REDWOOD TRUST INC
Form 10-Q
November 06, 2015

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended: September 30, 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)
Not Applicable
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

Common Stock, $0.01 par value per share	82,124,371 shares outstanding as of November 5, 2015

REDWOOD TRUST, INC.
2015 FORM 10-Q REPORT
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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
REDWOOD TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data) (Unaudited)	September 30, 2015	December 31, 2014
ASSETS [1]		
Residential loans, held-for-sale, at fair value	$1,506,151	$1,342,519
Residential loans, held-for-investment, at fair value [2]	2,530,523	2,056,054
Commercial loans, held-for-sale, at fair value	80,756	166,234
Commercial loans, held-for-investment (includes $70,096 and $71,262 at fair value)	387,401	400,693
Real estate securities, at fair value	1,085,224	1,379,230
Mortgage servicing rights, at fair value	162,726	139,293
Cash and cash equivalents	235,362	269,730
Total earning assets	5,988,143	5,753,753
Restricted cash	8,361	628
Accrued interest receivable	20,223	18,222
Derivative assets	38,623	16,417
Deferred securities issuance costs	12,080	16,050
Other assets	201,596	113,896
Total Assets	$6,269,026	$5,918,966
LIABILITIES AND EQUITY [1]		
Liabilities		
Short-term debt	$1,872,793	$1,793,825
Accrued interest payable	14,738	8,503
Derivative liabilities	88,044	58,331
Accrued expenses and other liabilities	75,968	52,244
Deferred tax liability	10,236	10,236
Asset-backed securities issued (includes $1,105,588 and $0 at fair value) [2]	1,178,795	1,545,119
Long-term debt (includes $65,578 and $66,707 at fair value)	1,821,877	1,194,567
Total liabilities	5,062,451	4,662,825
Equity		
Common stock, par value $0.01 per share, 180,000,000 shares authorized; 82,124,927 and 83,443,141 issued and outstanding	821	834
Additional paid-in capital	1,746,775	1,774,030
Accumulated other comprehensive income	119,721	140,688
Cumulative earnings	977,624	906,867
Cumulative distributions to stockholders	(1,638,366)	(1,566,278)
Total equity	1,206,575	1,256,141
Total Liabilities and Equity	$6,269,026	$5,918,966

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(1) Our consolidated balance sheets include assets of consolidated variable interest entities ("VIEs") that can only be used to settle obligations of these VIEs and liabilities of consolidated VIEs for which creditors do not have recourse to Redwood Trust, Inc. or its affiliates. At September 30, 2015 and December 31, 2014, assets of consolidated VIEs totaled $1,539,350 and $1,900,208, respectively. At September 30, 2015 and December 31, 2014, liabilities of consolidated VIEs totaled $1,179,884 and $1,546,490, respectively. See Note 4 for further discussion.

(2)

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 (which are VIEs) at fair value. At December 31, 2014, amounts presented in residential loans held-for-investment for these assets included $1,474,386 at historical cost. See Note 3 for further discussion.

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

REDWOOD TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(In Thousands, Except Share Data)	Three Months Ended September 30,		Nine Months Ended September 30,	
(Unaudited)	2015	2014	2015	2014
Interest Income				
Residential loans	$29,472	$19,280	$80,289	$45,539
Commercial loans	11,191	12,603	34,784	34,204
Real estate securities	22,749	31,461	75,363	97,062
Other interest income	72	7	167	15
Total interest income	63,484	63,351	190,603	176,820
Interest Expense				
Short-term debt	(7,627)	(8,441)	(21,378)	(17,409)
Asset-backed securities issued	(5,190)	(7,838)	(17,037)	(24,462)
Long-term debt	(11,058)	(7,071)	(32,429)	(21,689)
Total interest expense	(23,875)	(23,350)	(70,844)	(63,560)
Net Interest Income	39,609	40,001	119,759	113,260
Reversal of provision for loan losses	60	1,596	115	629
Net Interest Income After Provision	39,669	41,597	119,874	113,889
Non-interest Income				
Mortgage banking and investment activities, net	(12,836)	14,166	(6,399)	9,984
Mortgage servicing rights income (loss), net	3,549	5,821	(6,545)	4,650
Other income	327	1,600	2,435	1,600
Realized gains, net	5,548	8,532	16,170	10,687
Total non-interest income (loss)	(3,412)	30,119	5,661	26,921
Operating expenses	(24,497)	(21,406)	(74,778)	(63,660)
Net income before provision for income taxes	11,760	50,310	50,757	77,150
Benefit from (provision for) income taxes	7,404	(5,213)	10,272	(3,703)
Net Income	$19,164	$45,097	$61,029	$73,447
Basic earnings per common share	$0.22	$0.53	$0.71	$0.87
Diluted earnings per common share	$0.22	$0.50	$0.69	$0.84
Regular dividends declared per common share	$0.28	$0.28	$0.84	$0.84
Basic weighted average shares outstanding	83,787,533	83,017,534	83,696,461	82,722,079
Diluted weighted average shares outstanding	85,074,704	96,956,232	85,338,996	85,031,130

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

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

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
(Unaudited)	2015	2014	2015	2014
Net Income	$19,164	$45,097	$61,029	$73,447
Other comprehensive income (loss):				
Net unrealized (loss) gain on available-for-sale securities	(5,673)	1,849	(5,701)	35,078
Reclassification of unrealized gain on available-for-sale securities to net income	(3,270)	(6,409)	(10,320)	(6,750)
Net unrealized loss on interest rate agreements	(12,049)	(3,258)	(5,023)	(17,454)
Reclassification of unrealized loss on interest rate agreements to net income	19	32	77	131
Total other comprehensive income (loss)	(20,973)	(7,786)	(20,967)	11,005
Total Comprehensive Income (Loss)	$(1,809)	$37,311	$40,062	$84,452

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

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

For the Nine Months Ended September 30, 2015

(In Thousands, Except Share Data) (Unaudited)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Cumulative Earnings	Cumulative Distributions to Stockholders	Total
December 31, 2014	83,443,141	$834	$1,774,030	$140,688	$906,867	$(1,566,278)	$1,256,141
Cumulative effect adjustment - adoption of ASU 2014-13 (1)	—	—	—	—	9,728	—	9,728
January 1, 2015	83,443,141	834	1,774,030	140,688	916,595	(1,566,278)	1,265,869
Net income	—	—	—	—	61,029	—	61,029
Other comprehensive loss	—	—	—	(20,967)	—	—	(20,967)
Dividend reinvestment & stock purchase plans	418,508	4	6,830	—	—	—	6,834
Employee stock purchase and incentive plans	714,801	7	(7,735)	—	—	—	(7,728)
Non-cash equity award compensation	—	—	9,002	—	—	—	9,002
Share repurchases	(2,451,523)	(24)	(35,352)	—	—	—	(35,376)
Common dividends declared	—	—	—	—	—	(72,088)	(72,088)
September 30, 2015	82,124,927	$821	$1,746,775	$119,721	$977,624	$(1,638,366)	$1,206,575

For the Nine Months Ended September 30, 2014

(In Thousands, Except Share Data) (Unaudited)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Cumulative Earnings	Cumulative Distributions to Stockholders	Total
December 31, 2013	82,504,801	$825	$1,760,899	$148,766	$806,298	$(1,471,005)	$1,245,783
Net income	—	—	—	—	73,447	—	73,447
Other comprehensive income	—	—	—	11,005	—	—	11,005
Dividend reinvestment & stock purchase plans	336,810	4	6,051	—	—	—	6,055
Employee stock purchase and incentive plans	442,781	4	(7,272)	—	—	—	(7,268)

Non-cash equity award compensation	—	—	8,934	—	—	—	8,934
Common dividends declared	—	—	—	—	—	(71,278)	(71,278)
September 30, 2014	83,284,392	$833	$1,768,612	$159,771	$879,745	$(1,542,283)	$1,266,678

(1) On January 1, 2015, we adopted ASU 2014-13. See Note 3 for further discussion.

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

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

(In Thousands) (Unaudited)	Nine Months Ended September 30,			
	2015		2014	
Cash Flows From Operating Activities:				
Net income	$61,029		$73,447	
Adjustments to reconcile net income to net cash used in operating activities:				
Amortization of premiums, discounts, and securities issuance costs, net	(26,244	)	(26,248	)
Depreciation and amortization of non-financial assets	510		369	
Purchases of held-for-sale loans	(8,794,939	)	(6,844,403	)
Proceeds from sales of held-for-sale loans	7,741,024		5,328,901	
Principal payments on held-for-sale loans	46,952		19,648	
Net settlements of derivatives	(47,002	)	(22,776	)
Provision for loan losses	(115	)	(629	)
Non-cash equity award compensation expense	9,002		8,934	
Market valuation adjustments	40,546		(1,787	)
Realized gains, net	(16,170	)	(10,687	)
Net change in:				
Accrued interest receivable and other assets	(90,605	)	(57,806	)
Accrued interest payable, deferred tax liabilities, and accrued expenses and other liabilities	26,094		(266	)
Net cash used in operating activities	(1,049,918	)	(1,533,303	)
Cash Flows From Investing Activities:				
Purchases of loans held-for-investment	(22,219	)	(65,584	)
Principal payments on loans held-for-investment	359,714		267,425	
Purchases of real estate securities	(66,601	)	(132,393	)
Proceeds from sales of real estate securities	309,101		457,131	
Principal payments on real estate securities	103,664		144,598	
Purchase of mortgage servicing rights	(23,315	)	(41,834	)
Proceeds from sales of mortgage servicing rights	17,235		—	
Net change in restricted cash	(7,733	)	(57	)
Net cash provided by investing activities	669,846		629,286	
Cash Flows From Financing Activities:				
Proceeds from borrowings on short-term debt	6,213,505		5,615,317	
Repayments on short-term debt	(6,160,226	)	(4,643,308	)
Repayments on asset-backed securities issued	(256,614	)	(286,248	)
Deferred securities issuance costs	(33	)	—	
Proceeds from issuance of long-term debt	1,156,396		272,937	
Repayments on long-term debt	(502,268	)	(685	)
Net settlements of derivatives	(32	)	(2,507	)
Net proceeds from issuance of common stock	7,198		3,840	
Net payments on repurchase of common stock	(32,042	)	—	
Taxes paid on equity award distributions	(8,092	)	(7,635	)
Dividends paid	(72,088	)	(71,278	)
Net cash provided by financing activities	345,704		880,433	
Net decrease in cash and cash equivalents	(34,368	)	(23,584	)
Cash and cash equivalents at beginning of period	269,730		173,201	
Cash and cash equivalents at end of period	$235,362		$149,617	
Supplemental Cash Flow Information:				

Cash paid during the period for:		
Interest	$57,998	$57,047
Taxes	55	1,399
Supplemental Noncash Information:		
Real estate securities retained from loan securitizations	$39,698	$126,009
Retention of mortgage servicing rights from loan securitizations and sales	52,297	30,962
Transfers from loans held-for-sale to loans held-for-investment	964,013	278,913
Transfers from loans held-for-investment to loans held-for-sale	66,918	—
Transfers from residential loans to real estate owned	5,740	4,753

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

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REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2015
(Unaudited)

Note 1. Organization

Redwood Trust, Inc., together with its subsidiaries, focuses on investing in mortgage- and other real estate-related assets and engaging in residential and commercial mortgage banking activities. We seek to invest in real estate-related assets that have the potential to generate attractive cash flow returns over time and to generate income through our residential and commercial mortgage banking activities. We operate our business in three segments: residential mortgage banking, residential investments, and commercial mortgage banking and investments. Redwood was incorporated in the State of Maryland on April 11, 1994, and commenced operations on August 19, 1994. 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. To qualify as a REIT, Redwood Trust, Inc. must distribute at least 90% of its annual REIT taxable income to shareholders (not including taxable income retained in its taxable subsidiaries) within the time frame set forth in the Internal Revenue Code and also meet certain other requirements related to assets, income, and stock ownership. We 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.” We generally intend to distribute as dividends at least 90% of the taxable income we generate at our REIT.

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

Note 2. Basis of Presentation

The consolidated financial statements presented herein are at September 30, 2015 and December 31, 2014, and for the three and nine months ended September 30, 2015 and 2014. These interim unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") — as prescribed by the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Codification (“ASC”) — have been condensed or omitted according to these SEC rules and regulations. Management believes that the disclosures included in these interim financial statements should be read in conjunction with consolidated financial statements and notes thereto included in the company's Annual Report on Form 10-K for the year ended December 31, 2014. In the opinion of management, all normal and recurring adjustments to present fairly the financial condition of the company at September 30, 2015 and results of operations for all periods presented have been made. The results of operations for the three and nine months ended September 30, 2015 should not be construed as indicative of the results to be expected for the full year.

In the second quarter of 2015, we began to specifically identify derivatives that are used to hedge our exposure to market interest rate risk associated with our MSR investments. As a result, beginning in the second quarter of 2015, we changed our income statement presentation to include the change in market value of these derivatives in the line item “Mortgage servicing rights income (loss), net.” As we previously managed our market interest rate risk on a portfolio-wide basis and did not necessarily rely on derivatives to hedge our MSRs, we cannot conform prior periods to the current presentation. Therefore, in periods prior to the second quarter of 2015 presented in our consolidated statements of income, amounts in “Mortgage servicing rights income (loss), net” do not reflect the impact of hedging.

These changes and year-over-year comparisons are discussed in further detail in Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations in this quarterly report on Form 10-Q. Additionally, beginning in the second quarter of 2015, we combined our "Mortgage banking activities" and "Other market valuation adjustments" line items on our consolidated statements of income into a single line, now called "Mortgage banking and investment activities, net." As we currently manage our market interest rate risk on the remainder of our assets (excluding MSRs) on a net basis, we believe that combining these two line items will better reflect the net effect of our hedging activities on the assets associated with derivatives that are marked-to-market each quarter. We have conformed the presentation of prior periods related to this change for consistency of comparison.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2015
(Unaudited)
Note 2. Basis of Presentation - (continued)

Principles of Consolidation
In accordance with GAAP, we determine whether we must consolidate transferred financial assets and variable interest entities (“VIEs”) for financial reporting purposes. We currently consolidate the assets and liabilities of certain Sequoia securitization entities where we maintain an ongoing involvement, as well as an entity formed in connection with a resecuritization transaction we engaged in during 2011 (“Residential Resecuritization”), and an entity formed in connection with a commercial securitization we engaged in during 2012 (“Commercial Securitization”). Each securitization entity is independent of Redwood and of each other and the assets and liabilities are not owned by and are not legal obligations of Redwood Trust, Inc. Our exposure to these entities is primarily through the financial interests we have retained, although we are exposed to certain financial risks associated with our role as a sponsor, manager, or depositor of these entities or as a result of our having sold assets directly or indirectly to these entities.
For financial reporting purposes, the underlying loans and securities owned at the consolidated Sequoia entities, the Residential Resecuritization entity, and the Commercial Securitization entity are shown under residential and commercial loans and real estate securities on our consolidated balance sheets. The asset-backed securities (“ABS”) issued to third parties by these entities are shown under ABS issued. In our consolidated statements of income, we record interest income on the loans and securities owned at these entities and interest expense on the ABS issued by these entities as well as other income and expenses associated with these entities' activities.
See Note 4 for further discussion on principles of consolidation.
Use of Estimates
The preparation of financial statements requires us to make a number of significant estimates. These include estimates of fair value of certain assets and liabilities, amounts and timing of credit losses, prepayment rates, and other estimates that affect the reported amounts of certain assets and liabilities as of the date of the consolidated financial statements and the reported amounts of certain revenues and expenses during the reported periods. It is likely that changes in these estimates (e.g., valuation changes due to supply and demand, credit performance, prepayments, interest rates, or other reasons) will occur in the near term. Our estimates are inherently subjective in nature and actual results could differ from our estimates and the differences could be material.
Note 3. Summary of Significant Accounting Policies

Significant Accounting Policies
Included in Note 3 to the Consolidated Financial Statements of our 2014 Annual Report on Form 10-K is a summary of our significant accounting policies. Provided below is a summary of additional accounting policies that are significant to the company’s consolidated financial condition and results of operations for the three and nine months ended September 30, 2015.
Recent Accounting Pronouncements
Adoption of ASU 2014-13
In November 2014, the FASB issued ASU 2014-13, “Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity” ("ASU 2014-13"). This update provides a measurement alternative to companies that consolidate collateralized financing entities ("CFEs"). Under the new guidance, companies can measure both the financial assets and financial liabilities of a CFE using the more observable of the fair value of the financial assets or fair value of the financial liabilities. This guidance is effective in the first quarter 2016 with early adoption permitted at the beginning of an annual period. The guidance can be applied either retrospectively to all relevant prior periods or by a modified retrospective approach with a cumulative-effect adjustment to equity as of the beginning of the annual period of adoption.
On January 1, 2015, we elected to early adopt ASU 2014-13, as we determined this measurement alternative more accurately reflects our economic interests in, and financial results from, certain consolidated financing entities. We

adopted the measurement alternative under this standard only for our consolidated Sequoia entities, which qualify under the standard as CFEs. We did not elect the measurement alternative for our Residential Resecuritization or our Commercial Resecuritization, and will continue to account for the assets and liabilities in these CFEs in accordance with existing accounting guidance.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2015
(Unaudited)

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

Under the provisions of ASU 2014-13, we use the fair value of the liabilities issued by the Sequoia CFEs (which we determined to be more observable) to determine the fair value of the assets, whereby the net assets we consolidate in our financial statements related to these entities represents the estimated fair value of our retained interests in the Sequoia CFEs. Similarly, the periodic net market valuation adjustments we record on our income statement from the consolidated assets and liabilities of the CFEs represents the change in fair value of our retained interests in the Sequoia CFEs.

