restricted under its terms (subject to certain exceptions) from making dividend distributions to stockholders, from repurchasing common stock or repurchasing or redeeming any other then-outstanding equity securities, and from making any other payments in respect of any equity interests in us or in respect of any then-outstanding debt that is pari passu or subordinate to this debt.

Note 16. Commitments and Contingencies

Lease Commitments

At December 31, 2020, we were obligated under eight non-cancelable operating leases with expiration dates through 2031 for \$20 million of cumulative lease payments. Our operating lease expense was \$4 million, \$3 million, and \$2 million for the years ended December 31, 2020, 2019 and 2018, respectively.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 16. Commitments and Contingencies - (continued)

The following table presents our future lease commitments at December 31, 2020.

Table 16.1 – Future Lease Commitments by Year

(In Thousands)	December 31, 2020
2021	\$ 3,469
2022	3,301
2023	2,813
2024	2,231
2025	1,983
2026 and thereafter	6,128
Total Lease Commitments	19,925
Less: Imputed interest	(3,238)
Operating Lease Liabilities	\$ 16,687

Leasehold improvements for our offices are amortized into expense over the lease term. There were \$3 million of unamortized leasehold improvements at December 31, 2020. For the years ended December 31, 2020, 2019, and 2018, we recognized \$0.5 million, \$0.4 million, and \$0.2 million of leasehold amortization expense, respectively.

During the year ended December 31, 2020, we entered into four office leases and determined that each of these leases qualified as operating leases. At December 31, 2020, our operating lease liabilities were \$17 million, which were a component of Accrued expenses and other liabilities, and our operating lease right-of-use assets were \$15 million, which were a component of Other assets.

We determined that none of our leases contained an implicit interest rate and used a discount rate equal to our incremental borrowing rate on a collateralized basis to determine the present value of our total lease payments. As such, we determined the applicable discount rate for each of our leases using a swap rate plus an applicable spread for borrowing arrangements secured by our real estate loans and securities for a length of time equal to the remaining lease term on the date of adoption. At December 31, 2020, the weighted-average remaining lease term and weighted-average discount rate for our leases was 7 years and 4.9%, respectively.

Commitment to Fund Bridge Loans

As of December 31, 2020, we had commitments to fund up to \$216 million of additional advances on existing bridge loans. These commitments are generally subject to loan agreements with covenants regarding the financial performance of the customer and other terms regarding advances that must be met before we fund the commitment. At December 31, 2020, we recorded a \$2 million contingent liability related to these commitments to fund construction advances. We may also advance funds related to loans sold under a separate loan sale agreement that are generally repaid immediately by the loan purchaser and do not generally expose us to loss. The outstanding commitments related to these loans that we may temporarily fund totaled approximately \$8 million at December 31, 2020.

Commitment to Fund Partnerships

In the fourth quarter of 2018, we invested in two partnerships created to acquire and manage certain mortgage servicing related assets (see *Note 10* for additional detail). In connection with this investment, we are required to fund future net servicer advances related to the underlying mortgage loans. The actual amount of net servicer advances we may fund in the future is subject to significant uncertainty and will be based on the credit and prepayment performance of the underlying loans.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 16. Commitments and Contingencies - (continued)

5 Arches Contingent Consideration

As part of the consideration for our acquisition of 5 Arches, we were committed to make earn-out payments up to \$29 million, payable in a mix of cash and Redwood common stock. These contingent earn-out payments were classified as a contingent consideration liability and carried at fair value prior to March 31, 2020. During the first quarter of 2020, we made a cash payment of \$11 million and granted \$3 million of Redwood common stock in connection with the first anniversary of the purchase date. Additionally, as a result of an amendment to the agreement, we reclassified the contingent liability to a deferred liability, as the remaining payments became payable on a set timetable without any remaining contingencies. At December 31, 2020, the balance of this liability was \$15 million, which will be paid in a mix of cash and common stock in March 2021.

Loss Contingencies — Risk-Sharing

During 2015 and 2016, we sold conforming loans to the Agencies with an original unpaid principal balance of \$3.19 billion, subject to our risk-sharing arrangements with the Agencies. At December 31, 2020, the maximum potential amount of future payments we could be required to make under these arrangements was \$44 million and this amount was fully collateralized by assets we transferred to pledged accounts and is presented as pledged collateral in Other assets on our consolidated balance sheets. We have no recourse to any third parties that would allow us to recover any amounts related to our obligations under the arrangements. At December 31, 2020, we had not incurred any losses under these arrangements. For the years ended December 31, 2020, 2019, and 2018, other income related to these arrangements was \$4 million for each of these periods, and was included in Other income on our consolidated statements of income. For the years ended December 31, 2020, 2019, and 2018, we recorded net market valuation losses related to these arrangements of \$1 million, \$0.2 million, and \$0.4 million, respectively, through Investment fair value changes, net, on our consolidated statements of income.

All of the loans in the reference pools subject to these risk-sharing arrangements were originated in 2014 and 2015, and at December 31, 2020, the loans had an unpaid principal balance of \$938 million and a weighted average FICO score of 757 (at origination) and LTV ratio of 75% (at origination). At December 31, 2020, \$39 million of the loans were 90 days or more delinquent, of which one of these loans with an unpaid principal balance of \$0.2 million was in foreclosure. At December 31, 2020, the carrying value of our guarantee obligation was \$10 million and included \$5 million designated as a non-amortizing credit reserve, which we believe is sufficient to cover current expected losses under these obligations.

Our consolidated balance sheets include assets of special purpose entities ("SPEs") associated with these risk-sharing arrangements (i.e., the "pledged collateral" referred to above) that can only be used to settle obligations of these SPEs for which the creditors of these SPEs (the Agencies) do not have recourse to Redwood Trust, Inc. or its affiliates. At December 31, 2020 and December 31, 2019, assets of such SPEs totaled \$46 million and \$48 million, respectively, and liabilities of such SPEs totaled \$10 million and \$14 million, respectively.

Loss Contingencies — Residential Repurchase Reserve

We maintain a repurchase reserve for potential obligations arising from representation and warranty violations related to residential loans we have sold to securitization trusts or third parties and for conforming residential loans associated with MSR that we have purchased from third parties. We do not originate residential loans and we 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. Additionally, for certain loans we sold during the second quarter of 2020 that were previously held for investment, we have a direct obligation to repurchase these loans in the event of any early payment defaults (or EPDs) by the underlying mortgage borrowers within certain specified periods following the sales.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 16. Commitments and Contingencies - (continued)

At December 31, 2020 and December 31, 2019, our repurchase reserve associated with our residential loans and MSR's was \$9 million and \$4 million, respectively, and was recorded in Accrued expenses and other liabilities on our consolidated balance sheets. We received 10 and 15 repurchase requests during the years ended December 31, 2020 and 2019, respectively. During the years ended December 31, 2020, 2019, and 2018, we repurchased one loan, zero loans, and two loans, respectively. During the years ended December 31, 2020, 2019, and 2018, we recorded repurchase provisions of \$4 million and reversals of repurchase provisions of \$0.1 million and \$0.7 million, respectively, that were recorded in Mortgage banking activities, net and Other income on our consolidated statements of income and had charge-offs of \$0.1 million, zero, and zero, respectively.

Loss Contingencies — Litigation, Claims and Demands

There is no significant update regarding the litigation matters described in Note 16 within the financial statements included in Redwood's Annual Report on Form 10-K for the year ended December 31, 2019 under the heading "Loss Contingencies - Litigation." At December 31, 2020, the aggregate amount of loss contingency reserves established in respect of the FHLB-Seattle and Schwab litigation matters described in our Annual Report on Form 10-K for the year ended December 31, 2019 was \$2 million.

