REDWOOD TRUST INC
Form 10-K
February 26, 2016

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

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended: December 31, 2015
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from _______________ to _______________.
Commission File Number 1-13759

REDWOOD TRUST, INC.
(Exact Name of Registrant as Specified in Its Charter)

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

(415) 389-7373
(Registrant’s Telephone Number, Including Area Code)
Securities Registered Pursuant to Section 12(b) of the Act:

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o
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 o No x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting

company” in Rule 12b-2 of the Exchange Act.

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

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

At June 30, 2015, the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant was $1,303,251,238 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, 2016 was 77,252,837.

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.
2015 ANNUAL REPORT ON FORM 10-K
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PART I

ITEM 1. BUSINESS

Introduction

Redwood Trust, Inc., together with its subsidiaries, focuses on investing in mortgage- and other real estate-related assets and engaging in mortgage banking activities. We seek to invest in real estate-related assets that have the potential to generate attractive cash flow returns over time and to generate income through our mortgage banking activities. During 2015, we operated our business in three segments: residential mortgage banking, residential investments, and commercial mortgage banking and investments.

Our primary sources of income are net interest income from our investment portfolios and 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 consists of the profit we seek to generate through the acquisition of loans and their subsequent sale or securitization. References herein to “Redwood,” the “company,” “we,” “us,” and “our” include Redwood Trust, Inc. and its consolidated subsidiaries, unless the context otherwise requires.

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 operating subsidiaries” or “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. Our executive offices are located at One Belvedere Place, Suite 300, Mill Valley, California 94941. 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

Our residential mortgage banking segment primarily consists of operating a mortgage loan conduit that acquires residential loans from third-party originators for subsequent sale, securitization, or transfer to our investment portfolio. 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. We occasionally supplement our flow purchases with bulk loan acquisitions. This segment also includes various derivative financial instruments and interest only securities retained from our Sequoia securitizations that we utilize to manage certain risks associated with residential loans we acquire. During 2015, we also acquired conforming loans (defined as loans eligible for sale to Fannie Mae and Freddie Mac (the "Agencies")) and the related servicing rights on a flow basis from our seller network. Conforming loans we acquired were generally sold to the Agencies. During the first quarter of 2016, as part of our ongoing evaluation of the efficiency and profitability of our businesses, we announced plans to restructure our conforming loan operations by discontinuing the acquisition and aggregation of conforming loans for resale to the Agencies, and instead focus on direct conforming-related investments in mortgage servicing rights and risk-sharing transactions.

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

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Our residential investments segment includes a portfolio of investments in residential mortgage-backed securities retained from our Sequoia securitizations, as well as residential mortgage-backed securities issued by third parties. In addition, this segment includes a subsidiary of Redwood Trust that is a member of the Federal Home Loan Bank of Chicago ("FHLBC") and that utilizes attractive long-term financing from the FHLBC to make long-term investments directly in residential mortgage loans. Finally, this segment invests in MSRs associated with residential loans we have sold or securitized, as well as MSRs that we purchased from third parties. The residential investments segment's main sources of revenue are interest income from investment portfolio securities and residential loans held-for-investment, as well as MSR income. Additionally, this segment may realize gains 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.

During 2015, our commercial mortgage banking and investments segment consisted primarily of a mortgage loan conduit that originated senior commercial loans for subsequent sale to third-party CMBS sponsors or other investors. In addition to senior loans, during 2015 we offered complementary forms of commercial real estate financing directly to borrowers that included mezzanine loans, subordinate mortgage loans, and other financing solutions. We typically have held the mezzanine and other subordinate loans we originated in our commercial investment portfolio. During the first quarter of 2016, as part of our ongoing evaluation of the efficiency and profitability of our businesses, we announced plans to reposition our commercial business to focus solely on investing activities and discontinue commercial loan originations. During 2015, this segment's main sources of revenue were mortgage banking income, which included valuation increases (or gains) on the sale of senior commercial loans and associated hedges, and net interest income from mezzanine or subordinate loans held in our investment portfolio. Funding expenses, direct operating expenses, and tax expenses associated with these activities are also included in this segment.

Sponsored, Managed, and Consolidated Entities

Throughout our history we have sponsored or managed other investment entities, including a private limited partnership fund that we managed, the Redwood Opportunity Fund, LP (the "Fund"), as well as Acacia securitization entities, certain of which we continue to manage. The Fund was primarily invested in residential securities and the Acacia entities are primarily invested in a variety of real estate-related assets.

During the third quarter of 2011, we engaged in a transaction in which we resecuritized a pool of senior residential securities (the "Residential Resecuritization") primarily for the purpose of obtaining permanent non-recourse financing on a portion of the residential securities we hold in our investment portfolio at the REIT. Similarly, during the fourth quarter of 2012, we engaged in a transaction in which we securitized a pool of commercial loans (the "Commercial Securitization") primarily for the purpose of obtaining permanent non-recourse financing on a portion of the commercial loans we hold.

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 our charters for our Audit Committee, Compensation Committee, and Corporate 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.

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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 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 confidence in our overall market position, strategy and long-term prospects, and our belief in the long-term efficiency of private label securitization as a form of mortgage financing; (ii) statements related to our financial outlook and expectations for 2016, including with respect to: 2016 earnings, growth in portfolio net interest income, reductions in operating expenses associated with the repositioning of our conforming residential and commercial mortgage banking activities, nonrecurring severance payments and other charges related to this repositioning, MSR portfolio net income, residential mortgage banking income, gain on sales income related to the sale of securities, expected capital allocation among our investment portfolio and mortgage banking activities; (iii) expectations related to our residential mortgage banking activities, including our focus on whole-loan acquisitions and sales; (iv) statements we make regarding our outlook for debt markets and potential dislocations in those markets, opportunities that may result from such dislocations, and our expectations with respect to our capital, liquidity and short-term securities repurchase financing; (v) statements regarding our residential investment portfolio, including our expectations regarding investments held at our FHLB-member subsidiary and the financing for such investments; (vi) statements we make regarding our stock and debt repurchase authorizations and our approach in considering additional repurchase activity; (vii) 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 2015 and at December 31, 2015, and statements relating to expected fallout and the corresponding volume of residential mortgage loans expected to be available for purchase; (viii) statements relating to our estimate of our available capital (including that we estimate our capital available for investments at December 31, 2015 to be approximately $172 million and at February 19, 2016 to be in excess of $200 million); (ix) statements we make regarding our dividend policy, including our intention to pay a regular dividend of $0.28 per share per quarter in 2016; and (x) 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, our estimates of REIT taxable income and TRS taxable income, and our anticipation of additional credit losses for tax purposes in future periods (and, in particular, our statement that, for tax purposes, we expect an additional $23 million of tax credit losses on residential securities we currently own to be realized over an estimated three- to five-year period).

Important factors, among others, that may affect our actual results in 2016 include: interest rate volatility, changes in credit spreads, and changes in liquidity in the market for real estate securities and loans; changes in the demand from investors for residential mortgages and investments, and our ability to distribute an increased volume of residential mortgages through our whole-loan distribution channel; our ability to finance our investments in securities and our acquisition of residential mortgages with short-term debt; the availability of assets for purchase at attractive risk-adjusted returns and our ability to reinvest cash and the proceeds from the potential sale of securities and investments we hold; changes in the values of assets we own; higher than expected operating expenses due to delays or decreases in the realization of expected operating expense reductions related to the repositioning of our conforming mortgage banking activities and commercial loan origination activities, and other unforeseen expenses; general economic trends, the performance of the housing, commercial real estate, mortgage, credit, and broader financial markets, and their effects on the prices of earning assets and the credit status of borrowers; federal and state legislative and regulatory developments, and the actions of governmental authorities, including those affecting the mortgage industry or our business (including, but not limited to, the Federal Housing Finance Agency's rules relating to FHLB membership requirements and the implications for our captive insurance subsidiary's membership in the FHLB); developments related to the fixed income and mortgage finance markets and the Federal Reserve's statements regarding its future open market activity and monetary policy; our exposure to credit risk and the timing of credit losses within our portfolio; the concentration of the credit risks we are exposed to, including due to the structure of assets we hold and the geographical concentration of real estate underlying assets we own; our exposure to adjustable-rate mortgage loans; the efficacy and expense of our efforts to manage or hedge credit risk, interest rate risk, and other financial and operational risks; changes in credit ratings on assets we own and changes in the rating agencies' credit rating methodologies; changes in interest rates; changes in mortgage prepayment rates; the ability of counterparties to satisfy their obligations to us; our involvement in securitization transactions, the profitability of those transactions, and the risks we are exposed to in engaging in securitization transactions; exposure to claims and litigation, including litigation arising from our involvement in securitization transactions; whether we have sufficient liquid assets to meet short-term needs; our ability to successfully compete and retain or attract key personnel; our ability to adapt our business model and strategies to changing circumstances; changes in our investment, financing, and hedging strategies and new risks we may be exposed to if we expand our business activities; our exposure to a disruption or breach of the security of our technology infrastructure and systems; exposure to environmental liabilities; our failure to comply with applicable laws and regulations; our failure to maintain appropriate internal controls over financial reporting and disclosure controls and procedures; the impact on our reputation that could result from our actions or omissions or from those of others; changes in accounting principles and tax rules; our ability to maintain our status as a REIT for tax purposes; limitations imposed on our business due to our REIT status and our status as exempt from registration under the Investment Company Act of 1940; decisions about raising, managing, and distributing capital; and other factors not presently identified.

This 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.

Certifications

Our Chief Executive Officer and Chief Financial Officer have executed certifications dated February 26, 2016, 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 June 8, 2015 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.

Employees

As of December 31, 2015, Redwood employed 211 people. Following the announcements during the first quarter of 2016 of the restructuring of our conforming loan operations and repositioning of our commercial business, as of February 19, 2016, Redwood employed 153 people.

Item 1A. Risk Factors

Strategic business and capital deployment decisions we made in 2015 and early 2016, including decisions relating to restructuring or repositioning certain of our business activities and decisions relating to repurchases of Redwood common stock, may not improve our profitability or competitiveness and may not represent the best allocation of our capital over the near- and long-term. Decisions we make in the future about our business strategy and the investment of our capital, including through the repurchase of common stock or other securities issued by Redwood, could also fail to improve our business and results of operations.

In January 2016, we announced that we were restructuring our residential conforming mortgage loan business by discontinuing the acquisition and aggregation of conforming loans for resale to Fannie Mae and Freddie Mac, and instead focusing on direct conforming-related investments in mortgage servicing rights and risk-sharing transactions. In addition, in February 2016 we announced a repositioning of our commercial loan business by discontinuing the origination of senior and mezzanine commercial mortgage loans to focus on managing our existing portfolio of commercial mezzanine loans and opportunities for attractive investments in commercial mortgage-backed securities and other commercial mortgage loan-related transactions. These changes to our overall business model and structure were intended to discontinue operations that had not recently been, and were not expected to be, profitable for Redwood and to free up capital for more profitable business and investment opportunities. These changes were premised on our outlook for economic and market conditions, as well as competitive considerations and assumptions about the workforce reductions and expense savings that could accompany these changes. The assumptions underlying these changes could turn out to be incorrect or economic and market conditions could develop in a manner that is not consistent with the outlook we held. In addition, the assumptions we made about the level of workforce reduction that could accompany these changes, and the expense savings that would result, could have been wrong. As a result, these changes could fail to improve the profitability of Redwood, could fail to result in capital being available for more profitable businesses and investments, 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 the investment of our capital could also fail to improve our business and results of operations.

In addition, in August 2015, our Board of Directors authorized the purchase of shares of Redwood common stock in an amount up to $100 million and we subsequently, during 2015 and in January 2016, repurchased approximately $100 million of common stock at an average price per share of $13.68. In February 2016, our Board of Directors approved an additional authorization for the purchase of up to $100 million of Redwood common stock and also authorized the repurchase of other securities issued by Redwood, including convertible and exchangeable debt securities due in 2018 and 2019, respectively. 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.

Recently adopted Federal regulations may limit, eliminate, or reduce the attractiveness of our subsidiary's ability to use borrowings from the Federal Home Loan Bank of Chicago to finance the mortgage loans and securities it holds and acquires, 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 has provided RWT Financial with access to attractive long-term collateralized financing for mortgage loans and securities it holds and acquires. RWT Financial currently has approximately $2.0 billion of long-term borrowings from the FHLBC to finance its portfolio of jumbo residential mortgage loans. In January 2016, federal regulations were adopted by the

Federal Housing Finance Agency ("FHFA"), which is the regulator of the Federal Home Loan Bank System, relating to captive insurance company membership in the Federal Home Loan Bank System. Under these regulations, RWT Financial, LLC is only eligible to remain as a member of the FHLBC for a five-year transition period and may not be able to obtain additional advances or increases to its borrowing capacity from the FHLBC, although the FHLBC is permitted to allow advances that were outstanding to RWT Financial prior to effectiveness of the regulations to remain outstanding until scheduled maturity (even if that scheduled maturity extends beyond the five-year transition period).

The final regulations published by the FHFA could negatively impact us in a number of different ways, including, without limitation, by: limiting our ability to acquire (or the attractiveness of acquiring) residential mortgage loans to hold as long-term investments; limiting our ability to increase net interest income earned by RWT Financial; and, following the five-year transition period and the scheduled maturity of our currently outstanding advances, requiring us to arrange for alternative (and, likely, less attractive) financing sources for residential mortgage loans held as long-term investments or, if such alternative financing sources are not then available, requiring us to liquidate our portfolio of residential loans held as long-term investments, any of which could negatively impact our business and operating results. In addition, our increased reliance on long-term financing from the FHLBC exposes us to risks of the type 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."

General economic developments and trends and the performance of the housing, commercial 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, high unemployment, rising government debt levels, 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 and commercial real estate markets, and changing expectations for inflation and deflation. Personal income and unemployment levels affect borrowers' ability to repay residential mortgage loans underlying residential real estate-related assets we own, and there is risk that economic growth and activity could be weaker than anticipated or negative.

The economic downturn that began in 2007 and the significant government interventions into the financial markets and fiscal stimulus spending that occurred in subsequent years have contributed to significantly increased U.S. budget deficits and overall debt levels. These increases can put upward pressure on interest rates and could be among the factors that could lead to higher interest rates over the long-term future. Higher long-term 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. In addition, near-term and long-term U.S. economic conditions are likely to be impacted by the ability of Congress and the President to effectively address policy differences regarding the U.S. federal budget, budget deficit, and debt level.

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. Over the last several years, government intervention has been important to support real estate markets, the overall U.S. economy, capital markets, and mortgage markets. Mortgage markets have also received substantial U.S. government support. In particular, the government's support of mortgage markets through its support of Fannie Mae and Freddie Mac expanded in late 2008, as the U.S. Treasury Department chose to backstop these government-sponsored enterprises. The governmental support for these entities has contributed to Fannie Mae's and Freddie Mac's continued dominance of residential mortgage finance and securitization activity, inhibiting the return of private 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.

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.

Statements by the Federal Reserve regarding monetary policy and the actions it takes to set or adjust monetary policy may affect the expectations and outlooks of market participants in ways that disrupt our business and adversely affect our financial results and the value of, and returns on, our portfolio of real-estate related investments and the pipeline of residential mortgage loans we own or may acquire. For example, from 2013 through 2015, statements made by the Chair and other members of the Board of Governors of the Federal Reserve System and by other Federal Reserve Bank officials regarding the U.S. economy, future economic growth, the Federal Reserve's future open market activity and monetary policy had a significant impact on, among other things, benchmark interest rates, the value of residential mortgage loans, and, more generally, the fixed income markets. These statements, the actions of the Federal Reserve, and other factors also significantly impacted many market participants' expectations and outlooks regarding future levels of benchmark interest rates and the expected yields these market participants would require to invest in fixed income instruments, including most residential mortgages and residential mortgage-backed securities (RMBS).

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 residential mortgage loans that we own and the overall value of the pipeline of residential mortgage loans that we have identified for 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 residential 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- and long-term borrowings. The short- and long-term borrowings we use to finance our acquisitions and holdings of residential mortgage loans are uncommitted and 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 residential 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 RMBS. In addition, any inability to fund 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 have had, and may continue to 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.

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 residential and commercial 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.

Changes to income tax laws and regulations, or other tax laws or regulations, which may be enacted at the federal or state level, could also negatively impact residential and commercial real estate markets, mortgage finance markets, and our business and financial results. For example, an elimination or reduction in the current personal income tax deduction for interest payments on residential mortgage debt, which is one of the mechanisms that lawmakers have discussed in connection with resolving the U.S. federal budget deficit, could negatively impact real estate values, our business, and our financial results.

Furthermore, the credit crisis 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, establishing comprehensive supervision of financial markets, protecting consumers and investors from financial abuse, providing the U.S. government with additional tools to manage financial crises, and raising international regulatory standards and improving international cooperation, but their scope could be expanded beyond what has been currently enacted, implemented, and proposed. Certain financial reforms focused specifically on the issuance of asset-backed securities through securitization transactions have not been fully implemented or have not yet, or have only recently, become effective, but include or are expected to 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.

During and since 2008, the federal government has also made available programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures, including through loan modification and refinancing programs. In addition, certain mortgage lenders and servicers have voluntarily, or as part of settlements with law enforcement authorities, established loan modification programs relating to the mortgages they hold or service and adopted new servicing standards intended to protect homeowners. Changes to servicing standards, whether resulting from a settlement or a change in regulation, are likely to have the effect of lengthening the time it takes for a servicer to foreclose on the property underlying a delinquent mortgage loan. Loan modification programs and changes to servicing standards and regulations, as well as future law enforcement and legislative or regulatory actions, may adversely affect the value of, and the returns on, the mortgage loans and mortgage securities we currently own or may acquire in the future.

In the wake of the recent financial crisis, certain counties, cities and other municipalities took steps to begin to consider how the power of eminent domain could be used to acquire residential mortgage loans from private-label securitization trusts and additional municipalities may be similarly considering this matter or may do so in the future. To the extent municipalities or other governmental authorities proceed to implement and carry out these or similar proposals and acquire residential mortgage loans from securitization trusts in which we hold an economic interest, there would likely be a negative impact on the value of our interests in those securitization trusts and a negative impact on our ability to engage in future securitizations (or on the returns we would otherwise expect to earn from executing future securitizations), which impacts could be material.

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.

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, and otherwise negatively affect our business.

Overview of credit risk

We assume credit risk primarily through the ownership of securities backed by residential and commercial real estate loans and through direct investments in residential and commercial 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. Credit losses on residential 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 homes; earthquakes, 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; 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 many 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 pledged by our subsidiary, RWT Financial, to secure long-term borrowings from the FHLBC, may have adjustable interest rates. Accordingly, when short-term interest rates rise, required monthly payments from homeowners will rise under the terms of these adjustable-rate mortgages, and this may increase borrowers' delinquencies and defaults.

Credit losses on commercial real estate loans can occur for many of the reasons noted above for residential real estate loans. Losses on commercial real estate loans can also occur for other reasons including decreases in the net operating income from the underlying property, which could be adversely affected by a weak U.S. or international economy. Moreover, at any given time, most or all of our commercial real estate loans are not 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.

Commercial real estate loans are particularly sensitive to changes in the local economy, so even minor local adverse economic events may adversely affect the performance of commercial real estate assets. We are typically exposed to credit risk associated with both senior and subordinated commercial loans, and much of our exposure to credit risk associated with commercial loans is in the form of subordinate financing (e.g., mezzanine loans, b-notes, preferred equity, and subordinated interests in securitized pools). We have directly originated commercial loans and may participate in loans originated by others (including through ownership of commercial mortgage-backed securities). Our origination of commercial loans results in our exposure to credit, legal, and other risks that may be greater than risks associated with loans we acquire or participate in that are originated by others. We may incur losses on commercial real estate loans and securities for reasons not necessarily related to an adverse change in the performance of the property (or properties) associated with any such loan or the loan (or loans) underlying any such security. This includes bankruptcy by the owner of the property, issues regarding the form of ownership of the property, poor property management, origination errors, inaccurate appraisals, fraud, and non-timely actions by servicers. If and when these problems become apparent, we may have little or no recourse to the borrower, issuer of the securities, or seller of the loan and we may incur credit losses as a result.

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

Within a securitization of residential or commercial 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 or commercial 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 mezzanine or preferred equity investors, if any, then by a cash reserve fund or letter of credit, if any, then 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 equity support, reserve fund, letter of credit, and 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 and commercial 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 have 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.

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.

Most or all of the commercial real estate loan assets we own are only partially amortizing or do not provide for any principal amortization prior to a balloon principal payment at maturity. Commercial 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 commercial 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. 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, or flood), 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 commercial and residential real estate loans we own or those underlying the securities or other investments we own. 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 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 commercial loans we have originated or may otherwise acquire are larger than residential loans and we may continue to have a geographically concentrated commercial loan portfolio. Our commercial loans are generally concentrated in or near major metropolitan areas. Additional information on geographic distribution of our commercial loan portfolio is set forth in Note 7 to the Financial Statements within this Annual Report on Form 10-K.

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 residential and commercial 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 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 earnings volatility. 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 collateralizing or underlying residential loans or investments may decline. The value of the commercial properties collateralizing or underlying commercial loans or investments 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 loans, second lien loans, loans in certain locations, residential mortgage loans that are not "qualified mortgages" under regulations promulgated by the CFPB, 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 the credit ratings of bond insurers or any downgrades in the credit ratings of mortgage insurers 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.

Currently, and in the future, some of the loans we own or that underlie mortgage-backed securities we own may be insured in part by mortgage insurers, bond insurers, or financial guarantors. Mortgage insurance protects the lender or other holder of a loan up to a specified amount, in the event the borrower defaults on the loan. Mortgage insurance is generally obtained only when the principal amount of the loan at the time of origination is greater than 80% of the value of the property (loan-to-value), although it may not always be obtained in these circumstances. Any downgrade to the credit rating of a mortgage insurer, bond insurer, or financial guarantor that supports the creditworthiness of investments we hold could negatively impact the value of those investments. Any inability of the mortgage insurers to pay in full the insured portion of the loans that we hold would adversely affect the value of the securities we own that are backed by these loans, which could increase our credit risk, reduce our cash flows, or otherwise adversely affect our business.

Changes in prepayment rates of residential mortgage loans could reduce our earnings, dividends, cash flows, and access to liquidity. Similarly, with respect to commercial real estate loans, borrowers’ decisions to prepay or extend loans could reduce our earnings, dividends, cash flows, and access to liquidity.

The economic returns we earn from most of the residential real estate securities and loans we own (directly or indirectly) are affected by the rate of prepayment of the underlying residential 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 MSRs, associated with residential mortgage loans that are particularly sensitive to changes in prepayments rates. As the owner of an MSR, we are entitled to a portion of the interest payments made by the borrower in respect of the associated loan and 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 we own will have an adverse effect on our returns from these MSRs and may result in losses.

Some of the commercial real estate loans we 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 commercial 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.

Additionally, in recent periods our residential mortgage banking results have been affected by the combination of estimated market valuation adjustments on our pipeline of jumbo residential loans identified for purchase, but not yet purchased, and changes in the value of interest rate hedges relating to that pipeline, which may impact our reported financial results in different reporting periods. See the discussion 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.” Interest rate volatility, particularly at the beginning or end of a reporting period, tends to exacerbate these impacts on our reported financial results and may contribute to earnings volatility.

Higher interest rates generally reduce the fair value of many of our assets, with the exception of our 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 is difficult to predict the impact on interest rates of any change in the credit rating of the U.S. government, the United Kingdom, or one or more Eurozone nations; however, any change in the 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 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 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 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. 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 their current fair values. Assets with a lower GAAP basis than current fair values generate higher GAAP yields, yields that 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 proceeds from principal repayments and deploy capital we raise, we must invest in or acquire new assets. If the availability of new assets is limited, we may not be able to 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 few 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.

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 recent years residential mortgage interest rates were generally declining, with the result that a significant portion of industry-wide origination volumes have been related to residential borrowers refinancing existing mortgage loans. To the extent interest rates increase or remain steady, the volume of refinance loans is likely to decline significantly 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.

We no longer originate commercial loans, but we may invest in commercial loans originated by third parties. Overall industry-wide volume of commercial real estate loan originations and financings remains below the volume the industry has experienced in the past and the high-quality commercial assets we seek to invest in may be competitively sought after by other investors.

The supply of new issue 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.

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, since 2012 and continuing into 2016 we have increased our holdings of MSRs associated with residential mortgage loans. As another example, in 2014 our FHLBC-member subsidiary established a borrowing facility with the FHLBC that provides a source of long-term financing for residential mortgage loans that our subsidiary buys and holds, as a result of which its holdings of residential whole loans have increased. Also in 2014, we began entering into risk-sharing arrangements with Fannie Mae and Freddie Mac under which we can enhance the profitability of transacting in conforming loan products by committing to absorb credit losses on new conforming loans that we sell to Fannie Mae and Freddie Mac. Any of these actions may expose us to new, different, or increased investment, operational, financial, or management risks.

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 and commercial 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. We have originated first mortgage commercial loans which we have sold to others (while, in some cases, retaining a subordinate interest in these loans or retaining subordinate financing for the same property) and this exposes us to certain representation and warranty, aggregation, market value, and other risks on loan balances in excess of our potential investments.

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 "Redwood has elected to be a REIT and, as such, is required to meet certain tests in order to maintain its 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. 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, we could in the future 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, 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 these 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.

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 GAAP purposes, we may mark to market some, but not all, of the assets and 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, MSRs, 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, MSRs, 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 in the immediately following risk factor.

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 and commercial 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 residential and commercial loans we hold. 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, 2015, our total consolidated liabilities (excluding indebtedness associated with asset-backed securities issued by consolidated Sequoia entities and a commercial securitization entity, for which we are not liable) was $4.03 billion, including $288 million of outstanding convertible notes due in 2018 and $205 million of outstanding exchangeable securities due in 2019. 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 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. 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 in the risk factor titled “Redwood has elected to be a REIT and, as such, is required to meet certain tests in order to maintain its 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. 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 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.”