Using the modified retrospective approach, we recorded a cumulative-effect adjustment to equity of $10 million through retained earnings as of January 1, 2015. This cumulative-effect adjustment represents the net effect of adjusting the assets and liabilities of the Sequoia CFEs from amortized historical cost to fair value.

Subsequent to the adoption of ASU 2014-13, the consolidated assets and liabilities of the Sequoia CFEs are both carried at fair value, with the periodic net changes in fair value recorded on our income statement, in mortgage banking and investment activities, net.

The following table presents the assets and liabilities of the consolidated Sequoia entities at December 31, 2014 prior to the adoption of ASU 2014-13, the adjustments required to adopt the new standard, and the adjusted balances at January 1, 2015.

Table 3.1 – Impact of Adoption of ASU 2014-13 on Balance Sheet[1]

(In Millions)	December 31, 2014	ASU 2014-13 Adjustment	January 1, 2015
Loan Principal	$1,486	$—	$1,486
Loan unamortized premium	13	(13)	—
Allowance for loan losses	(21)	21	—
Loan market valuation adjustment	—	(113)	(113)
Residential loans held-for-investment	1,478	(105)	1,373
Deferred bond issuance costs	1	(1)	—
Other assets	5	—	5
Total assets	1,482	(105)	1,377
ABS issued principal	1,428	—	1,428
ABS issued unamortized discount	(10)	10	—
ABS market valuation adjustment	—	(125)	(125)
Total liabilities	1,418	(115)	1,303
Redwood's investment in consolidated Sequoia entities	$64	$10	$74

(1) Certain totals may not foot due to rounding.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2015
(Unaudited)

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

Other Recent Accounting Pronouncements
In April 2015, the FASB issued ASU 2015-03, “Simplifying the Presentation of Debt Issuance Costs.” This new guidance requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with the presentation of a debt discount. This new guidance is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The new guidance is required to be applied on a retrospective basis. We plan to adopt this new guidance by the required date and will reclassify our deferred securities issuance costs that we currently present on the face of our consolidated balance sheets and present them as debt discounts.
In February 2015, the FASB issued ASU 2015-02, “Consolidation (Topic 810) - Amendments to the Consolidation Analysis.” This new guidance provides a new scope exception for certain money market funds, makes targeted amendments to the current consolidation guidance, and ends the deferral granted to investment companies from applying the VIE guidance. This new guidance is effective for annual periods beginning after December 15, 2015. Early adoption is allowed, including in any interim period. We are evaluating the impact of adopting this new standard.
In June 2014, the FASB issued ASU 2014-11, “Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures.” This new guidance amends the accounting guidance for “repo-to-maturity” transactions and repurchase agreements executed as repurchase financings. In addition, the new standard requires a transferor to disclose more information about certain transactions, including those in which it retains substantially all of the exposure to the economic returns of the underlying transferred asset over the transaction’s term. This new guidance is effective in the first interim reporting period beginning after December 15, 2014. However, for repurchase and securities lending transactions reported as secured borrowings, the new standard’s enhanced disclosures are effective for annual periods beginning after December 15, 2014 and interim periods beginning after March 15, 2015. We adopted the new guidance, as required, in the first quarter of 2015 and adopted the disclosure requirements in the second quarter of 2015, as required, which are included in Note 12 of these notes to our consolidated financial statements. The adoption in the first quarter of 2015 did not have a material impact on our financial statements, as we did not have repo-to-maturity transactions outstanding.
In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers.” The update modifies the guidance companies use to recognize revenue from contracts with customers for transfers of goods or services and transfers of nonfinancial assets, unless those contracts are within the scope of other standards. The guidance also requires new qualitative and quantitative disclosures, including information about contract balances and performance obligations. In July 2015, the FASB approved a one year deferral of the effective date. Accordingly, the update is effective for us in the first quarter of 2018 with retrospective application to prior periods presented or as a cumulative effect adjustment in the period of adoption. Early adoption is permitted in the first quarter of 2017. We are evaluating the impact the update will have on our consolidated financial statements.
In January 2014, the FASB issued ASU 2014-04, “Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.” This update to the receivable guidance clarifies when a creditor is considered to have received physical possession of residential real estate resulting from an in substance repossession or foreclosure. In addition, the amendments require disclosure of both: (i) the amount of foreclosed residential real estate property held by the creditor; and (ii) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The update requires the guidance to be applied using either a modified retrospective transition method or a prospective transition method for interim and annual periods beginning after December 15, 2014, with early adoption permitted. We adopted this standard in the first quarter of 2015, as

required, and it did not have a material impact on our financial statements.

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

Balance Sheet Netting
Certain of our derivatives and short-term debt are subject to master netting arrangements or similar agreements. Under GAAP, in certain circumstances we may elect to present certain financial assets, liabilities and related collateral subject to master netting arrangements in a net position on our consolidated balance sheets. However, we do not report any of these financial assets or liabilities on a net basis, and instead present them on a gross basis on our consolidated balance sheets.
The table below presents financial assets and liabilities that are subject to master netting arrangements or similar agreements categorized by financial instrument, together with corresponding financial instruments and corresponding collateral received or pledged at September 30, 2015 and December 31, 2014.
Table 3.2 – Offsetting of Financial Assets, Liabilities, and Collateral

September 30, 2015 (In Thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in Consolidated Balance Sheet	Net Amounts of Assets (Liabilities) Presented in Consolidated Balance Sheet	Gross Amounts Not Offset in Consolidated Balance Sheet [1] Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets [2]						
Interest rate agreements	$16,788	$—	$16,788	$(9,932)	$(6,856)	$—
Credit default index swaps	2,792	—	2,792	—	—	2,792
TBAs	8,910	—	8,910	(8,659)	—	251
Total Assets	$28,490	$—	$28,490	$(18,591)	$(6,856)	$3,043
Liabilities [2]						
Interest rate agreements	$(72,415)	$—	$(72,415)	$9,932	$59,933	$(2,550)
TBAs	(14,994)	—	(14,994)	8,659	3,868	(2,467)
Futures	(188)	—	(188)	—	188	—
Loan warehouse debt	(1,271,610)	—	(1,271,610)	1,271,610	—	—
Security repurchase agreements	(475,494)	—	(475,494)	475,494	—	—
Total Liabilities	$(1,834,701)	$—	$(1,834,701)	$1,765,695	$63,989	$(5,017)

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

December 31, 2014 (In Thousands)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in Consolidated Balance Sheet	Net Amounts of Assets (Liabilities) Presented in Consolidated Balance Sheet	Gross Amounts Not Offset in Consolidated Balance Sheet (1) Financial Instruments	Cash Collateral (Received) Pledged	Net Amount
Assets (2)						
Interest rate agreements	$7,006	$—	$7,006	$(1,160)	$(4,360)	$1,486
Credit default index swaps	1,598	—	1,598	—	(375)	1,223
TBAs	6,653	—	6,653	(5,815)	—	838
Total Assets	$15,257	$—	$15,257	$(6,975)	$(4,735)	$3,547
Liabilities (2)						
Interest rate agreements	$(48,173)	$—	$(48,173)	$1,160	$47,013	$—
TBAs	(9,506)	—	(9,506)	5,815	2,715	(976)
Futures	(372)	—	(372)	—	372	—
Loan warehouse debt	(1,185,316)	—	(1,185,316)	1,185,316	—	—
Security repurchase agreements	(608,509)	—	(608,509)	608,509	—	—
Total Liabilities	$(1,851,876)	$—	$(1,851,876)	$1,800,800	$50,100	$(976)

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

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

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

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Note 4. Principles of Consolidation

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

Analysis of Consolidated VIEs

As of September 30, 2015, the VIEs we are required to consolidate include certain Sequoia securitization entities, the Residential Resecuritization entity, and the Commercial Securitization entity. Each of these entities is independent of Redwood and of each other and the assets and liabilities of these entities are not owned by and are not legal obligations of ours. Our exposure to these entities is primarily through the financial interests we have retained, although we are exposed to certain financial risks associated with our role as a sponsor, manager, or depositor of these entities or as a result of our having sold assets directly or indirectly to these entities. The following table presents a summary of the assets and liabilities of these VIEs. Intercompany balances have been eliminated for purposes of this presentation.

Table 4.1 – Assets and Liabilities of Consolidated VIEs

September 30, 2015 (Dollars in Thousands)	Sequoia Entities	Residential Resecuritization	Commercial Securitization	Total
Residential loans, held-for-investment	$1,170,246	$—	$—	$1,170,246
Commercial loans, held-for-investment	—	—	180,394	180,394
Real estate securities	—	181,253	—	181,253
Restricted cash	191	—	138	329
Accrued interest receivable	1,505	364	1,357	3,226
Other assets	3,902	—	—	3,902
Total Assets	$1,175,844	$181,617	$181,889	$1,539,350
Accrued interest payable	$770	$1	$318	$1,089
Asset-backed securities issued	1,105,588	5,261	67,946	1,178,795
Total Liabilities	$1,106,358	$5,262	$68,264	$1,179,884
Number of VIEs	24	1	1	26

Since 2012, we have transferred residential loans to 25 Sequoia securitization entities sponsored by us and accounted for these transfers as sales for financial reporting purposes, in accordance with ASC 860. We also determined we were not the primary beneficiary of these VIEs as we lacked the power to direct the activities that will have the most significant economic impact on the entities. For the transferred loans where we held the servicing rights prior to the transfer and continue to hold the servicing rights, we recorded MSRs on our consolidated balance sheets, and classified those MSRs as Level 3 assets. We also retained senior and subordinate securities in these securitizations that we classified as Level 3 assets. Our continuing involvement in these securitizations is limited to customary servicing obligations associated with retaining residential MSRs (which we retain a third-party sub-servicer to perform) and the receipt of interest income associated with the securities we retained.

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Note 4. Principles of Consolidation - (continued)

The following table presents information related to securitization transactions that occurred during the three and nine months ended September 30, 2015 and 2014.

Table 4.2 – Securitization Activity Related to Unconsolidated VIEs Sponsored by Redwood

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Principal balance of loans transferred	$—	$635,608	$1,038,451	$982,913
Trading securities retained, at fair value	—	1,680	33,389	71,243
AFS securities retained, at fair value	—	39,330	6,309	59,757
MSRs recognized	—	4,356	7,874	6,542

The following table summarizes the cash flows during the three and nine months ended September 30, 2015 and 2014 between us and the unconsolidated VIEs sponsored by us.

Table 4.3 – Cash Flows Related to Unconsolidated VIEs Sponsored by Redwood

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Proceeds from new transfers	$—	$610,167	$1,018,312	$877,943
MSR fees received	3,817	3,571	11,287	10,618
Funding of compensating interest	(86)	(68)	(283)	(144)
Cash flows received on retained securities	8,190	16,190	31,541	44,417

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

Table 4.4 – Assumptions Related to Assets Retained from Unconsolidated VIEs Sponsored by Redwood

	Issued During The Three Months Ended September 30, 2015			Nine Months Ended September 30, 2015		
At Date of Securitization	MSRs	Senior Securities	Subordinate Securities	MSRs	Senior Securities	Subordinate Securities
Prepayment rate	N/A	N/A	N/A	5 - 15%	8%	8%
Discount rates	N/A	N/A	N/A	11%	3%	6%
Credit loss assumptions	N/A	N/A	N/A	N/A	0.25%	0.25%

	Issued During The Three Months Ended September 30, 2014			Nine Months Ended September 30, 2014		
At Date of Securitization	MSRs	Senior Securities	Subordinate Securities	MSRs	Senior Securities	Subordinate Securities
Prepayment rate	5 - 16%	8%	8%	5 - 16%	8 - 10%	8 - 10%
Discount rates	11%	21%	5%	11%	3%	5%
Credit loss assumptions	N/A	0.25%	0.25%	N/A	0.25%	0.25%

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REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 4. Principles of Consolidation - (continued)

The following table presents additional information at September 30, 2015 and December 31, 2014, related to unconsolidated securitizations accounted for as sales since 2012.

Table 4.5 – Unconsolidated VIEs Sponsored by Redwood

(In Thousands)	September 30, 2015	December 31, 2014
On-balance sheet assets, at fair value:		
Interest-only, senior and subordinate securities, classified as trading	$61,602	$93,802
Senior and subordinate securities, classified as AFS	292,948	460,990
Mortgage servicing rights	52,940	56,801
Maximum loss exposure (1)	$407,490	$611,593
Assets transferred:		
Principal balance of loans outstanding	$7,289,025	$7,276,825
Principal balance of delinquent loans 30+ days delinquent	14,204	17,022

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

The following table presents key economic assumptions for assets retained from unconsolidated VIEs and the sensitivity of their fair values to immediate adverse changes in those assumptions at September 30, 2015 and December 31, 2014.

Table 4.6 – Key Assumptions and Sensitivity Analysis for Assets Retained from Unconsolidated VIEs Sponsored by Redwood

September 30, 2015 (Dollars in Thousands)	MSRs	Senior Securities (1)	Subordinate Securities
Fair value at September 30, 2015	$52,940	$51,308	$303,242
Expected life (in years) (2)	6	6	11
Prepayment speed assumption (annual CPR) (2)	14 %	11 %	12 %
Decrease in fair value from:			
10% adverse change	$1,542	$1,308	$953
25% adverse change	5,003	3,103	2,252
Discount rate assumption (2)	11 %	11 %	5 %
Decrease in fair value from:			
100 basis point increase	$933	$1,984	$22,816
200 basis point increase	2,773	3,826	42,885
Credit loss assumption (2)	N/A	0.25 %	0.25 %
Decrease in fair value from:			
10% higher losses	N/A	$31	$3,050
25% higher losses	N/A	76	7,567

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 4. Principles of Consolidation - (continued)

December 31, 2014 (Dollars in Thousands)	MSRs		Senior Securities [1]		Subordinate Securities	
Fair value at December 31, 2014	$56,801		$93,802		$460,990	
Expected life (in years) [2]	7		6		10	
Prepayment speed assumption (annual CPR) [2]	14	%	9	%	10	%
Decrease in fair value from:						
10% adverse change	$2,419		$3,999		$684	
25% adverse change	5,639		9,475		2,355	
Discount rate assumption [2]	11	%	8	%	5	%
Decrease in fair value from:						
100 basis point increase	$2,104		$4,214		$34,149	
200 basis point increase	4,102		8,091		64,474	
Credit loss assumption [2]	N/A		0.25	%	0.25	%
Decrease in fair value from:						
10% higher losses	N/A		$126		$3,169	
25% higher losses	N/A		299		7,841	

(1) Senior securities include $29 million and $88 million of interest only securities as of September 30, 2015 and December 31, 2014, respectively.
(2) Expected life, prepayment speed assumption, discount rate assumption, and credit loss assumption presented in the tables above represent weighted averages.

Analysis of Third-Party VIEs

Third-party VIEs are securitization entities in which we maintain an economic interest, but do not sponsor. Our economic interest may include several securities from the same third-party VIE, and in those cases, the analysis is performed in consideration of all of our interests. The following table presents a summary of our interests in third-party VIEs at September 30, 2015, grouped by security type.