From time to time and in the ordinary course of business, we may submit or receive demand letters to or from counterparties relating to breaches of representations and warranties, be named in lawsuits brought by mortgage borrowers relating to foreclosure proceedings initiated by the servicers of the related mortgage loans or seeking to establish that their mortgage notes and/or mortgages are unenforceable as a matter of law due to defects in the transfer and assignment of those notes and mortgages, or be named in lawsuits brought by mortgage borrowers seeking remedies against the originator of the mortgage for fraud or defects in the originator's origination process, including defects in the disclosure of mortgage terms at the time of origination (in these cases we may be named in connection with the origination of the loan, in the case of business purpose loans we originate, or on a theory of assignee liability in the case of residential loans we acquire). Additionally, following our recent acquisitions of the 5 Arches and CoreVest business purpose loan origination platforms, there are litigation matters that relate to these two platforms that represent a level of litigation activity that we believe is generally consistent with the ordinary course of business of a loan originator, which has not been associated with Redwood historically.

In addition to those matters, as previously disclosed, in connection with the impact of the effects of the pandemic on the non-Agency mortgage finance market and on our business and operations, a number of the counterparties that have regularly sold residential mortgage loans to us believe that we breached perceived obligations to them, and requested or demanded that we purchase loans from them and/or compensate them for perceived damages resulting from our decisions earlier in 2020 not to purchase certain loans from them ("Residential Loan Seller Demands"). We believe that these Residential Loan Seller Demands are without merit or subject to defenses and we intend to defend vigorously any such allegations and any related demand or claim to which we are or become a party. Despite our beliefs about the legal merits of these allegations, because our ordinary course of business is to seek to continue to regularly engage in mutually beneficial transactions with these counterparties, in some cases we have been willing to engage in discussions with these counterparties with the intention of reaching resolution, including through structuring arrangements that incentivize both the counterparty and us to continue to engage in residential loan purchase and sale transactions in the future.

With respect to certain of the Residential Loan Seller Demands, these resolution discussions have been successful in resolving, or establishing a framework that we believe will be the basis for successfully resolving, the demands of these counterparties, including through forward-looking joint business undertakings and structured arrangements that incentivize both the counterparty and us to continue to engage in residential loan purchase and sale transactions in the future. With respect to these counterparties, we have incurred or expect to incur certain costs in connection with finalizing these arrangements (including costs that are contingent on the successful completion of future residential loan purchase and sale transactions with these counterparties) and have recorded any such actual costs incurred through December 31, 2020, as well as an accrual for the estimated costs associated with counterparties where a resolution or go-forward framework has been agreed to or has been discussed but not finalized, a portion of which was recorded through Other expense and a portion of which was recorded through Mortgage banking activities, net on our consolidated income statement. In accordance with GAAP, the accrual for estimated costs is based on the opinion of management, that it is probable that these resolutions and forward-looking joint business undertakings and structured arrangements will result in an expense and the amount of expense can be reasonably estimated. In addition, as previously disclosed, one such counterparty filed a breach of contract lawsuit against us in May 2020 alleging that it had suffered in excess of \$2 million of losses as a result of our alleged failure to

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 16. Commitments and Contingencies - (continued)

purchase residential mortgage loans from it; and in October 2020 we and the plaintiff agreed to settle the lawsuit on mutually satisfactory terms.

During the year ended December 31, 2020, we recorded \$10 million of expenses in association with Residential Loan Seller Demands. At December 31, 2020, the aggregate amount of our accrual for estimated costs associated with Residential Loan Seller Demands was \$2.5 million, a portion of which would be contingent on the successful completion of future residential loan purchase and sale transactions with certain counterparties. We believe we have either resolved or adequately accrued for any unresolved Residential Loan Seller Demands and that there are no other Residential Loan Seller Demands that are reasonably possible to result in a material loss.

Future developments (including receipt of additional information and documents relating to these matters, new or additional resolution or settlement communications relating to these matters, resolutions of similar claims against other industry participants in similar circumstances, or receipt of additional Residential Loan Seller Demands) could result in our concluding in the future to establish additional accruals or reserves or disclose a range of reasonably possible losses with respect to these Residential Loan Seller Demand matters. Our actual losses, and any accruals or reserves we may establish in the future relating to these matters, may be materially higher than the accruals and reserves we have noted above, including in the event that any of these matters proceed to trial and result in a judgment against us. We cannot be certain that any of these matters that are not already formally resolved will be resolved through a resolution or settlement and we cannot be certain that the resolution of these matters, whether through litigation, settlement, or otherwise, will not have a material adverse effect on our financial condition or results of operations in any future period.

In accordance with GAAP, we review the need for any loss contingency reserves and establish reserves when, in the opinion of management, it is probable that a matter would result in a liability and the amount of loss, if any, can be reasonably estimated. Additionally, we record receivables for insurance recoveries relating to litigation-related losses and expenses if and when such amounts are covered by insurance and recovery of such losses or expenses are due. We review our litigation matters each quarter to assess these loss contingency reserves and make adjustments in these reserves, upwards or downwards, as appropriate, in accordance with GAAP based on our review.

In the ordinary course of any litigation matter, including certain of the above-referenced matters, we have engaged and may continue to engage in formal or informal settlement communications with the plaintiffs or co-defendants. Settlement communications we have engaged in relating to certain of the above-referenced litigation matters are one of the factors that have resulted in our determination to establish the loss contingency reserves described above. We cannot be certain that any of these matters will be resolved through a settlement prior to litigation and we cannot be certain that the resolution of these matters, whether through trial or settlement, will not have a material adverse effect on our financial condition or results of operations in any future period.

Future developments (including resolution of substantive pre-trial motions relating to these matters, receipt of additional information and documents relating to these matters (such as through pre-trial discovery), new or additional settlement communications with plaintiffs relating to these matters, or resolutions of similar claims against other defendants in these matters) could result in our concluding in the future to establish additional loss contingency reserves or to disclose an estimate of reasonably possible losses in excess of our established reserves with respect to these matters. Our actual losses with respect to the above referenced litigation matters may be materially higher than the aggregate amount of loss contingency reserves we have established in respect of these litigation matters, including in the event that any of these matters proceeds to trial and the plaintiff prevails. Other factors that could result in our concluding to establish additional loss contingency reserves or estimate additional reasonably possible losses, or could result in our actual losses with respect to the above-referenced litigation matters being materially higher than the aggregate amount of loss contingency reserves we have established in respect of these litigation matters include that: there are significant factual and legal issues to be resolved; information obtained or rulings made during the lawsuits could affect the methodology for calculation of the available remedies; and we may have additional obligations pursuant to indemnity agreements, representations and warranties, and other contractual provisions with other parties relating to these litigation matters that could increase our potential losses.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 17. Equity

The following table provides a summary of changes to accumulated other comprehensive income by component for the years ended December 31, 2020 and 2019. During the year ended December 31, 2020, we recognized net unrealized losses of \$2 million on our Level 3 AFS securities which we owned as of December 31, 2020.

Table 17.1 – Changes in Accumulated Other Comprehensive Income (Loss) by Component

	Years Ended December 31,			
	2020		2019	
(In Thousands)	Net Unrealized Gains on Available-for-Sale Securities	Net Unrealized Losses on Interest Rate Agreements Accounted for as Cash Flow Hedges	Net Unrealized Gains on Available-for-Sale Securities	Net Unrealized Losses on Interest Rate Agreements Accounted for as Cash Flow Hedges
Balance at beginning of period	\$ 92,452	\$ (50,939)	\$ 95,342	\$ (34,045)
Other comprehensive (loss) income before reclassifications	(3,951)	(32,806)	17,077	(16,894)
Amounts reclassified from other accumulated comprehensive (loss) income	(12,165)	3,188	(19,967)	—
Net current-period other comprehensive loss	(16,116)	(29,618)	(2,890)	(16,894)
Balance at End of Period	\$ 76,336	\$ (80,557)	\$ 92,452	\$ (50,939)

The following table provides a summary of reclassifications out of accumulated other comprehensive income for the years ended December 31, 2020 and 2019.

