PennyMac Mortgage Investment Trust
Form 10-Q
August 05, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

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: 001-34416

PennyMac Mortgage Investment Trust

(Exact name of registrant as specified in its charter)

Maryland	27-0186273
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
3043 Townsgate Road, Westlake Village, California	91361
(Address of principal executive offices)	(Zip Code)

(818) 224-7442

(Registrant’s telephone number, including area code)

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 (§ 232.405 of this chapter) 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 the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	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 registrant’s classes of common stock, as of the latest practicable date.

Class	Outstanding at August 4, 2016
Common Shares of Beneficial Interest, $0.01 par value	67,655,441

PENNYMAC MORTGAGE INVESTMENT TRUST

FORM 10-Q

June 30, 2016

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (“Report”) contains certain forward-looking statements that are subject to various risks and uncertainties. Forward-looking statements are generally identifiable by use of forward-looking terminology such as “may,” “will,” “should,” “potential,” “intend,” “expect,” “seek,” “anticipate,” “estimate,” “approximately,” “believe,” “ “predict,” “continue,” “plan” or other similar words or expressions.

Forward-looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain financial and operating projections or state other forward-looking information. Examples of forward-looking statements include the following:

- projections of our revenues, income, earnings per share, capital structure or other financial items;
- descriptions of our plans or objectives for future operations, products or services;
- forecasts of our future economic performance, interest rates, profit margins and our share of future markets; and
- descriptions of assumptions underlying or relating to any of the foregoing expectations regarding the timing of generating any revenues.

Our ability to predict results or the actual effect of future events, actions, plans or strategies is inherently uncertain. Although we believe that the expectations reflected in such forward-looking statements are based on reasonable assumptions, our actual results and performance could differ materially from those set forth in the forward-looking statements. There are a number of factors, many of which are beyond our control that could cause actual results to differ significantly from management’s expectations. Some of these factors are discussed below.

You should not place undue reliance on any forward-looking statement and should consider the following uncertainties and risks, as well as the risks and uncertainties discussed elsewhere in this Report and the section entitled “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the Securities and Exchange Commission (“SEC”) on February 29, 2016.

Factors that could cause actual results to differ materially from historical results or those anticipated include, but are not limited to:

- changes in our investment objectives or investment or operational strategies, including any new lines of business or new products and services that may subject us to additional risks;
- volatility in our industry, the debt or equity markets, the general economy or the real estate finance and real estate markets specifically, whether the result of market events or otherwise;
- events or circumstances which undermine confidence in the financial markets or otherwise have a broad impact on financial markets, such as the sudden instability or collapse of large depository institutions or other significant corporations, terrorist attacks, natural or man-made disasters, or threatened or actual armed conflicts;
- changes in general business, economic, market, employment and political conditions, or in consumer confidence and spending habits from those expected;
- declines in real estate or significant changes in U.S. housing prices or activity in the U.S. housing market;
- the availability of, and level of competition for, attractive risk-adjusted investment opportunities in mortgage loans and mortgage-related assets that satisfy our investment objectives;
- the inherent difficulty in winning bids to acquire mortgage loans, and our success in doing so;
- the concentration of credit risks to which we are exposed;
- the degree and nature of our competition;
- our dependence on our manager and servicer, potential conflicts of interest with such entities and their affiliates, and the performance of such entities;
- changes in personnel and lack of availability of qualified personnel at our manager, servicer or their affiliates;
- the availability, terms and deployment of short-term and long-term capital;
- the adequacy of our cash reserves and working capital;

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- our ability to maintain the desired relationship between our financing and the interest rates and maturities of our assets;
- the timing and amount of cash flows, if any, from our investments;
- unanticipated increases or volatility in financing and other costs, including a rise in interest rates;
- the performance, financial condition and liquidity of borrowers;
- the ability of our servicer, which also provides us with fulfillment services, to approve and monitor correspondent sellers and underwrite loans to investor standards;
- incomplete or inaccurate information or documentation provided by customers or counterparties, or adverse changes in the financial condition of our customers and counterparties;
- our indemnification and repurchase obligations in connection with mortgage loans we purchase and later sell or securitize;
- the quality and enforceability of the collateral documentation evidencing our ownership and rights in the assets in which we invest;
- increased rates of delinquency, default and/or decreased recovery rates on our investments;
- our ability to foreclose on our investments in a timely manner or at all;
- increased prepayments of the mortgages and other loans underlying our mortgage-backed securities (“MBS”) or relating to our mortgage servicing rights (“MSRs”), excess servicing spread (“ESS”) and other investments;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- the effect of the accuracy of or changes in the estimates we make about uncertainties, contingencies and asset and liability valuations when measuring and reporting upon our financial condition and results of operations;
- our failure to maintain appropriate internal controls over financial reporting;
- technologies for loans and our ability to mitigate security risks and cyber intrusions;
- our ability to obtain and/or maintain licenses and other approvals in those jurisdictions where required to conduct our business;
- our ability to detect misconduct and fraud;
- our ability to comply with various federal, state and local laws and regulations that govern our business;
- developments in the secondary markets for our mortgage loan products;
- legislative and regulatory changes that impact the mortgage loan industry or housing market;
- changes in regulations or the occurrence of other events that impact the business, operations or prospects of government agencies such as the Government National Mortgage Association (“Ginnie Mae”), the Federal Housing Administration (the “FHA”) or the Veterans Administration (the “VA”), the U.S. Department of Agriculture (“USDA”), or government-sponsored entities such as the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (Fannie Mae, Freddie Mac and Ginnie Mae are each referred to as an “Agency” and, collectively, as the “Agencies”), or such changes that increase the cost of doing business with such entities;
- the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and its implementing regulations and regulatory agencies, and any other legislative and regulatory changes that impact the business, operations or governance of mortgage lenders and/or publicly-traded companies;
- the Consumer Financial Protection Bureau (“CFPB”) and its issued and future rules and the enforcement thereof;
- changes in government support of homeownership;
- changes in government or government-sponsored home affordability programs;
- limitations imposed on our business and our ability to satisfy complex rules for us to qualify as a real estate investment trust (“REIT”) for U.S. federal income tax purposes and qualify for an exclusion from the Investment Company Act of 1940 (the “Investment Company Act”) and the ability of certain of our subsidiaries to qualify as REITs or as taxable REIT subsidiaries (“TRSs”) for U.S. federal income tax purposes, as applicable, and our ability and the ability of our subsidiaries to operate effectively within the limitations imposed by these rules;
- changes in governmental regulations, accounting treatment, tax rates and similar matters (including changes to laws governing the taxation of REITs, or the exclusions from registration as an investment company);