Table 4.7 – Third-Party Sponsored VIE Summary

(Dollars in Thousands)	September 30, 2015
Residential Mortgage Backed Securities	
Senior	$415,827
Re-REMIC	167,639
Subordinate	147,208
Total Investments in Third-Party Sponsored VIEs	$730,674

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

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

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REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 5. Fair Value of Financial Instruments

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

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

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

The following table presents the carrying values and estimated fair values of assets and liabilities that are required to be recorded or disclosed at fair value at September 30, 2015 and December 31, 2014.

Table 5.1 – Carrying Values and Fair Values of Assets and Liabilities

	September 30, 2015		December 31, 2014	
(In Thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Residential loans, held-for-sale				
At fair value	$1,504,705	$1,504,705	$1,341,032	$1,341,032
At lower of cost or fair value	1,446	1,645	1,488	1,669
Residential loans, held-for-investment (1)				
At fair value	2,530,523	2,530,523	581,668	581,668
At amortized cost	—	—	1,474,386	1,381,918
Commercial loans, held-for-sale	80,756	80,756	166,234	166,234
Commercial loans, held-for-investment				
At fair value	70,096	70,096	71,262	71,262
At amortized cost	317,305	322,535	329,431	334,876
Trading securities	114,211	114,211	111,606	111,606
Available-for-sale securities	971,013	971,013	1,267,624	1,267,624
MSRs	162,726	162,726	139,293	139,293
Cash and cash equivalents	235,362	235,362	269,730	269,730
Restricted cash	8,361	8,361	628	628
Accrued interest receivable	20,223	20,223	18,222	18,222
Derivative assets	38,623	38,623	16,417	16,417
REO (2)	3,902	4,620	4,391	4,703
Margin receivable (2)	97,685	97,685	65,374	65,374
FHLBC stock (2)	30,001	30,001	10,688	10,688
Guarantee asset (2)	5,120	5,120	7,201	7,201
Pledged collateral (2)	28,482	28,482	9,927	9,927
Liabilities				
Short-term debt	$1,872,793	$1,872,793	$1,793,825	$1,793,825
Accrued interest payable	14,738	14,738	8,502	8,502
Guarantee obligation	13,394	12,123	7,201	7,201
Derivative liabilities	88,044	88,044	58,331	58,331
ABS issued (1)				
Fair value	1,105,588	1,105,588	—	—
Amortized cost	73,207	73,207	1,545,119	1,446,605
FHLBC long-term borrowings	1,124,299	1,124,299	495,860	495,860
Commercial secured borrowings	65,578	65,578	66,707	66,707
Convertible notes	492,500	464,164	492,500	492,188
Other long-term debt	139,500	90,675	139,500	101,835

(1) Upon adoption of ASU 2014-13 on January 1, 2015, we began to record loans held-for-investment in, and ABS issued by, consolidated Sequoia entities at fair value. See Note 3 for further discussion.
(2) These assets are included in other assets on our consolidated balance sheets.

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

During the three and nine months ended September 30, 2015, we elected the fair value option for $9 million and $68 million of residential subordinate securities, zero and $33 million of residential senior securities, $2.91 billion and $8.09 billion of residential loans (principal balance), $168 million and $518 million of commercial loans (principal balance), and $23 million and $74 million of MSRs, respectively. We anticipate electing the fair value option for all future purchases of residential loans and commercial senior loans that we intend to sell to third parties or transfer to securitizations as well as for MSRs purchased or retained from sales of residential loans.
The following table presents the assets and liabilities that are reported at fair value on our consolidated balance sheets on a recurring basis at September 30, 2015, as well as the fair value hierarchy of the valuation inputs used to measure fair value.
Table 5.2 – Assets and Liabilities Measured at Fair Value on a Recurring Basis at September 30, 2015

September 30, 2015	Carrying	Fair Value Measurements Using		
(In Thousands)	Value	Level 1	Level 2	Level 3
Assets				
Residential loans	$4,035,228	$—	$236,314	$3,798,914
Commercial loans	150,852	—	—	150,852
Trading securities	114,211	—	—	114,211
Available-for-sale securities	971,013	—	—	971,013
Derivative assets	38,623	8,910	19,580	10,133
MSRs	162,726	—	—	162,726
Pledged collateral	28,482	28,482	—	—
FHLBC stock	30,001	30,001	—	—
Guarantee asset	5,120	—	—	5,120
Liabilities				
Derivative liabilities	$88,044	$15,182	$72,415	$447
Commercial secured borrowings	65,578	—	—	65,578
ABS issued	1,105,588	—	—	1,105,588

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

The following table presents additional information about Level 3 assets and liabilities measured at fair value on a recurring basis for the nine months ended September 30, 2015.

Table 5.3 – Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis

	Assets							Liabilities	
(In Thousands)	Residential Loans	Commercial Loans	Trading Securities	AFS Securities	MSRs	Guarantee Asset	Derivatives (1)	Commercial Secured Borrowings	ABS Issued
Beginning balance - December 31, 2014	$1,677,984	$237,496	$111,606	$1,267,624	$139,293	$7,201	$1,119	$66,707	$—
Transfer to FVO (2)	1,370,699	—	—	—	—	—	—	—	1,302,216
Principal paydowns	(369,576)	(584)	(1,722)	(101,944)	—	—	—	(416)	(201,885)
Gains (losses) in net income, net	8,024	10,068	(15,970)	43,860	(32,337)	(1,954)	51,638	(750)	6,198
Unrealized losses in OCI, net	—	—	—	(15,789)	—	—	—	—	—
Acquisitions	4,084,501	517,894	101,429	14,788	73,976	—	—	—	—
Sales	(2,968,446)	(614,022)	(81,132)	(237,886)	(18,206)	—	—	—	(1,362)
Other settlements, net	(4,272)	—	—	360	—	(127)	(43,071)	37	421
Ending balance - September 30, 2015	$3,798,914	$150,852	$114,211	$971,013	$162,726	$5,120	$9,686	$65,578	$1,105,588

(1) For the purpose of this presentation, derivative assets and liabilities, which consist of loan purchase commitments, are presented on a net basis.
(2) Upon adoption of ASU 2014-13 on January 1, 2015, loans held-for-investment in, and ABS issued by, consolidated financial entities are now recorded at fair value. See Note 3 for further discussion.

The following table presents the portion of gains or losses included in our consolidated statements of income that were attributable to Level 3 assets and liabilities recorded at fair value on a recurring basis and held at September 30, 2015 and 2014. Gains or losses incurred on assets or liabilities sold, matured, called, or fully written down during the three and nine months ended September 30, 2015 and 2014 are not included in this presentation.

Table 5.4 – Portion of Net Gains (Losses) Attributable to Level 3 Assets and Liabilities Still Held at September 30, 2015 and 2014 Included in Net Income

Included in Net Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Assets				
Residential loans at Redwood	$16,451	$7,280	$12,115	$8,524
Residential loans at consolidated Sequoia entities	(419)	—	4,912	—
Commercial loans	3,175	2,009	1,971	2,009
Trading securities	(8,298)	(1,882)	(13,274)	(16,033)
Available-for-sale securities	(226)	(188)	(226)	(434)
MSRs	(25,523)	3,509	(15,989)	(3,184)
Other assets - Guarantee asset	(1,098)	—	(1,799)	—
Liabilities				
Loan purchase commitments	$9,736	$932	$9,806	$932
Commercial secured borrowing	(454)	(420)	750	1,339
ABS issued	300	—	(6,198)	—

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

The following table presents information on assets recorded at fair value on a non-recurring basis at September 30, 2015. This table does not include the carrying value and gains or losses associated with the asset types below that were not recorded at fair value on our balance sheet at September 30, 2015.

Table 5.5 – Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis at September 30, 2015

September 30, 2015	Carrying Value	Fair Value Measurements Using			Gain (Loss) for Three Months Ended	Nine Months Ended
(In Thousands)		Level 1	Level 2	Level 3	September 30, 2015	September 30, 2015
Assets						
Residential loans, at lower of cost or fair value	$1,099	$—	$—	$1,099	$1	$2
REO	3,120	—	—	3,120	(621)	(748)

The following table presents the net gains and losses recorded in each line item of our consolidated statements of income for the three and nine months ended September 30, 2015 and 2014.

Table 5.6 – Market Valuation Gains and Losses, Net

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Mortgage banking and investment activities, net				
Residential loans held-for-sale, at fair value	$11,010	$13,489	$9,892	$34,608
Residential loan purchase and forward sale commitments	25,173	2,487	44,482	6,077
Residential loans held-for-investment, at Redwood	9,077	(991)	5,170	(991)
Consolidated Sequoia entities [1]	(500)	(361)	(2,277)	(825)
Commercial loans, at fair value	3,974	4,305	10,819	13,644
Trading securities	(8,783)	(1,909)	(15,946)	(15,072)
Impairments on AFS securities	(226)	(188)	(226)	(565)
Risk management derivatives, net	(52,749)	(4,036)	(60,060)	(29,145)
Guarantee asset	(1,297)	—	(2,081)	—
Other investments	199	—	282	—
Total mortgage banking and investment activities, net[2]	$(14,122)	$12,796	$(9,945)	$7,731
MSR Income (loss), net				
MSRs	$(28,496)	$2,321	$(32,337)	$(5,944)
Risk management derivatives, net	23,551	—	1,736	—
Total MSR income (loss), net [3]	$(4,945)	$2,321	$(30,601)	$(5,944)
Total market valuation gains and losses, net	$(19,067)	$15,117	$(40,546)	$1,787

(1) On January 1, 2015, we adopted ASU 2014-13 and began to record the assets and liabilities of consolidated Sequoia entities at fair value. This amount includes the net change in fair value of the consolidated assets and liabilities of these entities, which include residential loans held-for-investment, REO, and ABS issued. This combined amount represents the estimated change in value of our retained interests in these entities. See Note 3 for further discussion.

(2) Mortgage banking and investment activities, net presented above does not include fee income or provisions for repurchases that are components of mortgage banking and investment activities, net presented on our consolidated statements of income, as these amounts do not represent market valuation changes.

(3) MSR Income (loss), net presented above does not include net fee income or provisions for repurchases that are components of MSR Income (loss), net on our consolidated statements of income, as these amounts do not represent market valuation adjustments.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 5. Fair Value of Financial Instruments - (continued)

At September 30, 2015, our valuation policy and processes had not changed from those described in our Annual Report on Form 10-K for the year ended December 31, 2014. The following table provides quantitative information about the significant unobservable inputs used in the valuation of our Level 3 assets and liabilities measured at fair value.

Table 5.7 – Fair Value Methodology for Level 3 Financial Instruments

September 30, 2015 (Dollars in Thousands, except input values)	Fair Value	Unobservable Input	Range		Weighted Average	
Assets						
Residential loans, at fair value:						
Jumbo fixed rate loans uncommitted to sell	$2,032,815	IO Multiple	3.8 - 4.0	x	3.8	x
		Prepayment rate (annual CPR)	12 - 15	%	14	%
		Senior spread to TBA price	$3.56 - $3.56		$3.56	
		Subordinate spread to swap rate	373 - 373	bps	373	bps
		Credit support	5 - 5	%	5	%
		Whole loan spread to TBA price	$2.90 - $4.27		$4.08	
Jumbo hybrid loans uncommitted to sell	158,149	Spread to swap rate	125 - 165	bps	138	bps
Jumbo loans committed to sell	437,704	Committed Sales Price	$102.1 - $103.0		$102.4	
Loans held by consolidated Sequoia entities (1)	1,170,246	Liability price	N/A		N/A	
Residential loans, at lower of cost or fair value	1,099	Loss severity	13 - 30	%	21	%
Commercial loans, at fair value	150,852	Spread to swap rate	195 - 195	bps	195	bps
		Credit support	23 - 23	%	23	%
Trading and AFS securities	1,085,224	Discount rate	4 - 12	%	7	%
		Prepayment rate (annual CPR)	1 - 35	%	13	%
		Default rate	0 - 35	%	8	%
		Loss severity	20 - 65	%	34	%
		Credit support	0 - 49	%	4	%

MSRs	162,726	Discount rate	8 - 12	%	10	%
		Prepayment rate (annual CPR)	5 - 55	%	12	%
		Per loan annual cost to service	$72 - $82		$78	
Guarantee asset	5,120	Discount rate	10 - 10	%	10	%
		Prepayment rate (annual CPR)	16 - 16	%	16	%
REO	3,120	Loss severity	0 - 89	%	52	%
Loan purchase commitments, net (2)	9,687	MSR Multiple	0 - 5.0	x	3.0	x
		Fallout rate	2 - 98	%	34	%
Liabilities						
ABS issued by consolidated Sequoia entities (1)	1,105,588	Discount rate	5 - 9	%	5	%
		Prepayment rate (annual CPR)	6 - 20	%	13	%
		Default rate	0 - 12	%	6	%
		Loss severity	20 - 32	%	27	%
		Credit support	0 - 70	%	12	%
Commercial secured financing	65,578	Spread to swap rate	194 - 195	bps	194	bps
		Credit support	23 - 23	%	23	%

(1) Upon adoption of ASU 2014-13 on January 1, 2015, we began to record loans held-for-investment in, and ABS issued by, consolidated Sequoia entities at fair value. In accordance with this new guidance, the fair value of the loans in these entities was based on the fair value of the liabilities issued by these entities, which we determined were more readily observable. See Note 3 for further discussion.

(2) For the purpose of this presentation, loan purchase commitment assets and liabilities are presented net.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 5. Fair Value of Financial Instruments - (continued)

Determination of Fair Value
A description of the instruments measured at fair value as well as the general classification of such instruments pursuant to the Level 1, Level 2, and Level 3 valuation hierarchy is listed herein. We generally use both market comparable information and discounted cash flow modeling techniques to determine the fair value of our Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the preceding table. Accordingly, a significant increase or decrease in any of these inputs – such as anticipated credit losses, prepayment rates, interest rates, or other valuation assumptions – in isolation would likely result in a significantly lower or higher fair value measurement.
Residential loans
Estimated fair values for residential loans are determined using models that incorporate various observable inputs, including pricing information from recent securitizations and whole loan sales. Certain significant inputs in these models are considered unobservable and are therefore Level 3 in nature. Pricing inputs obtained from market securitization activity include indicative spreads to indexed TBA prices for senior RMBS and index swap rates (Level 3). Pricing inputs obtained from market whole loan transaction activity include indicative spreads to indexed swap rates (Level 3). Other observable inputs include Agency RMBS transactions, benchmark interest rates, and prepayment rates. These assets would generally decrease in value based upon an increase in the credit spread, prepayment speed, or credit support assumptions.
Estimated fair values for conforming loans are determined based upon quoted market prices (Level 2). Conforming loans are mortgage loans that conform to Agency guidelines. As necessary, these values are adjusted for servicing value, market conditions and liquidity.
Commercial loans
Estimated fair values for senior commercial loans held-for-sale are determined by an exit price to securitization. Certain significant inputs in the valuation analysis are Level 3 in nature. Relevant market indicators that are factored into the analyses include pricing points for current third-party Commercial Mortgage-Backed Securities ("CMBS") sales, pricing points for secondary sales of CMBS, yields for synthetic instruments that use CMBS bonds as an underlying index, indexed swap yields, credit rating agency guidance on expected credit enhancement levels for newly issued CMBS transactions, and interest rates (Level 3). In certain cases, commercial senior mortgage loans are valued based on third-party offers for the loans for purchase into securitization (Level 2). The estimated fair value of our senior commercial loans would generally decrease based upon an increase in credit spreads or required credit support.
Estimated fair values for mezzanine commercial loans are determined by both market comparable pricing and discounted cash flow analysis valuation techniques (Level 3). Our discounted cash flow models utilize certain significant unobservable inputs including the underwritten net operating income and debt coverage ratio assumptions and actual performance relative to those underwritten metrics as well as estimated market discount rates. An increase in market discount rates would reduce the estimated fair value of the commercial loans.
Real estate securities
Real estate securities include residential, commercial, and other asset-backed securities that are generally illiquid in nature and trade infrequently. Significant inputs in the valuation analysis are predominantly Level 3 in nature, due to the lack of readily available market quotes and related inputs. For real estate securities, we utilize both market comparable pricing and discounted cash flow analysis valuation techniques. Relevant market indicators that are factored into the analyses include bid/ask spreads, the amount and timing of credit losses, interest rates, and collateral prepayment rates. Estimated fair values are based on applying the market indicators to generate discounted cash flows (Level 3). These cash flow models use significant unobservable inputs such as a discount rate, prepayment rate,

default rate, loss severity and credit support. The estimated fair value of our securities would generally decrease based upon an increase in default rates, serious delinquencies, or a decrease in prepayment rates or credit support.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 5. Fair Value of Financial Instruments - (continued)

As part of our securities valuation process, we request and consider indications of value from third-party securities dealers. For purposes of pricing our securities at September 30, 2015, we received dealer price indications on 78% of our securities, representing 91% of our carrying value. In the aggregate, our internal valuations of the securities for which we received dealer price indications were within 1% of the aggregate average dealer valuations. Once we receive the price indications from dealers, they are compared to other relevant market inputs, such as actual or comparable trades, and the results of our discounted cash flow analysis. In circumstances where relevant market inputs cannot be obtained, increased reliance on discounted cash flow analysis and management judgment are required to estimate fair value.