Table 17.2 – Reclassifications Out of Accumulated Other Comprehensive Income (Loss)

(In Thousands)	Affected Line Item in the Income Statement	Amount Reclassified From Accumulated Other Comprehensive Income	
		Year Ended December 31, 2020	2019
Net Realized (Gain) Loss on AFS Securities			
Credit loss expense on AFS securities	Investment fair value changes, net	\$ 388	\$ —
Gain on sale of AFS securities	Realized gains, net	(12,553)	(19,967)
		<u>\$ (12,165)</u>	<u>\$ (19,967)</u>
Net Realized Loss on Interest Rate Agreements Designated as Cash Flow Hedges			
Amortization of deferred loss	Interest expense	\$ 3,188	\$ —
		<u>\$ 3,188</u>	<u>\$ —</u>

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 17. Equity - (continued)

Issuance of Common Stock

In 2018, we established a program to sell up to an aggregate of \$150 million of common stock from time to time in at-the-market ("ATM") offerings. In March 2020, we increased the maximum aggregate amount of common stock offered under the ATM program to \$175 million. During the year ended December 31, 2020, we issued 129,500 common shares for net proceeds of approximately \$2 million through ATM offerings. During the year ended December 31, 2019, we issued 2,259,758 common shares for net proceeds of approximately \$36 million through ATM offerings. At December 31, 2020, approximately \$110 million remained outstanding for future offerings under this program.

Direct Stock Purchase and Dividend Reinvestment Plan

During the year ended December 31, 2020, we did not issue any shares of common stock through our Direct Stock Purchase and Dividend Reinvestment Plan. During the year ended December 31, 2019, we issued 399,838 shares of common stock through our Direct Stock Purchase and Dividend Reinvestment Plan, resulting in net proceeds of approximately \$6 million.

Earnings per Common Share

The following table provides the basic and diluted earnings per common share computations for the years ended December 31, 2020, 2019, and 2018.

Table 17.3 – Basic and Diluted Earnings per Common Share

(In Thousands, except Share Data)	Years Ended December 31,		
	2020	2019	2018
Basic (Loss) Earnings per Common Share:			
Net (loss) income attributable to Redwood	\$ (581,847)	\$ 169,183	\$ 119,600
Less: Dividends and undistributed earnings allocated to participating securities	(1,990)	(4,797)	(3,754)
Net (loss) income allocated to common shareholders	<u>\$ (583,837)</u>	<u>\$ 164,386</u>	<u>\$ 115,846</u>
Basic weighted average common shares outstanding	113,935,605	101,120,744	78,724,912
Basic (Loss) Earnings per Common Share	\$ (5.12)	\$ 1.63	\$ 1.47
Diluted (Loss) Earnings per Common Share:			
Net (loss) income attributable to Redwood	\$ (581,847)	\$ 169,183	\$ 119,600
Less: Dividends and undistributed earnings allocated to participating securities	(1,990)	(5,273)	(4,283)
Adjust for interest expense and gain on extinguishment of convertible notes for the period, net of tax	—	36,212	32,653
Net (loss) income allocated to common shareholders	<u>\$ (583,837)</u>	<u>\$ 200,122</u>	<u>\$ 147,970</u>
Weighted average common shares outstanding	113,935,605	101,147,225	78,724,912
Net effect of dilutive equity awards	—	251,100	189,120
Net effect of assumed convertible notes conversion to common shares	—	35,382,269	31,113,738
Diluted weighted average common shares outstanding	<u>113,935,605</u>	<u>136,780,594</u>	<u>110,027,770</u>
Diluted (Loss) Earnings per Common Share	\$ (5.12)	\$ 1.46	\$ 1.34

We included participating securities, which are certain equity awards that have non-forfeitable dividend participation rights, in the calculations of basic and diluted earnings per common share as we determined that the two-class method was more dilutive than the alternative treasury stock method for these shares. Dividends and undistributed earnings allocated to participating securities under the basic and diluted earnings per share calculations require specific shares to be included that may differ in certain circumstances.

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Note 17. Equity - (continued)

During the years ended December 31, 2019 and 2018, certain of our convertible notes were determined to be dilutive and were included in the calculation of diluted EPS under the "if-converted" method. Under this method, the periodic interest expense (net of applicable taxes) for dilutive notes is added back to the numerator and the weighted average number of shares that the notes are entitled to (if converted, regardless of whether they are in or out of the money) are included in the denominator.

For the year ended December 31, 2020, 31,306,089 of common shares related to the assumed conversion of our convertible notes were antidilutive and were excluded in the calculation of diluted earnings per share.

For the years ended December 31, 2020, 2019, and 2018, the number of outstanding equity awards that were antidilutive totaled 12,622, 10,051, and 7,230, respectively.

Stock Repurchases

In February 2018, our Board of Directors approved an authorization for the repurchase of our common stock, increasing the total amount authorized for repurchases of common stock to \$100 million, and also authorized the repurchase of outstanding debt securities, including convertible and exchangeable debt. This authorization increased the previous share repurchase authorization approved in February 2016 and has no expiration date. This repurchase authorization does not obligate us to acquire any specific number of shares or securities. Under this authorization, shares or securities may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended. During the year ended December 31, 2020, we repurchased 3,047,335 shares of our common stock pursuant to this authorization for \$22 million. At December 31, 2020, \$78 million of the current authorization remained available for the repurchase of shares of our common stock and we also continued to be authorized to repurchase outstanding debt securities.

Note 18. Equity Compensation Plans

During 2020, Redwood shareholders approved for grant an additional 5 million shares of common stock under our Incentive Plan. At December 31, 2020 and December 31, 2019, 7,957,891 and 3,637,480 shares of common stock, respectively, were available for grant under our Incentive Plan. The unamortized compensation cost of awards issued under the Incentive Plan which are settled by delivery of shares of common stock and purchases under the Employee Stock Purchase Plan totaled \$28 million at December 31, 2020, as shown in the following table.

Table 18.1 – Activities of Equity Compensation Costs by Award Type

(In Thousands)	Year Ended December 31, 2020					
	Restricted Stock Awards	Restricted Stock Units	Deferred Stock Units	Performance Stock Units	Employee Stock Purchase Plan	Total
Unrecognized compensation cost at beginning of period	\$ 1,990	\$ 3,534	\$ 17,858	\$ 8,946	\$ —	\$ 32,328
Equity grants	—	3,465	12,261	4,937	137	20,800
Performance-based valuation adjustment	—	—	—	(7,352)	—	(7,352)
Equity grant forfeitures	(531)	(2,163)	(4,733)	(648)	—	(8,075)
Equity compensation expense	(895)	(1,296)	(7,620)	(89)	(137)	(10,037)
Unrecognized Compensation Cost at End of Period	\$ 564	\$ 3,540	\$ 17,766	\$ 5,794	\$ —	\$ 27,664

At December 31, 2020, the weighted average amortization period remaining for all of our equity awards was one year.

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Note 18. Equity Compensation Plans - (continued)

Restricted Stock Awards ("RSAs")

The following table summarizes the activities related to RSAs for the years ended December 31, 2020, 2019, and 2018.

Table 18.2 – Restricted Stock Awards Activities

	Years Ended December 31,					
	2020		2019		2018	
	Shares	Weighted Average Grant Date Fair Market Value	Shares	Weighted Average Grant Date Fair Market Value	Shares	Weighted Average Grant Date Fair Market Value
Outstanding at beginning of period	216,470	\$ 14.85	334,606	\$ 14.92	257,507	\$ 15.23
Granted	—	—	—	—	168,537	14.71
Vested	(102,615)	14.44	(118,136)	15.05	(83,968)	15.46
Forfeited	(34,857)	15.16	—	—	(7,470)	15.05
Outstanding at End of Period	78,998	\$ 15.23	216,470	\$ 14.85	334,606	\$ 14.92

The expenses recorded for RSAs were \$1 million, \$2 million, and \$2 million for the years ended December 31, 2020, 2019 and 2018, respectively. As of December 31, 2020, there was \$1 million of unrecognized compensation cost related to unvested RSAs. This cost will be recognized over a weighted average period of less than one year. Restrictions on shares of RSAs outstanding lapse through 2022.