The inability to access financial leverage through warehouse and repurchase facilities, credit facilities, our FHLB-member subsidiary’s borrowing facility with the FHLBC, 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, 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. In addition, it is 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, federal regulations were adopted by the Federal Housing Finance Agency in January 2016 relating to captive insurance company membership in the Federal Home Loan Bank System. Under these regulations, our captive insurance company subsidiary, RWT Financial, LLC, which is currently a member of the Federal Home Loan Bank of Chicago (FHLBC), is only eligible to remain as a member of the FHLBC for a five-year transition period and may not be able to obtain additional advances or increases to its borrowing capacity from the FHLBC. Although FHLBC is permitted to allow advances that were outstanding to RWT Financial prior to effectiveness of the regulations to remain outstanding until scheduled maturity (even if that scheduled maturity extends beyond the five-year transition period), these regulations may limit RWT Financial's ability to increase the size of its portfolio of residential mortgage loans and thereby may impact the ability to increase net interest income generated by RWT Financial's portfolio of held-for-investment loans, and could otherwise have an adverse effect on our business and results of operations, as further described under the risk factor titled "Recently adopted Federal regulations may limit, eliminate, or reduce the attractiveness of our subsidiary's ability to use borrowings from the Federal Home Loan Bank of Chicago to finance the mortgage loans and securities it holds and acquires, 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 well 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. 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.

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. Potential payment 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 its subsidiaries, that enter into interest rate hedging agreements and other hedging instruments and derivatives. This increased regulation could result in Redwood or certain of its 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. 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 short-term borrowings becomes insolvent, we may fail to recover the full value of our pledged collateral, thus reducing our earnings and liquidity. In the event a counterparty to our interest rate agreements, credit default swaps, 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 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.

Through certain of our wholly-owned subsidiaries we have engaged in the past, and plan to continue to engage, in acquiring residential 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 plan to continue to engage, in acquiring residential MSRs. These types of transactions and investments expose us to potentially material risks.

Acquiring 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 fair value of the assets pledged as collateral declines, we would 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 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 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 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 loans over the short or long term.

Prior to 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 refuses or is unable (e.g., due to its financial condition) to 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 was inaccurate.

In addition, when selling residential 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, 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 claim damages for a breach of representation or warranty. Furthermore, to the extent we claim that counterparties we have acquired loans from 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.

Since mid-2014, RWT Financial, our FHLB-member subsidiary, has been increasing the portfolio of residential mortgage loans it acquires and holds for investment with long-term financing provided by the FHLBC. At December 31, 2014, RWT Financial had approximately $496 million of long-term borrowings outstanding from the FHLBC, which were collateralized by residential mortgage loans. At December 31, 2015, RWT Financial had approximately $1.3 billion of long-term borrowings and $138 million of short-term borrowings outstanding from the FHLBC, which were collateralized by residential mortgage loans. RWT Financial currently has borrowing capacity from the FHLBC of $2.0 billion, and it may not be able to obtain any increases to its borrowing capacity in the future. As of February 25, 2016, RWT Financial had outstanding advances from the FHLB Chicago of $2.0 billion. This source of financing has enabled RWT Financial to earn attractive returns on loans held as long-term investments, contributing a significant amount to our 2015 earnings. RWT Financial's ability to increase the size of its portfolio of residential mortgage loans may be limited and this may impact the ability to increase net interest income generated by RWT Financial, as further described under the risk factor titled "Recently adopted Federal regulations may limit, eliminate, or reduce the attractiveness of our subsidiary's ability to use borrowings from the Federal Home Loan Bank of Chicago to finance the mortgage loans and securities it holds and acquires, which could negatively impact our business and operating results." Additionally, the increase in residential mortgage loans held as long-term investments exposes us to the risk of loss on the full balance of those loans, which is typically not the case with respect to securities we retain from securitization transactions we sponsor. The materialization of any of these risks related to RWT Financial's investment activity and FHLB financing could significantly impact our financial and operating results.

Through certain of our wholly-owned subsidiaries we have engaged in the past, and expect to continue to engage in, securitization transactions relating to residential mortgage loans. We have in the past also engaged in, and may in the future engage in, other types of securitization transactions or similar transactions, including securitization transactions relating to commercial real estate loans and other types of commercial real estate investments. 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, either on a recourse or non-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 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 with the intent to sell these loans to third parties or hold them as investments. Similarly, we have engaged in the past, and plan to continue to engage, in acquiring servicing rights associated with residential mortgage loans. 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 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 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 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.

In recent years there has also been debate as to whether there are 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.

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 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 to perform, including failure to perform due to reasons such as fraud, negligence, errors, miscalculations, or insolvency. For example, many loan servicers are experiencing higher volumes of delinquent loans than they have in the past and, as a result, there is a risk that their operational infrastructures cannot properly process this increased volume. Many loan servicers have been accused of improprieties in the handling of the 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.

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 "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." 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.

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. In the context of our commercial loan investment activities, we rely on third parties to manage and operate the properties that directly or indirectly collateralize our commercial loans, to generate operating results and cash flow sufficient to service our loans and support the repayment or refinancing of our loans at maturity, and to mitigate the risk of losses.

Our ability to execute or participate in future securitization transactions, including, in particular, securitizations of residential 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.

In July 2010, the Dodd-Frank Act was enacted. Provisions of the Dodd-Frank Act require, among other things, significant revisions to the legal and regulatory framework under which ABS, including residential mortgage-backed securities (RMBS), are issued through the execution of securitization transactions. Some of the provisions of the Dodd-Frank Act have become effective or been implemented, while others are in the process of being implemented or will become effective soon. In addition, prior to the passage of the Dodd-Frank Act, the Securities and Exchange Commission (SEC) and the Federal Deposit Insurance Corporation had already published proposed and final regulations under already existing legislative authority 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 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 residential 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. If, as a result, 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. In addition, the actual short- and long-term impact on our ability to securitize residential mortgage loans in the future will depend, in large part, on how the rating agencies assess the investment risks that result from the ability-to-repay regulations promulgated by the CFPB that first became effective in January 2014, including, for example, how they assess investment risks associated with residential mortgage loans that have an interest-only payment feature or loans under which the borrower has a debt-to-income ratio of more than 43% (as 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).

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 commercial real estate loans, residential mortgage 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 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 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 residential mortgage loans and the relative desirability to originators of retaining residential 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 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 residential 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 were are not able to profitably execute future securitizations of residential 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 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 securitization transactions relating to residential mortgage loans, commercial mortgage loans, commercial real estate loans, and other types of assets. In the future we expect to continue to engage in or participate in securitization transactions, including, in particular, securitization transactions relating to residential 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. 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 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.

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 relates in part to residential mortgage-backed securities that were issued by a Sequoia securitization entity and alleges 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 15 to the Financial Statements within this Annual Report on Form 10-K.

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 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. We are also subject to various 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.

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.

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, 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 2018 and 2019, respectively.

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.

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 "Redwood has elected to be a REIT and, as such, is required to meet certain tests in order to maintain its REIT status. This adds complexity and costs to running our business and exposes us to additional risks."

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

We are subject to competition in seeking investments, acquiring and selling residential 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 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. 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 $417,000. In February 2008, Congress passed an economic stimulus package that temporarily increased the size of certain loans these entities could purchase to up to $729,750, if the loans were made to secure real estate purchases in certain high-cost areas of the U.S. As of December 31, 2015, this $729,750 loan size limit had been reduced to $625,500, which is an amount that continues to be above the historical $417,000 loan size limit. In addition, in September 2008, Fannie Mae and Freddie Mac were placed into conservatorship and have become, in effect, instruments of the U.S. federal government. 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. 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 24% of the aggregate dollar value of residential loans originated in the U.S. in 2015. 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.

Due to the recent financial crisis and downturn in the U.S. real estate markets and the economy, the mortgage industry and the related capital markets are still undergoing significant changes, 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. 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 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 "Strategic business and capital deployment decisions we made in 2015 and early 2016, including decisions relating to restructuring or repositioning certain of our business activities and decisions relating to repurchases of Redwood common stock, may not improve our profitability or competitiveness and may not represent the best allocation of our capital over the near- and long-term. Decisions we make in the future about our business strategy and the investment of our capital, including through the repurchase of common stock or other securities issued by Redwood, could also 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 real estate-related 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 2015, 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, as compared to four securitizations in the second half of 2013, and eight securitizations in the first half of 2013. Even if regular residential mortgage 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 return to or sustain the volume of securitization activity we previously conducted.

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 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, we recently announced a restructuring of our conforming residential loan business, which was originally an expansion of our residential mortgage banking business that was initiated in late 2013. In addition, we recently announced a repositioning of our commercial loan business, which was an expansion of our mortgage banking activities that we initiated in 2010. Further discussion of each of these business changes is set forth in the risk factor titled “Strategic business and capital deployment decisions we made in 2015 and early 2016, including decisions relating to restructuring or repositioning certain of our business activities and decisions relating to repurchases of Redwood common stock, may not improve our profitability or competitiveness and may not represent the best allocation of our capital over the near- and long-term. Decisions we make in the future about our business strategy and the investment of our capital, including through the repurchase of common stock or other securities issued by Redwood, could also 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. Generally, these subsidiaries would be wholly-owned, directly or indirectly, 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 members of our executive management team such as our Chief Executive Officer, our President, our Chief Financial Officer, and our General Counsel. To the extent personnel we attempt to hire 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 the personnel we need to operate our business. We cannot assure you that we will be able to attract and retain key personnel.

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. 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 mortgage loans in the secondary market may, in some circumstances, require us to maintain various state licenses. Acquiring the right to service residential 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 residential 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 residential 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 Bureau that are applicable to our business. One of the Bureau’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 MSRs) 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 Bureau against us that could restrict our business, expose us to penalties or other claims, negatively impact our financial results, and damage our reputation.

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. 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.

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 residential or commercial 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.
Maintaining cybersecurity is important to our business and a breach of our cybersecurity could have a material adverse impact. 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. When we acquire residential mortgage loans, or the rights to service residential 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 party service providers, including loan sub-servicers, or with third parties interested in acquiring such loans from us. We have acquired more than 90,000 residential mortgage loans and rights to service residential mortgage loans since 2010 and also acquired thousands of residential mortgage loans prior to 2010. 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 party 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 exposes 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 exposes 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.
In addition, 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 we rely upon computer hardware and software systems. 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.
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.

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. 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 may also result 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.

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 assets we manage for others through our investment advisory subsidiary. 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. 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, 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.

Redwood has elected to be a REIT and, as such, is required to meet certain tests in order to maintain its 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 qualify 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 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 income tax at regular corporate rates on our 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 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 25% (20% for taxable years beginning after December 31, 2017) of the value of our total securities 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 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 our book 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 net 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 net 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.
"Qualified dividends" payable to shareholders that are individuals, trusts and estates generally are subject to tax at preferential rates. Subject to limited exceptions, dividends payable by REITs are not eligible for these reduced rates and are taxable at ordinary income tax rates. The more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including the shares of our capital 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 originated and retained as investments commercial mezzanine loans, which are loans secured by equity interests in a partnership or limited liability company that directly or indirectly owns commercial 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 treat as real estate assets generally meet 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 such 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.

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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 January 1, 2016, we had approximately 102 million unissued shares of stock authorized for issuance under our charter (although approximately 30 million of these shares are reserved for issuance under our equity compensation plans, dividend reinvestment and stock purchase plan, 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 operating expenses may increase significantly relative to our capital base.

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 failed to meet the 55% Requirement or the 25% Requirement, we could, among other things, be required either (i) to change the manner in which we conduct our 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.

An SEC review, initiated in 2011, of one section of the Investment Company Act and the regulations and regulatory interpretations promulgated thereunder that we rely on to exempt us from registration and regulation as an investment company under the Investment Company Act could eventually result in legislative or regulatory changes, which could require us to change our business and operations in order for us to continue to rely on that exemption or operate without the benefit of that exemption.

In August 2011, the SEC published a Concept Release within which it reviewed interpretive issues under the Investment Company Act relating to the status under the Investment Company Act of companies that are engaged in the business of acquiring mortgages and mortgage-related instruments and that rely on the exemption set forth in Section 3(c)(5)(C) of the Investment Company Act from requirements under the Investment Company Act. Among other things, the SEC expressed in the Concept Release that it was “concerned that certain types of mortgage-related pools today appear to resemble in many respects investment companies such as closed-end funds and may not be the kinds of companies that were intended to be excluded from regulation under the Investment Company Act by Section 3(c)(5)(C).” To the extent we rely on Section 3(c)(5)(C) of the Investment Company Act to exempt us from regulation under the Investment Company Act, we believe that our reliance is proper. However, additional SEC review and action could eventually lead to legislative or regulatory changes that could affect our ability to rely on that exemption or could eventually require us to change our business and operations in order for us to continue to rely on that exemption. Even if the SEC’s review of this exemption does not eventually have these effects on us, in the interim, while the SEC’s Concept Release is outstanding, any uncertainty created by the SEC’s review process could negatively impact the ability of companies, such as us, that rely on this exemption to raise capital, borrow money, or engage in certain other types of business transactions, which could negatively impact our business and financial results.

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.

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 and limited our operations (including our recent restructuring of certain aspects of our conforming residential mortgage loan operations and repositioning of our commercial mortgage loan business) 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 19, 2016, based on filings of Schedules 13D and 13G with the SEC, we believe that seven institutional shareholders each owned approximately 5% or more 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 90% 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 19, 2016, our directors and executive officers beneficially owned, in the aggregate, approximately 3% 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.
There is a risk that you may not receive dividend distributions or that dividend distributions may decrease over time.
Changes in the amount of dividend distributions we pay, in the tax characterization of dividend distributions we pay, or in the rate at which holders of our common stock are taxed on 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 for tax purposes pursuant to the Internal Revenue Code. We generally intend to distribute to our shareholders at least 90% of our REIT taxable income, although our reported financial results for GAAP purposes may differ materially from our REIT taxable income.
For 2015, we maintained our regular dividend at a rate of $0.28 per share per quarter and in December 2015 our Board of Directors announced its intention to continue to pay regular dividends during 2016 at a rate of $0.28 per share per quarter. Our ability to pay a dividend of $0.28 per share per quarter in 2016 may be adversely affected by a number of factors, including the risk factors described herein. These same factors may affect our ability to pay other future dividends. In addition, to the extent we determine that future dividends would represent a return of capital to investors, 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. 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.
The rate at which holders of our common stock are taxed on dividends we pay and the characterization of our dividends - as ordinary income, capital gains, or a return of capital - could have an impact on the market price of our common stock. In addition, 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 expectation, including due to errors, changes made in the course of preparing our corporate tax returns, or changes made in response to an IRS audit), with the result that holders of our common stock could incur greater income tax liabilities than expected.

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, 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 administrative offices throughout the United States. We do not own any properties and lease the space we utilize for our offices. Additional information on our leases is included in Note 15 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

Location	Lease Expiration
One Belevedere Place, Suite 300 Mill Valley, CA 94941	2018
8310 South Valley Highway, Suite 425 Englewood, CO 80112	2021
1114 Avenue of the Americas, Suite 2810 New York, NY 10036	2021
225 W. Washington St., Suite 1440 Chicago, IL 60606	2019

ITEM 3. LEGAL PROCEEDINGS

On or about December 23, 2009, the Federal Home Loan Bank of Seattle (the “FHLB-Seattle”) filed a complaint in the Superior Court for the State of Washington (case number 09-2-46348-4 SEA) against Redwood Trust, Inc., our subsidiary, Sequoia Residential Funding, Inc. (“SRF”), Morgan Stanley & Co., and Morgan Stanley Capital I, Inc. (collectively, the “FHLB-Seattle Defendants”) alleging that the FHLB-Seattle Defendants made false or misleading statements in offering materials for a mortgage pass-through certificate (the “Seattle Certificate”) issued in the Sequoia Mortgage Trust 2005-4 securitization transaction (the “2005-4 RMBS”) and purchased by the FHLB-Seattle. Specifically, the complaint alleges that the alleged misstatements concern the (1) loan-to-value ratio of mortgage loans and the appraisals of the properties that secured loans supporting the 2005-4 RMBS, (2) occupancy status of the properties, (3) standards used to underwrite the loans, and (4) ratings assigned to the Seattle Certificate. The FHLB-Seattle alleges claims under the Securities Act of Washington (Section 21.20.005, et seq.) and seeks to rescind the purchase of the Seattle Certificate and to collect interest on the original purchase price at the statutory interest rate of 8% per annum from the date of original purchase (net of interest received) as well as attorneys’ fees and costs. The Seattle Certificate was issued with an original principal amount of approximately $133 million, and, as of December 31, 2015, the FHLB-Seattle has received approximately $120 million of principal and $11 million of interest payments in respect of the Seattle Certificate. As of December 31, 2015, the Seattle Certificate had a remaining outstanding principal amount of approximately $13 million. The claims were subsequently dismissed for lack of personal jurisdiction as to Redwood Trust and SRF. Redwood agreed to indemnify the underwriters of the 2005-4 RMBS for certain losses and expenses they might incur as a result of claims made against them relating to this RMBS, including, without limitation, certain legal expenses. The FHLB-Seattle’s claims against the underwriters of this RMBS were not dismissed and remain pending. Regardless of the outcome of this litigation, we could incur a loss as a result of these indemnities.

On or about July 15, 2010, The Charles Schwab Corporation ("Schwab") filed a complaint in the Superior Court for the State of California in San Francisco (case number CGC-10-501610) against SRF and 26 other defendants (collectively, the "Schwab Defendants") alleging that the Schwab Defendants made false or misleading statements in offering materials for various residential mortgage-backed securities sold or issued by the Schwab Defendants. Schwab alleged only a claim for negligent misrepresentation under California state law against SRF and sought unspecified damages and attorneys' fees and costs from SRF. Schwab claims that SRF made false or misleading statements in offering materials for a mortgage pass-through certificate (the "Schwab Certificate") issued in the 2005-4 RMBS and purchased by Schwab. Specifically, the complaint alleges that the misstatements for the 2005-4 RMBS concern the (1) loan-to-value ratio of mortgage loans and the appraisals of the properties that secured loans supporting the 2005-4 RMBS, (2) occupancy status of the properties, (3) standards used to underwrite the loans, and (4) ratings assigned to the Schwab Certificate. On November 14, 2014, Schwab voluntarily dismissed with prejudice its negligent misrepresentation claim, which resulted in the dismissal with prejudice of SRF from the action. The Schwab Certificate was issued with an original principal amount of approximately $15 million, and, as of December 31, 2015, approximately $13 million of principal and $1 million of interest payments have been made in respect of the Schwab Certificate. As of December 31, 2015, the Schwab Certificate had a remaining outstanding principal amount of approximately $1 million. We agreed to indemnify the underwriters of the 2005-4 RMBS, which underwriters were also named and remain as defendants in the action, for certain losses and expenses they might incur as a result of claims made against them relating to this RMBS, including, without limitation, certain legal expenses. Regardless of the outcome of this litigation, Redwood could incur a loss as a result of these indemnities.

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. At December 31, 2015, the aggregate amount of loss contingency reserves established in respect of the FHLB-Seattle and Schwab litigation matters described above was $2 million. 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. 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 trial 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.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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 22, 2016, our common stock was held by approximately 739 holders of record and at February 12, 2016 the total number of beneficial stockholders holding stock through depository companies was approximately 18,637. At February 22, 2016, there were 77,252,837 shares of common stock outstanding.

The high and low sales prices of shares of our common stock, as reported by the Bloomberg Financial Markets service, and the cash dividends declared on our common stock for each full quarterly period during 2015 and 2014 were as follows:

	Stock Prices		Common Dividends Declared			
	High	Low	Record Date	Payable Date	Per Share	Dividend Type
Year Ended December 31, 2015						
Fourth Quarter	$14.25	$12.55	12/17/2015	12/29/2015	$0.28	Regular
Third Quarter	$16.20	$13.84	9/15/2015	9/30/2015	$0.28	Regular
Second Quarter	$18.54	$15.70	6/16/2015	6/30/2015	$0.28	Regular
First Quarter	$20.38	$17.87	3/17/2015	3/31/2015	$0.28	Regular
Year Ended December 31, 2014						
Fourth Quarter	$20.36	$15.97	12/15/2014	12/29/2014	$0.28	Regular
Third Quarter	$20.09	$16.53	9/15/2014	9/30/2014	$0.28	Regular
Second Quarter	$21.90	$18.82	6/13/2014	6/30/2014	$0.28	Regular
First Quarter	$21.32	$18.20	3/14/2014	3/31/2014	$0.28	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 earnings, 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, 2016, for dividend distributions made in 2015, we expect 100% of our dividends paid in 2015 to be characterized as ordinary income. None of the dividend distributions made in 2015 are expected to be characterized for federal income tax purposes as return of capital or long-term capital gain dividends.

During the year ended December 31, 2015, we did not sell any equity securities that were not registered under the Securities Act of 1933, as amended.

In August 2015, our Board of Directors authorized the repurchase of up to $100 million of our common stock. During the year ended December 31, 2015, there were approximately 6.5 million shares repurchased pursuant to this authorization. At December 31, 2015, approximately $11 million of this authorization remained available for the repurchase of shares of our common stock. During the first quarter of 2016, we repurchased shares representing substantially all of the remaining $11 million under this repurchase authorization.

In February 2016, our Board of Directors approved an additional authorization for the repurchase of up to $100 million of our common stock and also authorized the repurchase of outstanding debt securities, including convertible and exchangeable debt. This authorization replaced all previous share repurchase plans and has no expiration date. Our 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.

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, 2015.

(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, 2015 - October 31, 2015	1	$13.84	—	$—
November 1, 2015 - November 30, 2015	1,576	$13.24	1,576	$43,761
December 1, 2015 - December 31, 2015	2,425	$13.42	2,425	$11,214
Total	4,002	$13.35	4,001	

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, 2010. 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.

	2010	2011	2012	2013	2014	2015
Redwood Trust, Inc.	100	74	132	160	172	124
NAREIT Mortgage REIT Index	100	98	117	115	135	123
S&P Composite-500 Index	100	102	118	157	178	181

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data are qualified in their entirety by, and should be read in conjunction with, the more detailed information contained in the Consolidated Financial Statements and Notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Annual Report on Form 10-K and in our Annual Reports on Form 10-K as of and for each of the years ended December 31, 2014, 2013, 2012, and 2011. Certain amounts for prior periods have been reclassified to conform to the 2015 presentation.

(In Thousands, Except Per Share Data)	2015	2014	2013	2012	2011
Selected Statement of Operations Data:					
Interest income	$259,432	$242,070	$226,156	$231,384	$217,179
Interest expense	(95,883)	(87,463)	(80,971)	(120,705)	(98,978)
Net interest income	163,549	154,607	145,185	110,679	118,201
Reversal of (provision for) loan losses	355	(961)	(4,737)	(3,648)	(16,151)
Net interest income after provision	163,904	153,646	140,448	107,031	102,050
Non-interest income					
Mortgage banking and investment activities, net	(10,385)	24,792	96,785	38,132	(40,017)
Mortgage servicing rights income (loss), net	(3,922)	(4,261)	20,309	(1,391)	—
Other income	3,192	1,781	—	—	—
Realized gains, net	36,369	15,478	25,259	54,921	10,946
Total non-interest income, net	25,254	37,790	142,353	91,662	(29,071)
Operating expenses	(97,416)	(90,123)	(86,607)	(65,633)	(47,741)
Other expense	—	—	(12,000)	—	—
Net income before provision for income taxes	91,742	101,313	184,194	133,060	25,238
Benefit from (provision for) income taxes	10,346	(744)	(10,948)	(1,291)	(42)
Net income	102,088	100,569	173,246	131,769	25,196
Less: Net (loss) income attributable to noncontrolling interest	—	—	—	—	(1,147)
Net Income Attributable to Redwood Trust, Inc.	$102,088	$100,569	$173,246	$131,769	$26,343
Average common shares – basic	82,945,103	82,837,369	81,985,897	79,529,950	78,299,510
Earnings per share – basic	$1.20	$1.18	$2.05	$1.61	$0.31
Average common shares – diluted	84,518,395	85,098,579	93,694,924	80,673,682	78,299,510
Earnings per share – diluted	$1.18	$1.15	$1.94	$1.59	$0.31
Regular dividends declared per common share	$1.12	$1.12	$1.12	$1.00	$1.00
Selected Balance Sheet Data:					
Earning assets	$5,976,911	$5,753,753	$4,519,775	$4,343,628	$5,613,753
Total assets	$6,231,027	$5,918,966	$4,608,528	$4,444,098	$5,743,298
Short-term debt	$1,855,003	$1,793,825	$862,763	$551,918	$428,056
Asset-backed securities issued – Resecuritization	$—	$45,044	$94,934	$164,746	$219,551
Asset-backed securities issued – Commercial	$53,137	$83,313	$153,693	$171,714	$—
Asset-backed securities issued – Sequoia	$996,820	$1,416,762	$1,694,335	$2,193,481	$3,710,423
Asset-backed securities issued – Acacia	$—	$—	$—	$—	$209,381
Long-term debt	$2,038,175	$1,194,567	$476,467	$139,500	$139,500
Total liabilities	$5,084,762	$4,662,825	$3,362,745	$3,303,934	$4,850,714
Total stockholders' equity	$1,146,265	$1,256,141	$1,245,783	$1,140,164	$892,584

Number of common shares outstanding	78,162,765	83,443,141	82,504,801	81,716,416	78,555,908
Book value per common share	$14.67	$15.05	$15.10	$13.95	$11.36
Other Selected Data:					
Average assets	$6,015,420	$5,356,839	$4,904,878	$5,318,442	$5,357,065
Average debt and ABS issued outstanding	$4,505,079	$3,871,404	$3,571,389	$4,130,216	$4,148,421
Average stockholders’ equity	$1,240,345	$1,250,627	$1,200,461	$987,330	$1,003,523
Net income/average stockholders’ equity	8.2 %	8.0 %	14.4 %	13.3 %	2.6 %

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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 consolidated 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 financial review 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, focuses on investing in mortgage- and other real estate-related assets and engaging in mortgage banking activities. We seek to invest in real estate-related assets that have the potential to generate attractive cash flow returns over time and to generate income through our mortgage banking activities. During 2015, we operated our business in three segments: residential mortgage banking, residential investments, and commercial mortgage banking and investments.

Our primary sources of income are net interest income from our investment portfolios and 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 consists of the profit we seek to generate through the acquisition of loans and their subsequent sale or securitization. For tax purposes, Redwood Trust, Inc. is structured as a real estate investment trust ("REIT"). We generally refer, collectively, to Redwood Trust, Inc. and those of its subsidiaries that are not subject to subsidiary-level corporate income tax as "the REIT" or "our REIT." We generally refer to subsidiaries of Redwood Trust, Inc. that are subject to subsidiary-level corporate income tax as "our operating subsidiaries" or "our taxable REIT subsidiaries" or "TRS."