- our ability to make distributions to our shareholders in the future;
- the effect of public opinion on our reputation;
- the occurrence of natural disasters or other events or circumstances that could impact our operations; and
- our organizational structure and certain requirements in our charter documents.

Other factors that could also cause results to differ from our expectations may not be described in this Report or any other document. Each of these factors could by itself, or together with one or more other factors, adversely affect our business, results of operations and/or financial condition.

Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update any forward-looking statement to reflect the impact of circumstances or events that arise after the date the forward-looking statement was made.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 30, 2016	December 31, 2015
	(in thousands, except share amounts)	
ASSETS		
Cash	$95,705	$ 58,108
Short-term investments	16,877	41,865
Mortgage-backed securities at fair value pledged to creditors	531,612	322,473
Mortgage loans acquired for sale at fair value (includes $1,441,956 and $1,268,455 pledged to creditors, respectively)	1,461,029	1,283,795
Mortgage loans at fair value (includes $2,016,889 and $2,201,513 pledged to creditors, respectively)	2,035,997	2,555,788
Excess servicing spread purchased from PennyMac Financial Services, Inc. at fair value pledged to secure note payable to PennyMac Financial Services, Inc.	294,551	412,425
Derivative assets	35,007	10,085
Real estate acquired in settlement of loans (includes $216,143 and $283,343 pledged to creditors, respectively)	299,458	341,846
Real estate held for investment	20,662	8,796
Mortgage servicing rights pledged to creditors (includes $57,977 and $66,584 carried at fair value, respectively)	471,458	459,741
Servicing advances	74,090	88,010
Deposits securing credit risk transfer agreements (includes $292,632 pledged to creditors at June 30, 2016)	338,812	147,000
Due from PennyMac Financial Services, Inc.	12,375	8,806
Other	79,929	88,186
Total assets	$5,767,562	$ 5,826,924
LIABILITIES		
Assets sold under agreements to repurchase	$3,275,691	$ 3,128,780
Mortgage loan participation and sale agreements	96,335	—
Federal Home Loan Bank advances	—	183,000
Notes payable	163,976	236,015
Asset-backed financing of a variable interest entity at fair value	325,939	247,690
Exchangeable senior notes	245,564	245,054
Note payable to PennyMac Financial Services, Inc.	150,000	150,000
Interest-only security payable at fair value	1,663	—

Derivative liabilities	3,894	3,157
Accounts payable and accrued liabilities	75,587	64,474
Due to PennyMac Financial Services, Inc.	22,054	18,965
Income taxes payable	26,774	33,505
Liability for losses under representations and warranties	19,258	20,171
Total liabilities	4,406,735	4,330,811
SHAREHOLDERS' EQUITY		
Common shares of beneficial interest—authorized, 500,000,000 common shares of $0.01 par value; issued and outstanding, 67,723,293 and 73,767,435 common shares	677	738
Additional paid-in capital	1,389,962	1,469,722
(Accumulated deficit) retained earnings	(29,812)	25,653
Total shareholders' equity	1,360,827	1,496,113
Total liabilities and shareholders' equity	$5,767,562	$ 5,826,924

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

Assets and liabilities of consolidated variable interest entities ("VIEs") included in total assets and liabilities (the assets of each VIE can only be used to settle liabilities of that VIE):

	June 30, 2016	December 31, 2015
	(in thousands)	
ASSETS		
Mortgage loans at fair value	$427,091	$ 455,394
Derivative assets	—	593
Deposits securing credit risk transfer agreements	338,812	147,000
Other assets - interest receivable	1,322	1,447
	$767,225	$ 604,434
LIABILITIES		
Asset-backed financing at fair value	$325,939	$ 247,690
Interest-only security payable at fair value	1,663	—
Derivative liabilities	199	—
Accounts payable and accrued liabilities—interest payable	925	724
	$328,726	$ 248,414