Restricted Stock Units ("RSUs")

The following table summarizes the activities related to RSUs for the years ended December 31, 2020, 2019, and 2018.

Table 18.3 – Restricted Stock Units Activities

	Years Ended December 31,					
	2020		2019		2018	
	Shares	Weighted Average Grant Date Fair Market Value	Shares	Weighted Average Grant Date Fair Market Value	Shares	Weighted Average Grant Date Fair Market Value
Outstanding at beginning of period	275,173	\$ 15.65	4,876	\$ 15.38	—	\$ —
Granted	205,482	16.86	270,297	15.66	4,876	15.38
Vested	(68,076)	15.65	—	—	—	—
Forfeited	(130,155)	16.60	—	—	—	—
Outstanding at End of Period	282,424	\$ 16.09	275,173	\$ 15.65	4,876	\$ 15.38

The expenses recorded for RSUs were \$1 million, \$1 million, and less than \$0.1 million for the years ended December 31, 2020, 2019 and 2018, respectively. As of December 31, 2020, there was \$4 million of unrecognized compensation cost related to unvested RSUs. This cost will be recognized over a weighted average period of less than two years. Restrictions on shares of RSUs outstanding lapse through 2024.

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Note 18. Equity Compensation Plans - (continued)

Deferred Stock Units (“DSUs”)

The following table summarizes the activities related to DSUs for the years ended December 31, 2020, 2019, and 2018.

Table 18.4 – Deferred Stock Units Activities

	Years Ended December 31,					
	2020		2019		2018	
	Units	Weighted Average Grant Date Fair Market Value	Units	Weighted Average Grant Date Fair Market Value	Units	Weighted Average Grant Date Fair Market Value
Outstanding at beginning of period	2,630,805	\$ 15.66	2,336,720	\$ 15.58	1,878,491	\$ 15.92
Granted	1,186,154	10.69	733,096	16.06	670,254	15.53
Distributions	(720,562)	14.31	(419,113)	15.96	(212,025)	18.37
Forfeitures	(291,253)	16.25	(19,898)	15.96	—	—
Balance at End of Period	2,805,144	\$ 13.84	2,630,805	\$ 15.66	2,336,720	\$ 15.58

We generally grant DSUs annually, as part of our compensation process. In addition, DSUs are granted from time to time in connection with hiring and promotions and in lieu of the payment in cash of a portion of annual bonus earned. DSUs vest over the course of a four-year vesting period, and are distributed after the end of the final vesting period or after an employee is terminated. At December 31, 2020 and 2019, the number of outstanding DSUs that were unvested was 1,599,019 and 1,344,743, respectively. The weighted average grant-date fair value of these unvested DSUs was \$13.30 and \$15.76 at December 31, 2020 and 2019, respectively. Unvested DSUs at December 31, 2020 will vest through 2024.

Expenses related to DSUs were \$8 million for each of the years ended December 31, 2020, 2019, and 2018. At December 31, 2020, there was \$18 million of unrecognized compensation cost related to unvested DSUs. This cost will be recognized over a weighted average period of less than two years. At December 31, 2020 and 2019, the number of outstanding DSUs that had vested was 1,206,125 and 1,286,063, respectively.

Performance Stock Units (“PSUs”)

At December 31, 2020 and December 31, 2019, the target number of PSUs that were unvested was 978,735 and 839,070, respectively. During 2020, 2019, and 2018, 473,845, 307,938, and 258,078 target number of PSUs were granted, respectively, with per unit grant date fair values of \$10.42, \$17.13, and \$17.05, respectively. During the year ended December 31, 2020, 99,175 PSUs were forfeited due to employee departures. During the years ended December 31, 2019 and 2018, there were no PSUs forfeited.

With respect to 473,845, 275,831, and 206,034 target number of PSUs granted in December 2020, December 2019, and December 2018, respectively, and still outstanding at December 31, 2020, the number of underlying shares of common stock that vest and that the recipient becomes entitled to receive at the time of vesting will generally range from 0% to 250% of the target number of PSUs granted, with the target number of PSUs granted being adjusted to reflect the value of any dividends declared on our common stock during the vesting period. Vesting of these PSUs will generally occur as of January 1, 2024 for the December 2020 awards, January 1, 2023 for the December 2019 awards, and as of January 1, 2022 for the December 2018 awards. Vesting is based on a three-step process as described below.

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Note 18. Equity Compensation Plans - (continued)

With respect to the December 2020 PSU awards:

- Target PSUs are divided into three equal tranches. Baseline vesting for each tranche would range from 0% - 200% of the Target PSUs in such tranche based on the level of the Company's book value total shareholder return ("bvTSR") attained over a corresponding calendar year measurement period within the three-year vesting period, with 100% of the Target PSUs in each tranche vesting if one-year bvTSR for such tranche is 7.7%.
- Second, at the end of the three-year vesting period, the aggregate vesting level of the three tranches, or total baseline vesting, would then be adjusted to increase or decrease by up to 50 percentage points based on the Company's three-year relative total stockholder return ("rTSR") against a comparator group of companies measured over the three-year vesting period, with median rTSR performance correlating to no adjustment from the total baseline level of vesting.
- Third, if the aggregate vesting level after steps one and two is greater than 100% of the Target PSUs, but the Company's absolute total shareholder return ("TSR") is negative over the three-year performance period, vesting would be capped at 100% of Target PSUs.

With respect to the December 2019 and December 2018 PSU awards:

- First, baseline vesting would range from 0% - 200% of the target number of PSUs granted based on the level of bvTSR attained over the three-year vesting period, with 100% of the target number of PSUs vesting if three-year bvTSR is 25%. Book Value TSR is defined as the percentage by which our book value "per share price" has increased or decreased as of the last day of the three-year vesting period relative to the first day of such vesting period, adjusted to reflect the reinvestment of all dividends declared and/or paid on our common stock, compared to the bvTSR goal for the performance period.
- Second, the vesting level would then be adjusted to increase or decrease by up to an additional 50 percentage points based on Redwood's rTSR against a comparator group of companies measured over the three-year vesting period, with median rTSR performance correlating to no adjustment from the baseline level of vesting.
- Third, if the vesting level after steps one and two is greater than 100% of the target number of PSUs, but absolute TSR is negative over the three-year performance period, vesting would be capped at 100% of target number of PSUs. TSR is defined as the percentage by which our common stock "per share price" has increased or decreased as of the last day of the three-year vesting period relative to the first day of such vesting period, adjusted to reflect the reinvestment of all dividends declared and/or paid on our common stock ("Three-Year TSR").

The grant date fair value of the December 2020 PSUs of \$10.42 was determined through Monte-Carlo simulations using the following assumptions: the common stock closing price at the grant date for Redwood and each member of the comparator group, the average closing price of the common stock price for the 60 trading days beginning January 1, 2021 for Redwood and each member of the comparator group, and the range of performance-based vesting based on absolute TSR over three years from the grant date. For the 2020 PSU grant, an implied volatility assumption of 54% (based on historical volatility), a risk-free rate of 0.18% (the three-year Treasury rate on the grant date), and a 0% dividend yield (the mathematical equivalent to reinvesting the dividends over the three-year performance period as is consistent with the terms of the PSUs) were used.

The grant date fair value of the December 2019 PSUs of \$17.13 was determined through Monte-Carlo simulations using the following assumptions: the common stock closing price at the grant date for Redwood and each member of the comparator group, the average closing price of the common stock price for the 60 trading days prior to the grant date for Redwood and each member of the comparator group, and the range of performance-based vesting based on Absolute TSR over three years from the grant date. For the 2019 PSU grant, an implied volatility assumption of 15% (based on historical volatility), a risk-free rate of 1.68% (the three-year Treasury rate on the grant date), and a 0% dividend yield (the mathematical equivalent to reinvesting the dividends over the three-year performance period as is consistent with the terms of the PSUs) were used.