Derivative assets and liabilities

Our derivative instruments include swaps, swaptions, TBAs, financial futures, CMBX credit default index swaps, loan purchase commitments ("LPCs"), and forward sale commitments ("FSCs"). Fair values of derivative instruments are determined using quoted prices from active markets, when available, or from valuation models and are supported by valuations provided by dealers active in derivative markets. TBA and financial futures fair values are generally obtained using quoted prices from active markets (Level 1). Our derivative valuation models for swaps and swaptions require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates, and correlations of certain inputs. Model inputs can generally be verified and model selection does not involve significant management judgment (Level 2). LPC fair values are estimated based on quoted Agency MBS prices, estimates of the fair value of the MSRs we expect to retain in the sale of the loans, and the probability that the mortgage loan will be purchased (Level 3). FSC fair values are obtained using quoted Agency prices. Model inputs can generally be verified and model selection does not involve significant management judgment (Level 2).

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

MSRs

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

As part of our MSR valuation process, we received a valuation estimate from a third-party valuations firm. In the aggregate, our internal valuation of the MSRs were within 1% of the third-party valuation.

FHLBC Stock

Our Federal Home Loan Bank ("FHLB") member subsidiary is required to purchase Federal Home Loan Bank of Chicago ("FHLBC") stock under a borrowing agreement between our FHLBC member subsidiary and the FHLBC. Under this agreement, the stock is redeemable at face value, which represents the carrying value and fair value of the stock (Level 1).

Guarantee Asset

The guarantee asset represents the estimated fair value of cash flows we are contractually entitled to receive related to a risk sharing arrangement with Fannie Mae. Significant inputs in the valuation analysis are Level 3, due to the nature of this asset and the lack of market quotes. The fair value of the guarantee asset is determined using a discounted cash flow model, for which significant inputs include prepayment rates and market discount rate (Level 3). An increase in prepayment speed or market discount rate will reduce the estimated fair value of the guarantee asset.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 5. Fair Value of Financial Instruments - (continued)

Pledged Collateral
Pledged collateral consists of cash and U.S. Treasury securities held by a custodian in association with certain agreements we have entered into. Treasury securities are carried at their fair value, which is determined using quoted prices in active markets
(Level 1).
Cash and cash equivalents
Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less. Fair values equal carrying values (Level 1).
Restricted cash
Restricted cash primarily includes interest-earning cash balances at consolidated Sequoia entities and at the Residential Resecuritization and Commercial Securitization entities for the purpose of distribution to investors and reinvestment. Due to the short-term nature of the restrictions, fair values approximate carrying values (Level 1).
Accrued interest receivable and payable
Accrued interest receivable and payable includes interest due on our assets and payable on our liabilities. Due to the short-term nature of when these interest payments will be received or paid, fair values approximate carrying values (Level 1).
REO
REO includes properties owned in satisfaction of foreclosed loans. Fair values are determined using available market quotes, appraisals, broker price opinions, comparable properties, or other indications of value (Level 3).
Margin receivable
Margin receivable reflects cash collateral we have posted with our various derivative and debt counterparties as required to satisfy margin requirements. Fair values approximate carrying values (Level 2).
Short-term debt
Short-term debt includes our credit facilities that mature within one year. As these borrowings are secured and subject to margin calls and as the rates on these borrowings reset frequently to market rates, we believe that carrying values approximate fair values (Level 2).
ABS issued
ABS issued includes asset-backed securities issued through the Sequoia, Residential Resecuritization, and Commercial Securitization entities. These instruments are generally illiquid in nature and trade infrequently. Significant inputs in the valuation analysis are predominantly Level 3, due to the nature of these instruments and the lack of readily available market quotes. For ABS issued, we utilize both market comparable pricing and discounted cash flow analysis valuation techniques. Relevant market indicators factored into the analyses include bid/ask spreads, the amount and timing of collateral credit losses, interest rates, and collateral prepayment rates. Estimated fair values are based on applying the market indicators to generate discounted cash flows (Level 3). These liabilities would generally decrease in value (become a larger liability) if credit losses decreased or if the prepayment rate or discount rate were to increase.
FHLBC Borrowings
FHLBC borrowings include amounts borrowed from the FHLBC that are secured by residential mortgage loans. As these borrowings are secured and subject to margin calls and as the rates on these borrowings reset frequently to market rates, we believe that carrying values approximate fair values (Level 1).

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 5. Fair Value of Financial Instruments - (continued)

Commercial secured borrowings
Commercial secured borrowings represent liabilities recognized as a result of transfers of portions of senior commercial mortgage loans to third parties that do not meet the criteria for sale treatment under GAAP and are accounted for as secured borrowings. Fair values for commercial secured borrowings are based on the fair values of the senior commercial loans associated with the borrowings (Level 3).
Convertible notes
Convertible notes include unsecured convertible and exchangeable senior notes. Fair values are determined using quoted prices in active markets (Level 2).
Trust preferred securities and subordinated notes
Estimated fair values of trust preferred securities and subordinated notes are determined using discounted cash flow analysis valuation techniques. Significant inputs in the valuation analysis are predominantly Level 3, due to the nature of these instruments and the lack of readily available market quotes. Estimated fair values are based on applying the market indicators to generate discounted cash flows (Level 3).
Note 6. Residential Loans
We acquire residential loans from third-party originators. The following table summarizes the classifications and carrying values of the residential loans owned at Redwood and at consolidated Sequoia entities at September 30, 2015 and December 31, 2014.
Table 6.1 – Classifications and Carrying Values of the Residential Loans

September 30, 2015			
(In Thousands)	Redwood	Sequoia [(1)]	Total
Held-for-sale			
Fair value - conforming	$236,314	$—	$236,314
Fair value - jumbo	1,268,391	—	1,268,391
Lower of cost or fair value	1,446	—	1,446
Held-for-investment			
Fair value - jumbo	1,360,277	1,170,246	2,530,523
Total Residential Loans	$2,866,428	$1,170,246	$4,036,674

December 31, 2014			
(In Thousands)	Redwood	Sequoia [(1)]	Total
Held-for-sale			
Fair value - conforming	$244,714	$—	$244,714
Fair value - jumbo	1,096,317	—	1,096,317
Lower of cost or fair value	1,488	—	1,488
Held-for-investment			
Fair value - jumbo	581,668	—	581,668
At amortized cost	—	1,474,386	1,474,386
Total Residential Loans	$1,924,187	$1,474,386	$3,398,573

(1) Upon adoption of ASU 2014-13 on January 1, 2015, we began to record loans held-for-investment at consolidated Sequoia entities at fair value. See Note 3 for further discussion.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 6. Residential Loans - (continued)

At September 30, 2015, we owned mortgage servicing rights associated with $2.22 billion (principal balance) of consolidated residential loans purchased from third-party originators. The value of these MSRs is included in the carrying value of the associated loans on our balance sheet. We contract with a licensed sub-servicer that performs servicing functions for these loans.

Residential Loans Held-for-Sale

At Fair Value

At September 30, 2015, we owned 2,669 loans held-for-sale at fair value with an unpaid principal balance of $1.46 billion, compared to 2,273 loans with an unpaid principal balance of $1.30 billion at December 31, 2014. At September 30, 2015 and December 31, 2014, none of these loans were greater than 90 days delinquent and none of these loans were in foreclosure.

During the three and nine months ended September 30, 2015, we purchased $2.91 billion and $8.09 billion (principal balance) of loans, respectively, for which we elected the fair value option and recorded $11 million and $10 million of positive valuation adjustments, respectively, on residential loans held-for-sale at fair value through mortgage banking and investment activities, net, a component of our consolidated statements of income. During the three and nine months ended September 30, 2015, we sold $2.07 billion and $7.00 billion (principal balance) of loans held-for-sale, respectively. At September 30, 2015, loans held-for-sale with a market value of $1.30 billion were pledged as collateral under short-term borrowing agreements.

At Lower of Cost or Fair Value

At September 30, 2015 and December 31, 2014, we held nine residential loans at the lower of cost or fair value with $2 million in outstanding principal balance and a carrying value of $1 million for both periods.

Residential Loans Held-for-Investment at Fair Value

At Redwood

At September 30, 2015, we owned 1,808 held-for-investment loans at Redwood with an unpaid principal balance of $1.33 billion compared to 803 loans with an unpaid principal balance of $566 million at December 31, 2014. At September 30, 2015, none of these loans were greater than 90 days delinquent and none of these loans were in foreclosure. At December 31, 2014, one of these loans was greater than 90 days delinquent and none of the loans were in foreclosure.

During the three and nine months ended September 30, 2015, we transferred loans with a fair value of $300 million and $962 million, respectively, from held-for-sale to held-for-investment. During the three months ended September 30, 2015, we transferred loans with a fair value of $67 million from held-for-investments to held-for-sale. During the three and nine months ended September 30, 2015, we recorded positive $9 million and positive $5 million of valuation adjustments, respectively, on residential loans held-for-investment at fair value through mortgage banking and investment activities, net, a component of our consolidated statements of income. At September 30, 2015, $1.36 billion of these loans were pledged as collateral under a borrowing agreement with the FHLBC.

The outstanding loans held-for-investment at Redwood at September 30, 2015 were originated in 2014 and 2015 and the weighted average FICO score of borrowers backing these loans was 772 (at origination) and the weighted average loan-to-value ("LTV") ratio of these loans was 64% (at origination). At September 30, 2015, these loans were comprised of 97% fixed-rate loans with a weighted average coupon of 4.10%, and the remainder were hybrid loans with a weighted average coupon of 3.41%.

At Consolidated Sequoia Entities

On January 1, 2015, we eliminated $13 million of unamortized premium, net and $21 million of allowance for loan losses, related to loans at our consolidated Sequoia entities as part of our initial adoption of ASU 2014-13 and recorded a valuation adjustment on these loans to reduce the loan carrying values to their estimated fair values. See

Note 3 for further discussion.

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Note 6. Residential Loans - (continued)

The following table details the carrying value for residential loans held-for-investment at consolidated Sequoia entities at September 30, 2015 and December 31, 2014.

Table 6.2 – Carrying Value for Held-for-Investment Residential Loans at Sequoia Entities

(In Thousands)	September 30, 2015	December 31, 2014
Principal balance	$1,275,609	$1,483,213
Unamortized premium, net	—	12,511
Allowance for loan losses	—	(21,338)
Valuation adjustment	(105,363)	—
Carrying value	$1,170,246	$1,474,386

At September 30, 2015, we owned 4,815 held-for-investment loans at consolidated Sequoia entities, as compared to 5,315 loans at December 31, 2014. The weighted average FICO score of borrowers backing these loans was 732 (at origination) and the weighted average LTV ratio of these loans was 66% (at origination). At September 30, 2015 and December 31, 2014, the unpaid principal balance of loans at consolidated Sequoia entities delinquent greater than 90 days was $63 million and $73 million, respectively, and the unpaid principal balance of loans in foreclosure was $32 million and $39 million, respectively. During the three and nine months ended September 30, 2015, we recorded negative $0.4 million and positive $5 million, respectively, of net valuation adjustments on these loans through mortgage banking and investment activities, net on our consolidated statements of income.

Note 7. Commercial Loans

We invest in commercial loans that we originate as well as loans that we acquire from third-party originators. The following table summarizes the classifications and carrying value of commercial loans at September 30, 2015 and December 31, 2014.

Table 7.1 – Classifications and Carrying Value of Commercial Loans

(In Thousands)	September 30, 2015	December 31, 2014
Held-for-sale, at fair value	$80,756	$166,234
Held-for-investment		
At fair value	70,096	71,262
At amortized cost	317,305	329,431
Total Commercial Loans	$468,157	$566,927

Of the held-for-investment commercial loans at amortized cost shown above at September 30, 2015 and December 31, 2014, $180 million and $195 million, respectively, were financed through the Commercial Securitization entity.

Commercial Loans Held-for-Sale at Fair Value

Commercial loans held-for-sale include loans we originate and intend to sell to third parties. At September 30, 2015, we held 7 senior commercial mortgage loans at fair value, with an aggregate outstanding principal balance of $78 million and an aggregate fair value of $81 million. As of December 31, 2014, there were 13 senior commercial mortgage loans at fair value, with an aggregate outstanding principal balance of $163 million and an aggregate fair value of $166 million.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 7. Commercial Loans - (continued)

During the three and nine months ended September 30, 2015, we acquired $168 million and $518 million (principal balance), respectively, of senior commercial loans for which we elected the fair value option and sold $254 million and $602 million (principal balance), respectively, of loans to third parties. During the three months ended September 30, 2015 and 2014, we recorded positive $4 million of valuation adjustments for both periods on senior commercial mortgage loans for which we elected the fair value option through mortgage banking and investment activities, net on our consolidated statements of income. During the nine months ended September 30, 2015 and 2014, we recorded positive $11 million and positive $14 million, respectively, of valuation adjustments on senior commercial mortgage loans for which we elected the fair value option through mortgage banking and investment activities, net on our consolidated statements of income. At September 30, 2015, all commercial loans held-for-sale were current and loans with a market value of $53 million were pledged as collateral under short-term borrowing arrangements.

Commercial Loans Held-for-Investment

At Fair Value

Commercial loans held-for-investment at fair value include senior mortgage loans for which we have elected the fair value option and have been split into senior A-notes and junior B-notes. Although the A-notes for each of the loans were sold, the transfers did not qualify for sale accounting treatment and we treated the sales as secured borrowings. At September 30, 2015, we held three of these A/B notes with an aggregate outstanding principal balance of $67 million and an aggregate fair value of $70 million. At December 31, 2014, we held three A/B notes, with an aggregate outstanding principal balance of $68 million and an aggregate fair value of $71 million. We carry the A-notes and associated secured commercial borrowings at the same fair values and the periodic valuation adjustments associated with these assets and liabilities offset through mortgage banking and investment activities, net on our consolidated statements of income. During the three and nine months ended September 30, 2015 and 2014, there were no net changes in the fair value of the B-notes, in which we retain an actual economic interest. The carrying value of the B-notes at both September 30, 2015 and December 31, 2014 were $5 million.

At Amortized Cost

Commercial loans held-for-investment at amortized cost include loans we originate and preferred equity investments we make or, in either case, acquire from third parties. As of September 30, 2015, these loans primarily include mezzanine loans that are secured by a borrower's ownership interest in a single purpose entity that owns commercial property, rather than a lien on the commercial property. The preferred equity investments are typically preferred equity interests in a single purpose entity that owns commercial property and are included within, and referred to herein, as commercial loans held-for-investment due to the fact that their risks and payment characteristics are nearly equivalent to commercial mezzanine loans.

The following table provides additional information for our commercial loans held-for-investment at amortized cost at September 30, 2015 and December 31, 2014.