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands, except per share amounts)			
Net investment income				
Interest income:				
From nonaffiliates	$46,053	$39,515	$93,404	$76,448
From PennyMac Financial Services, Inc.	5,713	5,818	12,728	9,570
	51,766	45,333	106,132	86,018
Interest expense:				
To nonaffiliates	34,371	29,206	64,773	54,952
To PennyMac Financial Services, Inc.	2,222	533	3,824	533
	36,593	29,739	68,597	55,485
Net interest income	15,173	15,594	37,535	30,533
Net gain on mortgage loans acquired for sale	24,226	11,175	39,275	21,335
Mortgage loan origination fees	8,519	7,279	15,420	12,566
Net (loss) gain on investments:				
From nonaffiliates	337	14,025	14,066	23,719
From PennyMac Financial Services, Inc.	(15,824)	8,589	(33,451)	2,342
	(15,487)	22,614	(19,385)	26,061
Net mortgage loan servicing fees	15,691	13,017	31,245	21,019
Results of real estate acquired in settlement of loans	(2,565)	(1,806)	(8,601)	(7,638)
Other	2,061	1,892	4,345	3,546
Net investment income	47,618	69,765	99,834	107,422
Expenses				
Earned by PennyMac Financial Services, Inc.:				
Mortgage loan fulfillment fees	19,111	15,333	32,046	28,199
Mortgage loan servicing fees	16,427	12,136	27,880	22,806
Management fees	5,199	5,779	10,551	12,782
Mortgage loan collection and liquidation	4,290	3,182	6,504	4,627
Professional services	2,011	1,662	4,304	3,490
Compensation	2,224	1,389	3,513	4,198
Other	6,515	5,196	12,151	10,052
Total expenses	55,777	44,677	96,949	86,154
(Loss) income before benefit from income taxes	(8,159)	25,088	2,885	21,268
Benefit from income taxes	(2,892)	(2,983)	(6,344)	(14,311)
Net (loss) income	$(5,267)	$28,071	$9,229	$35,579
(Loss) earnings per share				
Basic	$(0.08)	$0.37	$0.12	$0.46
Diluted	$(0.08)	$0.36	$0.12	$0.46
Weighted-average shares outstanding				
Basic	68,446	74,683	70,165	74,618
Diluted	68,446	83,480	70,165	74,997
Dividends declared per share	$0.47	$0.61	$0.94	$1.22

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

	Common shares Number of shares	Par value	Additional paid-in capital	(Accumulated deficit) Retained earnings	Total
	(in thousands, except per share amounts)				
Balance at December 31, 2014	74,510	$745	$1,479,699	$ 97,728	$1,578,172
Net income	—	—	—	35,579	35,579
Share-based compensation	302	3	3,682	—	3,685
Common share dividends, $1.22 per share	—	—	—	(92,147)	(92,147)
Issuance of common shares	—	—	8	—	8
Balance at June 30, 2015	74,812	$748	$1,483,389	$ 41,160	$1,525,297
Balance at December 31, 2015	73,767	$738	$1,469,722	$ 25,653	$1,496,113
Net income	—	—	—	9,229	9,229
Share-based compensation	298	3	3,010	—	3,013
Common share dividends, $0.94 per share	—	—	—	(64,694)	(64,694)
Repurchase of common shares	(6,342)	(64)	(82,770)	—	(82,834)
Balance at June 30, 2016	67,723	$677	$1,389,962	$ (29,812)	$1,360,827

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six months ended June 30,	
	2016	2015
	(in thousands)	
Cash flows from operating activities		
Net income	$9,229	$35,579
Adjustments to reconcile net income to net cash used by operating activities:		
Accrual of unearned discounts and amortization of premiums on mortgage-backed securities, mortgage loans at fair value, and asset-backed financing of a variable interest entity	(1,086)	(119)
Capitalization of interest on mortgage loans at fair value	(39,715)	(20,130)
Capitalization of interest on excess servicing spread	(12,728)	(9,570)
Amortization of debt issuance costs	6,472	5,401
Net gain on mortgage loans acquired for sale	(39,275)	(21,335)
Net loss (gain) on investments	19,385	(26,061)
Change in fair value, amortization and impairment of mortgage servicing rights	29,656	27,497
Results of real estate acquired in settlement of loans	8,601	7,638
Share-based compensation expense	3,013	3,685
Purchase of mortgage loans acquired for sale at fair value from nonaffiliates	(25,461,808)	(20,820,811)
Purchase of mortgage loans acquired for sale at fair value from PennyMac Financial Services, Inc.	(8,139)	(10,828)
Repurchase of mortgage loans subject to representation and warranties	(6,654)	(12,972)
Sale and repayment of mortgage loans acquired for sale at fair value to nonaffiliates	8,465,753	5,707,641
Sale of mortgage loans acquired for sale to PennyMac Financial Services, Inc.	16,790,189	13,523,345
Decrease (increase) in servicing advances	12,277	(8,870)
Increase in due from PennyMac Financial Services, Inc.	(2,688)	(2,541)
Decrease (increase) in other assets	39,774	(24,223)
Increase in accounts payable and accrued liabilities	14,084	8,440
Increase (decrease) in due to PennyMac Financial Services, Inc.	2,032	(7,469)
Decrease in income taxes payable	(6,731)	(14,710)
Net cash used in operating activities	(178,359)	(1,660,413)
Cash flows from investing activities		
Net decrease in short-term investments	24,988	107,483
Purchase of mortgage-backed securities at fair value	(249,925)	(25,129)
Sale and repayment of mortgage-backed securities at fair value	49,141	39,744
Purchase of mortgage loans at fair value	—	(241,981)
Sale and repayment of mortgage loans at fair value	458,466	147,465
Purchase of excess servicing spread from PennyMac Financial Services, Inc.	—	(187,287)
Repayment of excess servicing spread by PennyMac Financial Services, Inc.	38,281	31,083
Sale of excess servicing spread to PennyMac Financial Services, Inc.	59,045	—
Net settlement of derivative financial instruments	(2,793)	(10,554)
Sale of real estate acquired in settlement of loans	135,573	128,097
Purchase of mortgage servicing rights	(2,602)	—