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Note 18. Equity Compensation Plans - (continued)

The grant date fair value of the December 2018 PSUs of \$17.23 was determined through Monte-Carlo simulations using the following assumptions: the common stock closing price at the grant date for Redwood and each member of the comparator group, the average closing price of the common stock price for the 60 trading days prior to the grant date for Redwood and each member of the comparator group, and the range of performance-based vesting based on Absolute TSR over three years from the grant date. For the 2018 PSU grant, an implied volatility assumption of 22% (based on historical volatility), a risk-free rate of 2.78% (the three-year Treasury rate on the grant date), and a 0% dividend yield (the mathematical equivalent to reinvesting the dividends over the three-year performance period as is consistent with the terms of the PSUs) were used.

In May 2018, 23,025 target number of PSUs with a per unit grant date fair value of \$15.20 were granted to two executives in connection with their promotions. The grant date fair values of these PSUs were determined through Monte-Carlo simulations using the following assumptions: our common stock closing price at the grant date, the average closing price of our common stock price for the 60 trading days prior to the grant date and the range of performance-based vesting based on Three-Year TSR and the performance-based vesting formula described below with respect to PSUs granted in December 2017. For this PSU grant, an implied volatility assumption of 27% (based on historical volatility), a risk-free rate of 2.71% (the three-year Treasury rate on the grant date), and a 0% dividend yield (the mathematical equivalent to reinvesting the dividends over the three-year performance period as is consistent with the terms of the PSUs) were used.

With respect to the PSUs granted in May 2018, vesting will generally occur at the end of three years from their grant date, with the level of vesting at that time contingent on the Three-Year TSR. The number of underlying shares of our common stock that will vest in future years will vary between 0% (if Three-Year TSR is zero or negative) and 200% (if Three-Year TSR is greater than or equal to 125%) of the target number of PSUs originally granted, adjusted upward (if vesting is greater than 0%) to reflect the value of dividends paid during the three-year vesting period.

With respect to PSUs granted in 2017, the three-year performance period ended during the fourth quarter of 2020, resulting in the vesting of no shares of our common stock. With respect to the PSUs granted in 2016, the three-year performance period ended during the fourth quarter of 2019, resulting in the vesting of 222,769 shares of our common stock. With respect to the PSUs granted in 2015, the three-year performance period ended during the fourth quarter of 2018, resulting in the vesting of 387,937 shares of our common stock.

Expenses related to PSUs were \$0.1 million for the year ended December 31, 2020, and \$3 million for each of the years ended December 31, 2019, and 2018. As of December 31, 2020, there was \$6 million of unrecognized compensation cost related to unvested PSUs. During 2020, for PSUs granted in 2018 and 2019, we adjusted our vesting estimate to assume that none of these awards will meet the minimum performance thresholds for vesting. This adjustment resulted in a reversal of \$1 million of stock-based compensation expense that had been recorded prior to 2020.

Employee Stock Purchase Plan ("ESPP")

The ESPP allows a maximum of 600,000 shares of common stock to be purchased in aggregate for all employees. As of December 31, 2020, 489,886 shares had been purchased, respectively, and there remained a negligible amount of uninvested employee contributions in the ESPP at December 31, 2020.

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Note 18. Equity Compensation Plans - (continued)

The following table summarizes the activities related to the ESPP for the years ended December 31, 2020, 2019, and 2018.

Table 18.5 – Employee Stock Purchase Plan Activities

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Balance at beginning of period	\$ 4	\$ 6	\$ 4
Employee purchases	347	524	375
Cost of common stock issued	(334)	(526)	(373)
Balance at End of Period	\$ 17	\$ 4	\$ 6

Executive Deferred Compensation Plan

The following table summarizes the cash account activities related to the EDCP for the years ended December 31, 2020, 2019, and 2018.

Table 18.6 – EDCP Cash Accounts Activities

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Balance at beginning of period	\$ 2,454	\$ 2,484	\$ 2,171
New deferrals	726	789	759
Accrued interest	42	68	82
Withdrawals	(933)	(887)	(528)
Balance at End of Period	\$ 2,289	\$ 2,454	\$ 2,484

In 2018, our Board of Directors approved an amendment to the EDCP to increase by 200,000 shares the shares available to allow non-employee directors to defer certain cash payments and dividends into DSUs. At December 31, 2020, there were 99,281 shares available for grant under this plan.

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Note 19. Mortgage Banking Activities

The following table presents the components of Mortgage banking activities, net, recorded in our consolidated statements of income for the years ended December 31, 2020, 2019, and 2018.

Table 19.1 – Mortgage Banking Activities

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Residential Mortgage Banking Activities, Net			
Changes in fair value of:			
Residential loans, at fair value ⁽¹⁾	\$ 41,284	\$ 63,527	\$ 21,808
Trading securities ⁽²⁾	(4,535)	—	—
Risk management derivatives ⁽³⁾	(26,376)	(17,519)	35,248
Other income (expense), net ⁽⁴⁾	(6,652)	1,735	2,567
Total residential mortgage banking activities, net	3,721	47,743	59,623
Business Purpose Mortgage Banking Activities, Net			
Changes in fair value of:			
Single-family rental loans, at fair value ⁽¹⁾	82,510	17,004	453
Risk management derivatives ⁽³⁾	(21,403)	1,796	(510)
Bridge loans, at fair value	(4,998)	4,518	—
Other income, net ⁽⁵⁾	18,642	16,205	—
Total business purpose mortgage banking activities, net	74,751	39,523	(57)
Mortgage Banking Activities, Net	\$ 78,472	\$ 87,266	\$ 59,566

- (1) For residential loans, includes changes in fair value for associated loan purchase and forward sale commitments. For single-family rental loans, includes changes in fair value for associated interest rate lock commitments.
- (2) Represents fair value changes on trading securities that are being used along with risk management derivatives as hedges to manage the mark-to-market risks associated with our residential mortgage banking operations.
- (3) Represents market valuation changes of derivatives that were used to manage risks associated with our mortgage banking operations.
- (4) Amounts in this line item include other fee income from loan acquisitions, provisions for repurchase expense, and expenses related to resolving residential loan seller demands, presented net.
- (5) Amounts in this line item include other fee income from loan originations.

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Note 20. Other Income

The following table presents the components of Other income recorded in our consolidated statements of income for the years ended December 31, 2020, 2019 and 2018.

Table 20.1 – Other Income

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
MSR (loss) income, net	\$ (9,694)	\$ 3,521	\$ 7,076
Risk share income	4,367	3,522	3,613
FHLBC capital stock dividend	1,229	2,169	1,763
Equity investment income	1,037	1,405	618
5 Arches loan administration fee income	2,912	4,400	—
Gain on re-measurement of investment in 5 Arches	—	2,441	—
Other	4,337	1,799	—
Other Income	\$ 4,188	\$ 19,257	\$ 13,070

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Note 21. General and Administrative Expenses, Loan Acquisition Costs, and Other Expenses

Components of our general and administrative expenses, loan acquisition costs, and other expenses for the years ended December 31, 2020, 2019 and 2018 are presented in the following table.

Table 21.1 – Components of General and Administrative Expenses, Loan Acquisition Costs, and Other Expenses

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
General and Administrative Expenses			
Fixed compensation expense	\$ 46,689	\$ 39,639	\$ 24,445
Annual variable compensation expense	14,116	21,728	14,589
Long-term incentive award expense ⁽¹⁾	12,439	13,402	12,388
Acquisition-related equity compensation expense ⁽²⁾	4,848	1,010	—
Systems and consulting	11,728	10,746	7,451
Office costs	7,794	6,310	4,705
Accounting and legal	7,928	5,450	5,529
Corporate costs	2,829	2,351	1,955
Other	6,833	8,101	4,236
Total General and Administrative Expenses	115,204	108,737	75,298
Loan Acquisition Costs			
Commissions	4,321	3,833	78
Underwriting costs	4,945	4,767	5,140
Transfer and holding costs	1,757	1,335	2,266
Total Loan Acquisition Costs	11,023	9,935	7,484
Other Expenses			
Goodwill impairment expense	88,675	—	—
Amortization of purchase-related intangible assets	15,925	8,696	177
Contingent consideration expense ⁽³⁾	249	3,218	—
Other	3,936	1,108	19
Total Other Expenses	108,785	13,022	196
Total General and Administrative Expenses, Loan Acquisition Costs, and Other Expenses	\$ 235,012	\$ 131,694	\$ 82,978

- (1) For the year ended December 31, 2020, long-term incentive award expense includes \$10 million of expense for awards settleable in shares of our common stock and \$2 million of expense for awards settleable in cash.
- (2) Acquisition-related equity compensation expense relates to 588,260 shares of restricted stock that were issued to members of CoreVest management as a component of the consideration paid to them for our purchase of their interests in CoreVest. The grant date fair value of these restricted stock awards was \$10 million, which will be recognized as compensation expense over the two-year vesting period on a straight-line basis in accordance with GAAP.
- (3) Contingent consideration expense relates to the acquisition of 5 Arches during 2019. Refer to *Note 2* for additional detail.