Table 7.2 – Carrying Value for Commercial Loans Held-for-Investment

(In Thousands)	September 30, 2015	December 31, 2014
Principal balance	$328,925	$341,750
Unamortized discount, net	(4,279)	(4,862)
Recorded investment	324,646	336,888
Allowance for loan losses	(7,341)	(7,457)
Carrying Value	$317,305	$329,431

At September 30, 2015 and December 31, 2014, we held 62 and 60, respectively, commercial loans held-for-investment at amortized cost. During the three and nine months ended September 30, 2015, we originated or acquired $13 million and $22 million, respectively, of commercial loans held-for-investment at amortized cost. Of the

$325 million of recorded investment in commercial loans held-for-investment at September 30, 2015, 7% was originated in 2015, 18% was originated in 2014, 15% was originated in 2013, 32% was originated in 2012, 24% was originated in 2011, and 4% was originated in 2010.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 7. Commercial Loans - (continued)

Allowance for Loan Losses on Commercial Loans

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

Our methodology for assessing the adequacy of the allowance for loan losses includes a formal review of each commercial loan in the portfolio and the assignment of an internal impairment status. Based on the assigned impairment status, a loan is categorized as “Pass,” “Watch List,” or “Workout.”

The following table presents the principal balance of commercial loans held-for-investment by risk category.

Table 7.3 – Principal Balance of Commercial Loans Held-for-Investment by Risk Category

(In Thousands)	September 30, 2015	December 31, 2014
Pass	$303,462	$316,122
Watch list	25,463	25,628
Total Commercial Loans Held-for-Investment	$328,925	$341,750

The following table summarizes the activity in the allowance for commercial loan losses for the three and nine months ended September 30, 2015 and 2014.

Table 7.4 – Activity in the Allowance for Commercial Loan Losses

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Balance at beginning of period	$7,401	$8,317	$7,456	$7,373
Charge-offs, net	—	—	—	—
(Reversal of) provision for loan losses	(60)	(888)	(115)	56
Balance at End of Period	$7,341	$7,429	$7,341	$7,429

At September 30, 2015 and December 31, 2014, all of our commercial loans collectively evaluated for impairment were current. We did not have any commercial loans individually evaluated for impairment at either September 30, 2015 or December 31, 2014. The following table summarizes the balances for loans collectively evaluated for impairment at September 30, 2015 and December 31, 2014.

Table 7.5 – Loans Collectively Evaluated for Impairment Review

(In Thousands)	September 30, 2015	December 31, 2014
Principal balance	$328,925	$341,750
Recorded investment	324,646	336,888
Related allowance	7,341	7,457

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 8. Real Estate Securities

We invest in residential mortgage-backed securities. The following table presents the fair values of our real estate securities by type at September 30, 2015 and December 31, 2014.

Table 8.1 – Fair Values of Real Estate Securities by Type

(In Thousands)	September 30, 2015	December 31, 2014
Trading	$114,211	$111,606
Available-for-sale	971,013	1,267,624
Total Real Estate Securities	$1,085,224	$1,379,230

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

Trading Securities

We elected the fair value option for certain securities and classify them as trading securities. At September 30, 2015, our trading securities included $36 million of interest-only securities, for which there is no principal balance, $22 million of senior securities and $56 million of subordinate securities. The unpaid principal balance of senior and subordinate securities classified as trading securities was $22 million and $70 million, respectively, at September 30, 2015. During the three and nine months ended September 30, 2015, we acquired $9 million and $103 million (principal balance), respectively, of senior and subordinate securities for which we elected the fair value option and classified as trading, and sold $2 million and $81 million, respectively, of such securities. During the three months ended September 30, 2015 and 2014, we recorded negative $9 million and negative $2 million, respectively, of valuation adjustments on trading securities, included in mortgage banking and investment activities, net on our consolidated income statements. During the nine months ended September 30, 2015 and 2014, we recorded negative $16 million and negative $15 million, respectively, of valuation adjustments on trading securities, included in mortgage banking and investment activities, net on our consolidated statements of income.

The following table presents trading securities by collateral type at September 30, 2015 and December 31, 2014.

Table 8.2 – Trading Securities by Collateral Type

(In Thousands)	September 30, 2015	December 31, 2014
Senior Securities		
Prime	$51,308	$93,802
Non-prime	6,514	7,951
Total Senior Securities	57,822	101,753
Subordinate Securities		
Prime mezzanine	38,750	—
Prime subordinate	17,639	9,853
Total Subordinate Securities	56,389	9,853
Total Trading Securities	$114,211	$111,606

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 8. Real Estate Securities - (continued)

AFS Securities

The following table presents the fair value of our available-for-sale securities held at Redwood by collateral type at September 30, 2015 and December 31, 2014.

Table 8.3 – Available-for-Sale Securities by Collateral Type

(In Thousands)	September 30, 2015	December 31, 2014
Senior Securities		
Prime	$251,273	$307,813
Non-prime	158,040	179,744
Total Senior Securities	409,313	487,557
Re-REMIC Securities	167,639	168,347
Subordinate Securities		
Prime mezzanine (1)	233,458	448,838
Prime subordinate (2)	160,603	162,882
Total Subordinate Securities	394,061	611,720
Total AFS Securities	$971,013	$1,267,624

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

(2) Subordinate securities includes less than $1 million of non-prime securities at both September 30, 2015, and December 31, 2014.

The senior securities shown above at September 30, 2015 and December 31, 2014, included $81 million and $105 million, respectively, of prime securities, and $100 million and $117 million, respectively, of non-prime securities that were financed through the Residential Resecuritization entity, as discussed in Note 4. As of September 30, 2015, AFS securities with a carrying value of $587 million were pledged as collateral under short-term borrowing agreements. See Note 12 for additional information on short-term debt.

During the three and nine months ended September 30, 2015, we purchased zero and $15 million of AFS securities, respectively, and sold $35 million and $237 million of AFS securities, respectively, which resulted in net realized gains of $4 million and $14 million, respectively. During the three and nine months ended September 30, 2014, we purchased $41 million and $192 million of AFS securities, respectively, and sold $395 million and $396 million of AFS securities, respectively, which resulted in net realized gains of $8 million and $9 million, respectively.

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

At September 30, 2015, there were less than $1 million of AFS securities with contractual maturities less than five years, $2 million of AFS securities with contractual maturities greater than five years but less than 10 years, and the remainder of our AFS securities had contractual maturities greater than 10 years.

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(Unaudited)

Note 8. Real Estate Securities - (continued)

The following table presents the components of carrying value (which equals fair value) of AFS securities at September 30, 2015 and December 31, 2014.

Table 8.4 – Carrying Value of AFS Securities

September 30, 2015	Senior				
(In Thousands)	Prime	Non-prime	Re-REMIC	Subordinate	Total
Principal balance	$257,526	$174,285	$192,215	$490,891	$1,114,917
Credit reserve	(2,377)	(8,964)	(11,135)	(32,865)	(55,341)
Unamortized discount, net	(27,476)	(25,505)	(74,377)	(134,371)	(261,729)
Amortized cost	227,673	139,816	106,703	323,655	797,847
Gross unrealized gains	26,899	18,515	60,936	71,226	177,576
Gross unrealized losses	(3,299)	(291)	—	(820)	(4,410)
Carrying Value	$251,273	$158,040	$167,639	$394,061	$971,013
December 31, 2014	Senior				
(In Thousands)	Prime	Non-prime	Re-REMIC	Subordinate	Total
Principal balance	$311,573	$196,258	$195,098	$742,150	$1,445,079
Credit reserve	(3,660)	(9,644)	(15,202)	(41,561)	(70,067)
Unamortized discount, net	(34,782)	(31,491)	(79,611)	(150,458)	(296,342)
Amortized cost	273,131	155,123	100,285	550,131	1,078,670
Gross unrealized gains	35,980	24,682	68,062	63,026	191,750
Gross unrealized losses	(1,298)	(61)	—	(1,437)	(2,796)
Carrying Value	$307,813	$179,744	$168,347	$611,720	$1,267,624

The following table presents the changes for the three and nine months ended September 30, 2015, in unamortized discount and designated credit reserves on residential AFS securities.

Table 8.5 – Changes in Unamortized Discount and Designated Credit Reserves on AFS Securities

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
(In Thousands)	Credit Reserve	Unamortized Discount, Net	Credit Reserve	Unamortized Discount, Net
Beginning balance	$61,700	$273,119	$70,067	$296,342
Amortization of net discount	—	(9,115)	—	(28,277)
Realized credit losses	(1,706)	—	(7,420)	—
Acquisitions	—	—	858	5,705
Sales, calls, other	(1,632)	(5,522)	(1,632)	(18,799)
Impairments	—	226	—	226
Transfers to (release of) credit reserves, net	(3,021)	3,021	(6,532)	6,532
Ending Balance	$55,341	$261,729	$55,341	$261,729

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 8. Real Estate Securities - (continued)

AFS Securities with Unrealized Losses
The following table presents the components comprising the total carrying value of residential AFS securities that were in a gross unrealized loss position at September 30, 2015 and December 31, 2014.
Table 8.6 – Components of Fair Value of Residential AFS Securities by Holding Periods

	Less Than 12 Consecutive Months			12 Consecutive Months or Longer		
(In Thousands)	Amortized Cost	Unrealized Losses	Fair Value	Amortized Cost	Unrealized Losses	Fair Value
September 30, 2015	$87,796	$(2,090)	$85,706	$82,383	$(2,320)	$80,063
December 31, 2014	126,681	(1,374)	125,307	70,676	(1,422)	69,254

At September 30, 2015, after giving effect to purchases, sales, and extinguishment due to credit losses, our consolidated balance sheet included 247 AFS securities, of which 30 were in an unrealized loss position and 15 were in a continuous unrealized loss position for 12 consecutive months or longer. At December 31, 2014, our consolidated balance sheet included 290 AFS securities, of which 31 were in an unrealized loss position and 10 were in a continuous unrealized loss position for 12 consecutive months or longer.
Evaluating AFS Securities for Other-than-Temporary Impairments
Gross unrealized losses on our AFS securities were $4 million at September 30, 2015. We evaluate all securities in an unrealized loss position to determine if the impairment is temporary or other-than-temporary (resulting in an OTTI). At September 30, 2015, we did not intend to sell any of our AFS securities that were in an unrealized loss position, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost basis, which may be at their maturity. We review our AFS securities that are in an unrealized loss position to identify those securities with losses that are other-than-temporary based on an assessment of changes in expected cash flows for such securities, which considers recent security performance and expected future performance of the underlying collateral.
During the three and nine months ended September 30, 2015, we recognized less than $1 million of OTTI losses related to our AFS securities. AFS securities for which OTTI is recognized have experienced, or are expected to experience, credit-related adverse cash flow changes. In determining our estimate of cash flows for AFS securities we may consider factors such as structural credit enhancement, past and expected future performance of underlying mortgage loans, including timing of expected future cash flows, which are informed by prepayment rates, default rates, loss severities, delinquency rates, percentage of non-performing loans, FICO scores at loan origination, year of origination, loan-to-value ratios, and geographic concentrations, as well as general market assessments. Changes in our evaluation of these factors impacted the cash flows expected to be collected at the OTTI assessment date and were used to determine if there were credit-related adverse cash flows and if so, the amount of credit related losses. Significant judgment is used in both our analysis of the expected cash flows for our AFS securities and any determination of the credit loss component of OTTI.
The table below summarizes the significant valuation assumptions we used for our AFS securities in unrealized loss positions at September 30, 2015.
Table 8.7 – Significant Valuation Assumptions

	Range for Securities	
September 30, 2015	Prime	Non-prime
Prepayment rates	10 - 20 %	10 - 12 %
Projected losses	0 - 9 %	5 - 9 %

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 8. Real Estate Securities - (continued)

The following table details the activity related to the credit loss component of OTTI (i.e., OTTI recognized through earnings) for AFS securities held at September 30, 2015 and 2014, for which a portion of an OTTI was recognized in other comprehensive income.

Table 8.8 – Activity of the Credit Component of Other-than-Temporary Impairments

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Balance at beginning of period	$32,696	$34,256	$33,849	$37,149
Additions				
Initial credit impairments	226	—	226	261
Subsequent credit impairments	—	—	—	70
Reductions				
Securities sold, or expected to sell	—	(18)	(348)	(922)
Securities with no outstanding principal at period end	(446)	—	(1,251)	(2,320)
Balance at End of Period	$32,476	$34,238	$32,476	$34,238

Gains and losses from the sale of AFS securities are recorded as realized gains, net, in our consolidated statements of income. The following table presents the gross realized gains and losses on sales and calls of AFS securities for the three and nine months ended September 30, 2015 and 2014.

Table 8.9 – Gross Realized Gains and Losses on AFS Securities

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Gross realized gains - sales	$4,053	$10,227	$14,315	$11,219
Gross realized gains - calls	1,607	462	1,967	1,449
Gross realized losses - sales	—	(2,713)	—	(2,713)
Gross realized losses - calls	(112)	—	(112)	—
Total Realized Gains on Sales and Calls of AFS Securities, net	$5,548	$7,976	$16,170	$9,955

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 9. Mortgage Servicing Rights
We invest in mortgage servicing rights associated with residential mortgage loans and contract with a licensed sub-servicer to perform all servicing functions for these loans. The following table presents the fair value of MSRs and the aggregate principal amounts of associated loans as of September 30, 2015 and December 31, 2014.
Table 9.1 – Fair Value of MSRs and Aggregate Principal Amounts of Associated Loans

	September 30, 2015		December 31, 2014	
(In Thousands)	MSR Fair Value	Associated Principal	MSR Fair Value	Associated Principal
Mortgage Servicing Rights				
Conforming Loans	$108,593	$10,790,874	$81,301	$7,705,146
Jumbo Loans	54,133	5,943,725	57,992	5,962,784
Total Mortgage Servicing Rights	$162,726	$16,734,599	$139,293	$13,667,930

The following table presents activity for MSRs for the three and nine months ended September 30, 2015 and 2014.
Table 9.2 – Activity for MSRs

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Balance at beginning of period	$168,462	$71,225	$139,293	$64,824
Additions	22,760	61,606	73,976	76,272
Sales	—	—	(18,206)	—
Changes in fair value due to:				
Changes in assumptions (1)	(23,786)	4,323	(18,653)	(318)
Other changes (2)	(4,710)	(2,002)	(13,684)	(5,626)
Balance at End of Period	$162,726	$135,152	$162,726	$135,152

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

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 9. Mortgage Servicing Rights - (continued)

We make investments in MSRs through the retention of servicing rights associated with the residential mortgage loans that we acquire and subsequently transfer to third parties or through the direct acquisition of MSRs sold by third parties. We hold our MSR investments at a taxable REIT subsidiary. The following table details the retention and purchase of MSRs during the three and nine months ended September 30, 2015.

Table 9.3 – MSR Additions

(In Thousands)	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	MSR Fair Value	Associated Principal	MSR Fair Value	Associated Principal
Jumbo MSR additions:				
From securitization	$—	$—	$7,874	$835,254
From loan sales	237	21,775	501	48,042
Total jumbo MSR additions	237	21,775	8,375	883,296
Conforming MSR additions:				
From loan sales	$15,201	$1,384,126	$43,901	$4,085,655
From purchases	7,322	728,370	21,700	2,072,284
Total conforming MSR additions	22,523	2,112,496	65,601	6,157,939
Total MSR Additions	$22,760	$2,134,271	$73,976	$7,041,235

The following table presents the components of our MSR income.

Table 9.4 – Components of MSR Income (Loss), net

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Servicing income				
Income	$10,028	$4,590	$28,199	$12,287
Cost of sub-servicer	(1,313)	(437)	(3,704)	(1,040)
Net servicing income	8,715	4,153	24,495	11,247
Market valuation changes of MSRs	(28,496)	2,321	(32,337)	(5,944)
Market valuation changes of associated derivatives (1)	23,551	—	1,736	—
MSR provision for repurchases	(221)	(653)	(439)	(653)
MSR Income (Loss), Net	$3,549	$5,821	$(6,545)	$4,650

(1) In the second quarter of 2015, we began to identify specific derivatives used to hedge the exposure of our MSRs to changes in market interest rates. See Note 2 for additional detail.