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

Business Update

Despite the turmoil, uncertainty, and liquidity challenges facing the fixed income and equity markets, we are upbeat and reassured in our outlook for Redwood's earnings and growth prospects for 2016 and beyond. We recently repositioned our residential and commercial mortgage banking businesses, and believe this action will result in several important benefits going forward. Specifically, we expect it to reduce the drag and volatility these businesses placed on our recent results. It also strengthens our capital and liquidity and positions us to pursue attractive investment opportunities - including the possibility of buying back our own common shares.

In this Business Update, we will provide a high level summary of our fourth quarter of 2015 operating results, a review of our recent repositioning of our residential and commercial mortgage banking businesses, a high level review of our capital, liquidity, and investments, and a review of our current business strategy and the outlook for our businesses in 2016. A review of our full year 2015 operating results is set forth below in the section titled "2015 Financial Overview," which section also includes further detail on our capital, liquidity, and investments.

Fourth Quarter of 2015 Operating Results.

Our fourth quarter operating and financial highlights include the following:

- Our GAAP earnings were $0.46 per share for the fourth quarter of 2015, as compared to $0.22 per share for the third quarter of 2015. Earnings increased from higher net interest income from investments, higher jumbo mortgage banking margins, and higher realized gains from sales of residential securities.
- Our GAAP book value was $14.67 per share at December 31, 2015, as compared to $14.69 per share at September 30, 2015. Higher earnings and accretion from share repurchases were offset by our fourth quarter dividend distribution and a decrease in unrealized gains from securities that were sold during the fourth quarter of 2015. During the fourth quarter, we utilized our stock buyback authorization to repurchase approximately 4.0 million shares of common stock at an average price of $13.35 per share. These share repurchases increased book value by $0.07 per share for the fourth quarter of 2015.
- We deployed $116 million of capital in the fourth quarter of 2015 toward new investments, including $51 million invested in loans held by our FHLB-member subsidiary, $34 million of investments in residential securities, $21 million of investments in MSRs, and $4 million of commercial investments. Additionally, we deployed $53 million of capital to repurchase Redwood common stock as described above.
- Residential loans held for investment by our FHLB-member subsidiary increased by 32% during the fourth quarter of 2015, from $1.4 billion at September 30, 2015, to $1.8 billion at December 31, 2015. As of February 19, 2016, this subsidiary had increased its FHLB borrowings to $2 billion and we expect to increase loans held for investment by this subsidiary to $2.3 billion by the end of the first quarter of 2016. The weighted average maturity of these borrowings is approximately 9.5 years.
- We sold $130 million of residential securities during the fourth quarter of 2015, which generated realized gains on sale of $20 million, or $0.20 per share, and $123 million of capital for reinvestment after the repayment of associated debt.
- MSR income was $3 million for the fourth quarter of 2015, as compared to $4 million for the third quarter of 2015. Higher hedging expenses and spread widening on MSR investments during the fourth quarter reduced MSR investment returns below our normalized expectations.
- Mortgage banking and investment activities, net, was negative $4 million for the fourth quarter of 2015, as compared to negative $13 million for the third quarter of 2015. The improvement was primarily due to lower volatility in benchmark interest rates during the fourth quarter, which reduced hedging expenses associated with certain residential securities. Based upon the accounting elections we apply, positive valuation changes for the derivatives hedging these securities was reflected in our fourth quarter GAAP income, with the majority of the corresponding reduction in value of the hedged securities recorded through the balance sheet.
    - In the fourth quarter of 2015, income from mortgage banking activities declined $1 million from the third quarter of 2015. Residential mortgage banking income improved by $1 million during the fourth quarter due to higher margins on jumbo loan sales. Income from commercial mortgage banking declined $2 million due to a combination of lower origination volume and lower margins in the fourth quarter.
- We purchased $2.2 billion of residential loans during the fourth quarter of 2015, which contributed to total purchases of $10.5 billion for the full year of 2015. Fourth quarter sales of residential loans were $2.1 billion, which contributed

to total sales of $9.3 billion for the full year of 2015. Total 2015 sales included $1.4 billion of loans securitized, $5.5 billion of loans sold to the GSEs, and $2.5 billion of jumbo loans sold to third parties.

- Operating expenses were $23 million for the fourth quarter of 2015, as compared to $24 million for the third quarter of 2015. The decline was primarily due to a decrease in compensation expense, as we adjusted our full year accrual to reflect the impact from underperformance by our mortgage banking businesses.

Repositioning of Residential and Commercial Mortgage Banking Businesses.

In January and February of 2016, we announced the repositioning of our conforming residential loan operations and our commercial loan origination business. Collectively, repositioning these businesses will result in an estimated $6-7 million of severance and other nonrecurring charges that we expect to expense predominately in the first quarter of 2016. On a recurring basis, we expect to eliminate the earnings drag from the loss that we incurred from these two areas of our business during 2015. In addition, the repositioning of these two areas of our business is expected to free up approximately $150 million of capital for redeployment.

With respect to our conforming residential loan operations, we decided to discontinue our aggregation and loan sale activity in order to focus on other ways to acquire conforming mortgage servicing rights and participate in conforming mortgage risk-sharing transactions. We no longer believe that our conforming loan platform can generate sufficient loan sale margins, primarily due to competitive pricing pressure from major financial institutions. We have observed these financial institutions acquiring and retaining a portion of their conforming loan origination volume for portfolio investment. This is a change from our historical observations of these institutions, which typically saw the majority of 30-year fixed rate conforming loans sold through Agency-backed mortgage-backed securities transactions. We believe this change has been largely driven by high levels of liquidity within the banking system and unusually high guarantee fees charged by the Agencies relative to pre-financial-crisis levels. We have maintained our seller/servicer approvals from the Agencies, should our assumptions change in the future.

With respect to our commercial loan origination business, over the last 15 months excess lending capacity, pressure on credit spreads, and increased market volatility has significantly eroded the profit opportunity we once saw in this line of business. We have concluded these factors are unlikely to change in the foreseeable future, and in these conditions we cannot achieve proper scale to maintain pricing power and to profitably execute through the CMBS market.

Capital, Liquidity and Investments.

Assessing our current capital needs requires us to consider variables such as the relative attractiveness of third-party investment opportunities; the trading price of our common stock; and the liquidity capital needed to meet financial covenants or obligations made to our debt counterparties, all of which dynamically change and will continue to impact our day-to-day capital deployment decisions. We believe that the severe volatility and credit spread widening recently observed in the debt markets is signaling an element of potential dislocation and our response is to operate defensively and cautiously. This requires us to maintain or enhance Redwood’s already strong liquidity, in coordination with other uses of capital.

We estimate our capital available for investment, after completing the above-described repositioning of two areas of our business, will be in excess of $200 million. We will consider the following relevant factors, among others, when determining how much of this capital is allocated among share repurchases, maintaining our strong liquidity, and new investments:

- We fully utilized the $100 million stock repurchase authorization approved by Redwood’s Board of Directors in the third quarter of 2015. Subsequently, on February 24, 2016, our Board of Directors approved a new $100 million stock repurchase authorization. The pace and extent to which this authorization is used going forward will be based on the factors outlined above. The relative attractiveness of buying back shares remains the benchmark against which competing investment opportunities and capital decisions will be measured.
- We continually monitor the borrowing levels under our securities repurchase (or “repo”) facilities, which are subject to margin calls to the extent securities prices fall. Our outstanding balance under repurchase facilities was $578 million as of February 19, 2016. In light of the dislocation noted above, we intend to reduce this financing in the next few months through the sale of securities and by using excess cash reserves.
- We also consider the upcoming maturity of our $493 million of outstanding convertible and exchangeable debt ($288 million is due in 2018, with the remainder due in late 2019). While we may be able to attractively refinance this debt as it matures, we are also preparing for repayment and could evaluate sales of unencumbered portfolio assets as one source of funds for that purpose as we approach these maturity dates. In addition, we may also have opportunities to repurchase a portion of this debt at attractive prices prior to maturity.

A final consideration pertaining to our capital deployment is to keep some capital for attractive investment opportunities that may arise, and that we are beginning to see as a result of recent market dislocations. This is a strategy that proved successful for us in the post-crisis RMBS market. We also continue to evaluate our existing portfolio to ensure that our deployed capital is generating attractive risk-adjusted returns relative to other investment opportunities.

Current Business Strategy and 2016 Outlook.

Although our tactics have changed, our business strategy continues to be focused on creating attractive investments in residential and commercial mortgage credit. In 2016, we plan to have approximately 95% of our capital deployed in investment activities, while moving forward with three key areas of focus.

First, we expect our investment portfolio to generate attractive and reliable income in 2016 and beyond. A significant portion of this portfolio is funded with FHLB debt financing with attractive terms. We expect our investment portfolio to generate strong cash flows in 2016 and generate an increased amount of net interest income compared to 2015.

Second, our core jumbo mortgage banking franchise is well positioned and remains consistently profitable despite evolving market conditions. This business represents an engine for creating future investments, and contributes direct fee income and sourcing capabilities that cannot be easily replicated. While we expect our jumbo mortgage banking activities to focus primarily on whole loan acquisitions and sales in 2016, our flagship Sequoia securitization platform remains an active option and is positioned to efficiently create investments as opportunities arise. Our FHLB-funded captive insurance subsidiary continues to source loans for its investment portfolio through our jumbo mortgage-banking activities as its existing jumbo loan investments pay down.

Third, we expect that extended dislocation in the mortgage capital markets may result in significant opportunities to invest capital in high yielding assets. These may include traditional RMBS, CMBS, and credit-risk sharing transactions. We have taken the necessary steps to strengthen our liquidity and will be offensively-minded to the extent difficult markets force good assets to trade at distressed prices.

Overall, we believe that the recently announced changes to our residential and commercial operations have put us in a position to improve on our 2015 financial results. More importantly, we believe these changes will enable us to operate leaner, and with a renewed investment focus going forward. This reflects our current anticipation of growth in portfolio net interest income from deploying capital into increased investments and improved residential mortgage banking margins due to our focus on more profitable whole loan sale distributions. It also reflects a lower expectation for operating expenses which includes the benefit from the reduction associated with the repositioning of our mortgage banking business.

2015 Financial Overview

This section includes an overview of some of the significant factors impacting our 2015 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 2015 and 2014.

Table 1 - Selected Financial Highlights

	December 31,	
(Dollars in Thousands, Except per Share)	2015	2014
GAAP net income	$102,088	$100,569
Net income per diluted common share	$1.18	$1.15
REIT taxable income per share	$1.05	$0.77
Dividends per share	$1.12	$1.12
Book value per share	$14.67	$15.05
Return on equity	8.2 %	8.0 %

For the full-year 2015, we generated an 8.2% return on GAAP equity and earned net income in excess of our dividend. The increase in GAAP net income in 2015 was primarily driven by higher net interest income from our residential investment portfolio, gains realized from securities sales, and an income tax benefit for the year. These increases were offset by lower residential and commercial mortgage banking income and higher operating expenses.

Book Value per Share

At December 31, 2015 our GAAP book value was $1.15 billion, or $14.67 per share. The following table sets forth the changes in our GAAP book value per share for the year ended December 31, 2015.

Table 2 – Changes in Book Value per Share

(In Dollars, per share basis)	Year Ended December 31, 2015
Beginning book value	$15.05
Net income	1.18
Change in unrealized gains on securities, net	(0.57)
Change in unrealized losses on derivatives, net	(0.02)
Equity compensation, net	(0.08)
Dividends	(1.12)
Share repurchases	0.11
Adoption of ASU 2014-13	0.12
Ending Book Value per Share	$14.67

GAAP book value per share declined during 2015, despite our earnings more than covering our 2015 dividends paid to shareholders. This decline was primarily due to a decrease in unrealized gains recorded on securities and the effect of equity award distributions.

As many of our residential securities have appreciated in value in prior quarters, the net unrealized gains from these securities (i.e., the difference between the cost basis and the fair value of these securities) have declined as we recognized amortization income and realized gains from the sale of these securities. Although the fair value of our securities increased during 2015, reductions to unrealized gains on securities resulting from the realization of gains from security sales and amortization of purchase discounts on securities more than offset these increases, resulting in net decreases in unrealized gains from securities for the year.

During 2015, we utilized our stock buyback authorization to repurchase approximately 6.5 million shares at an average price of $13.76 per share, which increased book value by $0.11 per share. On January 1, 2015, we adopted ASU 2014-13 and began to account for the financial assets and liabilities of our consolidated Sequoia entities at fair value. As result, we recorded a one-time cumulative effect adjustment of $10 million to equity, which increased book value by $0.12 per share.

Investment Activity

The following table details our capital invested for the year ended December 31, 2015.

Table 3.1 – Investment Activity

(In Thousands)	Year Ended December 31, 2015
Residential	
Sequoia RMBS	$19,831
Third-party RMBS	164,061
Less: Short-term debt/Other liabilities	(102,903)
Total RMBS	80,989
Agency risk sharing transactions	10,560
Loans held-for-investment, net - FHLBC(1)	214,325
MSR investments	95,281
Total residential	401,155
Commercial	
Mezzanine investments	30,220
Less: Short-term debt	(13,956)
Total commercial	16,264
Capital Invested	$417,419

(1) Includes loans transferred to our FHLB-member subsidiary and FHLBC stock acquired, less secured borrowings.

Our allocation of capital invested in 2015 shifted away from Sequoia and third party RMBS, and into residential loans held-for- investment by our FHLB-member subsidiary. The reduction in Sequoia RMBS investments in 2015 was attributable to the reduction in securitizations we sponsored this year, as whole loan sales were a more attractive distribution alternative for our residential loans we did not otherwise retain for our investment portfolio.

During 2015, we sold $438 million of securities, including $260 million of Sequoia securities, for which we realized gains on sales of $36 million. After the repayment of the associated short-term debt, these security sales provided $237 million of capital for reinvestment. A portion of the proceeds from these security sales was used to fund our investments in residential loans, which we expect in aggregate to generate higher returns on capital than the securities we sold.

As of December 31, 2015, we had $3.01 billion of investments in our Residential Investments segment, including $1.03 billion of securities, $1.79 billion of residential loans held-for-investment, and $192 million of MSR investments. In addition, our Commercial Mortgage Banking and Investments segment had $300 million of commercial loans held-for-investment at December 31, 2015.

Capital, Liquidity, and Investments

Capital and Liquidity Position

We use a combination of corporate long-term debt and equity (which we collectively refer to as “capital”) to fund our businesses. We also utilize various forms of collateralized short-term and long-term debt to finance certain investments and to warehouse our inventory of certain residential and commercial loans held-for-sale. We do not consider this collateralized debt as "capital" and, therefore, it is not included in the table below.

Table 3.2 – Capital Position by Maturity
At December 31, 2015

(In Millions)	Less Than 1 Year	1 to 3 Years	3 to 5 Years	Greater than 9 Years	Total
Debt Capital					
Convertible notes	$—	$288	$—	$—	$288
Exchangeable notes	—	—	205	—	205
TruPs debt	—	—	—	140	140
Total debt capital	—	288	205	140	633
Equity capital					1,146
Total Capital	$—	$288	$205	$140	$1,779

Our total capital position was $1.78 billion at December 31, 2015, and included $1.15 billion of equity capital and $0.63 billion of long-term debt.

During 2015, we paid $95 million (or $1.12 per share) in dividends, and $38 million (or $0.45 per share) of interest expense on our convertible/exchangeable debt and trust-preferred securities. We currently anticipate paying similar amounts of interest and dividends on our capital for 2016.

Allocation of Capital and Return Profile

The following table presents the allocation of capital and return profile of investments at December 31, 2015.

Table 3.3 – Allocation of Capital and Return Profile
At December 31, 2015

(Dollars in Millions)	Investments Fair Value	Collateralized Debt	Allocated Capital	% of Total Capital	2015 Return [(1)]
Investments					
Residential loans/FHLB Stock	$1,826	$(1,481)	$345	19%	16%
Residential securities	1,028	(516)	512	29%	10%
Commercial investments	377	(179)	198	11%	11%
Mortgage servicing rights	192	—	192	11%	4%
Other assets/(other liabilities)	95	(36)	59	3%	—%
Available capital			172	10%	—%
Total investments	$3,518	$(2,212)	1,478	83%	9%
Mortgage banking					
Residential - Jumbo			150	8%	7%
Residential - Conforming			50	3%	(22)%
Commercial			100	6%	(3)%
Total mortgage banking			300	17%	(1)%
Total			$1,778	100%	

(1) Includes net interest income, change in market value and associated hedges that flow through GAAP earnings, direct operating expenses, and other income. Excludes realized and unrealized gains and losses on our securities portfolio, corporate operating expenses, and taxes.

Of our total capital of $1.78 billion at December 31, 2015, $1.49 billion (or 83%) was allocated to our investments with the remaining $0.30 billion (or 17%) allocated toward our mortgage-banking activities.

During the first quarter of 2016, we announced the discontinuation of residential conforming mortgage banking activities and commercial loan origination activities. After giving effect to these changes, we expect that approximately 95% of our total capital will be allocated to investments, with the remainder allocated to mortgage banking activities.

Included in our capital allocation is available capital, which represents a combination of capital available for investment and risk capital we held for liquidity management purposes. After taking into account the discontinuation of conforming mortgage banking activities, the discontinuation of commercial loan origination activities, and investments to date in the first quarter of 2016, we estimate that our capital available for investments to be in excess of $200 million at February 19, 2016, up from $172 million at December 31, 2015.

Analysis of Collateralized Debt and Leverage

The following table presents the collateralized debt by maturity years at December 31, 2015.

Table 3.4 – Analysis of Collateralized Debt

At December 31, 2015

(In Millions)	Less Than 1 Year	1 to 8 Years	Greater than 9 Years	Total
Type of debt				
Investments				
Securities repurchase debt	$516	$—	$—	$516
Commercial investments debt[1]	179	—	—	179
Other liabilities	36	—	—	36
FHLB debt [2]	138	—	1,343	1,481
Total investments	869	—	1,343	2,212
Residential mortgage banking				
Residential loan warehouse debt	950	—	—	950
Sequoia repurchase debt	178	—	—	178
Other debt	20	—	—	20
Total mortgage banking	1,148	—	—	1,148
Total	$2,017	$—	$1,343	$3,360

(1) Includes $116 million of non-recourse collateralized debt.

(2) During the first quarter of 2016, our FHLB-member subsidiary increased FHLB debt to $2 billion with a weighted average maturity of approximately 9.5 years.

Our debt-to-equity leverage ratio was 3.4x our reported book value at December 31, 2015. This ratio includes our $633 million of corporate debt capital and $3.3 billion of the $3.36 billion of total collateralized debt. We exclude $116 million of commercial collateralized debt from our leverage calculation, as it is non-recourse to Redwood.

At December 31, 2015, our leverage also included $1.15 billion of short-term debt associated with our residential mortgage banking operations, which consists of loan warehouse and securities repurchase facilities we use to finance our inventory of residential loans and Sequoia triple-A rated securities that we intend to sell to third parties in the near-term. As of February 19, 2016 the repurchase debt associated with the Sequoia triple-A rated securities had declined to $47 million, as a result of the sale of $146 million of these securities to third parties.

At December 31, 2015, our leverage also included $1.48 billion of FHLB debt with a weighted average maturity of 9 years.

Analysis of Residential Investments

Our residential investments portfolio represented 72% of our total capital at December 31, 2015. This portfolio provided the majority of our income during 2015.

Residential Loans/FHLB Stock

At December 31, 2015, our investments in residential loans included $1.78 billion of jumbo residential loans financed with FHLB debt by our FHLB-member subsidiary. In connection with these borrowings, our FHLB-member subsidiary is required to hold $34 million of FHLB stock. These investments generated, in aggregate, GAAP yields (after applicable hedging costs) of 16% for 2015. There were no delinquencies on any loans financed with FHLB debt at December 31, 2015.

We expect our FHLB-member subsidiary to increase its investment in residential loans to $2.30 billion by the end of the first quarter of 2016, financed by $2.0 billion of FHLB debt. Currently, the weighted average maturity of this FHLB debt is approximately 9.5 years with a weighted average cost, at February 19, 2016, of 0.59% per annum. Residential loans held by our FHLB-member subsidiary are pledged as collateral for this FHLB debt.

Under the final rule published by the Federal Housing Finance Agency in January 2016, our captive insurance subsidiary will remain an FHLB member through the five-year transition period for captive insurers. Our FHLB member subsidiary's existing $2.0 billion of advances, which mature beyond this transition period, are permitted to remain outstanding until their stated maturity. As residential loans pledged as collateral for these advances pay down, we are permitted to pledge additional loans or other eligible assets to collateralize these advances.

For 2016, we expect an increase in net interest income from residential loans held for investment, resulting from increased capital invested in a higher average balance of loans held by our FHLB-member subsidiary and financed with FHLB debt.

Residential Securities

Our holdings of residential securities are financed with a combination of capital and collateralized debt in the form of repurchase (or "repo") financing. The following tables present the fair value of our residential securities by segment that are financed and not financed with collateralized debt.

Table 3.5 – Residential Securities

At December 31, 2015

(Dollars in Millions)	Financed with Collateralized Debt	Not Financed with Collateralized Debt	Total	% Financed with Collateralized Debt
Residential investments				
Subordinate	$4	$175	$179	2 %
RE-REMIC	75	90	165	45 %
Mezzanine	315	33	348	91 %
Legacy senior	236	100	336	70 %
Total residential investments	630	398	1,028	61 %
Residential mortgage banking				
Sequoia Triple-A Securities	197	—	197	100 %
Total	$827	$398	$1,225	68 %

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Table 3.6 – Residential Securities Financed with Collateralized Debt
At December 31, 2015

(Dollars in Millions, Except Weighted Average Price)	Residential Securities	Collateralized Debt	Allocated Capital	Weighted Average Price (1)	Financing Haircut(2)
Residential investments					
Subordinate	$4	$(4)	$—	90	14%
Re-REMIC	75	(46)	29	88	38%
Mezzanine	315	(263)	52	97	17%
Legacy senior	236	(203)	33	94	14%
Total residential investments	630	(516)	114	95	18%
Residential mortgage banking					
Sequoia Tripe-A securities	197	(178)	19	101	10%
Total	$827	$(694)	$133	196	16%

(1) Fair value of residential securities per $100 of principal.
(2) Allocated capital divided by fair value of residential securities.

At December 31, 2015, the securities we financed through repurchase facilities had no material credit issues. In addition to the allocated capital listed in the table above that directly supports our repurchase facilities (i.e., "the haircut"), we continue to hold a designated amount of supplemental risk capital available for potential margin calls or future obligations relating to these facilities.

As of December 31, 2015, the weighted average GAAP fair value of our financed securities was 96% of their aggregate principal balance. All financed securities received external market price indications as of December 31, 2015 and were, in aggregate, valued for GAAP financial reporting purposes within 1% of the external market price indications. Between December 31, 2015 and February 19, 2016, our financing terms remained consistent for these securities and our utilization of repurchase financing declined to $578 million. We intend to further reduce this financing in the next few months through the sale of securities and by using available cash, rather than repurchase financing, to fund certain investments.

The majority of the $236 million of legacy senior securities and $75 million Re-REMIC securities noted in the table above are supported by seasoned residential loans originated prior to 2008. The credit performance of these investments continues to exceed our original investment expectations.

The $319 million of mezzanine and subordinate securities financed through repurchase facilities at December 31, 2015, carry investment grade credit ratings and are supported by residential loans originated between 2012 and 2015. The loans underlying these securities have experienced minimal delinquencies to date.

Included in our repurchase financing at December 31, 2015, was $178 million used to finance triple-A rated RMBS retained from our fourth quarter Sequoia securitization and that we hold in our residential mortgage banking segment. As of February 19, 2016 the repurchase financing associated with the Sequoia triple-A rated securities had declined to $47 million, as a result of the sale of $146 million of these securities to third parties. We expect to sell the remainder of these triple-A rated Sequoia securities over the near term.

Mortgage Servicing Rights

At December 31, 2015 we had $192 million, or 11%, of our total capital invested in MSRs. This portfolio includes conforming MSRs retained from loans sold to Fannie Mae and Freddie Mac, conforming MSRs acquired through co-issue relationships with third-party originators, and jumbo MSRs retained from loans transferred to Sequoia securitizations we completed over the past several years. The following table provides information on our MSR portfolio at December 31, 2015.

Table 3.7 – MSR Portfolio Composition
At December 31, 2015

(Dollars in Millions, Except Price and Cost per Loan to Service)	Conforming	Jumbo	Total
Principal [(1)]	$12,560	$5,706	$18,266
Fair value of MSRs	$134	$58	$192
Price [(2)]	$1.07	$1.02	$1.05
Implied multiple [(3)]	4.2x	4.1x	4.2x
GWAC [(4)]	3.86 %	3.99 %	3.90 %
Key assumptions in determining fair value			
Discount rate	9 %	11 %	9 %
Cost per loan to service	$82	$72	$79
Constant prepayment rate (CPR) of associated loans	9 %	11 %	10 %

(1) Represents principal balance of residential loans associated with MSRs in our portfolio.
(2) Fair value per $100 of principal.
(3) Price divided by annual base servicing fee of 25 basis points.
(4) Gross weighted average coupon of associated residential loans.

The following table provides information on the components of MSR income in 2015.

Table 3.8 – Components of MSR Income

(Dollars in Millions)	Year Ended December 31, 2015
Net servicing fee income	$34
Change in value from the realization expected cashflows	(19)
MSR provision for repurchases	(1)
MSR income before effect of assumption changes	14
Net effect of changes in assumptions and interest rates	
Changes in MSR assumptions[(1)]	(5)
Changes of associated derivatives[(2)]	(1)
Total net effect of changes in assumptions and interest rates	(6)
Mortgage servicing rights income, net	8
Operating expenses	(2)
Contribution from MSRs	$6
Average balance of MSRs in 2015	$155
MSR return	4 %

(1) Primarily reflects changes in prepayment assumptions on our MSRs due to changes in market interest rates.
(2) Includes a $13 million loss associated with derivatives recorded in MSR income on our consolidated income statement and $12 million of income on a hedges allocated in the first quarter of 2015 that were recorded to residential mortgage banking and investment activities, net.

Interest rate volatility during the early part of 2015 increased derivative expenses and reduced earnings in 2015 from our investment in MSRs below our normalized expectations. For 2016, we expect this investment to generate returns within our normalized range of expectations.