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Note 21. General and Administrative Expenses, Loan Acquisition Costs, and Other Expenses - (continued)

Cash-Based Retention Awards

During the three months ended September 30, 2020, \$8 million of cash-based retention awards were granted to certain executive and non-executive employees that will vest and be paid over the next three years, subject to continued employment through the vesting periods from 2021 through 2023. Additionally, during the three months ended September 30, 2020, Cash Performance Awards with an aggregate granted award value of \$2 million, were granted to certain executive and non-executive employees that will vest between 0% to 400% of granted award value based on a relative total stockholder return measure, and are contingent on continued employment over a three-year service period.

The value of the cash-based retention awards is being amortized into expense on a straight-line basis over each award's respective vesting period. The Cash Performance Awards are amortized on a straight-line basis over three years; however, they are remeasured at fair value each quarter-end and the cumulative straight-line expense is trued-up in respect to their updated value. For the year ended December 31, 2020, General and administrative expenses included \$5 million in aggregate related to the cash-based retention awards and the Cash Performance awards.

Cash-Settled Deferred Stock Units

In December 2020, \$2 million of cash-settled deferred stock units were granted to certain executive officers and non-executive employees that will vest over the next four years through 2024. These awards will be fully vested and payable in cash with a vested award value based on the closing market price of our common stock on December 15, 2024. These awards are classified as a liability in Accrued expenses and other liabilities on our consolidated balance sheets, and will be amortized over the vesting period on a straight-line basis, adjusted for changes in the value of our common stock at the end of each reporting period. For the year ended December 31, 2020, we recognized an expense of less than \$0.1 million in "Long-term incentive award expense," as presented in Table 21.1 above.

Note 22. Taxes

Components of our net deferred tax assets at December 31, 2020 and December 31, 2019 are presented in the following table.

Table 22.1 – Deferred Tax Assets (Liabilities)

(In Thousands)	December 31, 2020	December 31, 2019
Deferred Tax Assets		
Net operating loss carryforward – state	\$ 103,334	\$ 98,554
Net capital loss carryforward – state	23,487	—
Net operating loss carryforward – federal	82	82
Real estate assets	2,948	676
Allowances and accruals	3,324	1,930
Goodwill and intangible assets	23,231	2,739
Other	1,914	1,749
Tax effect of unrealized (gains) / losses - OCI	124	—
Total Deferred Tax Assets	158,444	105,730
Deferred Tax Liabilities		
Mortgage Servicing Rights	(2,458)	(13,783)
Interest rate agreements	(3,867)	(42)
Total Deferred Tax Liabilities	(6,325)	(13,825)
Valuation allowance	(151,248)	(97,057)
Total Deferred Tax Asset (Liability), net of Valuation Allowance	\$ 871	\$ (5,152)

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Note 22. Taxes (continued)

The deferred tax assets and liabilities reported above, with the exception of the state net operating loss ("NOL") and capital loss carryforwards, relate solely to our TRS. For state purposes, the REIT files a unitary combined return with its TRS. Because the REIT may have state taxable income apportioned to it from the activity of its TRS, we report the entire combined unitary state NOL and capital loss carryforwards as deferred tax assets, including the carryforwards allocated to the REIT.

Realization of our deferred tax assets ("DTAs") at December 31, 2020, is dependent on many factors, including generating sufficient taxable income prior to the expiration of NOL carryforwards and generating sufficient capital gains in future periods prior to the expiration of capital loss carryforwards. We determine the extent to which realization of the deferred assets is not assured and establish a valuation allowance accordingly.

As a result of GAAP losses at our TRS in 2020, we are reporting net federal ordinary and capital DTAs at December 31, 2020 and consequently a valuation allowance was recorded against our net federal ordinary DTAs. However, no valuation allowance was recorded against our net federal capital DTAs as we currently expect to utilize these DTAs due to our ability to recognize capital losses and carry them back to prior years. Consistent with prior periods, at December 31, 2020, we continued to maintain a valuation allowance against our net state DTAs as we remain uncertain about our ability to generate sufficient income in future periods needed to utilize net state DTAs beyond the reversal of our state DTLs.

As a result of GAAP income generated at our TRS in 2019, we reported net federal ordinary and capital deferred tax liabilities ("DTLs") at December 31, 2019 and consequently no valuation allowance was recorded against any federal DTA for this period.

Our 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. We assessed our tax positions for all open tax years (i.e., Federal, 2017 to 2020, and State, 2016 to 2020) and, at December 31, 2020 and December 31, 2019, concluded that we had no uncertain tax positions that resulted in material unrecognized tax benefits.

At December 31, 2020, our federal NOL carryforward at the REIT was \$36 million, of which \$28 million will expire in 2029 and \$7 million will carry forward indefinitely. In order to utilize NOLs at the REIT, taxable income must exceed dividend distributions. At December 31, 2020, our taxable REIT subsidiaries had \$0.8 million of federal NOLs, of which \$0.2 million will expire beginning in 2035 and \$0.6 million will carry forward indefinitely. Redwood and its taxable REIT subsidiaries accumulated an estimated state NOL of \$1.21 billion at December 31, 2020. These NOLs expire beginning in 2029. If certain substantial changes in the Company's ownership occur, there could be an annual limitation on the amount of the carryforwards that can be utilized.

The following table summarizes the provision for income taxes for the years ended December 31, 2020, 2019, and 2018.

Table 22.2 – Provision for Income Taxes

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Current Provision for Income Taxes			
Federal	\$ 1,598	\$ 12,036	\$ 11,387
State	(182)	897	820
Total Current Provision for Income Taxes	1,416	12,933	12,207
Deferred (Benefit) Provision for Income Taxes			
Federal	(6,024)	(3,976)	(1,419)
State	—	(1,517)	300
Total Deferred (Benefit) Provision for Income Taxes	(6,024)	(5,493)	(1,119)
Total (Benefit From) Provision for Income Taxes	\$ (4,608)	\$ 7,440	\$ 11,088

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 22. Taxes (continued)

The following is a reconciliation of the statutory federal and state tax rates to our effective tax rate at December 31, 2020, 2019, and 2018.

Table 22.3 – Reconciliation of Statutory Tax Rate to Effective Tax Rate

	December 31, 2020	December 31, 2019	December 31, 2018
Federal statutory rate	21.0 %	21.0 %	21.0 %
State statutory rate, net of Federal tax effect	8.6 %	8.6 %	8.6 %
Differences in taxable (loss) income from GAAP income	(19.6)%	(2.1)%	(1.7)%
Change in valuation allowance	(9.2)%	(2.2)%	1.9 %
Dividends paid deduction ⁽¹⁾	— %	(21.1)%	(21.3)%
Federal statutory rate change	— %	— %	— %
Effective Tax Rate	0.8 %	4.2 %	8.5 %

(1) The dividends paid deduction in the effective tax rate reconciliation is generally representative of the amount of distributions to shareholders that reduce REIT taxable income. For the year ended December 31, 2020, the dividends paid deduction is 0% due to our REIT incurring a taxable loss during the period; therefore, there was no REIT taxable income available to apply against the dividends paid.