Sale of mortgage servicing rights	106	376
Deposit of cash securing credit risk transfer agreements	(192,737)	—
Distribution from credit risk transfer agreements	7,320	—
Increase in margin deposits and restricted cash	(16,769)	(36,003)
Purchase of Federal Home Loan Bank capital stock	(225)	—
Redemption of Federal Home Loan Bank capital stock	7,320	—
Net cash provided by (used in) investing activities	315,189	(46,706)

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six months ended June 30, 2016	2015
	(in thousands)	
Cash flows from financing activities		
Sale of assets under agreements to repurchase	27,426,511	22,834,050
Repurchase of assets sold under agreements to repurchase	(27,279,985)	(22,062,255)
Sale of mortgage loan participation certificates	3,166,373	2,440,045
Repayment of mortgage loan participation certificates	(3,070,038)	(2,389,653)
Issuance of credit risk transfer financing	—	649,120
Federal Home Loan Bank advances	28,000	138,400
Repayment of Federal Home Loan Bank advances	(211,000)	—
Advance under notes payable	69,282	192,352
Repayment under notes payable	(141,386)	—
Advance under notes payable to PennyMac Financial Services, Inc.	—	71,072
Repayment under notes payable to PennyMac Financial Services, Inc.	—	(18,546)
Issuance of asset-backed financing of a variable interest entity at fair value	99,499	—
Repayment of asset-backed financing of a variable interest entity at fair value	(30,479)	(11,331)
Payment of debt issuance costs	(5,512)	(5,176)
Issuance of common shares	—	8
Repurchase of common shares	(82,834)	—
Payment of contingent underwriting fees payable	—	(688)
Payment of dividends	(67,664)	(91,967)
Net cash (used in) provided by financing activities	(99,233)	1,745,431
Net increase in cash	37,597	38,312
Cash at beginning of period	58,108	76,386
Cash at end of period	$95,705	$114,698

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1—Organization and Basis of Presentation

PennyMac Mortgage Investment Trust ("PMT" or the "Company") was organized in Maryland on May 18, 2009, and commenced operations on August 4, 2009, when it completed its initial offerings of common shares of beneficial interest ("common shares"). The Company is a specialty finance company, which, through its subsidiaries (all of which are wholly-owned), invests primarily in residential mortgage-related assets.

The Company operates in two segments, correspondent production and investment activities:

- The correspondent production segment represents the Company's operations aimed at serving as an intermediary between mortgage lenders and the capital markets by purchasing, pooling and reselling newly originated prime credit quality mortgage loans either directly or in the form of mortgage-backed securities ("MBS"), using the services of PNMAC Capital Management, LLC ("PCM" or the "Manager") and PennyMac Loan Services, LLC ("PLS"), both indirect controlled subsidiaries of PennyMac Financial Services, Inc. ("PFSI").

Most of the mortgage loans the Company has acquired in its correspondent production activities have been eligible for sale to government-sponsored entities such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") or through government agencies such as the Government National Mortgage Association ("Ginnie Mae"). Fannie Mae, Freddie Mac and Ginnie Mae are each referred to as an "Agency" and, collectively, as the "Agencies."

- The investment activities segment represents the Company's investments in mortgage-related assets, which include MBS, distressed mortgage loans, excess servicing spread ("ESS"), credit risk transfer agreements ("CRT Agreements"), real estate acquired in settlement of loans ("REO"), real estate held for investment, mortgage servicing rights ("MSRs"), and small balance commercial real estate loans.

The Company believes that it qualifies, and has elected to be taxed, as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended, beginning with its taxable period ended on December 31, 2009. To maintain its tax status as a REIT, the Company has to distribute at least 90% of its taxable income in the form of qualifying distributions to shareholders.

The Company conducts substantially all of its operations and makes substantially all of its investments through its subsidiary, PennyMac Operating Partnership, L.P. (the "Operating Partnership"), and the Operating Partnership's subsidiaries. A wholly-owned subsidiary of the Company is the sole general partner, and the Company is the sole limited partner, of the Operating Partnership.

The accompanying consolidated financial statements have been prepared in compliance with accounting principles generally accepted in the United States ("GAAP") as codified in the Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") for interim financial information and with the Securities and Exchange Commission's instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these financial statements and notes do not include all of the information required by GAAP for complete financial statements. The interim consolidated information should be read together with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

The accompanying unaudited consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, results of operations, and cash flows for the interim periods, but are not necessarily indicative of the results of operations that may be anticipated for the full year. Intercompany accounts and transactions have been eliminated.