Over the past few quarters, our jumbo mortgage banking business has not created significant investments in MSRs due to most loans being sold in whole loan form without our retaining the servicing rights. In 2016, new investments in MSRs are expected to be created primarily through co-issue relationships with conforming originators who sell the associated residential loans directly to the GSEs.

Analysis of Residential Mortgage Banking

Our residential mortgage banking business includes all activities associated with the sourcing and distribution of residential loans as summarized below.

Table 3.9 – Residential Mortgage Banking 2015 Pre-tax Return Summary

	Year Ended December 31, 2015		
(Dollars in Millions)	Jumbo	Conforming	Total
Allocated capital	$150	$50	$200
Net interest income	$29	$6	$35
Mortgage banking activities, net	2	6	8
Operating expenses	(20)	(23)	(43)
Pre-tax contribution	$11	$(11)	$—
Return metrics			
Return on capital	7.4%	(21.7)%	0.1%
Loan sale margins (in basis points)(1)	59	24	42
Pre-tax net margin (in basis points)	21	(22)	—

(1) Defined as net interest income plus mortgage banking activities, net divided by loan purchase commitments.

Table 3.10 – Residential Mortgage Banking 2015 Activity Summary

	Year Ended December 31, 2015		
(In Millions)	Jumbo	Conforming	Total
Loans purchased	$5,140	$5,335	$10,475
Loan distributions			
Sales	$2,462	$5,454	$7,916
Securitizations	1,400	—	1,400
Loans held for investment by our FHLB-member subsidiary	1,310	—	1,310
Total distributions	$5,172	$5,454	$10,626
Investments created			
Sequoia securities/GSE risk sharing arrangements	$14	$11	$25
MSRs(1)	9	56	65
Net investment in loans held by FHLB-member subsidiary	214	—	214
Total investments created	$237	$67	$304

(1) Excludes $31 million of investments in conforming MSRs created through our co-issue relationships.

During the first half of 2015, our jumbo mortgage banking operations were adversely affected by high interest rate volatility, and dislocation in the jumbo securitization market. In the second half of 2015, we repositioned our distribution of jumbo loans towards whole loan sales and retaining loans for investment financed with FHLB debt, which increased both margins and income relative to the first half of 2015. We expect to continue to distribute the majority of our jumbo loans through our whole loan sale network in 2016.

As a result of the discontinuation of our conforming loan mortgage banking activities, we have reduced our capital allocation to our residential mortgage banking business to $150 million in the first quarter of 2016 from $200 million at December 31, 2015.
At December 31, 2015, we had $950 million of warehouse debt outstanding to fund residential mortgages held-for-sale. In aggregate, we used our warehouse facilities to fund the acquisition and sale of over $10 billion of residential loans during 2015. Our warehouse capacity, at December 31, 2015, totaled $1.4 billion with four separate counterparties, which should continue to provide sufficient liquidity to fund our residential mortgage banking operations in 2016.

RESULTS OF OPERATIONS
In the second quarter of 2015, we modified the presentation of our consolidated income statement to more clearly present the offsetting impact of volatile interest rates throughout our business. These modifications exclusively impacted the "Non-interest income" portion of our consolidated income statement. Additional information on these changes is provided in Note 2 of our Notes to Consolidated Financial Statements in Part II, Item 8 of this Annual Report on Form 10-K. Throughout this section, we provide additional analysis on how these changes impacted the presentation of our financial results in 2015 and how they are comparable to prior periods.
The following table presents the components of our GAAP net income for the years ended December 31, 2015, 2014, and 2013.
Table 4 – Net Income

	Years Ended December 31,			Changes	
(In Thousands, Except per Share Data)	2015	2014	2013	'15/'14	'14/'13
Net Interest Income	$163,549	$154,607	$145,185	$8,942	$9,422
Reversal of (provision for) loan losses	355	(961)	(4,737)	1,316	3,776
Net Interest Income After Provision	163,904	153,646	140,448	10,258	13,198
Non-interest Income					
Mortgage banking and investment activities, net	(10,385)	24,792	96,785	(35,177)	(71,993)
MSR income (loss), net	(3,922)	(4,261)	20,309	339	(24,570)
Other income	3,192	1,781	—	1,411	1,781
Realized gains, net	36,369	15,478	25,259	20,891	(9,781)
Total non-interest income	25,254	37,790	142,353	(12,536)	(104,563)
Operating expenses	(97,416)	(90,123)	(86,607)	(7,293)	(3,516)
Other expense	—	—	(12,000)	—	12,000
Net income before income taxes	91,742	101,313	184,194	(9,571)	(82,881)
(Provision for) benefit from income taxes	10,346	(744)	(10,948)	11,090	10,204
Net Income	$102,088	$100,569	$173,246	$1,519	$(72,677)
Diluted earnings per common share	$1.18	$1.15	$1.94		

Net Interest Income
The $9 million increase in net interest income in 2015, as compared to 2014, was primarily attributable to a higher average balance of loans held-for-investment during 2015 at our residential investments segment, as well as a higher average balance of loans held-for-sale during 2015 at our residential mortgage banking segment. These increases in net interest income were offset by lower interest income from securities held at our residential investment segment, as well as an increase in interest expense from corporate borrowings during 2015 from exchangeable debt issued in the fourth quarter of 2014. In addition, net interest income from our consolidated Sequoia entities increased in 2015, as the result of the adoption of a new accounting standard.

The $9 million increase in net interest income in 2014, as compared to 2013, was primarily attributable to a higher average balance of securities and loans held-for-investment in 2014 at our residential investments segment, as well as higher average balances of loans held-for-sale during 2014 at both our residential and commercial mortgage banking segments. These increases in net interest income were offset by an increase in interest expense from corporate borrowings during 2014, including convertible and exchangeable debt issued in the first quarter of 2013 and the fourth quarter of 2014, respectively. In addition, we earned less net interest income from our Legacy Consolidated Entities in 2014 as the loans in these securitizations continue to pay down.

Additional detail on changes in net interest income at Redwood is provided in the “Net Interest Income” section below.

Provision for Loan Losses

During the year ended December 31, 2015, our reversal of provision for loan losses related entirely to our commercial loan investments and primarily resulted from repayments of commercial loans. The provision for loan losses in 2014 and 2013 is primarily related to our residential loans held-for-investment at our consolidated Sequoia entities. Subsequent to our adoption of ASU 2014-13 on January 1, 2015, we no longer have a provision for loan losses on residential loans held-for-investment at consolidated Sequoia entities as these loans are now carried at fair value. Additional information on the adoption of ASU 2014-13 is provided in the “Results of Consolidated Sequoia Entities” section that follows.

Mortgage Banking and Investment Activities, net

Income from mortgage banking and investment activities, net includes results from both our residential and commercial mortgage banking operations as well as income from market valuation changes on our investments that are carried at fair value, including trading securities, residential loans held-for-investment, and their associated derivatives.

The $35 million decrease in 2015, as compared to 2014, was primarily attributable to lower mortgage banking income from both our residential and commercial mortgage banking operations, which decreased $13 million and $11 million, respectively. In both cases, loan sale margins declined primarily due to increased competition and higher hedging expenses resulting from increased interest rate volatility during 2015. The remaining $11 million reduction in 2015 was from investment activities, which primarily resulted from higher negative market valuation adjustments on FHLB financed loans and their associated hedges.

The $72 million decrease in 2014, as compared to 2013, was primarily attributable to lower mortgage banking income from both our residential and commercial mortgage banking operations, which decreased $58 million and $10 million, respectively, and a $4 million decrease from investment activities.

Additional detail on mortgage banking activities is included in the Residential Mortgage Banking Segment and Commercial Mortgage Banking and Investments Segment portions of the “Results of Operations by Segment” section below.

MSR Income (Loss), net

MSR income (loss), net is comprised of the net fee income we earn from our MSR investments, changes in their market value and, beginning of the second quarter of 2015, changes in the market value of derivatives used to hedge our exposure to interest rate risk from our MSR investments.

Prior to the second quarter of 2015, we hedged our MSRs on an enterprise-wide basis and did not have specific derivatives identified to allocate to MSR income. The MSR losses in 2015 and 2014 primarily reflect the negative change in market value of our MSRs during the first quarter of 2015 and the full year 2014, resulting from a decrease in market interest rates during those periods. The MSR income in 2013 resulted from an increase in market interest rates during that period. The offsetting changes in the value of assets and derivatives that effectively served as hedges to the MSRs during those periods are presented in the mortgage banking and investment activities, net line item.

Additional detail on our investment in MSRs is included in the Residential Investments Segment portion of the “Results of Operations by Segment” section that follows.

Realized Gains, Net

Net gains recorded in 2015, 2014, and 2013, primarily resulted from the sale of $366 million, $440 million, and $176 million of AFS securities during each year, respectively. For additional detail on realized gains, see the Residential Investments Segment portion of the “Results of Operations by Segment” section that follows.

Operating Expenses

The increase in operating expenses in 2015 and 2014 was primarily due to additional costs associated with the expansion of our residential and commercial mortgage banking operations during the last three years. This expansion included an increase in year-end headcount from 141 in 2013 to 221 in 2014. Although our headcount decreased to 211 at year-end, the average number of employees was materially higher during the year, as we did not begin to reduce headcount until the fourth quarter of 2015.

Other Income and Other Expense

Other income in 2015 was primarily comprised of income from our risk sharing arrangements with the Agencies. Other income in 2014 was primarily related to a reduction in our litigation reserve. Other expense in 2013 resulted from litigation reserves we established in 2013.

(Provision for) Benefit From Income Taxes

Our income taxes result almost entirely from activity at our taxable REIT subsidiaries, which includes our residential and commercial mortgage banking activities, our net hedging activities, and our MSR investments. The benefit from income taxes in 2015 resulted from GAAP losses generated at our TRS while the provision for income taxes during 2014 and 2013 resulted from GAAP income generated at our TRS during those years. Losses at our TRS during 2015 were primarily due to lower mortgage banking income and negative market valuation adjustments on derivatives used to hedge our investment portfolio. Higher GAAP income earned from residential and commercial mortgage banking operations during 2013 primarily contributed to a higher tax provision that year.

For additional detail on income taxes, see the “Taxable Income” section that follows.

Net Interest Income

The following tables present the components of net interest income for the years ended December 31, 2015, 2014, and 2013.

Table 5 – Net Interest Income

(Dollars in Thousands)	Years Ended December 31, 2015 Interest Income/ (Expense)	2015 Average Balance (1)	2015 Yield	2014 Interest Income/ (Expense)	2014 Average Balance (1)	2014 Yield	2013 Interest Income/ (Expense)	2013 Average Balance (1)	2013 Yield
Interest Income									
Residential loans, held-for-sale	$47,221	$1,289,684	3.7 %	$38,679	$993,089	3.9 %	$33,353	$823,049	4.1 %
Residential loans - HFI at Redwood (2)	42,680	1,107,603	3.9 %	4,484	118,792	3.8 %	—	—	— %
Residential loans - HFI at Sequoia (2)	24,814	1,224,857	2.0 %	25,786	1,604,556	1.6 %	33,663	1,980,126	1.7 %
Commercial loans - held-for-sale	4,733	109,652	4.3 %	6,286	132,475	4.7 %	3,553	60,245	5.9 %
Commercial loans - HFI (3)	42,200	395,033	10.7 %	41,281	398,039	10.4 %	39,867	336,563	11.8 %
Trading securities	17,613	150,372	11.7 %	22,893	136,383	16.8 %	24,654	117,685	20.9 %
Available-for-sale securities	79,835	886,966	9.0 %	102,589	1,308,373	7.8 %	90,909	1,035,981	8.8 %
Other interest income	336	225,292	0.1 %	72	156,167	— %	157	154,829	0.1 %
Total interest income	259,432	5,389,459	4.8 %	242,070	4,847,874	5.0 %	226,156	4,508,478	5.0 %
Interest Expense									
Short-term debt	(30,572)	1,671,184	(1.8)%	(25,990)	1,522,965	(1.7)%	(17,436)	988,615	(1.8)%
ABS issued - Redwood	(5,822)	87,982	(6.6)%	(10,383)	190,694	(5.4)%	(13,840)	283,835	(4.9)%
ABS issued - Sequoia (2)	(15,647)	1,164,887	(1.3)%	(20,844)	1,541,282	(1.4)%	(25,876)	1,904,320	(1.4)%
Long-term debt - FHLBC	(2,848)	894,671	(0.3)%	(265)	99,945	(0.3)%	—	—	— %
Long-term debt - other	(40,994)	686,354	(6.0)%	(29,981)	516,518	(5.8)%	(23,819)	394,617	(6.0)%
Total interest expense	(95,883)	4,505,078	(2.1)%	(87,463)	3,871,404	(2.3)%	(80,971)	3,571,387	(2.3)%
Net Interest Income	$163,549			$154,607			$145,185		

(1) Average balances for residential and commercial loans held-for-sale, residential loans held-for-investment at Redwood and at Sequoia entities in 2015, 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-Sequoia in 2015, which is based upon fair value.

(2) Interest income from residential loans held-for-investment ("HFI") at Redwood exclude loans HFI at consolidated Sequoia entities. Interest income from residential loans - HFI at Sequoia and the interest expense from ABS issued - Sequoia represent activity from our consolidated Sequoia entities.

(3) Excluding A-notes sold, but accounted for as secured borrowings, the yield on commercial loans HFI was 11.9%, 11.3%, and 11.8% for the years ended December 31, 2015, 2014, and 2013, respectively.

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 6 - Net Interest Income - Volume and Rate Changes

	Change in Net Interest Income For the Years Ended December 31,					
	2015			2014		
(In Thousands)	Volume	Rate	Total	Volume	Rate	Total
Net Interest Income for the Beginning of the Year			$154,607			$145,185
Impact of Changes in Interest Income						
Residential loans - HFS	$11,552	$(3,010)	8,542	$6,891	$(1,565)	5,326
Residential loans - HFI FVO	37,324	872	38,196	4,484	—	4,484
Residential loans - HFI	(6,102)	5,130	(972)	(6,385)	(1,492)	(7,877)
Commercial loans - HFS	(1,083)	(470)	(1,553)	4,260	(1,527)	2,733
Commercial loans - HFI	(311)	1,230	919	7,282	(5,868)	1,414
Trading securities	2,348	(7,628)	(5,280)	3,917	(5,678)	(1,761)
Available-for-sale securities	(33,042)	10,288	(22,754)	23,903	(12,223)	11,680
Other Interest Income	32	232	264	1	(86)	(85)
Net changes in interest income	10,718	6,644	17,362	44,353	(28,439)	15,914
Impact of Changes in Interest Expense						
Short-term debt	(2,529)	(2,053)	(4,582)	(9,424)	870	(8,554)
ABS issued - Redwood	5,593	(1,032)	4,561	4,542	(1,085)	3,457
ABS issued - Sequoia	5,090	107	5,197	4,933	99	5,032
Long-term debt - FHLBC	(2,107)	(476)	(2,583)	(265)	—	(265)
Long-term debt - Other	(9,858)	(1,155)	(11,013)	(7,358)	1,196	(6,162)
Net changes in interest expense	(3,811)	(4,609)	(8,420)	(7,572)	1,080	(6,492)
Net changes in interest income and expense	6,907	2,035	8,942	36,781	(27,359)	9,422
Net Interest Income for the Year Ended			$163,549			$154,607

The following table presents the components of net interest income for the years ended December 31, 2015, 2014, and 2013.

Table 7– Net Interest Income by Segment

	Years Ended December 31,			Changes	
(In Thousands)	2015	2014	2013	'15/'14	'14/'13
Net interest income by Segment					
Residential Mortgage Banking	$35,053	$45,496	$42,350	$(10,443)	$3,146
Residential Investments	124,191	98,585	86,332	25,606	12,253
Commercial Mortgage Banking and Investments	33,124	31,731	30,743	1,393	988
Corporate/Other	(28,819)	(21,205)	(14,240)	(7,614)	(6,965)
Net Interest Income	$163,549	$154,607	$145,185	$8,942	$9,422

Analysis of Changes in Net Interest Income

2015 versus 2014

The $10 million decrease in net interest income from our residential mortgage banking segment in 2015 primarily resulted from lower average balances of Sequoia IO securities held at this segment during 2015. During the second quarter of 2015, we transferred our Sequoia IO securities held at this segment to our residential investment portfolio. The transfer of these securities accounted for a $15 million decrease in interest income, which was partially offset by a $9 million increase in interest income resulting from a higher average balance of loans held-for-sale during 2015.

The $26 million increase in net interest income from our residential investments segment in 2015 was primarily due to a $35 million increase in net interest income resulting from a higher average balance of residential loans held-for-investment by our FHLB-member subsidiary and financed with FHLBC advances during 2015, as well as additional interest income from the transfer of Sequoia IO securities into this segment in the second quarter of 2015. After being transferred at the end of the first quarter of 2015, these securities generated $9 million of net interest income for our residential investments segment for the year ended December 31, 2015. These increases were partially offset by lower net interest income earned on our AFS securities portfolio, as the average balance of these securities decreased in 2015.

The $1 million increase in net interest income from our commercial mortgage banking and investments segment in 2015 was primarily the result of $4 million of interest income from non-recurring yield maintenance payments received during 2015 from loan prepayments. This increase was partially offset by lower interest income resulting from lower average balances of held-for-sale loans in 2015 as compared to 2014, as well as higher interest expense on short-term commercial warehouse debt resulting from higher average balances of outstanding borrowings in 2015 as compared to 2014.

Additional details regarding the activities impacting net interest income at each segment are included in the “Results of Operations by Segment” section that follows.

The Corporate/Other line item includes interest expense related to long-term debt not directly allocated to our segments and net interest income from consolidated Sequoia entities. Interest expense from long-term debt not directly allocated to our segments (Long-term debt - other in Table 5 above) increased $11 million in 2015, primarily due to the exchangeable debt issued by a taxable subsidiary of ours in November 2014. This increase in interest expense was partially offset by higher net interest income of $4 million from our consolidated Sequoia entities, resulting from the adoption of ASU 2014-13 in January 2015. Details regarding consolidated Sequoia entities are included in the "Results from Consolidated Sequoia Entities" section that follows.

2014 versus 2013

The $3 million increase in net interest income from our residential mortgage banking segment in 2014 primarily resulted from a higher average balance of loans held-for-sale during 2014 as compared to 2013.

The $12 million increase in net interest income from our residential investments segment in 2014 was primarily due to a $12 million increase in interest income resulting from a higher average balance of AFS securities held during 2014, as well as $4 million of interest income from residential loans held-for-investment by our FHLB-member subsidiary that we began to acquire in the second half of 2014.

The $1 million increase in net interest income from our commercial mortgage banking and investments segment in 2014 was primarily due to higher average balances of held-for-sale and held-for-investment commercial loans in 2014 as compared to 2013.

The $7 million increase in net interest income from corporate/other in 2014 was primarily due to $6 million of additional interest expense from long-term debt not directly allocated to our segments, primarily resulting from the issuance of convertible and exchangeable debt in the first quarter of 2013 and the fourth quarter of 2014, respectively. Net interest income from our Legacy Consolidated Entities decreased $3 million to $5 million in 2014 as loans held in these consolidated securitizations paid down.

Specific Borrowing Costs

The following table presents the net interest rate spread between the yield on unsecuritized loans and securities and the debt yield of the short-term debt used in part to finance each investment type at December 31, 2015.

Table 8 – Interest Expense — Specific Borrowing Costs

December 31, 2015	Residential Loans Held-for-Sale	Commercial Loans Held-for-Sale	Commercial Loans Held-for-Investment	Residential Securities
Asset yield	3.91 %	4.84 %	9.75 %	6.69 %
Short-term debt yield	1.90 %	2.61 %	4.46 %	1.47 %
Net spread	2.01 %	2.23 %	5.29 %	5.22 %

For additional discussion on short-term debt, including information regarding margin requirements and financial covenants, see “Risks Relating to Debt Incurred under Short-Term and Long-Term Borrowing Facilities" in the Liquidity and Capital Resources section of this MD&A.

Results of Operations by Segment

The following is a discussion of the results of operations for our three business segments for the years ended December 31, 2015, 2014, and 2013. For additional information on our segments, refer to Note 21 in Part II, Item 8 and Part I, Item 1 of this Annual Report on Form 10-K.

Residential Mortgage Banking Segment

The following table presents the components of segment contribution for the residential mortgage banking segment for the years ended December 31, 2015, 2014, and 2013.

Table 9 – Residential Mortgage Banking Segment Contribution

	Years Ended December 31,			Changes	
(In Thousands)	2015	2014	2013	'15/'14	'14/'13
Interest income					
Loans	$47,222	$38,680	$33,353	$8,542	$5,327
Sequoia securities	5,038	19,592	19,164	(14,554)	428
Total interest income	52,260	58,272	52,517	(6,012)	5,755
Interest expense	(17,207)	(12,776)	(10,167)	(4,431)	(2,609)
Net interest income	35,053	45,496	42,350	(10,443)	3,146
Mortgage banking activities, net	8,268	21,554	79,431	(13,286)	(57,877)
Direct operating expenses	(43,182)	(37,664)	(22,880)	(5,518)	(14,784)
Segment contribution before income taxes	139	29,386	98,901	(29,247)	(69,515)
Benefit from income taxes	4,169	(1,774)	(5,947)	5,943	4,173
Segment Contribution	$4,308	$27,612	$92,954	$(23,304)	$(65,342)

The following tables provide the activity of unsecuritized residential loans during the years ended December 31, 2015 and 2014.

Table 10 – Residential Loans Held-for-Sale — Activity

	Years Ended December 31,					
	2015			2014		
(In Thousands)	Jumbo	Conforming	Total	Jumbo	Conforming	Total
Balance at beginning of period	$1,097,805	$244,714	$1,342,519	$392,765	$11,502	$404,267
Acquisitions	5,140,362	5,335,388	10,475,750	5,020,995	4,006,447	9,027,442
Sales	(3,862,155)	(5,454,215)	(9,316,370)	(3,748,916)	(3,765,386)	(7,514,302)
Transfers between portfolios (1)	(1,309,919)	—	(1,309,919)	(595,488)	(588)	(596,076)
Principal repayments	(77,463)	(2,490)	(79,953)	(28,977)	(1,148)	(30,125)
Changes in fair value, net	(2,711)	6,422	3,711	57,426	(6,113)	51,313
Balance at End of Period	$985,919	$129,819	$1,115,738	$1,097,805	$244,714	$1,342,519

(1) Represents the net transfers of loans into our Residential Investments segment and their reclassification from held-for-sale to held-for-investment.

The following table provides the activity of our retained Sequoia securities for the years ended December 31, 2015, and 2014.

Table 11 – Sequoia Securities Activity

	Years Ended December 31,	
(In Thousands)	2015	2014
Beginning fair value	$93,802	$110,505
Transfers between portfolios (1)	(65,809)	—
Acquisitions (2)	201,041	77,160
Sales	(13,588)	(64,098)
Effect of principal payments(3)	(3,261)	(5,989)
Change in fair value, net	(15,178)	(23,776)
Ending Fair Value	$197,007	$93,802

(1) Effective April 1, 2015, we transferred securities (primarily consisting of Sequoia IOs) held in our Residential Mortgage Banking segment into our Residential Investments segment.

(2) At December 31, 2015, we had retained $197 million of senior securities issued by the Sequoia securitization we sponsored in the fourth quarter of 2015. At the end of January 2016, we had sold $146 million of these securities and expect to sell the remainder in the near-term.

(3) 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.

Overview

During the year ended December 31, 2015, we purchased $10.48 billion of prime residential jumbo and conforming loans, completed four jumbo loan securitizations for a total of $1.40 billion, sold $5.45 billion of conforming loans to Fannie Mae and Freddie Mac (the "Agencies"), and sold $2.46 billion of jumbo loans to third parties. In addition, we had net transfers of $1.31 billion of loans to our Residential Investments segment and financed them with borrowings from the FHLBC. Our pipeline of loans identified for purchase at December 31, 2015, included $959 million of jumbo loans and $182 million of conforming loans (unadjusted for expected fallout). Our residential mortgage banking operations created $338 million and $212 million of investments for our investment portfolio during 2015 and 2014, respectively.

On January 20, 2016, we announced plans to restructure certain aspects of our conforming residential mortgage loan operations by discontinuing the acquisition and aggregation of conforming loans for resale to the Agencies. Additional information on this restructuring and the impact to our business is discussed in the Capital, Liquidity, and Investments portion of the Introduction section of this MD&A.

The decrease in segment contribution from residential mortgage banking for 2015 primarily resulted from a decrease in income from mortgage banking activities resulting from lower loan sale margins as compared to 2014, as well as the transfer of Sequoia securities out of this segment during the second quarter of 2015, which reduced net interest income. Also contributing to the decrease in segment contribution was an increase in direct operating expenses, primarily resulting from higher personnel costs as we increased our internal and external resources during 2014 and the first half of 2015 to manage the increase in loan acquisition volume during that time.

Segment contribution from residential mortgage banking decreased $65 million to $28 million in 2014, primarily due to a decline in income from mortgage banking activities, resulting from lower profit margins experienced in 2014 as well as higher direct operating expenses due to a combination of the higher loan purchase volume and the expansion of our conforming loan platform.

All residential mortgage banking activities are performed in taxable REIT subsidiaries and the provision for income taxes generally changes in relation to the amount of this segment's contribution before income taxes. However, this may not always be the case due to expenses allocated to our taxable REIT subsidiaries that are eliminated in consolidation, but not eliminated for tax provision calculation purposes.

Net Interest Income

Net interest income from residential mortgage banking is primarily comprised of interest income earned on residential loans from the time we purchase the loans to when we sell or securitize them, offset by interest expense incurred on short-term warehouse debt used in part to finance the loans while we hold them on our balance sheet. Prior to the second quarter of 2015, net interest income included interest income from Sequoia securities that were used in part to mitigate certain risks related to interest rate movements on our residential loan pipeline. On April 1, 2015, we permanently transferred all Sequoia IO securities from the Residential Mortgage Banking segment to the Residential Investments segment.

In 2015, interest income from loans held-for-sale increased due to higher average balances of loans outstanding during 2015 as compared to 2014, primarily resulting from higher loan acquisition volumes during 2015. Interest income from Sequoia securities decreased in 2015, primarily resulting from the transfer of Sequoia securities out of this segment in the second quarter of 2015.

In 2014, interest income from loans held-for-sale increased due to higher average balances of loans outstanding during 2014 as compared to 2013, primarily resulting from higher loan acquisition volumes during 2014.