We believe that we have met all requirements for qualification as a REIT for federal income tax purposes. Many requirements for qualification as a REIT are complex and require analysis of particular facts and circumstances. Often there is only limited judicial or administrative interpretive guidance and as such there can be no assurance that the Internal Revenue Service or courts would agree with our various tax positions. If we were to fail to meet all the requirements for qualification as a REIT and the requirements for statutory relief, we would be subject to federal corporate income tax on our taxable income and we would not be able to elect to be taxed as a REIT for four years thereafter. Such an outcome could have a material adverse impact on our consolidated financial statements.

Note 23. Segment Information

Redwood operates in three segments: Residential Lending, Business Purpose Lending, and Third-Party Investments. During 2020, we reorganized our segments and combined what was previously our Multifamily Investments segment and Third-Party Residential Investments into a new segment called Third-Party Investments, and began including convertible debt and trust-preferred interest expense in our Corporate/Other segment. We conformed the presentation of prior periods. The accounting policies of the reportable segments are the same as those described in *Note 3 — Summary of Significant Accounting Policies*. For a full description of our segments, see Item 1—*Business* in this Annual Report on Form 10-K.

Segment contribution represents the measure of profit that management uses to assess the performance of our business segments and make resource allocation and operating decisions. Certain corporate expenses not directly assigned or allocated to one of our three segments, as well as activity from certain consolidated Sequoia entities, are included in the Corporate/Other column as reconciling items to our consolidated financial statements. These unallocated corporate expenses primarily include interest expense and realized gains from the repurchase of our convertible notes and trust preferred securities, indirect general and administrative expenses and other expense.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 23. Segment Information (continued)

The following tables present financial information by segment for the years ended December 31, 2020, 2019, and 2018.

Table 23.1 – Business Segment Financial Information

(In Thousands)	Year Ended December 31, 2020				
	Residential Lending	Business Purpose Lending	Third-Party Investments	Corporate/ Other	Total
Interest income	\$ 150,906	\$ 218,890	\$ 192,984	\$ 9,136	\$ 571,916
Interest expense	(107,371)	(157,292)	(135,722)	(47,620)	(448,005)
Net interest income	43,535	61,598	57,262	(38,484)	123,911
Non-interest income					
Mortgage banking activities, net	3,721	74,751	—	—	78,472
Investment fair value changes, net	(153,388)	(81,042)	(352,004)	(2,004)	(588,438)
Other income, net	(4,642)	4,651	1,494	2,685	4,188
Realized gains, net	2,001	—	3,241	25,182	30,424
Total non-interest income, net	(152,308)	(1,640)	(347,269)	25,863	(475,354)
General and administrative expenses	(17,939)	(39,319)	(5,046)	(52,900)	(115,204)
Loan acquisition costs	(2,785)	(7,544)	(684)	(10)	(11,023)
Other expenses	(4,114)	(104,147)	194	(718)	(108,785)
Provision for income taxes	4,567	(4,063)	4,104	—	4,608
Segment Contribution	\$ (129,044)	\$ (95,115)	\$ (291,439)	\$ (66,249)	
Net Loss					\$ (581,847)
Non-cash amortization (expense) income, net	\$ 2,401	\$ (24,638)	\$ 1,867	\$ (4,954)	\$ (25,324)
Other significant non-cash expense: goodwill impairment	\$ —	\$ (88,675)	\$ —	\$ —	\$ (88,675)

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 23. Segment Information (continued)

(In Thousands)	Year Ended December 31, 2019				
	Residential Lending	Business Purpose Lending	Third-Party Investments	Corporate/ Other	Total
Interest income	\$ 268,559	\$ 54,372	\$ 281,701	\$ 17,649	\$ 622,281
Interest expense	(171,119)	(32,232)	(213,312)	(63,145)	(479,808)
Net interest income	97,440	22,140	68,389	(45,496)	142,473
Non-interest income					
Mortgage banking activities, net	47,743	39,523	—	—	87,266
Investment fair value changes, net	(27,920)	(6,722)	71,759	(1,617)	35,500
Other income	9,210	5,852	1,484	2,711	19,257
Realized gains, net	8,292	—	15,529	—	23,821
Total non-interest income (loss), net	37,325	38,653	88,772	1,094	165,844
General and administrative expenses	(26,717)	(25,591)	(3,561)	(52,868)	(108,737)
Loan acquisition costs	(3,954)	(5,064)	(780)	(137)	(9,935)
Other expenses	—	(8,521)	(1,106)	(3,395)	(13,022)
Provision for income taxes	(4,074)	(947)	(2,419)	—	(7,440)
Segment Contribution	\$ 100,020	\$ 20,670	\$ 149,295	\$ (100,802)	
Net Income					\$ 169,183
Non-cash amortization income (expense), net	\$ 3,669	\$ (9,173)	\$ 6,956	\$ (4,813)	\$ (3,361)

(In Thousands)	Year Ended December 31, 2018				
	Residential Lending	Business Purpose Lending	Third-Party Investments	Corporate/ Other	Total
Interest income	\$ 245,124	\$ 4,588	\$ 108,969	\$ 20,036	\$ 378,717
Interest expense	(134,590)	(1,598)	(41,887)	(60,964)	(239,039)
Net interest income	110,534	2,990	67,082	(40,928)	139,678
Non-interest income					
Mortgage banking activities, net	59,623	(57)	—	—	59,566
Investment fair value changes, net	(21,686)	(29)	(2,978)	(996)	(25,689)
Other income	12,452	—	—	618	13,070
Realized gains, net	7,709	—	19,332	—	27,041
Total non-interest income (loss), net	58,098	(86)	16,354	(378)	73,988
General and administrative expenses	(26,897)	(1,948)	(2,140)	(44,313)	(75,298)
Loan acquisition costs	(5,242)	(649)	(1,584)	(9)	(7,484)
Other expense	—	—	(18)	(178)	(196)
Provision for income taxes	(8,033)	—	(3,055)	—	(11,088)
Segment Contribution	\$ 128,460	\$ 307	\$ 76,639	\$ (85,806)	
Net Income					\$ 119,600
Non-cash amortization income (expense), net	\$ 4,486	\$ (290)	\$ 12,294	\$ (4,111)	\$ 12,379

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 23. Segment Information (continued)

The following table presents the components of Corporate/Other for the years ended December 31, 2020, 2019, and 2018.

Table 23.2 – Components of Corporate/Other

(In Thousands)	Years Ended December 31,								
	2020			2019			2018		
	Legacy Consolidated VIEs ⁽¹⁾	Other	Total	Legacy Consolidated VIEs ⁽¹⁾	Other	Total	Legacy Consolidated VIEs ⁽¹⁾	Other	Total
Interest income	\$ 9,061	\$ 75	\$ 9,136	\$ 17,649	\$ —	\$ 17,649	\$ 20,036	\$ —	\$ 20,036
Interest expense	(5,945)	(41,675)	(47,620)	(14,418)	(48,727)	(63,145)	(16,519)	(44,445)	(60,964)
Net interest income (loss)	3,116	(41,600)	(38,484)	3,231	(48,727)	(45,496)	3,517	(44,445)	(40,928)
Non-interest income									
Investment fair value changes, net	(1,512)	(492)	(2,004)	(1,545)	(72)	(1,617)	(1,016)	20	(996)
Other income	—	2,685	2,685	—	2,711	2,711	—	618	618
Realized gains, net	—	25,182	25,182	—	—	—	—	—	—
Total non-interest (loss) income, net	(1,512)	27,375	25,863	(1,545)	2,639	1,094	(1,016)	638	(378)
General and administrative expenses	—	(52,900)	(52,900)	—	(52,868)	(52,868)	—	(44,313)	(44,313)
Loan acquisition costs	—	(10)	(10)	—	(137)	(137)	—	(9)	(9)
Other expenses	—	(718)	(718)	—	(3,395)	(3,395)	—	(178)	(178)
Total	\$ 1,604	\$ (67,853)	\$ (66,249)	\$ 1,686	\$ (102,488)	\$ (100,802)	\$ 2,501	\$ (88,307)	\$ (85,806)

(1) Legacy consolidated VIEs represent Legacy Sequoia entities that are consolidated for GAAP financial reporting purposes. See *Note 4* for further discussion on VIEs.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2020

Note 23. Segment Information (continued)

The following table presents supplemental information by segment at December 31, 2020 and December 31, 2019.