Preparation of financial statements in compliance with GAAP requires the Manager to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the reporting period. Actual results will likely differ from those estimates.

Note 2—Concentration of Risks

As discussed in Note 1— Organization and Basis of Presentation above, PMT's operations and investing activities are centered in residential mortgage-related assets, a substantial portion of which are distressed at acquisition. The mortgage loans at fair value not acquired for sale or held in a variable interest entity ("VIE") are generally purchased at discounts reflecting their distressed state or perceived higher risk of default, as well as a greater likelihood of collateral documentation deficiencies.

Due to the nature of the Company's investments, PMT is exposed, to a greater extent than traditional mortgage investors, to the risks that borrowers may be in economic distress and/or may have become unemployed, bankrupt or otherwise unable or unwilling to make payments when due, and to the effects of fluctuations in the residential real estate market on the performance of its investments. Factors influencing these risks include, but are not limited to:

- changes in the overall economy, unemployment rates and residential real estate values in the markets where the properties securing the Company's mortgage loans are located;
- PCM's ability to identify and PLS' ability to execute optimal resolutions of certain mortgage loans;
- the accuracy of valuation information obtained during the Company's due diligence activities;
- PCM's ability to effectively model, and to develop appropriate model inputs that properly anticipate, future outcomes;
- the level of government support for resolution of certain mortgage loans and the effect of current and future proposed and enacted legislative and regulatory changes on the Company's ability to effect cures or resolutions to distressed mortgage loans; and
- regulatory, judicial and legislative support of the foreclosure process, and the resulting effect on the Company's ability to acquire and liquidate the real estate securing its portfolio of distressed mortgage loans in a timely manner or at all.

Due to these uncertainties, there can be no assurance that risk management activities identified and executed on PMT's behalf will prevent significant losses arising from the Company's investments in real estate-related assets.

A substantial portion of the distressed mortgage loans and REO purchased by the Company in prior years has been acquired from or through one or more subsidiaries of Citigroup Inc., as presented in the following summary:

	June 30, 2016	December 31, 2015
	(in thousands)	
Mortgage loans at fair value	$616,018	$ 855,691
REO	60,009	88,088
	$676,027	$ 943,779
Total carrying value of mortgage loans at fair value and REO	$2,335,455	$ 2,897,634

Note 3—Transactions with Related Parties

Operating Activities

Correspondent Production Activities

Following is a summary of correspondent production activity between the Company and PLS:

	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)			

Fulfillment fees earned by PLS	$19,111	$15,333	$32,046	$28,199
Unpaid principal balance ("UPB") of mortgage loans fulfilled by PLS	$5,174,020	$3,579,078	$8,433,383	$6,469,210
Sourcing fees received from PLS included in Net gain on mortgage loans acquired for sale	$2,824	$2,427	$4,773	$3,848
UPB of mortgage loans sold to PLS	$9,409,399	$8,082,764	$15,905,121	$12,818,138
Purchases of mortgage loans acquired for sale at fair value from PLS	$3,424	$2,423	$8,139	$10,828
Tax service fee paid to PLS included in Other expense	$1,464	$1,113	$2,471	$2,002
Mortgage banking and warehouse services fees paid to PLS included in Mortgage loan servicing fees	$1	$—	$2	$—

	June 30, 2016	December 31, 2015
	(in thousands)	
Mortgage loans included in Mortgage loans acquired for sale at fair value pending sale to PLS	$619,008	$ 669,288

Mortgage Loan Servicing Activities

Following is a summary of mortgage loan servicing fees earned by PLS and MSR recapture income earned from PLS:

	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Mortgage loan servicing fees:				
Mortgage loans acquired for sale at fair value:				
Base	$79	$42	$135	$68
Activity-based	172	59	287	90
	251	101	422	158
Mortgage loans at fair value:				
Distressed mortgage loans				
Base	2,908	4,183	6,267	8,215
Activity-based	8,518	3,093	11,967	5,987
	11,426	7,276	18,234	14,202
Mortgage loans held in VIE:				
Base	51	27	92	57
Activity-based	—	—	—	—
	51	27	92	57
MSRs:				
Base	4,583	4,627	8,927	8,253
Activity-based	116	105	205	136
	4,699	4,732	9,132	8,389
	$16,427	$12,136	$27,880	$22,806
MSR recapture income recognized included in Net mortgage loan servicing fees	$311	$—	$440	$—
Average investment in:				
Mortgage loans acquired for sale at fair value	$1,422,945	$1,014,883	$1,170,720	$887,660
Mortgage loans at fair value:				
Distressed mortgage loans	$1,791,429	$2,295,807	$1,925,605	$2,303,080
Mortgage loans held in a VIE	$437,542	$504,309	$446,013	$514,879
Average mortgage loan servicing portfolio	$45,647,524	$35,742,835	$44,531,795	$35,215,677

Management Fees

Following is a summary of the base management and performance incentive fees payable to PCM recorded by the Company:

	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Base management	$5,199	$5,709	$10,551	$11,439