The amount of net interest income we earn on loans held-for-sale is dependent on many variables, including the amount of loans and the time they are outstanding on our balance sheet and their interest rates, as well as the amount of leverage we employ through the use of short-term debt to finance the loans and the interest rates on that debt. These factors will impact interest income in future periods.

Mortgage Banking Activities, Net

Mortgage banking activities, net, includes the changes in market value of both the loans we hold for sale and commitments for loans we intend to purchase (collectively, our loan pipeline), as well as the effect of hedges we utilize to manage risks associated with our loan pipeline. Our loan sale profit margins are measured over the period from when we commit to purchase a loan and subsequently sell or securitize the loan. Accordingly, these profit margins may encompass positive or negative market valuation adjustments on loans, hedging gains or losses associated with our loan pipeline, and any other related transaction expenses, and may be realized over the course of one or more quarters for financial reporting purposes.

Prior to the second quarter of 2015, we utilized a combination of derivatives and Sequoia securities to serve as hedges for our jumbo loan pipeline's exposure to market interest rate changes. In the second quarter of 2015, we transferred all Sequoia securities out of this segment and into our Residential Investments segment, and began to record a hedging allocation between our segments.

The following table presents the components of residential mortgage banking activities, net. Amounts presented include both the changes in market values for loans that were sold and associated derivative positions that were settled during the periods presented, as well as changes in market values of loans, derivatives and hedges outstanding at the end of each year presented.

Table 12 – Components of Residential Mortgage Banking Activities, Net

	Years Ended December 31,			Changes	
(In Thousands)	2015	2014	2013	'15/'14	'14/'13
Changes in fair value of:					
Residential loans, at fair value (1)	$3,712	$51,311	$(10,455)	$(47,599)	$61,766
Sequoia securities	(15,261)	(23,839)	42,451	8,578	(66,290)
Risk management derivatives(2)	14,657	(9,386)	47,387	24,043	(56,773)
Hedging allocation	1,120	—	—	1,120	—
Other income, net (3)	4,040	3,468	48	572	3,420
Total residential mortgage banking activities, net	$8,268	$21,554	$79,431	$(13,286)	$(57,877)

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

(2) Represents market valuation changes of derivatives that are used to manage risks associated with our accumulation of residential loans.

(3) Amounts in this line include other fee income from loan acquisitions and the provision for repurchase expense, presented net.

The decreases in income from mortgage banking activities in 2015 and 2014 primarily resulted from a decrease in loan sale margins on our jumbo loans during the last two years.

At December 31, 2015, we had a repurchase reserve of $5 million outstanding related to residential loans sold through this segment. For each of the years ended December 31, 2015 and 2014, we recorded $2 million of provision for repurchases. We review our loan repurchase reserves each quarter and adjust them as necessary based on current information available at each reporting date.

The following table details outstanding principal balances for residential loans held-for-sale by product type at December 31, 2015.

Table 13 – Characteristics of Residential Loans Held-for-Sale

December 31, 2015 (Dollars In Thousands)	Principal Value	Weighted Average Coupon
First Lien Prime		
Fixed - 30 year	$671,022	4.23 %
Fixed - 15, 20, & 25 year	138,781	3.44 %
Hybrid	276,457	3.32 %
ARM	5,258	3.20 %
Total Outstanding Principal	$1,091,518	

Residential Investments Segment

Our residential investments segment is primarily comprised of our residential securities portfolio, our portfolio of residential mortgage loans held-for-investment and financed through the FHLBC, and our MSR investment portfolio. Certain of our retained Sequoia securities that are included as a component of senior prime trading securities in our consolidated financial statements were included in our residential mortgage banking segment for reporting purposes and are excluded from amounts and tables in this section.
The following table presents the components of segment contribution for the residential investments segment for the years ended December 31, 2015, 2014, and 2013.
Table 14 – Residential Investments Segment Contribution

	Years Ended December 31,			Changes	
(In Thousands)	2015	2014	2013	'15/'14	'14/'13
Interest income	$135,395	$110,433	$96,399	$24,962	$14,034
Interest expense	(11,204)	(11,848)	(10,067)	644	(1,781)
Net interest income	124,191	98,585	86,332	25,606	12,253
Non-interest income					
Investment activities, net	(20,089)	(9,178)	(5,134)	(10,911)	(4,044)
MSR income (loss), net	(3,922)	(4,261)	20,309	339	(24,570)
Other income	3,192	181	—	3,011	181
Realized gains, net	36,369	13,777	24,765	22,592	(10,988)
Total non-interest income (loss), net	15,550	519	39,940	15,031	(39,421)
Direct operating expenses	(4,346)	(3,681)	(4,035)	(665)	354
Segment contribution before income taxes	135,395	95,423	122,237	39,972	(26,814)
Benefit from (provision for) income taxes	847	1,340	(3,027)	(493)	4,367
Total Segment Contribution	$136,242	$96,763	$119,210	$39,479	$(22,447)

The following table presents our portfolios of investment assets in our residential investments segment at December 31, 2015 and December 31, 2014.
Table 15 – Residential Investments

(In Thousands)	December 31, 2015	December 31, 2014	Change
Residential loans held-for-investment	$1,791,195	$581,668	$1,209,527
Residential securities	1,028,171	1,285,428	(257,257)
Mortgage servicing rights	191,976	139,293	52,683
Total residential investments	$3,011,342	$2,006,389	$1,004,953

Overview

During 2015, the increase in our total residential investments was primarily attributable to the addition of residential loans held-for-investment by our FHLB-member subsidiary and financed through the FHLBC. During 2015, we increased our investment of capital into MSRs and residential loans held-for-investment, while we reduced our investments in residential securities. Our residential investments were funded in part with short-term debt, borrowings from the FHLBC, and equity capital. Over three quarters of the residential investments acquired during 2015 were created from our residential mortgage banking operations. Over time we expect the majority of our residential investments will continue to be sourced from our internal operations.

Our redeployment of capital out of residential securities and into held-for-investment residential loans during 2015 has benefited this segment in the form of higher net interest income. Non-interest income has remained volatile during the past two years, primarily due to interest rate hedges on our mezzanine securities, for which valuation changes are recorded in the consolidated income statements, while offsetting valuation changes on the AFS securities are recorded in our balance sheet through accumulated comprehensive income. In addition, gains on sales of securities have fluctuated from period to period as we have sold securities, which has also contributed to overall variability in non-interest income. Despite some periodic variability due to interest rate hedging, overall, we have also benefited from increased income from our additional investments in MSRs during 2015.

Net Interest Income

Net interest income from Residential Investments includes interest income from our residential loans held-for-investment and our securities portfolio, as well as the associated interest expense from short-term debt, FHLBC borrowings, and ABS issued. The following tables present the components of net interest income for our residential investment segment for the years ended December 31, 2015, 2014, and 2013.

Table 16 - Net Interest Income ("NII") from Residential Investments

(Dollars in Thousands)	Years Ended December 31, 2015 Interest Income/ (Expense)	Average Balance [(1)]	Yield	2014 Interest Income/ (Expense)	Average Balance [(1)]	Yield	2013 Interest Income/ (Expense)	Average Balance [(1)]	Yield
Residential loans HFI	$42,680	$1,107,603	3.9 %	$4,484	$118,792	3.8 %	$—	$—	— %
Long-term debt - FHLBC	(2,848)	894,671	(0.3)%	(265)	99,945	(0.3)%	—	—	— %
NII from HFI loans	39,832			4,219			—		
Trading securities	12,575	N/A	N/A	3,301	N/A	N/A	5,490	N/A	N/A
AFS securities	79,835	886,966	9.0 %	102,589	1,308,373	7.8 %	90,909	1,035,981	8.8 %
Short-term debt	(7,746)	550,081	(1.4)%	(9,775)	737,096	(1.8)%	(6,763)	405,725	(1.7)%
ABS issued	(610)	17,762	(4.6)%	(1,808)	67,001	(2.7)%	(3,304)	127,473	(2.6)%
NII from securities	84,054			94,307			86,332		
Other interest income	305			59			—		
NII from Residential Investments	$124,191			$98,585			$86,332		

(1) Average balances for residential loans held-for-investment ("HFI") 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.

The increase in net interest income from our residential investments portfolio for 2015 was primarily attributable to a higher average balance of held-for-investment loans financed through the FHLBC, which we did not begin to invest in until the third quarter of 2014. These increases were partially offset by a decline in interest income from available-for-sale securities, due to lower average balances in 2015 as we sold lower yielding senior and mezzanine securities in order to redeploy capital, primarily into held-for-investment loans.

The increase in net interest income from our residential investments portfolio in 2014, as compared to 2013, was primarily attributable to higher average balances of AFS securities, as well as held-for-investment loans financed through the FHLBC.

Investment Activities, Net

The following table presents the components of investment activities, net for our residential investments segment for the years ended December 31, 2015, 2014, and 2013.

Table 17 - Investment Activities, net from Residential Investments

	Years Ended December 31,		
(In Thousands)	2015	2014	2013
Investment activities			
Market valuation changes:			
Residential loans held-for-investment [(1)]	$(6,337)	$(697)	$—
Trading securities - IOs	956	—	(168)
Securities - other	(3,220)	(923)	(5,189)
Risk sharing investment	(1,886)	104	—
Risk management derivatives	(8,532)	(7,662)	223
Hedging allocation	(1,070)	—	—
Investment activities, net	$(20,089)	$(9,178)	$(5,134)

(1) Market valuation changes from residential loans held-for-investment above do not include loans at consolidated Sequoia entities, which are not included in this segment.

Market valuation changes included in investment activities, net, generally result from changes in the fair value of investments due to changes in market interest rates, changes in credit spreads, and reductions in the basis of residential loans recorded at a premium and IO securities, when those investments remit cash to us. In addition, valuation changes from risk management derivatives associated with our mezzanine securities portfolio are included in investment activities, net, while valuation changes of the mezzanine securities are reported through accumulated other comprehensive income on our balance sheet. This mismatch creates periodic volatility in our investment activities, net as interest rates change each quarter.

Within this segment, our residential loans held-for-investment, trading securities, AFS mezzanine securities, MSR investments and risk sharing investments are all subject to market interest rate risk. Historically, we managed our exposure to market interest rate risk for these assets on an enterprise-wide basis and relied on certain assets (i.e., jumbo loans and jumbo loan purchase commitments) to serve as natural hedges to other assets (i.e., IO securities and risk sharing investments) that each change in value inversely as interest rates change, and then used derivatives to manage our net exposure.

During the second quarter of 2015, we began to allocate specific derivatives used to hedge our exposure to interest rate risk from our MSR investments and present the changes in the value of those derivatives as a component of MSR income (loss), net, on our consolidated income statements. Prior to the second quarter of 2015, changes in the values of investments that in part served as hedges to our MSRs, were presented in investment activities, net, on our consolidated income statements. In addition, during the second quarter of 2015, we transferred all of our Sequoia IO securities that were held in our residential mortgage banking segment into our residential investments segment and began to record a hedging allocation between our segments, reflecting the net effect of hedging provided by assets held in each of our two residential segments.

Investment activities of negative $20 million in 2015 included $12 million of positive valuation changes associated with hedges of our MSR investments (prior to derivatives being specifically identified for MSRs in the second quarter of 2015), $11 million of negative valuation changes attributable to reductions in the basis of IO securities and loans held at premiums, $6 million of negative valuation changes for hedges associated with mezzanine securities (where the securities were marked-to-market through our consolidated income statements), and negative $15 million of valuation changes resulting from the net effect of changes in credit spreads and hedging costs. Market interest rates were highly volatile throughout 2015, and in general, this resulted in increased hedging costs for our various interest rate sensitive assets that we hedge.

Investment activities of negative $9 million in 2014 included $12 million of positive valuation changes associated with hedges of our MSR investments, $11 million of negative valuation changes attributable to reductions in the basis of IO securities, negative $12 million of valuation changes for hedges associated with mezzanine securities, and positive $2 million of valuation changes resulting from the net effect of changes in credit spreads and hedging costs.

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MSR Income (Loss), net

The following table presents the components of MSR income (loss), net for the years ended December 31, 2015, 2014, and 2013.

Table 18 – MSR Income (Loss), net

	Years Ended December 31,			Changes	
(In Thousands)	2015	2014	2013	'15/'14	'14/'13
Servicing income	$38,964	$19,362	$9,239	$19,602	$10,123
Cost of sub-servicers	(5,079)	(1,834)	(925)	(3,245)	(909)
Net servicing fee income	33,885	17,528	8,314	16,357	9,214
Market valuation changes of MSRs					
Changes in assumptions (1)	(5,453)	(12,467)	15,719	7,014	(28,186)
Other changes (2)	(18,939)	(8,614)	(3,724)	(10,325)	(4,890)
Market valuation changes of associated derivatives	(12,708)	—	—	(12,708)	—
Provision for repurchases	(707)	(708)	—	1	(708)
MSR Income (Loss), Net	$(3,922)	$(4,261)	$20,309	$339	$(24,570)

(1) Primarily reflects changes in prepayment assumptions due to changes in market interest rates.

(2) Represents changes due to the realization of expected cash flows.

The increase in net servicing fee income from MSRs during the last three years primarily resulted from higher average balances of MSRs each consecutive year as we have continued to grow this portfolio.

The net MSR loss for 2015 resulted from decreases in market interest rates during the first quarter of 2015, as we did not begin to identify specific derivatives for hedging MSRs until the second quarter of 2015 (as discussed above). During the first quarter of 2015, we managed our exposure to market interest rate risk for our MSRs on an enterprise-wide basis and the associated hedging offset related to changes in market interest rates of positive $12 million during that quarter is presented as a component of investment activities, net on our consolidated income statements. After including the effect of MSR hedges, MSR income for 2015 would be positive $8 million.

Decreases in market interest rates during 2014 resulted in market valuation decreases on our MSR investments that year, whereas market interest rate increases in 2013 resulted in market valuation increases on our MSR investments during that year. As we managed our exposure to market interest rate risk for our MSRs on an enterprise-wide basis during all of 2014 and 2013, the associated hedging offset related to changes in market interest rates during those years are presented as a component of investment activities, net on our consolidated income statements.

Direct Operating Expenses and Provision for Income Taxes

The increases in operating expenses at our residential investments segment for the year ended December 31, 2015 were primarily attributable to due diligence expenses associated with the acquisition of MSRs which we began acquire on a flow basis from various counterparties in 2015.

In 2015, the benefit for income taxes resulted from a GAAP loss recorded at our taxable REIT subsidiaries associated with this segment. As the amount of GAAP income or loss changes at the taxable REIT subsidiaries in future periods, the corresponding provision/benefit for income taxes will generally increase or decrease accordingly. However, this change may not always be evident as a significant portion of the GAAP income earned at this segment is recorded at the REIT, for which no tax provision is recorded.

Residential Loans Held-for-Investment Portfolio

The following table provides the activity of residential loans held-for-investment at Redwood during the years ended December 31, 2015 and 2014.

Table 19 – Residential Real Estate Loans Held-for-Investment at Redwood - Activity

	Years Ended December 31,	
(In Thousands)	2015	2014
Fair value at beginning of period	$581,668	$—
Transfers between portfolios	1,401,541	596,529
Principal repayments	(185,677)	(14,151)
Changes in fair value, net	(6,337)	(710)
Fair Value at End of Period	$1,791,195	$581,668

During 2015, we had net transfers of $1.31 billion of residential loans from our residential mortgage banking segment to our residential investments segment. In addition, during the fourth quarter of 2015, we transferred $92 million of loans into this segment that were previously held-for-investment in consolidated Sequoia entities that were dissolved during that quarter. At December 31, 2015, $1.79 billion of loans were held by our FHLB-member subsidiary and partially financed with $1.48 billion of borrowings from the FHLBC.

The following table presents the unpaid principal balances for residential real estate loans held-for-investment at fair value by product type at December 31, 2015.

Table 20 – Characteristics of Residential Real Estate Loans Held-for-Investment at Fair Value

December 31, 2015

(Dollars in Thousands)	Principal Balance	Weighted Average Coupon
First Lien, Prime		
Fixed - 30 year	1,663,128	4.08 %
Fixed - 10, 15, 20, & 25 year	50,093	3.53 %
Hybrid & ARM	45,769	3.55 %
Total Outstanding Principal	$1,758,990	

The outstanding loans held-for-investment at Redwood at December 31, 2015 were prime-quality, first lien loans, of which 88% were originated in 2014 and 2015, 6% were originated in 2013, and 6% were originated in 2012 and prior years. The weighted average FICO score of borrowers backing these loans was 772 (at origination) and the weighted average loan-to-value ("LTV") ratio was 65% (at origination). At December 31, 2015, none of these loans was greater than 90 days delinquent.

Residential Securities Portfolio

The following table sets forth real estate securities activity by collateral type in our residential investments segment for the years ended December 31, 2015 and 2014.

Table 21 – Real Estate Securities Activity by Collateral Type

Year Ended December 31, 2015 (In Thousands)	Senior	Re-REMIC[1]	Subordinate	Total
Beginning fair value	$495,508	$168,347	$621,573	$1,285,428
Transfers	65,809	—	—	65,809
Acquisitions				
Sequoia securities	35,074	—	17,980	53,054
Third-party securities	9,649	—	161,538	171,187
Sales				
Sequoia securities	(47,738)	—	(212,145)	(259,883)
Third-party securities	(110,124)	(1,170)	(64,697)	(175,991)
Gains on sales and calls, net	14,998	—	21,371	36,369
Effect of principal payments [2]	(97,774)	(518)	(19,446)	(117,738)
Change in fair value, net	(28,807)	(1,595)	338	(30,064)
Ending Fair Value	$336,595	$165,064	$526,512	$1,028,171
Year Ended December 31, 2014 (In Thousands)	Senior	Re-REMIC[1]	Subordinate	Total
Beginning fair value	$864,762	$176,376	$531,218	$1,572,356
Acquisitions				
Sequoia securities	—	—	78,219	78,219
Third-party securities	116,260	10,200	42,194	168,654
Sales				
Sequoia securities	(3,074)	—	(54,348)	(57,422)
Third-party securities	(354,544)	(25,632)	(8,018)	(388,194)
Gains on sales and calls, net	2,571	6,114	5,232	13,917
Effect of principal payments [2]	(145,615)	(66)	(18,588)	(164,269)
Change in fair value, net	15,148	1,355	45,664	62,167
Ending Fair Value	$495,508	$168,347	$621,573	$1,285,428

(1) Re-REMIC securities, as presented herein, were created by third parties through the resecuritization of certain senior RMBS.

(2) 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.

At December 31, 2015, our residential securities (as a percentage of their current market value) consisted of fixed-rate assets (67%), adjustable-rate assets (15%), and hybrid assets that reset within the next year (18%).

The following table presents real estate securities at December 31, 2015 and December 31, 2014, categorized by portfolio vintage (the years the securities were issued), by priority of cash flows (senior, re-REMIC, and subordinate), and by quality of underlying loans (prime and non-prime).

Table 22 – Securities by Vintage and as a Percentage of Total Securities

December 31, 2015 (In Thousands)	Sequoia Securities 2012-2015	Third-party Securities 2012-2015	2006-2008	2005 & Earlier	Total	% of Total Securities	
Senior							
Prime	$51,563	$—	$36,358	$174,635	$262,556	26	%
Non-prime	—	—	133	73,906	74,039	7	%
Total Senior	51,563	—	36,491	248,541	336,595	33	%
Re-REMIC	—	—	108,594	56,470	165,064	16	%
Subordinate					—		
Prime Mezzanine (1)	185,993	162,209	—	—	348,202	34	%
Prime Subordinate (2)	96,849	48,605	812	32,044	178,310	17	%
Total Subordinate	282,842	210,814	812	32,044	526,512	51	%
Total Securities	$334,405	$210,814	$145,897	$337,055	$1,028,171	100	%

December 31, 2014 (In Thousands)	Sequoia Securities 2012-2014	Third-party Securities 2012-2014	2006-2008	2005 & Earlier	Total	% of Total Securities	
Senior							
Prime	$—	$—	$63,950	$243,863	$307,813	24	%
Non-prime	—	—	4,273	183,422	187,695	15	%
Total Senior	—	—	68,223	427,285	495,508	39	%
Re-REMIC	—	—	108,369	59,978	168,347	13	%
Subordinate					—		
Prime Mezzanine (1)	371,706	77,132	—	—	448,838	35	%
Prime Subordinate (2)	89,284	28,069	1,157	54,225	172,735	13	%
Total Subordinate	460,990	105,201	1,157	54,225	621,573	48	%
Total Securities	$460,990	$105,201	$177,749	$541,488	$1,285,428	100	%

(1) Prime mezzanine includes securities initially rated AA, A, and BBB and issued in 2012 or later.

(2) Subordinate securities include less than $1 million of non-prime securities at both December 31, 2015 and December 31, 2014.

The following tables present the components of the interest income we earned on AFS securities for the years ended December 31, 2015, 2014, and 2013.

Table 23 – Interest Income — AFS Securities

Year Ended December 31, 2015					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	$13,633	$17,650	$31,283	$385,072	3.54 %	4.58 %	8.12 %
Re-REMIC	8,648	9,200	17,848	104,414	8.28 %	8.81 %	17.09 %
Subordinate							
Mezzanine	11,466	3,519	14,985	283,049	4.05 %	1.24 %	5.29 %
Subordinate	9,238	6,481	15,719	114,431	8.07 %	5.66 %	13.74 %
Total AFS Securities	$42,985	$36,850	$79,835	$886,966	4.85 %	4.15 %	9.00 %

Year Ended December 31, 2014					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	$22,894	$25,554	$48,448	$676,399	3.38 %	3.78 %	7.16 %
Re-REMIC	10,481	6,246	16,727	111,590	9.39 %	5.60 %	14.99 %
Subordinate							
Mezzanine	16,976	3,876	20,852	411,119	4.13 %	0.94 %	5.07 %
Subordinate	9,412	7,159	16,571	109,265	8.61 %	6.55 %	15.17 %
Total AFS Securities	$59,763	$42,835	$102,598	$1,308,373	4.57 %	3.27 %	7.84 %

Year Ended December 31, 2013					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	$23,892	$20,887	$44,779	$566,620	4.22 %	3.69 %	7.90 %
Re-REMIC	10,938	4,110	15,048	101,319	10.80 %	4.06 %	14.85 %
Subordinate			—				
Mezzanine	11,403	2,457	13,860	276,810	4.12 %	0.89 %	5.01 %
Subordinate	9,758	7,464	17,222	91,232	10.70 %	8.18 %	18.88 %
Total AFS Securities	$55,991	$34,918	$90,909	$1,035,981	5.40 %	3.37 %	8.78 %

The following tables present the components of carrying value at December 31, 2015 and December 31, 2014 for our AFS residential securities.

Table 24 – Carrying Value of AFS Securities

December 31, 2015 (In Thousands)	Senior	Re-REMIC	Subordinate	Total
Principal balance	$293,196	$189,782	$490,249	$973,227
Credit reserve	(6,406)	(10,332)	(32,131)	(48,869)
Unamortized discount, net	(30,474)	(71,670)	(134,963)	(237,107)
Amortized cost	256,316	107,780	323,155	687,251
Gross unrealized gains	26,512	57,284	63,205	147,001
Gross unrealized losses	(3,577)	—	(1,430)	(5,007)
Carrying Value	$279,251	$165,064	$384,930	$829,245
December 31, 2014 (In Thousands)	**Senior**	**Re-REMIC**	**Subordinate**	**Total**
Principal balance	$507,831	$195,098	$742,150	$1,445,079
Credit reserve	(13,304)	(15,202)	(41,561)	(70,067)
Unamortized discount, net	(66,273)	(79,611)	(150,458)	(296,342)
Amortized cost	428,254	100,285	550,131	1,078,670
Gross unrealized gains	60,662	68,062	63,026	191,750
Gross unrealized losses	(1,359)	—	(1,437)	(2,796)
Carrying Value	$487,557	$168,347	$611,720	$1,267,624

At December 31, 2015, credit reserves for our AFS securities totaled $49 million, or 5.0% of the principal balance of our residential securities, down from $70 million, or 4.8%, at December 31, 2014. The decrease in the credit reserve primarily resulted from realized credit losses, as well as a transfer of credit reserves to accretable unamortized discount, and the realization of gains from sales during 2015. Release of credit reserves to accretable discount were primarily based on sustained improvements in the overall credit performance of loans underlying our securities that reduced our estimate of future losses on these loans. Accretable unamortized discounts are recognized into income prospectively over the remaining life of the associated loans. During the years ended December 31, 2015 and 2014, realized credit losses on our residential securities totaled $9 million and $12 million, respectively.

Senior Securities

The fair value of our senior AFS securities was equal to 95% of their principal balance at December 31, 2015, and the amortized cost was equal to 87% of the principal balance. We expect future losses will extinguish a portion of the outstanding principal of these AFS securities, as reflected by the $6 million of credit reserves we have provided for on the $293 million principal balance of these securities. In addition, the fair value of our senior securities in this segment accounted for as trading securities was $57 million at December 31, 2015.

Re-REMIC Securities

Our re-REMIC portfolio consists primarily of prime residential senior securities that were pooled and re-securitized in 2009 and 2010 by third parties to create two-tranche structures. We own support (or subordinate) securities within those structures. The fair value of our re-REMIC AFS securities was equal to 87% of the principal balance of the portfolio at December 31, 2015, while our amortized cost was equal to 57% of the principal balance. We expect future losses will extinguish a portion of the outstanding principal of these securities, as reflected by the $10 million of credit reserves we have provided for on the $190 million principal balance of these securities.

Subordinate Securities

The fair value of our subordinate AFS securities was equal to 79% of the principal balance at December 31, 2015, and the amortized cost was equal to 66% of the principal balance. Credit losses totaled $5 million in our residential subordinate portfolio during 2015, as compared to $8 million of losses during 2014. We expect future losses will extinguish a portion of the outstanding principal of these securities, as reflected by the $32 million of credit reserves we have provided for on the $490 million principal balance of those securities. The fair value of our subordinate securities in this segment accounted for as trading securities was $142 million as of December 31, 2015.

Mortgage Servicing Rights Portfolio

Our MSRs are held and managed at one of our taxable REIT subsidiaries and typically are acquired together with loans from originators and then separately recognized under GAAP when the MSR is retained and the associated loan is sold to a third party or transferred to a Sequoia residential securitization sponsored by us that meets the GAAP criteria for sale. In addition, we also purchase MSRs on a flow basis from third-parties that sell the associated loans directly to the Agencies and we may also purchase portfolios of MSRs on a bulk basis. Although we own the rights to service loans, we contract with sub-servicers to perform these activities. Our receipt of MSR income is not subject to any covenants other than customary performance obligations associated with servicing residential loans. If a sub-servicer we contract with was to fail to perform these obligations, our servicing rights could be terminated and we would evaluate our MSR asset for impairment at that time.