Table 23.3 – Supplemental Segment Information

(In Thousands)	Residential Lending	Business Purpose Lending	Third-Party Investments	Corporate/ Other	Total
December 31, 2020					
Residential loans	\$ 1,741,963	\$ —	\$ 2,221,153	\$ 285,935	\$ 4,249,051
Business purpose loans	—	4,136,353	—	—	4,136,353
Multifamily loans	—	—	492,221	—	492,221
Real estate securities	160,780	—	183,345	—	344,125
Other investments	8,815	21,627	317,282	451	348,175
Goodwill and intangible assets	—	56,865	—	—	56,865
Total assets	1,989,802	4,323,040	3,232,415	809,809	10,355,066
December 31, 2019					
Residential loans	\$ 4,939,745	\$ —	\$ 2,367,215	\$ 407,890	\$ 7,714,850
Business purpose loans	—	3,506,743	—	—	3,506,743
Multifamily loans	—	—	4,408,524	—	4,408,524
Real estate securities	229,074	—	870,800	—	1,099,874
Other investments	42,224	21,002	294,904	—	358,130
Goodwill and intangible assets	—	161,464	—	—	161,464
Total assets	5,410,540	3,786,641	8,028,946	769,313	17,995,440

REDWOOD TRUST, INC. AND SUBSIDIARIES
SCHEDULE IV - MORTGAGE LOANS ON REAL ESTATE
December 31, 2020

(In Thousands)

Description	Number of Loans	Interest Rate	Maturity Date	Carrying Amount	Principal Amount Subject to Delinquent Principal or Interest
Residential Loans Held-for-Investment					
At Legacy Sequoia ⁽¹⁾ :					
ARM loans	1,899	0.25 % to 5.63%	2020-10 - 2036-05	\$ 282,551	\$ 17,285
Hybrid ARM loans	9	2.63 % to 4.00%	2033-07 - 2034-03	3,384	—
At Sequoia Choice ⁽¹⁾ :					
Hybrid ARM loans	54	3.13 % to 6.75%	2043-12 - 2050-02	43,003	2,415
Fixed loans	2,123	2.75 % to 6.75%	2029-04 - 2050-04	1,522,319	72,327
At Freddie Mac SLST ⁽²⁾ :					
Fixed loans	13,605	2.00 % to 11.00%	2020-12 - 2059-10	2,221,153	389,245
Total Residential Loans Held-for-Investment				<u>\$ 4,072,410</u>	<u>\$ 481,272</u>
Residential Loans Held-for-Sale ⁽³⁾:					
Hybrid ARM loans	2	2.00 % to 4.38%	2032-11 - 2047-10	\$ 1,014	\$ —
Fixed loans	196	2.38 % to 5.50%	2040-11 - 2051-01	175,627	1,882
Total Residential Loans Held-for-Sale				<u>\$ 176,641</u>	<u>\$ 1,882</u>
Single-Family Rental Loans Held-for-Sale ⁽³⁾:					
Fixed loans	65	3.82 % to 7.75%	2020-05 - 2050-03	\$ 245,394	\$ 7,127
Total Single-Family Rental Loans Held-for-Sale				<u>\$ 245,394</u>	<u>\$ 7,127</u>
Single-Family Rental Loans Held-for-Investment:					
At CAFL ⁽¹⁾ :					
Fixed loans	1,094	3.93 % to 7.57%	2020-11 - 2031-01	\$ 3,249,194	\$ 61,440
Total Single-Family Rental Loans Held-for-Investment				<u>\$ 3,249,194</u>	<u>\$ 61,440</u>
Bridge Loans Held-for-Investment ⁽⁴⁾:					
Fixed loans	1,725	6.04 % to 13.00%	2019-10 - 2022-12	\$ 641,765	\$ 39,415
Total Bridge Loans Held-for-Investment				<u>\$ 641,765</u>	<u>\$ 39,415</u>
Multifamily Loans Held-for-Investment ⁽²⁾:					
At Freddie Mac K-Series:					
Fixed loans	28	4.25 % to 4.25%	2025-09 - 2025-09	\$ 492,221	\$ —
Total Multifamily Loans Held-for-Investment				<u>\$ 492,221</u>	<u>\$ —</u>

- (1) For our held-for-investment loans at consolidated Legacy Sequoia, Sequoia Choice, and CAFL entities, the aggregate tax basis for Federal income tax purposes at December 31, 2020 was zero, as the transfers of these loans into securitizations were treated as sales for tax purposes.
- (2) Our held-for-investment loans at Freddie Mac SLST and Freddie Mac K-Series entities were consolidated for GAAP purposes. For tax purposes, we acquired real estate securities issued by these entities and therefore, the tax basis in these loans was zero at December 31, 2020.
- (3) The aggregate tax basis for Federal income tax purposes of our mortgage loans held at Redwood approximates the carrying values, as disclosed in the schedule.
- (4) For our held-for-investment bridge loans at Redwood, the aggregate tax basis for Federal income tax purposes at December 31, 2020 was \$654 million.

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTE TO SCHEDULE IV - RECONCILIATION OF MORTGAGE LOANS ON REAL ESTATE

December 31, 2020

The following table summarizes the changes in the carrying amount of mortgage loans on real estate during the years ended December 31, 2020, 2019, and 2018.

(In Thousands)	Years Ended December 31,		
	2020	2019	2018
Balance at beginning of period	\$ 15,630,117	\$ 9,540,598	\$ 5,115,210
Additions during period:			
Originations/acquisitions	5,914,728	12,911,261	10,607,896
Deductions during period:			
Sales	(6,398,690)	(5,218,797)	(5,426,304)
Principal repayments	(2,313,143)	(1,851,278)	(843,984)
Transfers to REO	(14,104)	(7,552)	(4,104)
Deconsolidation adjustments	(3,849,779)	—	—
Changes in fair value, net	(91,503)	255,885	91,884
Balance at end of period	\$ 8,877,626	\$ 15,630,117	\$ 9,540,598

**CHIEF EXECUTIVE OFFICER CERTIFICATION PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002**

I, Christopher J. Abate, certify that:

1. I have reviewed this Annual Report on Form 10-K of Redwood Trust, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over the financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 26, 2021

/s/ CHRISTOPHER J. ABATE

Christopher J. Abate
Chief Executive Officer

**CHIEF FINANCIAL OFFICER CERTIFICATION PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002**

I, Collin L. Cochrane, certify that:

1. I have reviewed this Annual Report on Form 10-K of Redwood Trust, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over the financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 26, 2021

/s/ COLLIN L. COCHRANE

Collin L. Cochrane

Chief Financial Officer

CERTIFICATION

Pursuant to 18 U.S.C. §1350, the undersigned officer of Redwood Trust, Inc. (the “Registrant”) hereby certifies that the Registrant’s Annual Report on Form 10-K for the year ended December 31, 2020 (the “Annual Report”) fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Annual Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Date: February 26, 2021

/s/ CHRISTOPHER J. ABATE

Christopher J. Abate

Chief Executive Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. §1350 and is not being filed as part of the Annual Report or as a separate disclosure document.

CERTIFICATION

Pursuant to 18 U.S.C. §1350, the undersigned officer of Redwood Trust, Inc. (the “Registrant”) hereby certifies that the Registrant’s Annual Report on Form 10-K for the year ended December 31, 2020 (the “Annual Report”) fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Annual Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Date: February 26, 2021

/s/ COLLIN L. COCHRANE

Collin L. Cochrane

Chief Financial Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. §1350 and is not being filed as part of the Annual Report or as a separate disclosure document.