Performance incentive	—	70	—	1,343
	$5,199	$5,779	$10,551	$12,782

Expense Reimbursement and Amounts Payable to and Receivable from PFSI

The Company reimburses PCM and its affiliates for other expenses, including common overhead expenses incurred on its behalf by PCM and its affiliates, in accordance with the terms of its management agreement as summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Reimbursement of:				
Common overhead incurred by PCM and its affiliates (1)	$2,435	$2,702	$4,996	$5,431
Expenses (reimbursements) incurred on the Company's behalf	(169)	83	(114)	462
	$2,266	$2,785	$4,882	$5,893
Payments and settlements during the year (2)	$28,952	$24,114	$56,613	$46,866

(1) For the quarter ended June 30, 2015, in accordance with the terms of the Company's management agreement, PCM provided the Company a discretionary waiver of $700,000 of overhead expenses that otherwise would have been allocable to the Company. On December 15, 2015, the Operating Partnership amended its management agreement to provide that the overhead costs and expenses incurred by PFSI in any quarter and reimbursable by the Operating Partnership is capped at an amount equal to the product of (A) 70 basis points (0.0070), multiplied by (B) PMT's shareholders' equity (as defined in the management agreement) as of the last day of the month preceding quarter end, divided by four.

(2) Payments and settlements include payments and netting settlements made pursuant to master netting agreements between the Company and PFSI for operating, investment and financing activities itemized in this Note.

Amounts receivable and payable to PFSI are summarized below:

	June 30, 2016	December 31, 2015
	(in thousands)	
Receivable from PFSI:		
MSR recapture receivable	$605	$ 781
Other	11,770	8,025
	$12,375	$ 8,806
Payable to PFSI:		
Servicing fees	$9,154	$ 3,682
Management fees	5,200	5,670
Correspondent production fees	2,567	2,729
Interest on Note payable to PFSI	1,042	412
Conditional Reimbursement	900	900
Allocated expenses	847	390
Fulfillment fees	1,890	1,082
Expenses paid by PFSI on PMT's behalf	454	4,100
	$22,054	$ 18,965

Investing Activities

On February 29, 2016, the Company and PLS terminated that certain master spread acquisition and MSR servicing agreement that the parties entered into effective February 1, 2013 (the "2/1/13 Spread Acquisition Agreement") and all amendments thereto. In connection with the termination of the 2/1/13 Spread Acquisition Agreement, PLS reacquired from the Company all of its right, title and interest in and to all of the Fannie Mae ESS previously sold by PLS to the Company under the 2/1/13 Spread Acquisition Agreement and then subject to such 2/1/13 Spread Acquisition Agreement. On February 29, 2016, PLS also reacquired from the Company all of its right, title and interest in and to all of the Freddie Mac ESS previously sold to the Company by PLS. During the six months ended June 30, 2016, the amount of ESS sold by the Company to PLS under these reacquisitions was $59.0 million.

Following is a summary of investing activities between the Company and PFSI:

	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
ESS:				
Purchases	$—	$140,875	$—	$187,287
Received pursuant to a recapture agreement	$1,690	$1,319	$3,601	$2,565
Repayments and sales	$17,400	$18,352	$97,326	$31,083
Interest income	$5,713	$5,818	$12,728	$9,570
Net loss included in Net (loss) gain on investments :				
Valuation changes	$(17,428)	$7,133	$(36,877)	$(403)
Recapture income	1,604	1,456	3,426	2,745
	$(15,824)	$8,589	$(33,451)	$2,342

Financing Activities

PFSI held 75,000 of the Company's common shares at both June 30, 2016 and December 31, 2015.

Note Payable to PLS

PLS is a party to a repurchase agreement between it and Credit Suisse First Boston Mortgage Capital LLC ("CSFB") (the "MSR Repo"), pursuant to which PLS finances Ginnie Mae MSRs and servicing advance receivables and pledges to CSFB all of its rights and interests in any Ginnie Mae MSRs it owns or acquires, and a separate acknowledgement agreement with respect thereto, by and among Ginnie Mae, CSFB and PLS.

In connection with the MSR Repo described above, the Company, through a wholly-owned subsidiary, entered into an underlying loan and security agreement with PLS, dated as of April 30, 2015, pursuant to which the Company may borrow up to $150 million from PLS for the purpose of financing its investment in ESS (the "Underlying LSA"). The principal amount of the borrowings under the Underlying LSA is based upon a percentage of the market value of the ESS pledged to PLS, subject to the $150 million sublimit described above. Pursuant to the Underlying LSA, the Company granted to PLS a security interest in all of its right, title and interest in, to and under the ESS pledged to secure the borrowings, and PLS, in turn, re-pledged such ESS to CSFB under the MSR Repo.

The Company agreed with PLS in connection with the Underlying LSA that the Company is required to repay PLS the principal amount of borrowings plus accrued interest to the date of such repayment, and PLS, in turn, is required to repay CSFB the corresponding amount under the MSR Repo. Interest accrues on the Company's note relating to the Underlying LSA at a rate based on CSFB's cost of funds under the MSR Repo. The Company was also required to pay PLS a fee for the structuring of the Underlying LSA in an amount equal to the portion of the corresponding fee paid by PLS to CSFB under the MSR Repo and allocable to the $150 million relating to the ESS financing. As of June 30, 2016 and December 31, 2015, the outstanding borrowings on the Underlying LSA totaled $150 million.