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REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 10. Derivative Financial Instruments
The following table presents the fair value and notional amount of our derivative financial instruments at September 30, 2015 and December 31, 2014.
Table 10.1 – Fair Value and Notional Amount of Derivative Financial Instruments

	September 30, 2015		December 31, 2014	
(In Thousands)	Fair Value	Notional Amount	Fair Value	Notional Amount
Assets - Risk Management Derivatives				
Interest rate swaps	$4,351	$475,000	$—	$—
TBAs	8,910	1,460,500	6,654	1,074,000
Swaptions	12,437	925,000	7,006	575,000
Credit default index swaps	2,792	50,000	1,597	50,000
Assets - Other Derivatives				
Loan purchase commitments	10,133	1,338,694	1,160	288,467
Total Assets	$38,623	$4,249,194	$16,417	$1,987,467
Liabilities - Cash Flow Hedges				
Interest rate swaps	$(51,853)	$139,500	$(46,845)	$139,500
Liabilities - Risk Management Derivatives				
Interest rate swaps	(20,562)	1,009,500	(1,328)	206,000
TBAs	(14,994)	1,915,000	(9,506)	1,110,000
Futures	(188)	36,000	(372)	90,000
Liabilities - Other Derivatives				
Loan purchase commitments	(447)	189,289	(41)	27,324
Loan forward sale commitments	—	—	(239)	102,793
Total Liabilities	$(88,044)	$3,289,289	$(58,331)	$1,675,617
Total Derivative Financial Instruments, Net	$(49,421)	$7,538,483	$(41,914)	$3,663,084

REDWOOD TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 10. Derivative Financial Instruments - (continued)

Risk Management Derivatives

To manage, to varying degrees, risks associated with certain assets and liabilities on our consolidated balance sheet, we may enter into derivative contracts. At September 30, 2015, we were party to swaps and swaptions with an aggregate notional amount of $2.41 billion, TBA contracts sold with an aggregate notional amount of $3.38 billion, and financial futures contracts with an aggregate notional amount of $36 million. At December 31, 2014, we were party to swaps and swaptions with an aggregate notional amount of $920 million, TBA contracts sold with an aggregate notional amount of $2.18 billion, and financial futures contracts with an aggregate notional amount of $90 million. Net market valuation adjustments on risk management derivatives were negative $29 million and negative $58 million for the three and nine months ended September 30, 2015, respectively. Net market valuation adjustments on risk management derivatives were negative $4 million and negative $29 million for the three and nine months ended September 30, 2014, respectively. These net market valuation adjustments are recorded in mortgage banking and investment activities, net and MSR income (loss), net on our consolidated statements of income.

Loan Purchase and Forward Sale Commitments

LPCs and FSCs that qualify as derivatives are recorded at their estimated fair values. Net valuation adjustments on LPCs and FSCs were positive $25 million and positive $44 million for the three and nine months ended September 30, 2015, respectively, and are recorded in mortgage banking and investment activities, net on our consolidated statements of income.

Derivatives Designated as Cash Flow Hedges

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

For the three months ended September 30, 2015 and 2014, changes in the values of designated cash flow hedges were negative $12 million and negative $3 million, respectively, and were recorded in accumulated other comprehensive income, a component of equity. For the nine months ended September 30, 2015 and 2014, changes in the values of designated cash flow hedges were negative $5 million and negative $17 million, respectively. For interest rate agreements currently or previously designated as cash flow hedges, our total unrealized loss reported in accumulated other comprehensive income was $51 million and $46 million at September 30, 2015 and December 31, 2014, respectively. For both the three and nine months ended September 30, 2015 and 2014, we reclassified less than $1 million of unrealized losses on derivatives to interest expense. Accumulated other comprehensive loss of less than $1 million will be amortized into interest expense, a component of our consolidated income statements, over the remaining life of the hedge liabilities.

The following table illustrates the impact on interest expense of our interest rate agreements accounted for as cash flow hedges for the three and nine months ended September 30, 2015 and 2014.

Table 10.2 – Impact on Interest Expense of Interest Rate Agreements Accounted for as Cash Flow Hedges

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Net interest expense on cash flows hedges	$(1,466)	$(1,487)	$(4,425)	$(4,465)
Realized expense due to ineffective portion of cash flow hedges	—	—	—	—
Realized net losses reclassified from other comprehensive income	(19)	(32)	(77)	(131)
Total Interest Expense	$(1,485)	$(1,519)	$(4,502)	$(4,596)

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REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 10. Derivative Financial Instruments - (continued)

Derivative Counterparty Credit Risk

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2014, we consider counterparty risk as part of our fair value assessments of all derivative financial instruments at each quarter-end. At September 30, 2015, we assessed this risk as remote and did not record a specific valuation adjustment.

At September 30, 2015, we had outstanding derivative agreements with eight counterparties (other than clearinghouses) and were in compliance with ISDA agreements governing our open derivative positions.

Note 11. Other Assets and Liabilities

Other assets at September 30, 2015 and December 31, 2014, are summarized in the following table.

Table 11.1 – Components of Other Assets

(In Thousands)	September 30, 2015	December 31, 2014
Margin receivable	$97,685	$65,374
FHLBC stock	30,001	10,688
Pledged collateral	28,482	9,927
Investment receivable	11,977	1,103
Income tax receivables	10,879	175
Guarantee asset	5,120	7,201
Fixed assets and leasehold improvements (1)	5,070	3,008
REO	3,902	4,391
Prepaid expenses	3,502	3,372
Deposits	—	5,000
Other	4,978	3,657
Total Other Assets	$201,596	$113,896

(1) Fixed assets and leasehold improvements have a basis of $6 million and accumulated depreciation of $1 million at September 30, 2015.

Accrued expenses and other liabilities at September 30, 2015 and December 31, 2014 are summarized in the following table.

Table 11.2 – Components of Accrued Expenses and Other Liabilities

(In Thousands)	September 30, 2015	December 31, 2014
Accrued compensation	$15,687	$19,273
Margin payable	20,529	6,455
Guarantee obligations	13,394	7,201
Current accounts payable	8,341	2,112
Residential loan and MSR repurchase reserve	5,768	3,724
Accrued operating expenses	3,508	3,334
Legal reserve	2,000	2,000
Unsettled trades	1,355	—
Income tax payable	594	—
Other	4,792	8,145
Total Other Liabilities	$75,968	$52,244

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 11. Other Assets and Liabilities - (continued)

Margin Receivable and Payable
Margin receivable and payable resulted from margin calls between us and our derivatives, master repurchase agreements, and warehouse facilities counterparties, whereby we or the counterparty were required to post collateral.
Investment Receivable and Unsettled Trades
In accordance with our policy to record purchases and sales of securities on the trade date, if the trade and settlement of a purchase or sale crosses over a quarterly reporting period, we will record an investment receivable for sales and an unsettled trades liability for purchases.
Guarantee Asset, Pledged Collateral, and Guarantee Obligation
The pledged collateral, guarantee asset, and guarantee obligations presented in the tables above are related to the risk sharing arrangements we entered into with Fannie Mae and Freddie Mae. See Note 15 for additional information on our risk sharing arrangements.
REO
The carrying value of REO at September 30, 2015, was $4 million, which includes the net effect of $6 million related to transfers into REO during the nine months ended September 30, 2015, offset by $3 million of REO liquidations, and $3 million of negative market valuation adjustments. At September 30, 2015 and December 31, 2014, there were 19 and 22 REO properties, respectively, recorded on our consolidated balance sheets, all of which were owned at consolidated Sequoia entities.
See Note 15 for additional information on the legal and residential repurchase reserves.
Note 12. Short-Term Debt
We enter into repurchase agreements, bank warehouse agreements, and other forms of collateralized (and generally uncommitted) short-term borrowings with several banks and major investment banking firms. At September 30, 2015, we had outstanding agreements with several counterparties and we were in compliance with all of the related covenants. Further information about these financial covenants is set forth in Part I, Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations of this Quarterly Report on Form 10-Q and in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2014.
The table below summarizes the facilities that are available to us, the outstanding balances, the weighted average interest rate, and the maturity information of the short-term debt at September 30, 2015 and December 31, 2014 by the type of collateral securing the debt.
Table 12.1 – Short-Term Debt by Collateral Type

	September 30, 2015						
(Dollars in Thousands)	Number of Facilities	Outstanding	Limit	Weighted Average Interest Rate		Maturity	Weighted Average Days Until Maturity
Collateral Type							
Held-for-sale residential loans	4	$1,161,202	$1,550,000	1.73	%	12/2015-6/2016	147
Held-for-investment residential loans (1)	1	125,689	—	0.19	%	7/2016-9/2016	286
Commercial loans	3	110,408	450,000	3.59	%	11/2015-9/2016	225
Real estate securities	8	475,494	—	1.44	%	10/2015-12/2015	18
Total	16	$1,872,793		1.67	%		128

(1) Amount represents the portion of our borrowings from the FHLBC that were due within 12 months as of September 30, 2015. See Note 14 for additional information on our FHLB-member subsidiary's borrowing

agreement with the FHLBC.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 12. Short-Term Debt - (continued)

	December 31, 2014						
(Dollars in Thousands)	Number of Facilities	Outstanding	Limit	Weighted Average Interest Rate		Maturity	Weighted Average Days Until Maturity
Collateral Type							
Held-for-sale residential loans	5	$1,076,188	$1,550,000	1.74	%	2/2015-12/2015	156
Commercial loans	3	109,128	400,000	3.66	%	4/2015-10/2016	185
Real estate securities	9	608,509	—	1.38	%	1/2015-3/2015	20
Total	17	$1,793,825		1.73	%		112

Borrowings under these facilities are generally charged interest based on a specified margin over the one-month LIBOR interest rate. At September 30, 2015, all of these borrowings were under uncommitted facilities and were due within 364 days (or less) of the borrowing date.

During the three months ended September 30, 2015, $26 million of FHLBC borrowings were reclassified from long-term debt to short-term debt as the maturity was less than one year as of September 30, 2015. In addition, during the three months ended September 30, 2015, our FHLB-member subsidiary borrowed $100 million from the FHLBC that was due within 12 months as of September 30, 2015.

The fair value of held-for-sale residential loans, commercial loans, and real estate securities pledged as collateral was $1.30 billion, $185 million, and $587 million, respectively, at September 30, 2015 and $1.22 billion, $161 million, and $762 million, respectively, at December 31, 2014. For the three and nine months ended September 30, 2015, the average balance of short-term debt was $1.69 billion and $1.56 billion, respectively. At both September 30, 2015 and December 31, 2014, accrued interest payable on short-term debt was $2 million.

We also maintain a $10 million committed line of credit with a financial institution that is secured by certain mortgage-backed securities with a fair market value in excess of $11 million at September 30, 2015. At both September 30, 2015 and December 31, 2014, we had no outstanding borrowings on this facility.

Remaining Maturities of Short-Term Debt

The following table presents the remaining maturities of short-term debt at September 30, 2015.

Table 12.2 – Short-Term Debt by Collateral Type and Remaining Maturities

	September 30, 2015			
(In Thousands)	Within 30 days	31 to 90 days	Over 90 days	Total
Collateral Type				
Held-for sale residential loans	$—	$465,673	$695,529	$1,161,202
Held-for-investment residential loans	—	—	125,689	125,689
Commercial loans	—	45,741	64,667	110,408
Real estate securities	433,435	42,059	—	475,494
Total Short-Term Debt	$433,435	$553,473	$885,885	$1,872,793

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Note 13. Asset-Backed Securities Issued

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

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

The carrying values of ABS issued by consolidated securitization entities we sponsored at September 30, 2015 and December 31, 2014, along with other selected information, are summarized in the following table.

Table 13.1 – Asset-Backed Securities Issued

	September 30, 2015			
(Dollars in Thousands)	Sequoia	Residential Resecuritization	Commercial Securitization	Total
Certificates with principal balance	$1,220,419	$5,261	$67,946	$1,293,626
Interest-only certificates	4,876	—	—	4,876
Market valuation adjustments [1]	(119,707)	—	—	(119,707)
Total ABS Issued	$1,105,588	$5,261	$67,946	$1,178,795
Range of weighted average interest rates, by series	0.41% to 4.39%	2.20%	5.62%	
Stated maturities	2017 - 2041	2046	2018	
Number of series	24	1	1	

(1) Upon adoption of ASU 2014-13 on January 1, 2015, we began to account for ABS issued by consolidated Sequoia entities at fair value. See Note 3 for additional information.

	December 31, 2014			
(Dollars in Thousands)	Sequoia	Residential Resecuritization	Commercial Securitization	Total
Certificates with principal balance	$1,427,056	$45,044	$83,313	$1,555,413
Interest-only certificates	2,079	—	—	2,079
Unamortized discount	(12,373)	—	—	(12,373)
Total ABS Issued	$1,416,762	$45,044	$83,313	$1,545,119
Range of weighted average interest rates, by series	0.36% to 4.27%	2.16%	5.62%	
Stated maturities	2014 - 2041	2046	2018	
Number of series	24	1	1	

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REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 13. Asset-Backed Securities Issued - (continued)

The actual maturity of each class of ABS issued is primarily determined by the rate of principal prepayments on the assets of the issuing entity. Each series is also subject to redemption prior to the stated maturity according to the terms of the respective governing documents of each ABS issuing entity. As a result, the actual maturity of ABS issued may occur earlier than its stated maturity. At September 30, 2015, $1.18 billion of ABS issued ($1.29 billion principal balance) had contractual maturities after five years. Amortization of Commercial Securitization and Residential Resecuritization deferred ABS issuance costs were less than $1 million for both for the three months ended September 30, 2015 and 2014, respectively. Amortization of Commercial Securitization and Residential Resecuritization deferred ABS issuance costs were less than $1 million and $2 million for the nine months ended September 30, 2015 and 2014, respectively. The following table summarizes the accrued interest payable on ABS issued at September 30, 2015 and December 31, 2014. Interest due on consolidated ABS issued is payable monthly.

Table 13.2 – Accrued Interest Payable on Asset-Backed Securities Issued

(In Thousands)	September 30, 2015	December 31, 2014
Sequoia	$770	$976
Residential Resecuritization	1	5
Commercial Securitization	318	390
Total Accrued Interest Payable on ABS Issued	$1,089	$1,371

The following table summarizes the carrying value components of the collateral for ABS issued and outstanding at September 30, 2015 and December 31, 2014.

Table 13.3 – Collateral for Asset-Backed Securities Issued

	September 30, 2015			
(In Thousands)	Sequoia	Residential Resecuritization	Commercial Securitization	Total
Residential loans	$1,170,246	$—	$—	$1,170,246
Commercial loans	—	—	180,394	180,394
Real estate securities	—	181,253	—	181,253
Restricted cash	191	—	138	329
Accrued interest receivable	1,505	364	1,357	3,226
REO	3,902	—	—	3,902
Total Collateral for ABS Issued	$1,175,844	$181,617	$181,889	$1,539,350

	December 31, 2014			
(In Thousands)	Sequoia	Residential Resecuritization	Commercial Securitization	Total
Residential loans	$1,474,386	$—	$—	$1,474,386
Commercial loans	—	—	194,991	194,991
Real estate securities	—	221,676	—	221,676
Restricted cash	147	43	137	327
Accrued interest receivable	2,359	477	1,511	4,347
REO	4,391	—	—	4,391
Total Collateral for ABS Issued	$1,481,283	$222,196	$196,639	$1,900,118

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Note 14. 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. As of September 30, 2015, under this agreement, our subsidiary could incur borrowings up to $1.40 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 made to borrow funds may be declined for any reason, even if at the time of the borrowing request the then-outstanding borrowings are less than the borrowing limits under this agreement. During the three and nine months ended September 30, 2015, our FHLB-member subsidiary borrowed an additional $368 million and $754 million, respectively, under this agreement. At September 30, 2015, $1.25 billion of advances were outstanding under this agreement, of which $1.12 billion were classified as long-term debt, with a weighted average interest rate of 0.35% and a weighted average maturity of nine years. Advances under this agreement incur interest charges based on a specified margin over the FHLBC’s 13-week discount note rate, which resets every 13 weeks. Total advances under this agreement were secured by residential mortgage loans with a fair value of $1.42 billion at September 30, 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 September 30, 2015, our subsidiary held $30 million of FHLBC stock that is included in other assets in our consolidated balance sheets.

Commercial Secured Borrowings

At September 30, 2015, we had commercial secured borrowings of $66 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 bifurcated 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.

Convertible Notes

In November 2014, RWT Holdings, Inc., a wholly-owned subsidiary of Redwood Trust, Inc., issued $205 million principal amount of 5.625% exchangeable senior notes due 2019. These exchangeable notes require semi-annual interest payments at a fixed coupon rate of 5.625% until maturity or exchange, which will be no later than November 15, 2019. After deducting the underwriting discount and offering costs, we received $198 million of net proceeds. Including amortization of deferred securities issuance costs, the interest expense yield on these exchangeable notes was 6.63% and 6.58% for the three and nine months ended September 30, 2015, respectively. At September 30, 2015, the accrued interest payable balance on this debt was $4 million and the unamortized deferred issuance costs were $6 million. At September 30, 2015, these notes were exchangeable at the option of the holder at an exchange rate of 46.1798 common shares per $1,000 principal amount of exchangeable senior notes (equivalent to an exchange price of $21.65 per common share). Upon exchange of these notes by a holder, the holder will receive shares of our common stock.