The following table provides the activity for MSRs by portfolio for the years ended December 31, 2015 and 2014.

Table 25 – MSR Activity by Portfolio

	Years Ended December 31,					
	2015			2014		
(In Thousands)	Jumbo	Conforming	Total MSRs	Jumbo	Conforming	Total MSRs
Balance at beginning of period	$57,992	$81,301	$139,293	$61,493	$3,331	$64,824
Additions						
MSRs retained from Sequoia securitizations	8,202	—	8,202	8,518	—	8,518
MSRs retained from third-party loan sales	352	55,954	56,306	488	38,995	39,483
Purchased MSRs	—	30,773	30,773	—	47,549	47,549
Sold MSRs	(132)	(18,074)	(18,206)	—	—	—
Market valuation adjustments	(8,276)	(16,116)	(24,392)	(12,507)	(8,574)	(21,081)
Balance at End of Period	$58,138	$133,838	$191,976	$57,992	$81,301	$139,293

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The following table presents characteristics of the loans associated with our MSR investments at December 31, 2015.
Table 26 – Characteristics of MSR Investments Portfolio

	December 31, 2015		
(Dollars In Thousands)	Jumbo	Conforming	Total
Unpaid principal balance	$5,705,939	12,560,533	$18,266,472
Fair value of MSRs	$58,138	$133,838	$191,976
MSR values as percent of unpaid principal balance	1.02 %	1.07 %	1.05 %
Gross cash yield [1]	0.27 %	0.22 %	0.27 %
Number of loans	8,131	53,329	61,460
Average loan size	$702	$235	$319
Average coupon	3.98 %	3.86 %	3.88 %
Average loan age (months)	28	13	17
Average original loan-to-value	68 %	73 %	71 %
Average original FICO score	771	760	763
60+ day delinquencies	0.05 %	0.06 %	0.06 %

(1) Gross cash yield is calculated by dividing the annualized quarterly gross servicing fees we received for the three months ended December 31, 2015, by the weighted average notional balance of loans associated with MSRs we owned during that period.

As of December 31, 2015, nearly all of our MSRs were comprised of base MSRs and we did not own any portion of a servicing right related to any loan where we did not own the entire servicing right. As of December 31, 2015, the weighted average servicing fee rate on our jumbo MSRs was 0.25% and on our conforming MSRs was 0.25%. At December 31, 2015, we had less than $1 million of servicer advances outstanding related to our MSRs, which are presented in other assets on our consolidated balance sheets.

Commercial Mortgage Banking and Investments Segment

The following table presents the components of segment contribution for the commercial mortgage banking and investments segment for the years ended December 31, 2015 and 2014.
Table 27 – Commercial Mortgage Banking and Investments Segment Contribution

	Years Ended December 31,			Changes	
(In Thousands)	2015	2014	2013	'15/'14	'14/'13
Interest income	$46,933	$47,567	$43,420	$(634)	$4,147
Interest expense	(13,809)	(15,836)	(12,677)	2,027	(3,159)
Net interest income	33,124	31,731	30,743	1,393	988
Reversal of (provision for) loan losses	355	(84)	(3,288)	439	3,204
Mortgage banking activities, net [1]	2,704	13,440	23,311	(10,736)	(9,871)
Direct operating expenses	(11,331)	(11,324)	(9,579)	(7)	(1,745)
Segment contribution before income taxes	24,852	33,763	41,187	(8,911)	(7,424)
(Provision for) benefit from income taxes	1,452	(234)	(3,827)	1,686	3,593
Total Segment Contribution	$26,304	$33,529	$37,360	$(7,225)	$(3,831)

(1) For the year ended December 31, 2013, mortgage banking activities, net included $0.2 million of net realized gains.

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The following table presents commercial loan activity during the years ended December 31, 2015 and 2014.
Table 28 – Commercial Loans — Activity

	Years Ended December 31,			
	2015		2014	
(In Thousands)	Held-for-Sale	Held-for-Investment	Held-for-Sale	Held-for-Investment
Balance at beginning of period	$166,234	$ 400,693	$89,111	$ 343,344
Originations/acquisitions	617,518	22,218	903,500	87,001
Sales	(754,691)	—	(807,809)	—
Transfers between portfolios [1]	—	—	(37,631)	37,631
Principal repayments	(185)	(57,496)	(584)	(71,045)
Discount amortization	—	747	—	671
Provision for loan losses	—	355	—	(84)
Changes in fair value, net	10,265	(3,011)	19,647	3,175
Balance at End of Period	$39,141	$ 363,506	$166,234	$ 400,693

(1) During the first quarter of 2014, we sold two senior A-note commercial mortgages to third parties that did not qualify as sales under GAAP, and were not derecognized from our balance sheet. These loans and the associated B-note mortgage loans we retained were transferred from held-for-sale to held-for-investment classification and are carried at fair value on our consolidated balance sheets.

Overview

The $7 million decline in segment contribution from commercial mortgage banking and investments during 2015 was primarily due to lower income from mortgage banking activities that resulted from lower origination volume and profit margins during 2015. Within this segment, commercial mortgage banking activities are performed at a taxable REIT subsidiary of ours, whereas our commercial investments are held at the REIT. As such, income taxes allocated to this segment are primarily affected by the amount of commercial mortgage banking income earned each period.

On February 9, 2016, we announced that we are repositioning our commercial business and will discontinue commercial loan originations. Additional information on this restructuring and the impact to our business is discussed in the Capital, Liquidity, and Investments portion of the Introduction section of this MD&A.

Net Interest Income

Net interest income from our commercial mortgage banking and investments segment is primarily generated from our commercial investments portfolio, which is comprised of mezzanine and other subordinate commercial loans, as well as from the senior loans we originate and hold for sale to third-party CMBS aggregators. The following table presents net interest income from each of these portfolios for the years ended December 31, 2015, 2014, and 2013.

Table 29 Commercial Loans - Net Interest Income

	Years Ended December 31,			Changes	
(In Thousands)	2015	2014	2013	'15/'14	'14/'13
Loans held-for-sale	$2,404	$4,324	$334	$(1,920)	$3,990
Loans held-for-investment	30,720	27,407	30,409	3,313	(3,002)
Net interest income	$33,124	$31,731	$30,743	$1,393	$988

The $1 million increase in net interest income during 2015 was primarily due to non-recurring yield maintenance payments that were received from loan prepayments in 2015. Interest income from commercial loans held-for-investment included $4 million, $2 million, and $3 million of yield maintenance payments from loan prepayments in 2015, 2014, and 2013, respectively. This increase was offset by lower interest income from loans held-for-sale, due to a lower average balance of loans in 2015, as compared to 2014. The $1 million increase in net interest income in 2014, as compared to 2013, was primarily due to a higher average balance of loans held-for-sale in 2014.

Mortgage Banking Activities, Net

Income from commercial mortgage banking activities includes changes in the fair value of commercial loans held-for-sale and of derivatives used to hedge these loans while they are being accumulated for sale to the CMBS market. The following table presents the components of commercial mortgage banking activities, net for the years ended December 31, 2015, 2014, and 2013.

Table 30 – Components of Commercial Mortgage Banking Activities, Net

	Years Ended December 31,			Changes	
(In Thousands)	2015	2014	2013	'15/'14	'14/'13
Changes in fair value of:					
Commercial loans held-for sale	$10,265	$20,789	$8,694	$(10,524)	$12,095
Risk management derivatives	(8,011)	(7,890)	3,376	(121)	(11,266)
Net gains on commercial loan sales (1)	—	—	11,031	—	(11,031)
Other fee income	450	541	—	(91)	541
Total Mortgage Banking Activities, Net	$2,704	$13,440	$23,101	$(10,736)	$(9,661)

(1) We elected the fair value option for all held-for-sale commercial senior loans originated subsequent to March 31, 2013. Amounts reported as net gains on loan sales for 2013 relate to the sale of loans held at the lower of cost or fair value that were purchased or originated prior to the dates we began to elect the fair value option for these loans and represent the net benefit of the gross proceeds from the sale of the loans, less the carrying value of the loans and any related issuance costs.

The decreases in commercial mortgage banking activities in 2015 and 2014 were primarily due to lower loan sale profit margins experienced in each consecutive year, as well as lower loan origination volumes in 2015 as compared to 2014.

Commercial Investment Portfolio

Our commercial investment portfolio is comprised of mezzanine and other subordinate loans that we originated and hold for investment. The carrying value of our held-for-investment commercial loans decreased during 2015, as principal payments outpaced originations. Excluding $63 million of senior A-notes that are classified as held-for-investment, the carrying value of loans in this portfolio was $300 million at December 31, 2015 and $334 million at December 31, 2014. Although we sold the A-notes in prior years, they did not meet the criteria for sale treatment under GAAP and we recorded the transfers of the loans as secured borrowings.

During 2015, we originated six mezzanine loans totaling $22 million, as compared to 16 loans for $57 million in 2014. At December 31, 2015, this portfolio included non-securitized loans with a carrying value of $134 million and loans with a carrying value of $166 million that are included in our Commercial Securitization with $53 million of associated ABS issued. At December 31, 2015, we had borrowings of $60 million under a short-term debt facility secured by commercial loans held-for-investment with an unpaid principal balance of $135 million.

The following table presents the characteristics of our commercial loans held-for-investment at December 31, 2015.
Table 31 – Characteristics of Commercial Loans Held-for-Investment

December 31, 2015 (Dollars In Thousands)	Number of Loans	Average Loan Size	Principal Balance	Percent of Total Principal		Weighted Average DSCR [(1)]	Weighted Average LTV [(2)]	
Office	12	$7,166	$85,987	28	%	1.22	77	%
Multi-family	23	3,352	77,090	25	%	1.31	79	%
Hospitality	10	6,178	61,781	20	%	1.37	67	%
Retail	11	5,211	57,324	18	%	1.18	77	%
Self-storage	3	6,330	18,989	6	%	1.39	75	%
Other	4	2,596	10,382	3	%	1.43	76	%
Total	63	$4,945	$311,553	100	%	1.28	75	%

(1) The debt service coverage ratio ("DSCR") is defined as the property's annual net operating income divided by the annual principal and interest payments of all outstanding borrowings. The weighted average DSCRs in this table are based on the ratios at the time the loans were originated and are not based on subsequent time periods during which there may have been increases or decreases in each property's operating income.

(2) The loan-to-value ("LTV") calculation is defined as the sum of the senior and all subordinate loan amounts divided by the value of the property at the time the loan was originated.

On average, our commercial held-for-investment loans have a maturity of more than five years, and an unlevered yield of approximately 10% per annum, exclusive of provisions for loan losses.

At both December 31, 2015 and December 31, 2014, we had an allowance for loan losses of $7 million. The allowance for loan losses represented 2.3% and 2.2% of the recorded investment of our commercial loans held-for-investment at amortized cost at December 31, 2015 and December 31, 2014, respectively. During the year ended December 31, 2015, we did not have any charge-offs and recorded less than $1 million of net reversals of provisions for loan losses related to our commercial investments portfolio. During the year ended December 31, 2014, we did not have any charge-offs and recorded less than $1 million of provisions for loan losses related to our commercial investments portfolio.

At December 31, 2015, we had no loans designated as impaired and had three loans with a carrying value of $33 million on our watch-list. At December 31, 2015, the loans on our watch-list were current on all payments and we continue to believe we will receive all amounts due according to the contractual terms of the loans. However, in our judgment, certain conditions warrant specific attention going forward. Improvements in these conditions would result in the assets being upgraded back to pass status and deterioration could warrant further downgrades and potential evaluation for impairment.

The following table details principal balances for these loans by geographic concentration at December 31, 2015.
Table 32 – Geographic Concentration of Commercial Loans Held-for-Investment at Amortized Cost

Geographic Concentration (by Principal)	December 31, 2015	
California	22	%
New York	19	%
Florida	10	%
Michigan	10	%
Texas	5	%
Tennessee	5	%
Washington	4	%
Delaware	3	%
Other states (none greater than 3%)	22	%
Total	100	%

Results of Consolidated Sequoia Entities

We sponsored Sequoia securitization entities prior to 2012 that are reported on our consolidated balance sheets for financial reporting purposes in accordance with GAAP. Each of these entities is independent of Redwood and of each other and the assets and liabilities of these entities are not, respectively, owned by us or legal obligations of ours. Prior to January 1, 2015, we accounted for the loans and ABS issued from these consolidated Sequoia entities at amortized historical cost and the carrying value of our investments in these entities, which was $64 million at December 31, 2014, reflected the historical book value of our retained investments in these entities rather than their current economic value. As discussed in Note 3 to our financial statements in Part II, Item 8 of this Annual Report on Form 10-K, we elected to early adopt ASU 2014-13 on January 1, 2015. In accordance with this new guidance, we began to record the assets and liabilities of the consolidated Sequoia entities at fair value, based on the estimated fair value of the debt securities (ABS) issued from the securitizations. As of December 31, 2015, the estimated fair value of our investments in the consolidated Sequoia entities was $31 million.

The following tables present the consolidated statements of income for the years ended December 31, 2015, 2014, and 2013 and the balance sheets of the consolidated Sequoia entities as of December 31, 2015 and December 31, 2014. All amounts in the consolidated statements of income and balance sheets presented below are included in our consolidated financial statements.

Table 33 – Consolidated Sequoia Entities Statements of Income

	Years Ended December 31,			Changes	
(In Thousands)	2015	2014	2013	'15/'14	'14/'13
Interest income	$24,814	$25,786	$33,663	$(972)	$(7,877)
Interest expense	(15,646)	(20,844)	(25,876)	5,198	5,032
Net interest income	9,168	4,942	7,787	4,226	(2,845)
Reversal of provision for loan losses	—	(877)	(1,449)	877	572
Investing activities, net	(1,192)	(894)	(613)	(298)	(281)
Realized gains	—	1,701	284	(1,701)	1,417
Operating expenses	—	(165)	(231)	165	66
Net Income from Consolidated Sequoia Entities	$7,976	$4,707	$5,778	$3,269	$(1,071)

Table 34 – Consolidated Sequoia Entities Balance Sheets

(In Thousands)	December 31, 2015	December 31, 2014
Residential loans held for investment, at fair value (1)	$1,021,870	$1,474,386
Other assets	6,254	7,589
Total Assets	$1,028,124	$1,481,975
Other liabilities	$655	$981
Asset-backed securities issued, at fair value(1)	996,820	1,416,762
Total liabilities	997,475	1,417,743
Equity (fair value of Redwood's retained investments in entities)	30,649	64,232
Total Liabilities and Equity	$1,028,124	$1,481,975

(1) On January 1, 2015, we adopted ASU 2014-13 and began to account for residential loans held-for-investment and asset backed securities issued at consolidated Sequoia entities at fair value. At December 31, 2014, amounts presented in residential loans held-for-investment and asset-based securities issued are at historical cost. See Note 3 - Summary of Significant Accounting Policies to our Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for further discussion.

During the fourth quarter of 2015, we exercised our rights to call three consolidated Sequoia entities. Upon calling the securitizations, we purchased the loans remaining in each securitization at par, the debt at the entities was repaid, and the entities were dissolved. As a result of these transactions, our net economic investment in the remaining consolidated Sequoia entities was reduced to $31 million at December 31, 2015.

Net Interest Income at Consolidated Sequoia Entities

The $4 million increase in net interest income in 2015 was primarily due to lower interest expense during 2015, as paydowns of loans at consolidated Sequoia entities resulted in a decrease in outstanding ABS issued. Interest income remained relatively consistent in both periods, despite a lower average loan balance during 2015, resulting from premium amortization that was recorded during 2014. As a result of the adoption of ASU 2014-13 on January 1, 2015, all unamortized premium was eliminated and did not affect interest income in 2015.

The $3 million decrease in net interest income in 2014 as compared to 2013 was primarily due to a lower average balance of loans outstanding at consolidated Sequoia entities in 2014, resulting from continued loan paydowns.

Loan Loss Provision at Consolidated Sequoia Entities

Upon adoption of ASU 2014-13 on January 1, 2015, we eliminated the allowance for losses associated with residential loans at consolidated Sequoia entities, as we now account for these loans at fair value.

Investment Activities, net at Consolidated Sequoia Entities

Investment activities, net at consolidated Sequoia entities includes the change in fair value of the residential loans held-for-investment, REO, and the ABS issued at the entities. In accordance with ASU 2014-13, we estimate the fair value of the ABS issued by the entities, as well as our retained investments in the entities (predominantly subordinate and interest only securities), and use that combined amount to determine the value of the assets of the entities. As such, the periodic change in the fair value of the consolidated assets and liabilities, represents the change in value of our retained investments in consolidated Sequoia entities.

Residential Loans at Consolidated Sequoia Entities

The following table provides details of residential loan activity at consolidated Sequoia entities for the years ended December 31, 2015 and 2014.

Table 35 – Residential Loans at Consolidated Sequoia Entities — Activity

	Years Ended December 31,	
(In Thousands)	2015	2014
Balance at beginning of period	$1,474,386	$1,762,167
ASU 2014-13 election adjustment	(103,649)	—
Adjusted beginning balance	1,370,737	1,762,167
Principal repayments	(258,876)	(278,902)
Charge-offs, net	—	4,965
Premium amortization	—	(4,280)
Transfers to REO	(5,792)	(8,687)
Transfers between portfolios	(91,622)	—
Provision for loan losses	—	(877)
Changes in fair value, net	7,423	—
Balance at End of Period	$1,021,870	$1,474,386

Characteristics of Loans at Consolidated Sequoia Entities

The following table highlights unpaid principal balances for loans at consolidated Sequoia entities by product type at December 31, 2015.

Table 36 – Characteristics of Loans at Consolidated Sequoia Entities
December 31, 2015

(Dollars in Thousands)	Principal Balance	Weighted Average Coupon	
First Lien			
ARM	$1,093,113	1.66	%
Hybrid [(1)]	20,827	2.77	%
Second Lien			
ARM	8,475	2.75	%
Total Outstanding Principal	$1,122,415		

(1) All of these loans have reached the initial interest rate reset date and are currently adjustable rate mortgages.

First lien adjustable rate mortgage ("ARM") and hybrid loans comprise nearly all of the loans in the consolidated Sequoia entities and were primarily originated in 2005 or prior. For outstanding loans at consolidated Sequoia entities at December 31, 2015, the weighted average FICO score of borrowers backing these loans was 729 (at origination) and the weighted average original LTV ratio was 66% (at origination). At December 31, 2015 and December 31, 2014, the unpaid principal balance of loans at consolidated Sequoia entities delinquent greater than 90 days was $59 million and $70 million, respectively, and the unpaid principal balance of loans in foreclosure was $32 million and $39 million, respectively.

Taxable Income

The following table summarizes our taxable income and distributions to shareholders for the years ended December 31, 2015, 2014, and 2013. For each of these periods, we had no undistributed REIT taxable income.

Table 37 – Taxable Income

	Years Ended December 31,				
(In Thousands)	2015 est. [(1)]		2014		2013
REIT taxable income	$85,292		$63,989		$72,429
Taxable REIT subsidiary income (loss)	(41,546	)	(18,242	)	16,978
Total taxable income	$43,746		$45,747		$89,407
Distributions to shareholders	$92,493		$92,935		$92,005
REIT taxable income per share	$1.05		$0.77		$0.88
Total taxable income per share	$0.55		$0.55		$1.09

(1) Our tax results for the year ended December 31, 2015 are estimates until we file tax returns for 2015.

Tax Provision for GAAP

For the year ended December 31, 2015, we recorded a tax benefit for GAAP of $10 million compared to a tax provision of $1 million for the year ended December 31, 2014. Our tax provision or benefit is primarily derived from the activities at our TRS as we do not book a material tax provision associated with income generated at our REIT. Therefore, the reduction of our tax provision into a tax benefit year-over-year was primarily the result of GAAP losses generated from residential and commercial mortgage banking operations at our TRS in 2015 compared to GAAP income in 2014. Nearly all of the tax benefit represents a future tax benefit while only a minimal amount represents a current corporate level tax liability that will be paid for 2015. We are currently benefiting from favorable timing differences between when income associated with our mortgage banking activities is recognized for GAAP purposes versus when it is recognized for tax purposes, thus deferring a significant portion of the tax liability on that income. The income earned at our TRS will not affect the tax characterization of our 2015 dividends.

The tax benefit for GAAP for 2015 would have been $5 million higher, if we had not recorded a valuation allowance against our federal net deferred tax assets. As we are uncertain about our ability to generate sufficient taxable income or capital gains in future periods needed to utilize net deferred tax assets beyond the reversal of our deferred tax liabilities, we recorded a full valuation allowance.

Taxable Income Distribution Requirement

As a REIT, we are required to distribute at least 90% of our taxable income, after the application of federal net operating loss carryforwards (“NOLs”), to our shareholders. For 2015, our estimated REIT taxable income of $85 million was more than our available NOLs by $15 million, and therefore our minimum dividend distribution requirement was $14 million. The following table details our federal NOLs and capital loss carryforwards available as of December 31, 2015.

Table 38 - Federal Net Operating and Capital Loss Carryforwards

	Loss Carryforward Expiration by Period				
(In Thousands)	1 to 3 Years	3 to 5 Years	5 to 15 Years	After 15 Years	Total
REIT Loss Carryforwards					
Net operating loss	$—	$—	$—	$(69,819)	$(69,819)
Capital loss	(169,948)	—	—	—	(169,948)
Total REIT Loss Carryforwards	$(169,948)	$—	$—	$(69,819)	$(239,767)
TRS Loss Carryforwards					
Net operating loss	$—	$—	$—	$(96,849)	$(96,849)
Capital loss	(15,923)	(7,521)	—	—	(23,444)
Total TRS Loss Carryforwards	$(15,923)	$(7,521)	$—	$(96,849)	$(120,293)

As of December 31, 2015, we maintained $70 million of NOLs at the REIT level. In order to utilize these carryforwards, taxable income must exceed our dividend distributions. During 2015, we distributed $92 million to shareholders, which exceeded our estimated taxable income of $85 million. We do not expect to report any REIT taxable income on our 2015 federal income tax return after the application of a dividends paid deduction. As a result, we do not expect any of our federal NOLs at the REIT level to be utilized in 2015. Federal NOLs at the REIT level do not expire until 2029. Federal NOLs at the TRS level expire between 2030 and 2035.

Federal capital loss carryforwards of $170 million and $23 million at the REIT and TRS, respectively, will expire between 2016 and 2020. In order to utilize these carryforwards, the respective entities must recognize capital gains in excess of capital losses before the expiration dates. Utilization of capital loss carryforwards by the REIT reduces the REIT’s taxable income and distribution requirement. Capital loss carryforwards do not reduce the taxability of dividends to shareholders.

Tax Characteristics of Distributions to Shareholders

For the year ended December 31, 2015, we declared and distributed four regular quarterly dividends totaling $92 million ($1.12 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.

Our 2015 dividend distributions are expected to be characterized for income tax purposes as 100% ordinary income. Thus, we expect all $92 million of our 2015 dividend distributions to be characterized as ordinary income to shareholders, as the taxable income and net capital gains we generated in 2015 prior to the application of a dividends paid deduction, NOLs, and capital loss carryforwards in accordance with federal income tax rules, exceeded our 2015 distributions. While the REIT earned net capital gains in 2015, none of the 2015 dividend distributions are expected to be characterized as long-term capital gains. Under the federal income tax rules applicable to REITs, capital loss carryforwards offset the 2015 capital gains when determining the characterization of ordinary versus long-term capital gain dividend distributions.

In December 2015, our board of directors announced its intention to pay a regular dividend of $0.28 per share each quarter in 2016.

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 are 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 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; and, (vi) for tax, we do not consolidate securitization entities as we do under GAAP. 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 $3.6 billion and $2.6 billion, respectively, at December 31, 2015. The GAAP basis in assets and liabilities at the REIT was $4.5 billion and $3.4 billion, respectively, at December 31, 2015. 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, 2015, 2014, and 2013.

Table 39 – Differences between Estimated Total Taxable Income and GAAP Net Income

	Year Ended December 31, 2015				
(In Thousands, Except per Share Data)	REIT (Est.)	TRS (Est.)	Total Tax (Est.)	GAAP	Differences
Interest income	$186,835	$40,990	$227,825	$259,432	$(31,607)
Interest expense	(43,875)	(35,955)	(79,830)	(95,883)	16,053
Net interest income	142,960	5,035	147,995	163,549	(15,554)
Reversal of provision for loan losses	—	—	—	355	(355)
Realized credit losses	(8,645)	—	(8,645)	—	(8,645)
Mortgage banking and investment activities, net	—	(27,912)	(27,912)	(10,385)	(17,527)
MSR income (loss), net	—	33,574	33,574	(3,922)	37,496
Operating expenses	(49,386)	(53,932)	(103,318)	(97,416)	(5,902)
Other income	403	1,771	2,174	3,192	(1,018)
Realized gains, net	—	—	—	36,369	(36,369)
Benefit from (provision for) income taxes	(40)	(82)	(122)	10,346	(10,468)
Net Income	$85,292	$(41,546)	$43,746	$102,088	$(58,342)
Income per share	$1.05	$(0.50)	$0.55	$1.18	$(0.63)

	Year Ended December 31, 2014				
(In Thousands, Except per Share Data)	REIT	TRS	Total Tax	GAAP	Differences
Interest income	$164,136	$42,078	$206,214	$242,070	$(35,856)
Interest expense	(48,233)	(18,975)	(67,208)	(87,463)	20,255
Net interest income	115,903	23,103	139,006	154,607	(15,601)
Reversal of provision for loan losses	—	—	—	(961)	961
Realized credit losses	(6,734)	—	(6,734)	—	(6,734)
Mortgage banking and investment activities, net	—	3,498	3,498	24,792	(21,294)
MSR income (loss), net	—	15,763	15,763	(4,261)	20,024
Operating expenses	(45,122)	(52,313)	(97,435)	(90,123)	(7,312)
Other income (expense)	12	(8,231)	(8,219)	1,781	(10,000)
Realized gains, net	—	—	—	15,478	(15,478)
Benefit from (provision for) income taxes	(70)	(62)	(132)	(744)	612
Net Income	$63,989	$(18,242)	$45,747	$100,569	$(54,822)
Income per share	$0.77	$(0.22)	$0.55	$1.15	$(0.60)

	Year Ended December 31, 2013				
(In Thousands, Except per Share Data)	REIT	TRS	Total Tax	GAAP	Differences
Interest income	$171,816	$37,501	$209,317	$226,156	$(16,839)
Interest expense	(42,878)	(12,221)	(55,099)	(80,971)	25,872
Net interest income	128,938	25,280	154,218	145,185	9,033
Reversal of provision for loan losses	—	—	—	(4,737)	4,737
Realized credit losses	(12,911)	—	(12,911)	—	(12,911)
Mortgage banking and investment activities, net	—	19,526	19,526	96,785	(77,259)
MSR income (loss), net	—	8,218	8,218	20,309	(12,091)
Operating expenses	(43,580)	(35,781)	(79,361)	(86,607)	7,246
Other expense	—	—	—	(12,000)	12,000
Realized gains, net	—	—	—	25,259	(25,259)
Provision for income taxes	(18)	(265)	(283)	(10,948)	10,665
Net Income	$72,429	$16,978	$89,407	$173,246	$(83,839)
Income per share	$0.88	$0.21	$1.09	$1.94	$(0.85)

Potential Taxable Income Volatility

We expect period-to-period estimated taxable income volatility for a variety of reasons, including those described below.