Conditional Reimbursement and Contingent Underwriting Fees

In connection with its initial public offering of common shares on August 4, 2009 ("IPO"), the Company conditionally agreed to reimburse PCM up to $2.9 million for underwriting fees paid to the IPO underwriters by PCM on the Company's behalf (the "Conditional Reimbursement"). Also in connection with its IPO, the Company agreed to pay the

IPO underwriters up to $5.9 million in contingent underwriting fees.

Following is a summary of financing activities between the Company and PFSI:

	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Note payable—Interest expense	$2,222	$533	$3,824	$533
Conditional Reimbursements paid to PCM	$—	$73	$—	$230

Note 4—Earnings Per Share

The Company grants restricted share units which entitle the recipients to receive dividend equivalents during the vesting period on a basis equivalent to the dividends paid to holders of common shares. Unvested share-based compensation awards containing non-forfeitable rights to receive dividends or dividend equivalents (collectively, "dividends") are classified as "participating securities" and are included in the basic earnings per share calculation using the two-class method.

Under the two-class method, all earnings (distributed and undistributed) are allocated to common shares and participating securities, based on their respective rights to receive dividends. Basic earnings per share is determined by dividing net income, reduced by income attributable to the participating securities, by the weighted-average common shares outstanding during the period.

Diluted earnings per share is determined by dividing net income attributable to diluted shareholders, which adds back to net income the interest expense, net of applicable income taxes, on the Company's exchangeable senior notes (the "Exchangeable Notes"), by the weighted-average common shares outstanding, assuming all potentially dilutive securities were issued. In periods in which the Company records a loss, potentially dilutive securities are excluded from the diluted loss per share calculation, as their effect on loss per share is anti-dilutive.

The following table summarizes the basic and diluted earnings per share calculations:

	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands except per share amounts)			
Basic (loss) earnings per share:				
Net (loss) income	$(5,267)	$28,071	$9,229	$35,579
Effect of participating securities—share-based compensation awards	(307)	(438)	(718)	(1,015)
Net (loss) income attributable to common shareholders	$(5,574)	$27,633	$8,511	$34,564
Diluted (loss) earnings per share:				
Net (loss) income attributable to common shareholders	$(5,574)	$27,633	$8,511	$34,564
Effect of participating securities—share-based compensation awards	—	—	—	—
Interest on Exchangeable Notes, net of income taxes	—	2,121	—	—
Net (loss) income attributable to diluted shareholders	$(5,574)	$29,754	$8,511	$34,564
Weighted-average basic shares outstanding	68,446	74,683	70,165	74,618
Potentially dilutive securities:				

Shares issuable under share-based compensation plan	—	330	—	—
Shares issuable pursuant to exchange of the Exchangeable Notes	—	8,467	—	379
Diluted weighted-average number of shares outstanding	68,446	83,480	70,165	74,997
Basic (loss) earnings per share	$(0.08)	$0.37	$0.12	$0.46
Diluted (loss) earnings per share	$(0.08)	$0.36	$0.12	$0.46

Dividends and undistributed earnings allocated to participating securities under the basic and diluted earnings per share calculations require specific shares to be included or excluded that may differ in certain circumstances. The following table summarizes the common shares excluded from the diluted earnings per share calculation for the periods as inclusion of such shares would have been antidilutive:

	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Shares issuable under share-based compensation awards	766	—	766	—
Shares issuable pursuant to exchange of the Exchangeable Notes	8,467	—	8,467	8,467

Note 5—Loan Sales and Variable Interest Entities

The Company is a variable interest holder in various special purpose entities that relate to its mortgage loan transfer and financing activities. These entities are classified as VIEs for accounting purposes. The Company has segregated its involvement with VIEs between those VIEs which the Company does not consolidate and those VIEs which the Company consolidates.

Unconsolidated VIEs with Continuing Involvement

The following table summarizes cash flows between the Company and transferees in transfers of mortgage loans that are accounted for as sales where the Company maintains continuing involvement with the mortgage loans, as well as UPB information at period end:

	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Cash flows:				
Proceeds from sales	$5,231,974	$3,063,397	$8,465,753	$5,707,641
Mortgage loan servicing fees received (1)	$29,179	$22,738	$56,755	$44,641

	June 30, 2016	December 31, 2015
	(in thousands)	
UPB of mortgage loans outstanding	$47,087,431	$42,300,338
Delinquent mortgage loans:		

30-89 days delinquent	$192,175	$175,599
90 or more days delinquent:		
Not in foreclosure or bankruptcy	39,377	38,669
In foreclosure or bankruptcy	44,267	31,386
	83,644	70,055
	$275,819	$245,654

(1) Net of guarantee fees.