In March 2013, we issued $288 million principal amount of 4.625% convertible senior notes due 2018. These convertible notes require semi-annual interest payments at a fixed coupon rate of 4.625% until maturity or conversion, which will be no later than April 15, 2018. After deducting the underwriting discount and offering costs, we received $279 million of net proceeds. Including amortization of deferred securities issuance costs, the interest expense yield on these convertible notes was 5.45% and 5.41% for the three and nine months ended September 30, 2015, respectively. At September 30, 2015, the accrued interest payable balance on this debt was $7 million and the unamortized deferred issuance costs were $4 million. At September 30, 2015, these notes were convertible at the option of the holder at a conversion rate of 41.1320 common shares per $1,000 principal amount of convertible senior notes (equivalent to a conversion price of $24.31 per common share). Upon conversion of these notes by a holder, the holder will receive shares of our common stock.

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Note 14. Long-Term Debt - (continued)

Trust Preferred Securities and Subordinated Notes

At September 30, 2015, we had trust preferred securities and subordinated notes outstanding of $100 million and $40 million, respectively. The interest expense yield on both our trust preferred securities and subordinated notes was 2.65% and 2.58% for the three months ended September 30, 2015 and 2014, respectively. Including hedging costs and amortization of deferred securities issuance costs, the interest expense yield on both our trust preferred securities and subordinated notes was 6.89% and 6.88% for the three months ended September 30, 2015 and 2014, respectively. The interest expense yield on both our trust preferred securities and subordinated notes was 2.60% and 2.58%for the nine months ended September 30, 2015 and 2014, respectively. Including hedging costs and amortization of deferred securities issuance costs, the interest expense yield on both our trust preferred securities and subordinated notes was 6.86% and 6.88% for the nine months ended September 30, 2015 and 2014, respectively.

At both September 30, 2015 and December 31, 2014, the accrued interest payable balance on our trust preferred securities and subordinated notes was less than $1 million. Under the terms of this debt, we covenant, among other things, to use our best efforts to continue to qualify as a REIT. If an event of default were to occur in respect of this debt, we would generally be restricted under its terms (subject to certain exceptions) from making dividend distributions to stockholders, from repurchasing common stock or repurchasing or redeeming any other then-outstanding equity securities, and from making any other payments in respect of any equity interests in us or in respect of any then-outstanding debt that is pari passu or subordinate to this debt.

Note 15. Commitments and Contingencies

Lease Commitments

At September 30, 2015, we were obligated under nine non-cancelable operating leases with expiration dates through 2021 for $11 million of cumulative lease payments. Operating lease expense was $2 million for both the nine-month periods ended September 30, 2015 and 2014, respectively.

The following table presents our future lease commitments at September 30, 2015.

Table 15.1 – Future Lease Commitments by Year

(In Thousands)	September 30, 2015
2015 (3 months)	$699
2016	2,838
2017	2,879
2018	1,827
2019	1,189
2020 and thereafter	1,495
Total Lease Commitments	$10,927

Loss Contingencies — Risk Sharing

In the fourth quarter of 2014, we entered into a risk sharing arrangement with Fannie Mae and, in the third quarter of 2015, we entered into a risk sharing arrangement with Freddie Mac and a new risk sharing arrangement with Fannie Mae. Under these arrangements, we committed to assume the first 1.00% or 2.25% (depending on the arrangement) of losses realized on reference pools of conforming residential mortgage loans that we acquired and then sold to the Agencies. As part of these risk sharing arrangements, during the 10 year term of the first Fannie Mae arrangement, we receive monthly cash payments from Fannie Mae based on the monthly outstanding unpaid principal balance of the reference pool of loans, and for the Freddie Mac and the new Fannie Mae arrangements, the Agencies charged us a reduced guarantee fee for the reference loans delivered in exchange for mortgage backed securities, which we then sold.

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REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 15. Commitments and Contingencies - (continued)

Additionally, under these arrangements we are required to pledge assets to the Agencies to collateralize our risk sharing commitments to them throughout the terms of the arrangements. These pledged assets are held by a third-party custodian for the benefit of the Agencies. To the extent approved losses are incurred, the custodian will transfer collateral to the Agencies. As a result of these transactions we recorded “pledged collateral” in the other assets line item, and “guarantee obligations” in the other liabilities line item, on our consolidated balance sheets. In addition, for the first Fannie Mae transaction, we recorded a “guarantee asset” in the other assets line item on our consolidated balance sheets. The guarantee obligations represent our commitments to assume losses under these arrangements, which at inception were recorded at fair value based on the fair value of the guarantee asset in the case of the first Fannie Mae arrangement, and the additional proceeds received that were attributable to the reduced guarantee fees for the Freddie Mac and new Fannie Mae arrangements. We amortize the guarantee obligations over the 10 year terms of the arrangements based primarily on changes in the outstanding unpaid principal balance of loans in the reference pools, with a portion of the liabilities treated as a credit reserve that is not amortized into income. In addition, each period we assess the need for a separate loss allowance related to these arrangements, based on our estimate of credit losses inherent in the reference pools of loans. At September 30, 2015, we determined an additional loss allowance was not required.

The loan delivery period for the first Fannie Mae arrangement ended on December 31, 2014 and we began amortizing the guarantee obligations associated with this arrangement in the first quarter of 2015. The initial loan delivery period for the Freddie Mac arrangement ended on September 30, 2015, and subsequent three-month loan delivery periods continue until the arrangement expires on June 30, 2016. The loan delivery period for the second Fannie Mae arrangement ends on November 30, 2015. We will begin amortizing the guarantee liabilities associated with these arrangements into income during the fourth quarter of 2015.

Income from cash payments received under the first Fannie Mae risk sharing arrangement and income related to the amortization of the guarantee obligations of all three arrangements are recorded in other income, and market valuation changes of the guarantee asset are recorded in mortgage banking and investment activities, net, on our consolidated statements of income. For the three and nine months ended September 30, 2015, other income related to these transactions was less than $1 million and $1 million, respectively, and market valuation changes were negative $1 million and negative $2 million, respectively.

All of the loans in the reference pools subject to these risk sharing arrangements were originated in 2014 and 2015 and at September 30, 2015, the loans had an unpaid principal balance of $1.8 billion and an original weighted average FICO score of 760 (at origination) and LTV of 76% (at origination). At September 30, 2015, $1 million of the outstanding principal balance was 30 days or more delinquent and $1 million of the loans were 90 days or more delinquent or in foreclosure. At September 30, 2015, the maximum potential amount of future payments we could be required to make under these obligations was $19 million and this amount was fully collateralized by assets we transferred to a custodian and are presented as pledged collateral in other assets on our consolidated balance sheets. We have no recourse to any third parties that would allow us to recover any amounts related to these guarantee obligations. As of September 30, 2015, we have not incurred any losses under these agreements.

Our consolidated balance sheets include assets of special purpose entities ("SPEs") associated with these risk sharing arrangements (i.e., the "pledged collateral" referred to above) that can only be used to settle obligations of these SPEs and liabilities of these SPEs for which the creditors of these SPEs (the Agencies) do not have recourse to Redwood Trust, Inc. or its affiliates. At September 30, 2015 and December 31, 2014, assets of such SPEs totaled $36 million and $19 million, respectively, and liabilities of such SPEs totaled $16 million and $7 million, respectively.

Loss Contingencies — Residential Repurchase Reserve

We maintain a repurchase reserve for potential obligations arising from representation and warranty violations related to residential loans we have sold to securitization trusts or third parties and for conforming residential loans associated with MSRs that we have purchased from third parties. We do not originate residential loans and we believe the initial risk of loss due to loan repurchases (i.e., due to a breach of representations and warranties) would generally be a contingency to the companies from whom we acquired the loans. However, in some cases, for example, where loans were acquired from companies that have since become insolvent, repurchase claims may result in our being liable for a repurchase obligation.

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Note 15. Commitments and Contingencies - (continued)

At September 30, 2015 and December 31, 2014, our repurchase reserve associated with our residential loans and MSRs was $6 million and $4 million, respectively, and was recorded in accrued expenses and other liabilities on our consolidated balance sheets. We received 69 repurchase requests during the nine months ended September 30, 2015 and none during the nine months ended September 30, 2014. We repurchased one loan during the nine months ended September 30, 2015. The loan was repurchased from us by the loan originator, resulting in no loss to us. During the three and nine months ended September 30, 2015 and 2014 we recorded repurchase provisions of $1 million and $2 million, respectively, that were recorded in mortgage banking and investment activities, net and MSR income (loss), net on our consolidated statements of income and did not charge-off any amounts to the reserve in either period.

Loss Contingencies — Litigation

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 September 30, 2015, the FHLB-Seattle has received approximately $120 million of principal and $11 million of interest payments in respect of the Seattle Certificate. 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 September 30, 2015, approximately $13 million of principal and $1 million of interest payments have been made in respect of the Schwab Certificate. 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 September 30, 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.

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Note 15. Commitments and Contingencies - (continued)

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.

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Note 16. Equity
The following table provides a summary of changes to accumulated other comprehensive income by component for the three and nine months ended September 30, 2015 and 2014.
Table 16.1 – Changes in Accumulated Other Comprehensive Income by Component

	Three Months Ended September 30, 2015		Three Months Ended September 30, 2014	
(In Thousands)	Net Unrealized Gains on Available-for-Sale Securities	Net Unrealized Losses on Interest Rate Agreements Accounted for as Cash Flow Hedges	Net Unrealized Gains on Available-for-Sale Securities	Net Unrealized Losses on Interest Rate Agreements Accounted for as Cash Flow Hedges
Balance at beginning of period	$179,659	$(38,965)	$197,542	$(29,985)
Other comprehensive income (loss) before reclassifications	(5,673)	(12,049)	1,849	(3,258)
Amounts reclassified from other accumulated comprehensive income	(3,270)	19	(6,409)	32
Net current-period other comprehensive loss	(8,943)	(12,030)	(4,560)	(3,226)
Balance at End of Period	$170,716	$(50,995)	$192,982	$(33,211)

	Nine Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
(In Thousands)	Net Unrealized Gains on Available-for-Sale Securities	Net Unrealized Losses on Interest Rate Agreements Accounted for as Cash Flow Hedges	Net Unrealized Gains on Available-for-Sale Securities	Net Unrealized Losses on Interest Rate Agreements Accounted for as Cash Flow Hedges
Balance at beginning of period	$186,737	$(46,049)	$164,654	$(15,888)
Other comprehensive income (loss) before reclassifications	(5,701)	(5,023)	35,078	(17,454)
Amounts reclassified from other accumulated comprehensive income	(10,320)	77	(6,750)	131
Net current-period other comprehensive income (loss)	(16,021)	(4,946)	28,328	(17,323)
Balance at End of Period	$170,716	$(50,995)	$192,982	$(33,211)

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Note 16. Equity - (continued)

The following table provides a summary of reclassifications out of accumulated other comprehensive income for three and nine months ended September 30, 2015 and 2014.

Table 16.2 – Reclassifications Out of Accumulated Other Comprehensive Income

		Amount Reclassified From Accumulated Other Comprehensive Income	
	Affected Line Item in the	Three Months Ended September 30,	
(In Thousands)	Income Statement	2015	2014
Net realized (gain) loss on AFS securities			
Other than temporary impairment [1]	Mortgage banking and investment activities, net	$198	$188
Gain on sale of AFS securities	Realized gains, net	(3,468)	(6,597)
		$(3,270)	$(6,409)
Net realized loss on interest rate agreements designated as cash flow hedges			
Amortization of deferred loss	Interest expense	$19	$32
		$19	$32

		Amount Reclassified From Accumulated Other Comprehensive Income	
	Affected Line Item in the	Nine Months Ended September 30,	
(In Thousands)	Income Statement	2015	2014
Net realized (gain) loss on AFS securities			
Other than temporary impairment [1]	Mortgage banking and investment activities, net	$198	$565
Gain on sale of AFS securities	Realized gains, net	(10,518)	(7,315)
		$(10,320)	$(6,750)
Net realized loss on interest rate agreements designated as cash flow hedges			
Amortization of deferred loss	Interest expense	$77	$131
		$77	$131

(1) For both the three and nine months ended September 30, 2015, other-than-temporary impairments were $257, of which $198 were recognized through the Income Statement and $59 were recognized in Accumulated Other Comprehensive Income. For the three months ended September 30, 2014, other-than-temporary impairments were $188, all of which were recognized through the Income Statement.

For the nine months ended September 30, 2014, other-than-temporary impairments were $4,774, of which $565 were recognized through the Income Statement, and $4,209 were recognized in Accumulated Other Comprehensive Income.

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Note 16. Equity - (continued)

Earnings Per Common Share
The following table provides the basic and diluted earnings per common share computations for the three and nine months ended September 30, 2015 and 2014.
Table 16.3 – Basic and Diluted Earnings Per Common Share

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands, Except Share Data)	2015	2014	2015	2014
Basic Earnings Per Common Share:				
Net income attributable to Redwood	$19,164	$45,097	$61,029	$73,447
Less: Dividends and undistributed earnings allocated to participating securities	(553)	(1,054)	(1,928)	(1,819)
Net income allocated to common shareholders	$18,611	$44,043	$59,101	$71,628
Basic weighted average common shares outstanding	83,787,533	83,017,534	83,696,461	82,722,079
Basic Earnings Per Common Share	$0.22	$0.53	$0.71	$0.87
Diluted Earnings Per Common Share:				
Net income attributable to Redwood	$19,164	$45,097	$61,029	$73,447
Less: Dividends and undistributed earnings allocated to participating securities	(553)	(756)	(1,928)	(1,784)
Add back: Interest expense on convertible notes for the period, net of tax	—	3,855	—	—
Net income allocated to common shareholders	$18,611	$48,196	$59,101	$71,663
Weighted average common shares outstanding	83,787,533	83,017,534	83,696,461	82,722,079
Net effect of dilutive equity awards	1,287,171	2,113,248	1,642,535	2,309,051
Net effect of assumed convertible notes conversion to common shares	—	11,825,450	—	—
Diluted weighted average common shares outstanding	85,074,704	96,956,232	85,338,996	85,031,130
Diluted Earnings Per Common Share	$0.22	$0.50	$0.69	$0.84

For the three and nine months ended September 30, 2015 and 2014, we determined certain equity awards outstanding during each of these periods qualified as participating securities. We included participating securities in the calculation of basic earnings per common share as well as diluted earnings per common share as we determined that the two-class method was more dilutive than the alternative treasury stock method for these shares. Dividends and undistributed earnings allocated to participating securities under the basic and diluted earnings per share calculations require specific shares to be included that may differ in certain circumstances.
For both the three and nine months ended September 30, 2015, 21,292,309 of common shares related to the assumed conversion of the convertible notes were antidilutive and were excluded in the calculation of diluted earnings per share. For the three and nine months ended September 30, 2015, the number of outstanding equity awards that were antidilutive totaled 163,296 and 180,897, respectively. For the three and nine months ended September 30, 2014, the number of outstanding equity awards that were antidilutive totaled 57,514 and 66,129, respectively.

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Note 16. Equity - (continued)

Stock Repurchases

In August 2015, our Board of Directors authorized the repurchase of up to $100 million of our common stock. This authorization replaced all previous share repurchase plans and has no expiration date. Our share repurchase authorization does not obligate us to acquire any specific number of shares. Under this authorization, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended. During the three months ended September 30, 2015, there were 2,451,523 shares repurchased pursuant to this authorization. At September 30, 2015, approximately $65 million of this authorization remained available for the repurchase of shares of our common stock.

Note 17. Equity Compensation Plans

At September 30, 2015 and December 31, 2014, 1,963,148 and 2,225,245 shares of common stock, respectively, were available for grant under our Incentive Plan. The unamortized compensation cost of awards issued under the Incentive Plan and purchases under the Employee Stock Purchase Plan totaled $20 million at September 30, 2015, as shown in the following table.