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. For GAAP purposes, we establish a credit reserve and only accrete the portion of the purchase discount we expect to realize into income and write-down securities that become impaired. Our income recognition is therefore faster for tax as compared to GAAP, especially in the early years of owning a security (when there are generally few credit losses). At December 31, 2015, the cumulative difference between the GAAP and tax amortized cost basis of our residential securities (excluding our investments in our consolidated securitization entities and IO securities) was $15 million.

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. We anticipate that credit losses will continue to be a meaningful, but declining, factor for determining taxable income. Credit losses are based on our tax basis, which differs materially from our basis for GAAP purposes. We anticipate an additional $23 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. At December 31, 2015, for GAAP we had a designated credit reserve of $49 million on our securities, and an allowance for loan losses of $7 million for our consolidated commercial loans.

Our estimated total taxable income for the year ended December 31, 2015 included $9 million in realized credit losses on investments. This compared to taxable income for the year ended December 31, 2014 that included $7 million in realized credit losses on investments. Taxable income for the year ended December 31, 2013 included $13 million in realized credit losses on investments.

Recognition of Gains and Losses on Sale

Since the computation of amortization and impairments on assets may differ for tax and GAAP, 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, gains realized for tax may be offset by prior capital losses and, thus, not affect taxable income. At December 31, 2015, the REIT had an estimated $170 million in federal capital loss carryforwards that can be used to offset future capital gains over the next two years. Since our intention is to generally make long-term investments, it is difficult to anticipate when sales may occur and, thus, when or whether we might exhaust these capital loss carryforwards. At December 31, 2015, we had an estimated $23 million in federal capital loss carryforwards at the TRS level. While we anticipate selling appreciated securities within the capital loss carryforward period, it is unlikely that the TRS will benefit from all of the capital loss carryforwards. As such, a valuation allowance was recorded against a portion of the corresponding deferred tax asset. However, our estimate could change in future periods and, to the extent we expect to utilize the capital loss carryforwards, we could record additional tax expense or benefit for GAAP.

Prepayments on Securities

We have retained certain IO securities since the time they were issued from Sequoia securitizations we sponsored. Our tax basis in these securities was $35 million at December 31, 2015, which includes a tax basis of $28 million for IOs retained from securitizations completed in 2010 and later. 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 now below the fair values for these IOs in the aggregate. If a Sequoia 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. 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 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.

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 preferred 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 and is not performance-based. 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 MSRs through the direct acquisition of servicing rights from third parties or through the retention of MSRs 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 serving contract). Tax basis in our normal MSR assets is not recognized when MSRs 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. For the year ended December 31, 2015, we retained $67 million of MSRs from jumbo and conforming loan sales for which no tax basis was recognized. Additionally, in 2015, we purchased $31 million of MSRs associated with conforming loans where the initial tax basis was equal to the purchase price. No other tax basis in our MSR assets was recognized in 2015.

For GAAP purposes, mortgage servicing fee income, net of servicing expense, as well as changes in the estimated fair value of our MSRs, 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 MSRs are recorded through the income statement for GAAP purposes, but not for tax purposes. Only when MSRs are sold will a tax gain or loss be recognized. As tax basis is not recognized for retained MSRs and the rules for writing-off tax basis of purchased MSRs are restrictive, the tax gain from the sale of MSRs can be substantial. For the year ended December 31, 2015, we recognized a tax gain of $18 million from the sale of MSRs. Future sales of MSRs could result in significant tax gains.

LIQUIDITY AND CAPITAL RESOURCES

Summary

At December 31, 2015, we held $220 million in cash. Our principal sources of cash consist of borrowings under mortgage loan warehouse facilities, securities repurchase agreements, our FHLB-member subsidiary’s borrowing facility with the FHLBC, payments of principal and interest we receive on our residential and commercial investments portfolio, and cash generated from our operating activities. Our most significant uses of cash are to purchase mortgage loans for our mortgage banking operations, to fund investments in residential and commercial loans, to repay principal and interest on our warehouse facilities, repurchase agreements, and long-term debt, to purchase investment securities, to make dividend payments on our capital stock, and to fund our operations.

Our total capital was $1.78 billion at December 31, 2015, and included $1.15 billion of equity capital and $633 million of the total $2.04 billion of long-term debt on our consolidated balance sheet. This portion of long-term debt included $140 million of trust-preferred securities due in 2037, $288 million of convertible debt due in 2018, and $205 million of exchangeable debt due in 2019.

Additional information on our liquidity and capital resources is included in the Capital, Liquidity, and Investments portion of the Introduction to this MD&A.

In August 2015, our Board of Directors authorized the repurchase of up to $100 million of our common stock. During the year ended December 31, 2015, there were approximately 6.5 million shares repurchased pursuant to this authorization. At December 31, 2015, approximately $11 million of this authorization remained available for the repurchases of shares of our common stock. During the first quarter of 2016, we repurchased shares representing the remaining $11 million under this repurchase authorization.

In February 2016, our Board of Directors approved an additional authorization for the repurchase of up to $100 million of our common stock and also authorized the repurchase of outstanding debt securities, including convertible and exchangeable debt. This authorization replaced all previous share repurchase plans and has no expiration date. Our 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.

While we believe our current investment capacity is sufficient to fund our currently content plated investment activities, we may raise capital from time-to-time to make long-term investments or for other purposes. To the extent we seek additional capital to fund our operations and investment activities, our approach to raising capital will continue to be based on what we believe to be in the best long-term interests of shareholders. Any future capital raising transaction could include the issuance of debt or equity securities under the shelf registration statement we currently have on file with the SEC or the issuance of similar or other types of securities in public or private offerings.
We are subject to risks relating to our liquidity and capital resources, including risks relating to incurring debt under residential and commercial 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, 2015

Cash flows from our residential and commercial mortgage banking activities and our investments can be volatile from quarter to quarter depending on many factors, including the timing and amount of loan and securities acquisitions and sales and repayments, the profitability of mortgage banking activities, as well as changes in credit losses, prepayments, and interest rates. 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.

Cash Flows from Operating Activities

Cash flows from operating activities were negative $1.25 billion in 2015. This amount was negative primarily due to the inclusion of the net cash utilized during the year from the purchase and sale of residential and commercial mortgage loans associated with our mortgage banking activities. Purchases of loans are financed to a large extent with short-term debt, for which changes in cash are included as a component of financing activities. Excluding cash flows from the purchase and sale of loans initially classified as held-for-sale, cash flows from operating activities were negative $46 million in 2015. Additionally, cash flows from operations during 2015 were reduced by the purchase of $24 million of FHLBC stock in 2015. Under our FHLB-member subsidiary’s borrowing agreement with the FHLBC, it must purchase and hold stock in the FHLBC in an amount equal to a specified percentage of outstanding advances.

Cash Flows from Investing Activities

During 2015, our net cash provided by investing activities was $863 million and primarily resulted from principal payments on loans held-for-investment at our consolidated Sequoia entities as well as principal payments from, and proceeds from sales of, real estate securities. Although we generally intend to hold our investment securities as long-term investments, we may sell certain of these securities in order to manage our interest rate risk and liquidity needs, to meet other operating objectives, and to adapt to market conditions. We cannot predict the timing and impact of future sales of investment securities, if any. Because many of our investment securities are financed through repurchase agreements, a significant portion of the proceeds from any sales of our investment securities would generally be used to repay balances under these financing sources. Similarly, all or a significant portion of cash flows from prepayments and scheduled amortization in respect of our investment in securities would also generally be used to repay balances under these financing sources.
During 2015, we had net transfers of residential loans with a carrying value of $1.56 billion from held-for-sale to held-for-investment, and retained MSRs with a carrying value of $65 million and securities with a carrying value of $244 million from Sequoia securitizations of loans held-for-sale. These non-cash transactions were not included in cash flows from investing activities. In addition, in accordance with GAAP, cash flows from loans initially classified as held-for-sale and subsequently reclassified to held-for-investment, are presented in cash flows from operating activities.

Cash Flows from Financing Activities

During 2015, our net cash provided by financing activities was $337 million. This primarily resulted from $985 million of net borrowings from the FHLBC that were used to finance residential loans held-for-investment. These financing proceeds were offset by $389 million of repayments of ABS issued, $86 million of cash utilized for stock repurchases, and $95 million of dividend payments, representing a dividend of $1.12 per share.

In December 2015, our Board of Directors announced its intention to pay a regular dividend of $0.28 per share per quarter in 2016. In February 2016, the Board of Directors declared a regular dividend of $0.28 per share for the first quarter of 2016, which is payable on March 31, 2016 to shareholders of record on March 16, 2016.

In accordance with the terms of outstanding deferred 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.

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 and the origination of commercial 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. At December 31, 2015, we had four short-term residential loan warehouse facilities with a total outstanding debt balance of $0.95 billion (secured by residential loans with an aggregate fair value of $1.07 billion) and a total uncommitted borrowing limit of $1.40 billion. At December 31, 2015, we also had two short-term commercial loan warehouse facilities with a total outstanding debt balance of $74 million (secured by commercial loans with an aggregate fair value of $152 million). In addition, at December 31, 2015, we had an aggregate outstanding short-term debt balance of $694 million under nine securities repurchase facilities, which were secured by securities with a fair market value of $827 million. We also had a secured line of credit with no outstanding debt balance and a total borrowing limit of $10 million (secured by securities with a fair market value in excess of $11 million) at December 31, 2015. In July, 2015 we elected not to renew one warehouse facility for residential loans held-for-sale, with an uncommitted borrowing capacity of $500 million.

At December 31, 2015, we had $1.86 billion of short-term debt outstanding. During 2015, the highest balance of our short-term debt outstanding was $2.17 billion.

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 may incur borrowings up to $2.00 billion, also referred to as “advances,” from the FHLBC secured by eligible collateral, including, but not limited to residential mortgage loans and residential mortgage-backed securities. This borrowing agreement is uncommitted, which means that any request we make to borrow funds 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 this agreement. During the year ended December 31, 2015, our FHLB-member subsidiary borrowed $985 million of new advances under this agreement.

At December 31, 2015, $1.48 billion of advances were outstanding under this agreement, of which $1.34 billion were classified as long-term debt, with a weighted average interest rate of 0.46% per annum and a weighted average maturity of nine years. FHLBC borrowings of $138 million are classified as short-term debt as these borrowings were due within 12 months as of December 31, 2015. At December 31, 2015, accrued interest payable on these borrowings was $0.6 million. Advances under this agreement are charged interest based on a specified margin over the FHLBC's 13-week discount note rate, which resets every 13 weeks. Our total advances under this agreement were secured by residential mortgage loans with a fair value of $1.68 billion at December 31, 2015. 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, 2015, our subsidiary held $34 million of FHLBC stock that is included in other assets in our consolidated balance sheets.

Under current Federal Housing Finance Agency rules, amounts outstanding under our FHLB-member subsidiary's borrowing facility are permitted to remain outstanding until their scheduled maturity, however our subsidiary may not be able to obtain additional borrowings or increases to its borrowing capacity. As of February 19, 2016, $2.0 billion of advances were outstanding under this facility.

Convertible Notes

In November 2014, one of our taxable subsidiaries issued $205 million principal amount of 5.625% exchangeable senior notes due 2019. After deducting the underwriting discount and issuance costs, we received approximately $198 million of net proceeds. Including amortization of deferred issuance costs, the interest expense yield on these exchangeable notes was 6.59% for the year ended December 31, 2015. At December 31, 2015, the accrued interest payable balance on this debt was $2 million.

In March 2013, we issued $288 million principal amount of 4.625% convertible senior notes due 2018. After deducting the underwriting discount and issuance costs, we received approximately $279 million of net proceeds. Including amortization of deferred issuance costs, the interest expense yield on our convertible notes was 5.42% for the year ended December 31, 2015. At December 31, 2015, the accrued interest payable balance on this debt was $3 million.

Trust Preferred Securities and Subordinated Notes

At December 31, 2015, we had trust preferred securities and subordinated notes of $100 million and $40 million, respectively, issued by us in 2006 and 2007. This debt requires quarterly distributions at a floating rate equal to three-month LIBOR plus 2.25% until the notes are redeemed in whole. Prior to 2014, we entered into interest rate swaps with aggregate notional values totaling $140 million to hedge the variability in this long-term debt interest expense, fixing our gross interest expense yield at 6.75%. These swaps are accounted for as cash flow hedges with all interest income recorded as a component of net interest income and other valuation changes recorded as a component of equity.

Commercial Secured Borrowings

At December 31, 2015, we had commercial secured borrowings of $63 million resulting from transfers of portions of senior commercial mortgage loans to third parties that did not meet the criteria for sale treatment under GAAP and were accounted for as financings. We structured certain of our senior commercial mortgage loans into a senior portion that was sold to a third party and a junior portion that we retained as an investment. Although GAAP requires us to record a secured borrowing liability when we receive cash from selling the senior portion of the loan, the liability has no economic substance to us in that it does not require periodic interest payments and has no maturity. For each commercial secured borrowing, at such time that the associated senior portion of the loan is repaid or we sell our retained junior portion, the secured borrowing liability and associated senior portion of the loan would be derecognized from our balance sheet.

Asset-Backed Securities

In July 2011, Redwood transferred $365 million of residential securities into the Residential Resecuritization in connection with the issuance of $245 million of ABS by the Residential Resecuritization to third parties. During the fourth quarter of 2015, the debt of the entity was repaid, the assets of the entity were distributed to us, and the entity was dissolved.

In November 2012, Redwood transferred $291 million (principal balance) of commercial loans into the Commercial Securitization in connection with the issuance of $172 million of ABS by the Commercial Securitization to third parties. At December 31, 2015, there were $166 million (carrying value) of commercial loans owned at the Commercial Securitization, which were funded with $53 million of ABS issued.

At December 31, 2015, there were $1.12 billion (principal balance) of loans owned at consolidated Sequoia securitization entities, which were funded with $1.11 billion (principal balance) of ABS issued at these entities. The loans and ABS issued from these entities are reported at estimated fair value. See the subsection titled "Results of Consolidated Sequoia Entities" in the Results of Operations section of this MD&A for additional details on these entities.

Ratio of Earnings to Fixed Charges

The ratio of earnings to fixed charges represents the number of times “fixed charges” are covered by “earnings.” “Fixed charges” consist of interest on outstanding long-term debt and asset-backed securities issued, as well as associated amortization of debt discount and deferred issuance costs. The proportion deemed representative of the interest factor of operating lease expense has not been deducted as the total operating lease expense in itself was de minimis and did not affect the ratios in a material way. “Earnings” consist of consolidated income before income taxes and fixed charges. The following table presents our ratio of earnings to fixed charges for the each of the years ended December 31, 2015, 2014, 2013, 2012, and 2011.

Table 40 Ratio of Earnings to Fixed Charges

	Years Ended December 31,				
	2015	2014	2013	2012	2011
Ratio of earnings to fixed charges	2.40 x	2.65 x	3.90 x	2.20 x	1.26 x

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 of residential mortgage loans (including those we acquire in anticipation of sale or securitization), finance commercial mortgage loans (including those we originate in anticipation of sale or securitization), finance the other commercial debt investments we originate and acquire, 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 Loan Warehouse Facilities. One source of our short-term debt financing is secured borrowings under residential loan warehouse facilities that, as of December 31, 2015, were in place with four different financial institution counterparties. Under these four warehouse facilities, we had an aggregate borrowing limit of $1.40 billion at December 31, 2015; however, 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. Short-term financing for residential 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 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. In addition, under these warehouse facilities, residential loans can only be financed for a maximum period, which period would not generally exceed 364 days. We generally intend to repay the short-term 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 borrowings, or with other equity or long-term debt capital. While a residential loan is financed under a 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 are 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. See further discussion below under the heading “-Margin Call Provisions Associated with Short-Term Debt and Other Debt Financing.”

Because 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 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 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 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 four residential 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 residential 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 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 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 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.

Commercial Mortgage Loan Warehouse Facilities. Another source of short-term debt financing is secured borrowings under commercial loan warehouse facilities that are in place with financial institution counterparties. Under these warehouse facilities, we had an aggregate borrowing limit of $300 million at December 31, 2015; however, 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. Short-term financing for commercial loans is obtained under these facilities by our transfer of commercial loans to a special purpose entity which transfers them to the counterparty in exchange for cash proceeds (in an amount less than 100% of the principal amount of the transferred commercial loans), and our covenant to reacquire those commercial loans from the counterparty for the same amount plus a financing charge. Other periodic payments are also due under these facilities.

In order to obtain financing for a commercial loan under these facilities, the commercial loan must initially (and continuously while the financing remains outstanding) meet certain eligibility criteria, including, without limitation, that the commercial loan is not in a delinquent status. In addition, under these facilities, a commercial loan can only be financed for a maximum period, which period would not generally exceed 180 days. We generally intend to repay the short-term financing of a commercial loan under these facilities at or prior to the expiration of the financing term with the proceeds of a sale or securitization of that commercial loan, through the proceeds of other short-term borrowings, or with other equity or long-term debt capital. While a commercial loan is financed under these facilities, to the extent the market value of the commercial loan declines (which market value is generally determined by the counterparty under the facility), we are required to either immediately reacquire the commercial loan or meet a margin requirement to pledge additional collateral, such as cash or additional commercial loans, 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."

Because these warehouse facilities are uncommitted, at any given time we may not be able to obtain additional financing under these facilities 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 commercial loans that at any given time are already being financed through these 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 commercial loans become ineligible to be financed, decline in value, or have been financed for the maximum term permitted under the facilities.

Under our commercial 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 (including of the type described above under the heading "-Residential Loan Warehouse Facilities"). 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."

Our commercial 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 these 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 commercial loan warehouse facilities described above, in the ordinary course of business we may seek to establish additional 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 facilities becomes insolvent or unable or unwilling to perform its obligations under a facility, we may be unable to access the financing we need or we may fail to recover the full value of our commercial loans financed under the applicable facility.

Other Short-Term Debt Facilities. 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.

Commercial Debt Investment Repurchase Facility. Another source of debt financing is secured borrowings through a commercial debt investment repurchase facility that is in place with a financial institution counterparty. Under this repurchase facility, we have an aggregate borrowing limit of $150 million; however, any request we make to borrow funds under this facility secured by a particular commercial debt investment 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 this facility. Financing for commercial debt investments is obtained under this facility by our transfer of commercial debt investments to a special purpose entity which is beneficially owned by the counterparty in exchange for cash proceeds (in an amount less than 100% of the principal amount of the transferred commercial debt investments), and our covenant to reacquire those commercial debt investments for the same amount plus a financing charge. Other periodic payments are also due under the facility.

In order to obtain financing for a commercial debt investment under this facility, the commercial debt investment must initially (and continuously while the financing remains outstanding) meet certain eligibility criteria, including, without limitation, that the commercial debt investment is not in a delinquent status. This facility has less than one year remaining of its original three-year term. We generally intend to repay the financing of a commercial debt investment under this facility at or prior to the expiration of the financing term with the proceeds of a securitization or other sale of that commercial debt investment, or with other equity or long-term debt capital. While a commercial debt investment is financed under this facility, to the extent the value of the commercial debt investment declines (which value is generally determined by the counterparty under the facility), we are required to either immediately reacquire the commercial debt investment or meet a margin requirement to pledge additional collateral, such as cash or additional commercial debt investments, 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." Because the counterparty under this facility retains discretion to accept or reject a financing with respect to any particular commercial debt investment, at any given time we may not be able to obtain additional financing under this facility 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 commercial debt investments that at any given time are already being financed through this facility, 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 commercial debt investments become ineligible to be financed, decline in value, or have been financed for the maximum term permitted under the facility.

Under our commercial debt investment repurchase facility, 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 this facility and this facility being unavailable to use for future financing needs. In particular, the terms of this facility include financial covenants, cross-default provisions, judgment default provisions, and other events of default (including of the type described above under the heading "-Residential 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 commercial debt investment repurchase facility 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 this 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.”

In addition to the commercial debt investment repurchase facility described above, in the ordinary course of business we may seek to establish additional 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 facilities becomes insolvent or unable or unwilling to perform its obligations under a facility, we may be unable to access the financing we need or we may fail to recover the full value of our commercial debt investments financed under the applicable facility.

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 mortgage loans and residential mortgage-backed securities. Under current Federal Housing Finance Agency rules, amounts outstanding under our FHLB-member subsidiary's borrowing facility are permitted to remain outstanding until their scheduled maturity, however our subsidiary may not be able to obtain additional borrowings or increases to its borrowing capacity. As of February 19, 2016, $2.0 billion of advances were outstanding under this facility.

Similar to the uncommitted warehouse and securities repurchase facilities described herein, under this facility 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. In particular, the terms of this facility permit the acceleration of the amortization of amounts borrowed through the facility if the FHLBC determines, in its sole discretion, that our creditworthiness or the creditworthiness of our FHLB-member subsidiary does not meet the minimum requirements of the FHLBC. Outstanding amounts borrowed under this facility could become immediately due and payable if the FHLBC determines there has been a material adverse change in our financial condition, or that we have breached or otherwise not complied with the terms of the FHLBC's credit policy. Additionally, the FHLBC may increase the required amount of collateral at any time as a result of a change in its credit policy or as a result of our credit deterioration, in which case we may be required to deliver additional collateral in the form of cash or other eligible collateral. Factors that may affect the FHLB's judgment of our or our FHLB member subsidiary's creditworthiness, financial condition, or compliance with its credit policy include, among other things, increases in levels of indebtedness, increases in debt-to-capital ratios, or decreases in stockholders' equity. The margin call provisions and financial covenants included in this facility 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 facility to incur 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.

Our access to financing under this facility is also subject to the risks described under the heading "Risk Factors - Recently adopted Federal regulations may limit, eliminate, or reduce the attractiveness of our subsidiary's ability to use borrowings from the Federal Home Loan Bank of Chicago to finance the mortgage loans and securities it holds and acquires, which could negatively impact our business and operating results" in Part I, Item 1A of this Annual Report on Form 10-K.

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 Loan Warehouse Facilities. As noted above, one source of our short-term debt financing is secured borrowings under residential loan warehouse facilities we have established and, as of December 31, 2015, were in place with four different financial institution counterparties. Financial covenants included in these warehouse facilities are as follows and at December 31, 2015, 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 or maintenance of an amount of cash and cash equivalents in excess of a specified percentage of outstanding short-term recourse indebtedness.
- Maintenance of a minimum ratio of consolidated recourse indebtedness to stockholders' equity and tangible net worth at Redwood.

- Maintenance of uncommitted residential loan warehouse facilities with a specified level of unused borrowing capacity.

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- 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, 2015, 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 minimum ratio of consolidated recourse indebtedness to consolidated adjusted tangible net worth at Redwood.
- Commercial Mortgage Loan Warehouse Facility. As noted above, another source of our short-term debt financing is secured borrowings under commercial loan warehouse facilities that we have in place with financial institution counterparties. Financial covenants included in these facilities are as follows and at December 31, 2015, 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 minimum ratio of consolidated recourse indebtedness to stockholders' equity at Redwood, including a separate minimum ratio for commercial assets which is applicable under certain specified circumstances.
- 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.
- Commercial Debt Investment Repurchase Facility. As noted above, one source of our debt financing is secured borrowings under a commercial debt investment repurchase facility we have established with a financial institution counterparty. Financial covenants included in this facility are as follows and at December 31, 2015, 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 minimum ratio of consolidated recourse indebtedness to stockholders' equity at Redwood.
- FHLB Borrowing Facility. As noted above, a wholly-owned subsidiary of ours, RWT Financial, also maintains a borrowing facility with the FHLBC, borrowings under which are required to be secured by eligible collateral including, but not limited to, residential mortgage loans and residential mortgage-backed securities. Financial covenants included in this facility are as follows and at December 31, 2015, and through the date of this Annual Report on Form 10-K, we were in compliance with each of these financial covenants:
- Maintenance by RWT Financial of a minimum ratio of total liabilities (excluding debt subordinated to the FHLBC and non-recourse debt) to stockholders' equity and debt subordinated to the FHLBC.
- Maintenance by RWT Financial of a minimum level of unencumbered assets based on the level of indebtedness to the FHLBC.
- Maintenance of a minimum ratio of total liabilities (excluding non-recourse debt) to stockholders' equity at Redwood.
- Maintenance of a minimum dollar amount of cash and cash equivalents at Redwood.

As noted above, at December 31, 2015, 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 December 31, 2015 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 December 31, 2015 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 Loan Warehouse Facilities. As noted above, one source of our short-term debt financing is secured borrowings under residential loan warehouse facilities we have established and, as of December 31, 2015, were in place with four different financial institution counterparties. These warehouse facilities include the margin call provisions described below and during the twelve months ended December 31, 2015, 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:

- 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 two 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 two 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 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, 2015, 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.

- Commercial Mortgage Loan Warehouse Facility. As noted above, another source of our short-term debt financing is secured borrowings under commercial loan warehouse facilities we have in place with financial institution counterparties. These facilities includes the margin call provisions described below and during the twelve months ended December 31, 2015, and through the date of this Annual Report on Form 10-K, we complied with any margin calls received from the creditors under these facilities:

- If at any time the market value (as determined by the creditor) of any commercial loan financed under a facility declines, then the creditor may demand that we transfer additional collateral to the creditor (in the form of cash or additional commercial mortgage loans) 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 following business day. The value of additional commercial loans 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, 2015, 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.