Table 17.1 – Activities of Equity Compensation Costs by Award Type

	Nine Months Ended September 30, 2015				
(In Thousands)	Restricted Stock	Deferred Stock Units	Performance Stock Units	Employee Stock Purchase Plan	Total
Unrecognized compensation cost at beginning of period	$1,091	$12,304	$6,874	$—	$20,269
Equity grants	2,758	5,997	—	236	8,991
Equity grant forfeitures	(387)	(169)	—	—	(556)
Equity compensation expense	(813)	(5,561)	(2,563)	(175)	(9,112)
Unrecognized Compensation Cost at End of Period	$2,649	$12,571	$4,311	$61	$19,592

At September 30, 2015, the weighted average amortization period remaining for all of our equity awards was less than two years.

Restricted Stock

At September 30, 2015 and December 31, 2014, there were 188,938 and 109,464 shares, respectively, of restricted stock outstanding. Restrictions on these shares lapse through 2019. During the nine months ended September 30, 2015, there were 141,069 shares of restricted stock granted, restrictions on 40,917 shares of restricted stock lapsed and those shares were distributed, and 20,678 shares of restricted stock awards forfeited.

Deferred Stock Units (“DSUs”)

At September 30, 2015 and December 31, 2014, there were 2,142,742 and 2,168,824 DSUs, respectively, outstanding of which 1,291,007 and 1,287,862, respectively, had vested. There were 319,546 DSUs granted, 335,461 DSUs distributed, and 10,167 DSUs forfeited during the nine months ended September 30, 2015. Unvested DSUs at September 30, 2015 vest through 2019.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 17. Equity Compensation Plans - (continued)

Performance Stock Units (“PSUs”)

At both September 30, 2015 and December 31, 2014, the target number of PSUs that were unvested was 761,051. PSUs do not vest until the third anniversary of their grant date, with the level of vesting at that time contingent on total stockholder return (defined as the change in our common stock price, adjusted to reflect the reinvestment of all dividends declared and/or paid on our common stock, relative to the per share price of our common stock on the date of the PSU grant) over the three-year vesting period (“Three-Year TSR”). The number of underlying shares of our common stock that will vest during 2015 and in future years will vary between 0% (if Three-Year TSR is negative) and 200% (if Three-Year TSR is greater than or equal to 125%) of the target number of PSUs originally granted, adjusted upward (if vesting is greater than 0%) to reflect the value of dividends paid during the three-year vesting period.

With respect to the PSUs granted in 2011, the three-year performance period ended during the fourth quarter of 2014, resulting in the vesting of 701,440 shares of our underlying common stock. The distribution of these underlying shares of common stock occurred in May 2015, in accordance with the terms of the PSUs and our Executive Deferred Compensation Plan.

Employee Stock Purchase Plan ("ESPP")

The ESPP allows a maximum of 450,000 shares of common stock to be purchased in aggregate for all employees. As of September 30, 2015 and December 31, 2014, 300,851 and 274,318 shares had been purchased, respectively, and there remained a negligible amount of uninvested employee contributions in the ESPP at September 30, 2015.

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Note 18. Mortgage Banking and Investment Activities, Net
The following table presents the components of mortgage banking and investment activities, net, recorded in our consolidated statements of income for the three and nine months ended September 30, 2015 and 2014.
Table 18.1 – Mortgage Banking and Investment Activities

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Residential mortgage banking activities, net:				
Changes in fair value of:				
Residential loans, at fair value [1]	$36,183	$15,976	$54,375	$40,685
Real estate securities [2]	—	(1,332)	(14,359)	(14,419)
Risk management derivatives [3]	(35,346)	(4,297)	(36,962)	(16,433)
Hedging allocation [2]	(1,683)	—	1,120	—
Other income, net [4]	1,177	1,082	3,209	1,871
Total residential mortgage banking activities, net:	331	11,429	7,383	11,704
Commercial mortgage banking activities, net:				
Changes in fair value of:				
Commercial loans, at fair value	3,974	4,305	10,819	13,644
Risk management derivatives [3]	(3,081)	1,892	(7,832)	(1,726)
Other fee income	109	289	336	382
Total commercial mortgage banking activities, net:	1,002	6,486	3,323	12,300
Investment activities, net				
Changes in fair value of:				
Residential loans held-for-investment, at Redwood	9,077	(991)	5,170	(991)
Real estate securities	(9,010)	(765)	(1,813)	(1,218)
Net investments in consolidated Sequoia entities	(500)	(361)	(2,277)	(825)
Risk sharing investments	(1,098)	—	(1,799)	—
Risk management derivatives	(14,321)	(1,632)	(15,266)	(10,986)
Hedging allocation [2]	1,683	—	(1,120)	—
Total investment activities:	(14,169)	(3,749)	(17,105)	(14,020)
Mortgage banking and investment activities, net	$(12,836)	$14,166	$(6,399)	$9,984

(1) Includes changes in fair value for associated loan purchase and forward sale commitments.
(2) In the second quarter of 2015, we transferred securities previously utilized as hedges for our mortgage banking segment to our residential investments segment and began to record a hedging allocation between our business segments. See Note 21 for further discussion.
(3) Represents market valuation changes of derivatives that are used to manage risks associated with our accumulation of residential and commercial loans.
(4) Amounts in this line item include other fee income from loan acquisitions and the provision for repurchases expense, presented net.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 19. Operating Expenses
Components of our operating expenses for the three and nine months ended September 30, 2015 and 2014 are presented in the following table.
Table 19.1 – Components of Operating Expenses

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2015	2014	2015	2014
Fixed compensation expense	$8,642	$7,445	$27,083	$21,109
Variable compensation expense	3,567	2,422	11,135	8,396
Equity compensation expense	2,835	2,261	9,112	7,415
Total compensation expense	15,044	12,128	47,330	36,920
Systems and consulting	2,355	3,463	6,718	10,906
Loan acquisition costs (1)	2,464	1,789	5,992	3,606
Accounting and legal	1,047	1,223	3,754	4,039
Office costs	1,314	1,282	3,912	3,437
Corporate costs	484	569	1,521	1,679
Other operating expenses	1,789	952	5,551	3,073
Total Operating Expenses	$24,497	$21,406	$74,778	$63,660

(1) Loan acquisition costs primarily includes underwriting and due diligence costs related to the acquisition of residential loans held-for-sale at fair value.

Note 20. Taxes
For the nine months ended September 30, 2015 and 2014, we recognized a benefit from income taxes of $10 million and a provision for income taxes of $4 million, respectively. The following is a reconciliation of the statutory federal and state tax rates to our effective tax rate at September 30, 2015 and 2014.
Table 20.1 – Reconciliation of Statutory Tax Rate to Effective Tax Rate

	September 30, 2015		September 30, 2014	
Federal statutory rate	34.0	%	34.0	%
State statutory rate, net of Federal tax effect	7.2	%	7.2	%
Differences in taxable (loss) income from GAAP income	(36.5	)%	(10.0	)%
Change in valuation allowance	20.9	%	(1.0	)%
Dividends paid deduction	(45.8	)%	(25.4	)%
Effective Tax Rate	(20.2	)%	4.8	%

The negative effective tax rate for the nine months ended September 30, 2015, resulted from a benefit for income taxes being recorded against GAAP losses generated at our taxable REIT subsidiaries, while the consolidated income statement reported GAAP income. On a consolidated basis, GAAP income generated at the REIT, for which no material tax provision was recorded due to the dividends paid deduction, exceeded the losses at the taxable REIT subsidiaries.
We assessed our tax positions for all open tax years (Federal - years 2012 to 2015, State - years 2011- 2015) and, at September 30, 2015 and December 31, 2014, concluded that we had no uncertain tax positions that resulted in material unrecognized tax benefits.

REDWOOD TRUST, INC. AND SUBSIDIARIES
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Note 21. Segment Information

Redwood operates in three segments: residential mortgage banking, residential investments, and commercial mortgage banking and investments. Our segments are based on our organizational and management structure, which aligns with how our results are monitored and performance is assessed. For a full description of our segments, see Item 1—Business in our Annual Report on Form 10-K for the year ended December 31, 2014.

Segment contribution represents the measure of profit that management uses to assess the performance of our business segments and make resource allocation and operating decisions. Certain expenses not directly assigned or allocated to one of the three primary segments, as well as activity from certain consolidated Sequoia entities consolidated for GAAP financial reporting purposes, are included in the Corporate/Other column as reconciling items to our consolidated financial statements. These unallocated expenses primarily include interest expense associated with certain long-term debt, indirect operating expenses, and other expense.

Prior to the second quarter of 2015, we utilized certain Sequoia interest only ("IO") securities in part to serve as hedges in our residential mortgage banking segment. As such, we included these securities in the segment's assets as well as the interest income and valuation adjustments related to the securities in the segment's results. During the second quarter of 2015, we transferred these securities to our residential investments segment.

Additionally, beginning in the second quarter of 2015, we began to record a hedging allocation between our segments. As we currently manage our market interest rate risk on an enterprise-wide basis, we rely on certain assets to serve as natural hedges to other assets, and in some cases these assets can be in different segments. Management uses this allocation to assess the economic returns of each segment on a stand-alone basis and the allocation has no impact on our consolidated results. This was a prospective change in how we are managing our business and allocating capital to each segment. As such, we have not conformed prior period results for our segments. Analysis of our year-over-year results are discussed in Part I, Item 2, Management's Discussion and Analysis of Results of Operations in this quarterly report on Form 10-Q.

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Note 21. Segment Information - (continued)

The following tables present financial information by segment for the three and nine months ended September 30, 2015 and 2014.

Table 21.1 – Business Segment Financial Information

	Three Months Ended September 30, 2015				
(In Thousands)	Residential Mortgage Banking	Residential Investments	Commercial Mortgage Banking and Investments	Corporate/ Other	Total
Interest income	$12,115	$34,074	$11,191	$6,104	$63,484
Interest expense	(4,313)	(2,660)	(3,502)	(13,400)	(23,875)
Net interest income (loss)	7,802	31,414	7,689	(7,296)	39,609
Reversal of provision for loan losses	—	—	60	—	60
Non-interest income					
Mortgage banking and investment activities, net [1]	331	(13,622)	1,002	(547)	(12,836)
MSR income (loss), net	—	3,549	—	—	3,549
Other income	—	327	—	—	327
Realized gains, net	—	5,548	—	—	5,548
Total non-interest income, net	331	(4,198)	1,002	(547)	(3,412)
Direct operating expenses	(11,278)	(1,311)	(3,136)	(8,772)	(24,497)
Benefit from income taxes	2,690	4,082	(389)	1,021	7,404
Segment Contribution	$(455)	$29,987	$5,226	$(15,594)	
Net Income					$19,164
Non-cash amortization income (expense)	$(45)	$9,115	$(61)	$(1,007)	$8,002
Hedging allocations [1]	(1,683)	1,683	—	—	—

	Three Months Ended September 30, 2014				
(In Thousands)	Residential Mortgage Banking	Residential Investments	Commercial Mortgage Banking and Investments	Corporate/ Other	Total
Interest income	$16,911	$27,600	$12,603	$6,237	$63,351
Interest expense	(4,192)	(3,142)	(4,526)	(11,490)	(23,350)
Net interest income (loss)	12,719	24,458	8,077	(5,253)	40,001
Reversal of provision for loan losses	—	—	888	708	1,596
Non-interest income					
Mortgage banking and investment activities, net	11,429	(3,371)	6,486	(378)	14,166
MSR income (loss), net	—	5,821	—	—	5,821
Other income	—	—	—	1,600	1,600
Realized gains, net	—	7,836	—	696	8,532
Total non-interest income, net	11,429	10,286	6,486	1,918	30,119
Direct operating expenses	(9,982)	(802)	(2,279)	(8,343)	(21,406)

(Provision for) benefit from income taxes	(3,352)	150	(1,764)	(247)	(5,213)
Segment Contribution	$10,814	$34,092	$11,408	$(11,217)	
Net Income					$45,097
Non-cash amortization income (expense)	$(43)	$10,890	$(191)	$(2,049)	$8,607

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Note 21. Segment Information - (continued)

	Nine Months Ended September 30, 2015				
(In Thousands)	Residential Mortgage Banking	Residential Investments	Commercial Mortgage Banking and Investments	Corporate/ Other	Total
Interest income	$37,886	$98,335	$34,784	$19,598	$190,603
Interest expense	(11,389)	(8,137)	(10,488)	(40,830)	(70,844)
Net interest income (loss)	26,497	90,198	24,296	(21,232)	119,759
Reversal of provision for loan losses	—	—	115	—	115
Non-interest income					
Mortgage banking and investment activities, net [1]	7,383	(14,745)	3,323	(2,360)	(6,399)
MSR income (loss), net	—	(6,545)	—	—	(6,545)
Other income	—	2,435	—	—	2,435
Realized gains, net	—	16,170	—	—	16,170
Total non-interest income, net	7,383	(2,685)	3,323	(2,360)	5,661
Direct operating expenses	(33,214)	(3,600)	(9,638)	(28,326)	(74,778)
Benefit from income taxes	3,562	3,824	321	2,565	10,272
Segment Contribution	$4,228	$87,737	$18,417	$(49,353)	
Net Income					$61,029
Non-cash amortization income (expense)	$(135)	$28,277	$(188)	$(2,984)	$24,970
Hedging allocations [1]	1,120	(1,070)	—	(50)	—

	Nine Months Ended September 30, 2014				
(In Thousands)	Residential Mortgage Banking	Residential Investments	Commercial Mortgage Banking and Investments	Corporate/ Other	Total
Interest income	$40,015	$83,120	$34,204	$19,481	$176,820
Interest expense	(7,674)	(9,106)	(12,234)	(34,546)	(63,560)
Net interest income (loss)	32,341	74,014	21,970	(15,065)	113,260
Reversal of (provision for) loan losses	—	—	(56)	685	629
Non-interest income					
Mortgage banking and investment activities, net	11,704	(13,117)	12,300	(903)	9,984
MSR income (loss), net	—	4,650	—	—	4,650
Other income	—	—	—	1,600	1,600
Realized gains, net	—	9,815	—	872	10,687
Total non-interest income, net	11,704	1,348	12,300	1,569	26,921
Direct operating expenses	(26,577)	(2,667)	(7,085)	(27,330)	(63,660)
(Provision for) benefit from income taxes	(3,258)	1,826	(2,159)	(112)	(3,703)
Segment Contribution	$14,210	$74,521	$24,970	$(40,253)	
Net Income					$73,447

Non-cash amortization income (expense)	$(131)	$32,724	$(579)	$(6,068)	$25,946

(1) Intersegment hedging allocation presented in the tables above is included in the mortgage banking and investment activities, net line item of the segment income statements for the three and nine months ended September 30, 2015.

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Note 21. Segment Information - (continued)

The following tables present the components of Corporate/Other for the three and nine months ended September 30, 2015 and 2014.

Table 21.2 – Components of Corporate/Other

	Three Months Ended September 30,					
	2015			2014		
(In Thousands)	Legacy Consolidated VIEs	Other	Total	Legacy Consolidated VIEs	Other	Total
Interest income	$6,098	$6	$6,104	$6,233	$4	$6,237
Interest expense	(3,842)	(9,558)	(13,400)	(5,250)	(6,240)	(11,490)
Net interest income (loss)	2,256	(9,552)	(7,296)	983	(6,236)	(5,253)
Reversal of provision for loan losses	—	—	—	708	—	708
Non-interest income						
Mortgage banking and investment activities, net	(501)	(46)	(547)	(361)	(17)	(378)
MSR income (loss), net	—	—	—	—	—	—
Other income	—	—	—	—	1,600	1,600
Realized gains, net	—	—	—	696	—	696
Total non-interest income, net	(501)	(46)	(547)	335	1,583	1,918
Direct operating expenses	—	(8,772)	(8,772)	(26)	(8,317)	(8,343)
(Provision for) benefit from income taxes	—	1,021	1,021	—	(247)	(247)
Total	$1,755	$(17,349)	$(15,594)	$2,000	$(13,217)	$(11,217)

	Nine Months Ended September 30,					
	2015			2014		
(In Thousands)	Legacy Consolidated VIEs	Other	Total	Legacy Consolidated VIEs	Other	Total
Interest income	$19,578	$20	$19,598	$19,473	$8	$19,481
Interest expense	(12,372)	(28,458)				