- Commercial Debt Investment Repurchase Facility. As noted above, one source of our debt financing is secured borrowings under a commercial debt investment repurchase facility we have established with a financial institution counterparty. This facility includes the margin call provisions described below during the twelve months ended December 31, 2015, and through the date of this Annual Report on Form 10-K, we complied with any margin calls received from the creditor under this facility:

- If at any time the asset value (as determined by the creditor) of any commercial debt investment financed under the facility declines, then the creditor may demand that we transfer additional collateral to the creditor (in the form of cash or additional commercial debt investments) 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 second business day thereafter (although demands received after a certain time would allow an additional business day for the transfer of additional collateral to occur). The value of additional commercial debt investments transferred as additional collateral is determined by the creditor.

- FHLB Borrowing Facility. As noted above, a wholly-owned subsidiary of ours, RWT Financial, also maintains a borrowing facility with the FHLBC, borrowings under which are required to be secured by eligible collateral including, but not limited to, residential mortgage loans and residential mortgage-backed securities. This facility includes the margin call provisions described below during the twelve months ended December 31, 2015, and through the date of this Annual Report on Form 10-K, we complied with any margin calls received from the creditor under this facility.
- If at any time the aggregate market value (as determined by the FHLBC) of the residential mortgage loans and residential mortgage-backed securities pledged as collateral under this facility declines to a value less than the required collateral level, or if any collateral ceases to be qualifying collateral under the terms of this facility, we would be required to promptly deliver additional collateral sufficient to maintain the required collateral level. The value of additional loans or securities transferred as additional collateral is determined by the FHLBC.

OFF BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

Off Balance Sheet Arrangements

We do not have any material off balance sheet arrangements.

Contractual Obligations

The following table presents our contractual obligations and commitments at December 31, 2015, as well as the obligations of the securitization entities that we consolidate for financial reporting purposes.

Table 41 – Contractual Obligations and Commitments

December 31, 2015	Payments Due or Commitment Expiration by Period				
(In Millions)	Less Than 1 Year	1 to 3 Years	3 to 5 Years	After 5 Years	Total
Obligations of Redwood					
Short-term debt	$1,717	$—	$—	$—	$1,717
Convertible notes	—	288	205	—	493
Anticipated interest payments on convertible notes	25	43	12	—	80
FHLBC borrowings	138	89	—	1,254	1,481
Anticipated interest payments on FHLBC borrowings	8	38	51	138	235
Other long-term debt	—	—	—	140	140
Anticipated interest payments on other long-term debt (1)	9	19	19	152	199
Accrued interest payable	8	—	—	—	8
Operating leases	3	5	2	—	10
Total Redwood Obligations and Commitments	$1,908	$482	$289	$1,684	$4,363
Obligations of Consolidated Entities for Financial Reporting Purposes					
Consolidated ABS (2)	$—	$—	$—	$1,162	$1,162
Anticipated interest payments on ABS (3)	16	40	45	148	249
Accrued interest payable	1	—	—	—	1
Total Obligations of Entities Consolidated for Financial Reporting Purposes	17	40	45	1,310	1,412
Total Consolidated Obligations and Commitments	$1,925	$522	$334	$2,994	$5,775

(1) Includes anticipated interest payments related to hedges.

(2) 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.

(3) 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, 2015.

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 Residential and Commercial Loans Held at Fair Value

Our residential and commercial loans held-for-sale on our consolidated balance sheet at December 31, 2015, were being held-for-sale or future securitization and were expected to be sold to third parties or non-consolidated securitization entities. At the time of purchase or origination, we typically elect the fair value option for these loans. Additionally, we have elected the fair value option for certain of our residential loans held-for-investment. For residential and commercial loans for which we have elected the fair value option, changes in fair values are recorded in mortgage banking and investment activities 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 below their cost basis, 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. For trading securities, changes in fair values are recorded in the consolidated statements of income. Periodic fluctuations in the values of these investments are inherently volatile and thus can lead to significant GAAP earnings volatility each quarter.

For AFS securities, cumulative unrealized gains and losses are recorded as a component of accumulated other comprehensive 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 declines in the values of AFS securities as other-than-temporary impairments and record them through our current earnings. Factors that determine other-than-temporary-impairment include a change in our ability or intent to hold 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. Impairments on AFS securities can lead to significant GAAP earnings volatility each quarter. In addition, sales of securities in large unrealized gain or loss positions that are not impaired can lead to significant GAAP earnings volatility each year.

Changes in Fair Values of Mortgage Servicing Rights

Mortgage servicing rights are carried on our consolidated balance sheets at their estimated fair values, with changes in fair values recorded in the consolidated statements of income as a component of MSR income (loss), net. Periodic fluctuations in the values of these investments are inherently volatile and can lead to significant GAAP earnings volatility each quarter. Periodic fluctuations in the values of our mortgage servicing rights can be caused by actual prepayments on the underlying loans, changes in assumptions regarding future projected prepayments on the underlying loans, or changes in the discount rate assumptions used to value mortgage servicing rights.

Changes in Fair Values of Derivative Financial Instruments
We can experience significant earnings volatility from our use of derivatives. 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 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 below, under the headings "Changes in the Fair Value of Residential and Commercial 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 have a significant effect on periodic income.

Changes in Yields for Securities
The yields we project on 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 15 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 GAAP earnings volatility each quarter.

Changes in Allowance for Loan Losses

For real estate loans classified as held-for-investment at amortized cost, we establish and maintain an allowance for loan losses based on our estimate of credit losses inherent in our loan portfolios at the reporting date. To calculate the allowance for loan losses, we assess inherent losses by determining loss factors (defaults, loss severities on default liquidations, and the timing of default liquidations) that can be specifically applied to each of the consolidated loans or pools of loans. Changes in our expectations or actual changes to defaults, loss severities and default timing can have a significant effect on periodic income.

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 volatility in GAAP earnings.

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.

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

If applicable, 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 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 residential and commercial 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.

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 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; faulty appraisals; documentation errors; poor underwriting; legal errors; poor servicing practices; weak economic conditions; decline in the value of homes, businesses, or commercial properties; special hazards; earthquakes and other natural events; over-leveraging of the borrower or on the property; reduction in market rents and occupancies and poor property management practices; changes in legal protections for lenders; reduction in personal incomes; job loss; and personal events such as divorce or health problems. In addition, if the U.S. economy or the housing market were to weaken (and that weakening was in excess of what we anticipated), credit losses could increase beyond levels that we have anticipated.

With respect to most of the loans securitized by 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 Alt-A quality loans (and, to a lesser degree, some backed by subprime loans) that have substantially higher credit risk characteristics than prime-quality loans. Consequently, we can expect these lower-quality loans to have higher rates of delinquency and loss, and if such losses differ from our assumptions, 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.

Commercial Loans

The commercial loans we invest in are typically fixed-rate loans, the majority of which are interest-only loans that are generally subordinate to senior lien holders and are backed by a transaction sponsor or borrowing entity and are not directly secured by real property. In general, the loans we invest in require balloon payments at maturity. Consequently, we could be exposed to credit losses at the maturity of these loans if the borrower is unable to repay or refinance the borrowing with another third-party lender. The ability of the borrower to pay us back at maturity is primarily a function of the cash flows generated on the commercial property, as well as the general level of interest rates. If interest rates rise to an extent that the cash flows on the property are insufficient to cover a new loan that is sufficient to pay off our loan, we would be subject to credit losses at maturity.

In addition, we originate commercial loans secured by first liens on commercial real estate with the intention to sell these loans or securitize them within a relatively short period of time following origination. Between the time of origination and the time of sale or securitization of these senior loans we are exposed to credit risk associated with these loans. In addition, we may, in some circumstances, invest in a subordinate security issued in a securitization transaction that includes one or more senior loans we originated, in which case we would continue to be exposed to credit risk with respect to these and other loans included in that securitization through our ownership of those subordinate securities.

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 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").

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) on a consolidated basis that assumes some interest rate risks but not to such a degree that the achievement of our long-term goals would likely be 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.

We purchase residential and commercial loans from third parties, 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. Additionally, during 2015 our FHLB member subsidiary held residential loans for investment that are financed by the FHLBC, which also exposes us to interest rate risk. 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 IOs) and MSRs benefit from slower prepayments on the underlying loans. In addition, loans held-for-investment at premiums benefit from slower prepayment rates. We note that changes in residential loan prepayment rates could result in GAAP and tax earnings volatility.

We caution that prepayment rates are difficult to predict or anticipate, and variations in prepayment rates can materially affect our earnings and dividend distribution requirements. ARM prepayment rates, for example, are driven by many factors, one of which is the steepness of the yield curve. As the yield curve flattens (short-term interest rates rise relative to longer-term interest rates), ARM prepayments typically increase. However, for borrowers who have impaired credit or who otherwise do not meet loan underwriting criteria, the ability to refinance (i.e., prepay) a loan even when interest rates decline may be limited.

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. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Separately, inflation or deflation in home prices can affect our credit risk.

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 or originate residential and commercial 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 also own residential and commercial loans that are held-for-investment and may be financed with borrowings from the FHLBC or funded with short-term debt. 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 FHLBC borrowings and short-term financing facilities by setting aside adequate capital.

Many of the securities we acquire are funded with a combination of our capital, and secured financing or short-term debt facilities. To the extent we use capital or secured financing, we can reduce our liquidity risks; however, we would still be exposed to adverse changes in fair value of these securities as a result of changes in overall market liquidity. 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), 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).

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, 2015. The table presents principal cash flows and related average interest rates by year of repayment. The forward curve (future interest rates as implied by the yield structure of debt markets) at December 31, 2015, 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 2016	2017	2018	2019	2020	Thereafter	December 31, 2015 Principal Balance	Fair Value
Interest rate sensitive assets									
Securitized Residential Loans									
Adjustable Rate	Principal	$205,822	$173,009	$150,782	$130,672	$113,487	$348,643	$1,122,415	$1,021,
	Interest Rate	2.03 %	2.47 %	2.97 %	3.25 %	3.45 %	3.58 %		
Unsecuritized Residential Loans									
Held-for-sale									
Adjustable Rate	Principal	5,258	—	—	—	—	—	5,258	5,042
	Interest Rate	2.54 %	N/A	N/A	N/A	N/A	N/A		
Fixed Rate	Principal	809,803	—	—	—	—	—	809,803	829,403
	Interest Rate	4.09 %	N/A	N/A	N/A	N/A	N/A		
Hybrid	Principal	276,457	—	—	—	—	—	276,457	281,460
	Interest Rate	3.31 %	N/A	N/A	N/A	N/A	N/A		
Held-for-Investment at Fair Value									
Adjustable Rate	Principal	334	303	274	247	224	2,119	3,501	3,523
	Interest Rate	3.60 %	4.10 %	4.70 %	5.00 %	5.20 %	5.39 %		
Fixed Rate	Principal	163,684	148,045	133,901	121,108	109,537	1,036,946	1,713,221	1,741,6
	Interest Rate	4.09 %	4.09 %	4.09 %	4.09 %	4.09 %	4.09 %		
Hybrid	Principal	4,038	3,653	3,304	2,988	2,702	25,583	42,268	42,798
	Interest Rate	3.50 %	3.50 %	3.50 %	4.93 %	5.13 %	5.32 %		
Residential Senior Securities									
Adjustable Rate	Principal	4,387	3,766	3,200	2,724	2,325	11,459	27,859	27,017
	Interest Rate	2.25 %	2.59 %	2.90 %	3.17 %	3.37 %	3.86 %		
Fixed Rate	Principal	49,303	43,262	37,712	27,848	23,588	108,635	290,347	319,830
	Interest Rate	3.54 %	3.24 %	3.64 %	3.25 %	3.26 %	3.20 %		
Hybrid	Principal	36,794	30,282	24,054	19,056	15,525	71,034	192,153	186,755
	Interest Rate	2.92 %	3.43 %	3.66 %	3.83 %	4.01 %	4.28 %		
Residential Re-REMIC Securities									
Fixed Rate	Principal	2,176	6,546	6,438	7,950	37,130	8,193	68,435	57,152
	Interest Rate	5.85 %	5.54 %	5.88 %	5.90 %	5.92 %	5.68 %		
Hybrid	Principal	7,554	14,318	17,976	14,262	53,282	13,955	121,347	107,912
	Interest Rate	2.83 %	3.21 %	3.69 %	3.97 %	4.23 %	4.76 %		
Residential Subordinate Securities									
Adjustable Rate	Principal	1,226	1,213	1,587	1,655	11,859	1,786	19,325	17,196
	Interest Rate	3.42 %	4.04 %	3.72 %	3.79 %	3.85 %	3.78 %		
Fixed Rate	Principal	17,645	19,291	25,175	29,091	426,614	34,103	559,029	468,383
	Interest Rate	3.72 %	4.48 %	3.79 %	3.82 %	3.85 %	3.93 %		
Hybrid	Principal	4,266	5,347	5,095	4,560	43,693	5,001	67,962	49,011
	Interest Rate	1.92 %	3.38 %	2.91 %	3.16 %	3.37 %	3.88 %		

Quantitative Information on Market Risk

(Dollars in Thousands)		Principal Amounts Maturing and Effective Rates During Period 2016	2017	2018	2019	2020	Thereafter	December 31, 201 Principal Balance	Fair Value
Interest rate sensitive assets (continued)									
Commercial Loans Held-for-Investment									
Fixed Rate	Principal	$50,609	$24,465	$47,414	$2,920	$422	$159,432	$285,262	$279,0
	Interest Rate	10.19 %	10.16 %	10.09 %	9.85 %	9.85 %	9.85 %		
Adjustable Rate	Principal	21,785	—	—	—	—	—	21,785	21,785
	Interest Rate	10.02 %	N/A	N/A	N/A	N/A	N/A		
Commercial Loans Held-for-Sale									
Fixed Rate	Principal	38,750	—	—	—	—	—	38,750	39,141
	Interest Rate	4.24 %	N/A	N/A	N/A	N/A	N/A		
Interest rate sensitive liabilities									
Asset-backed securities issued									
Sequoia Entities									
Adjustable Rate	Principal	60,503	64,845	64,446	64,755	65,756	767,654	1,087,958	976,94
	Interest Rate	0.94 %	1.43 %	1.87 %	2.10 %	2.26 %	2.61 %		
Hybrid	Principal	866	842	826	848	865	16,580	20,827	19,874
	Interest Rate	2.96 %	3.61 %	4.29 %	4.53 %	4.92 %	5.74 %		
Commercial Securitization									
Fixed Rate	Principal	53,137	—	—	—	—	—	53,137	53,137
	Interest Rate	6.31 %	N/A	N/A	N/A	N/A	N/A		
Short-term Debt	Principal	1,855,003	—	—	—	—	—	1,855,003	1,855,0
	Interest Rate	1.70 %	N/A	N/A	N/A	N/A	N/A		
Long-term Debt									
FHLBC Borrowings	Principal	—	89,208	—	—	—	1,253,815	1,343,023	1,343,0
	Interest Rate	0.59 %	1.26 %	1.70 %	1.94 %	2.13 %	2.56 %		
Convertible Notes	Principal	—	—	287,500	205,000	—	—	492,500	461,05
	Interest Rate	5.04 %	5.04 %	5.04 %	5.63 %	5.63 %	N/A		
Other long-term debt	Principal	—	—	—	—	—	139,500	139,500	83,700
	Interest Rate	6.75 %	6.75 %	6.75 %	6.75 %	6.75 %	6.75 %		
Interest rate agreements									
Interest Rate Swaps									
(Purchased)	Notional Amount	—	—	120,000	—	455,000	647,500	1,222,500	(4,711
	Receive Strike Rate	0.63 %	1.31 %	1.73 %	1.96 %	2.15 %	2.73 %		
	Pay Strike Rate	1.83 %	1.83 %	1.83 %	1.83 %	1.83 %	1.83 %		
(Sold)	Notional Amount	—	—	—	—	95,000	380,000	475,000	(2,833
	Receive Strike Rate	1.83 %	1.83 %	1.83 %	1.83 %	1.83 %	1.83 %		
	Pay Strike Rate	0.63 %	1.31 %	1.73 %	1.96 %	2.15 %	2.73 %		

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-94 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.

There have been no changes in our internal control over financial reporting during the fourth quarter of 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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 2015 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, 2015, was effective.

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, 2015, 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, 2015.

ITEM 9B. OTHER INFORMATION

On February 24, 2016, Charles J. Toeniskoetter, age 71, announced that he is retiring from the Board of Directors, effective as of May 16, 2016, and will not stand for reelection at the 2016 Annual Meeting of stockholders. Mr. Toeniskoetter serves on the Audit Committee and the Nominating and Governance Committee of the Board. Mr. Toeniskoetter’s retirement follows more than 20 years of service as a member of the Redwood Trust, Inc. Board of Directors.

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:
All 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:

Exhibit Number	Exhibit
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)
3.2.1	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)
4.1	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)
4.2	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)
4.3	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)

Exhibit Number	Exhibit
4.4	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)
4.5	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)
4.6	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)
4.7	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)
4.8	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)
4.9	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)
4.10	Indenture, dated as of November 28, 2012, among RCMC 2012-CREL1, LLC, as Issuer, KeyCorp Real Estate Capital Markets, Inc., as Advancing Agent, and Wells Fargo Bank, National Association, as Trustee, Paying Agent, Transfer Agent, Custodian, Backup Advancing Agent and Notes Registrar (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on December 4, 2012)
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	First Supplemental Indenture, dated March 6, 2013, between Redwood Trust, Inc. and Wilmington Trust, National Association, as Trustee (including the form of 4.625% Convertible Senior Note due 2018) (incorporated by reference to the Registrant's Current Report on Form 8-K/A, Exhibit 4.2, filed on March 6, 2013)
4.13	Indenture, by and among Redwood Trust, Inc., RWT Holdings, Inc. and Wilmington Trust, National Association, as Trustee, dated as of November 24, 2014 (including the form of 5.625% Exchangeable Senior Note due 2019) (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 4.1, filed on November 25, 2014)
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*	2014 Incentive Award Plan (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on May 23, 2014)
10.2*	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)
10.3*	Form of Redwood Trust, Inc. Performance Stock Unit Award Agreement under 2014 Incentive Award Plan (2014) (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.3, filed on February 25, 2015)
10.4*	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)
10.5*	Amended and Restated 1994 Executive and Non-Employee Director Stock Option Plan, as last amended January 24, 2002 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.14.5, filed on May 15, 2002)
10.6*	2002 Incentive Plan, as amended through May 16, 2013 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on May 21, 2013)

Exhibit Number	Exhibit
10.7*	Form of Employee Incentive Stock Option Grant Agreement under 2002 Incentive Plan (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.8.1, filed on March 16, 2005)
10.8*	Form of Employee Non-Qualified Stock Option Grant Agreement under 2002 Incentive Plan (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.8.2, filed on filed on March 16, 2005)
10.9*	Form of Amendment to Employee Non-Qualified Stock Option Grant Agreement under 2002 Incentive Plan (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.2, filed on November 17, 2005)
10.10*	Form of Restricted Stock Award Agreement under 2002 Incentive Plan – Pre-December 2011 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.8.3, filed on March 16, 2005)
10.11*	Form of Deferred Stock Unit Award Agreement under 2002 Incentive Plan – Pre-December 2011 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on December 2, 2010)
10.12*	Form of Performance Stock Unit Award Agreement under 2002 Incentive Plan – Pre-December 2011 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.2, filed on December 2, 2010)
10.13*	Form of Restricted Stock Award Agreement under 2002 Incentive Plan (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.3, filed on December 8, 2011)
10.14*	Form of Deferred Stock Unit Award Agreement under 2002 Incentive Plan (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on December 8, 2011)
10.15*	Form of Performance Stock Unit Award Agreement under 2002 Incentive Plan – December 2011 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.2, filed on December 8, 2011)
10.16*	Form of Performance Stock Unit Award Agreement under 2002 Incentive Plan – December 2012 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on December 11, 2012)
10.17*	2002 Employee Stock Purchase Plan, as amended through May 16, 2013 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.2, filed on May 21, 2013)
10.18*	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)
10.19*	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)
10.20*	

	Direct Stock Purchase and Dividend Reinvestment Plan (incorporated by reference to the Plan text included in the Registrant’s Prospectus Supplement filed on September 5, 2012)
10.21*	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 March 20, 2015)
10.22*	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)
10.23	Office Building Lease, dated February 27, 2003 (incorporated by reference to the Registrant’s Annual Report on Form 10-K, Exhibit 10.30.2, filed on March 12, 2004)
10.24	Office Building Lease (second floor), dated July 31, 2006 (incorporated by reference to the Registrant’s Quarterly Report on Form 10-Q, Exhibit 10.1, filed November 2, 2006)
10.25	Second Amendment to Lease, dated July 31, 2006 (incorporated by reference to the Registrant’s Quarterly Report on Form 10-Q, Exhibit 10.3, filed November 2, 2006)
10.26	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)
10.27	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)

Exhibit Number	Exhibit
10.28	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)
10.29	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)
10.30*	Amended and Restated Employment Agreement, dated as of March 31, 2009, by and between George E. Bull, III and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.1, filed on May 5, 2009)
10.31*	Amended and Restated Employment Agreement, dated as of March 31, 2009, by and between Martin S. Hughes and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.2, filed on May 5, 2009)
10.32*	Amended and Restated Employment Agreement, dated as of March 31, 2009, by and between Brett D. Nicholas and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.3, filed on May 5, 2009)
10.33*	Amended and Restated Employment Agreement, dated as of March 31, 2009, by and between Harold F. Zagunis and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.4, filed on May 5, 2009)
10.34*	First Amendment to Amended and Restated Employment Agreement, by and between Martin S. Hughes and the Registrant, dated as of March 17, 2010 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on March 18, 2010)
10.35*	First Amendment to Amended and Restated Employment Agreement, by and between Brett D. Nicholas and the Registrant, dated as of March 17, 2010 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.2, filed on March 18, 2010)
10.36*	Second Amendment to Amended and Restated Employment Agreement, by and between Martin S. Hughes and the Registrant, dated as of February 24, 2011 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.23, filed on February 24, 2011)
10.37*	Second Amendment to Amended and Restated Employment Agreement, by and between Brett D. Nicholas and the Registrant, dated as of February 24, 2011 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.24, filed on February 24, 2011)
10.38*	First Amendment to Amended and Restated Employment Agreement, by and between Harold F. Zagunis and the Registrant, dated as of February 24, 2011 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.25, filed on February 24, 2011)
10.39*	Third Amendment to Amended and Restated Employment Agreement, by and between Martin S. Hughes and the Registrant, dated as of May 17, 2012 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.3, filed on May 21, 2012)

10.40*	Third Amendment to Amended and Restated Employment Agreement, by and between Brett D. Nicholas and the Registrant, dated as of May 17, 2012 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.4, filed on May 21, 2012)
10.41*	Second Amendment to Amended and Restated Employment Agreement, by and between Harold F. Zagunis and the Registrant, dated as of May 17, 2012 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.5, filed on May 21, 2012)
10.42*	Fourth Amendment to Amended and Restated Employment Agreement, by and between Martin S. Hughes and the Registrant, dated as of December 14, 2012 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.35, filed on February 26, 2013)
10.43*	Fourth Amendment to Amended and Restated Employment Agreement, by and between Brett D. Nicholas and the Registrant, dated as of December 14, 2012 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.36, filed on February 26, 2013)

Exhibit Number	Exhibit
10.44*	Third Amendment to Amended and Restated Employment Agreement, by and between Harold F. Zagunis and the Registrant, dated as of December 14, 2012 (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.37, filed on February 26, 2013)
10.45*	Fifth Amendment to Amended and Restated Employment Agreement, by and between Martin S. Hughes and the Registrant, dated as of August 6, 2014 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.5, filed on August 8, 2014)
10.46*	Fifth Amendment to Amended and Restated Employment Agreement, by and between Brett D. Nicholas and the Registrant, dated as of August 6, 2014 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.6, filed on August 8, 2014)
10.47*	Sixth Amendment to Amended and Restated Employment Agreement, by and between Martin S. Hughes and the Registrant, dated as of August 5, 2015 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.1, filed on August 7, 2015)
10.48*	Sixth Amendment to Amended and Restated Employment Agreement, by and between Brett D. Nicholas and the Registrant, dated as of August 5, 2015 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.1, filed on November 6, 2015)
10.49*	Employment Agreement, by and between Christopher J. Abate and the Registrant, dated as of January 1, 2016 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on January 4, 2016)
10.50*	Employment Agreement, by and between Fred J. Matera and the Registrant, dated as of January 1, 2016 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.2, filed on January 4, 2016)
10.51*	Employment Agreement, by and between Andrew P. Stone and the Registrant, dated as of January 1, 2016 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.3, filed on January 4, 2016)
10.52*	Transition Agreement, dated as of December 10, 2008, between Douglas B. Hansen and the Registrant (incorporated by reference to the Registrant's Annual Report on Form 10-K, Exhibit 10.27, filed on February 26, 2009)
10.53*	Transition Agreement, dated as of March 17, 2010, between George E. Bull, III and the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 10.3, filed on May 5, 2010)
10.54*	Transition and Separation Agreement, dated as of June 6, 2013, between Scott M. Chisholm and the Registrant (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 10.1, filed on June 11, 2013)
10.55	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)
10.56	

	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)
10.57	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)
10.58	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)
12	Computation of Ratio of Earnings to Fixed Charges (filed herewith)
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)

Exhibit Number	Exhibit
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, 2015, is filed in XBRL-formatted interactive data files: (i) Consolidated Balance Sheets at December 31, 2015 and 2014; (ii) Consolidated Statements of Income for the years ended December 31, 2015, 2014, and 2013; (iii) Statements of Consolidated Comprehensive (Loss) Income for the years ended December 31, 2015, 2014, and 2013; (iv) Consolidated Statements of Changes in Equity for the years ended December 31, 2015, 2014, and 2013; (v) Consolidated Statements of Cash Flows for the years ended December 31, 2015, 2014, and 2013; and (vi) Notes to Consolidated Financial Statements.

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

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, 2016

By: /s/ MARTIN S. HUGHES
Martin S. Hughes
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.

Signature	Title	Date
/s/ MARTIN S. HUGHES	Director and Chief Executive Officer	February 26, 2016
Martin S. Hughes	(Principal Executive Officer)	