Consolidated VIEs

Credit Risk Transfer Agreements

The Company, through its wholly-owned subsidiary, PennyMac Corp. ("PMC"), entered into CRT Agreements with Fannie Mae, pursuant to which PMC, through subsidiary trust entities, sells pools of mortgage loans into Fannie Mae-guaranteed securitizations while retaining a portion of the credit risk underlying such mortgage loans in exchange for a portion of the contractual guarantee fee normally charged by Fannie Mae. The mortgage loans subject to the CRT Agreements are transferred by PMC to subsidiary trust entities which sell the mortgage loans into Fannie Mae mortgage loan securitizations and issue the credit guarantees to Fannie Mae. Transfers of mortgage loans subject to CRT Agreements receive sale accounting treatment upon fulfillment of the criteria for sale recognition contained in the Transfers and Servicing topic of the FASB's ASC.

The Manager has concluded that the Company's subsidiary trust entities are VIEs and the Company is the primary beneficiary of the VIEs as it is the holder of the primary beneficial interests which absorb the variability of the trusts' results of operations.

Consolidation of the VIEs results in the inclusion on the Company's consolidated balance sheet of the cash pledged to fulfill the guarantee obligation and a credit derivative comprised of the fair values of the credit guarantees and the Company's right to the related guarantee fees. The pledged cash represents the Company's maximum contractual exposure to claims under its credit guarantee, is the sole source of settlement of losses under the CRT Agreements and is included in Deposits securing credit risk transfer agreements on the consolidated balance sheet. Gains and losses on net derivatives related to CRT Agreements, including realized gains received, are included in Net (loss) gain on investments in the consolidated statements of operations.

Following is a summary of the CRT Agreements:

	Quarter Ended June 30, 2016	Six Months Ended June 30, 2016
	(in thousands)	
During the period:		
UPB of mortgage loans transferred and sold under CRT Agreements	$3,162,746	$5,084,744
Deposits of cash securing CRT Agreements	$126,031	$192,737
Gains (losses) recognized on CRT Agreements included in Net (loss) gain on investments		
Realized	$3,859	$6,395
Resulting from valuation changes	3,905	(2,774)
	$7,764	$3,621
Payments made to settle losses	$—	$—

	June 30, 2016	December 31, 2015
	(in thousands)	
UPB of mortgage loans subject to credit guarantee obligation	$8,976,961	$4,546,265
Delinquency status (in UPB):		
Current—89 days delinquent	$8,976,093	$4,546,265
90 or more days delinquent	$868	$—
Carrying value of CRT Agreements:		
Net derivative included in Derivative assets	$—	$593
Deposits securing credit risk transfer agreements	$338,812	$147,000
Interest-only security payable at fair value	$1,663	$—
Net derivative included in Derivative liabilities	$199	$—

Jumbo Mortgage Loan Financing

On September 30, 2013, the Company completed a securitization transaction in which PMT Loan Trust 2013-J1, a VIE, issued $537.0 million in UPB of certificates backed by fixed-rate prime jumbo mortgage loans, at a 3.9% weighted yield. The Company retained $366.8 million in fair value of such certificates. During the year ended December 31, 2015 and six months ended June 30, 2016, the Company sold an additional $111.0 million and $100.6 million in UPB of those certificates, respectively, which reduced the fair value of the certificates retained by the Company to $101.2 million as of June 30, 2016.

The VIE is consolidated by the Company as the Manager determined that PMT is the primary beneficiary of the VIE as it had the power, through PLS, in its role as servicer of the mortgage loans, to direct the activities of the VIE that most significantly impact its economic performance and the retained subordinated and residual interest trust certificates expose the Company to losses that could potentially be significant to the VIE.

Note 6—Netting of Financial Instruments

The Company uses derivative financial instruments to manage exposure to interest rate risk created by its MBS, interest rate lock commitments (“IRLCs”), mortgage loans acquired for sale at fair value, mortgage loans at fair value held in VIE, ESS and MSRs. All derivative financial instruments are recorded on the consolidated balance sheets at fair value. The Company has elected to net derivative asset and liability positions, and cash collateral obtained (or posted) from (or to) its counterparties when subject to a legally enforceable master netting arrangement. The derivative financial instruments that are not subject to master netting arrangements are IRLCs and the net derivatives related to CRT Agreements. As of June 30, 2016 and December 31, 2015, the Company did not enter into reverse repurchase agreements or securities lending transactions that are required to be disclosed in the following tables.

Offsetting of Derivative Assets

Following is a summary of net derivative assets. As discussed above, all derivatives with the exception of IRLCs and CRT Agreements are subject to master netting arrangements.

	June 30, 2016			December 31, 2015		
	Gross amounts of recognized assets	Gross amounts offset in the consolidated balance sheet	Net amounts of assets presented in the consolidated balance sheet	Gross amounts of recognized assets	Gross amounts offset in the consolidated balance sheet	Net amounts of assets presented in the consolidated balance sheet
	(in thousands)					
Derivative assets						
Not subject to master netting arrangements:						
Interest rate lock commitments	$16,803	$ —	$ 16,803	$4,983	$ —	$ 4,983
CRT Agreements	—	—	—	593	—	593
	16,803	—	16,803	5,576	—	5,576
Subject to master netting arrangements:						
MBS put options	593	—	593	93	—	93
Forward purchase contracts	35,768	—	35,768	2,444	—	2,444
Forward sale contracts	43	—	43	2,604	—	2,604
Put options on interest rate futures	453	—	453	1,512	—	1,512
Call options on interest rate futures	3,379	—	3,379	1,156	—	1,156
Netting	—	(22,032)	(22,032)	—	(3,300)	(3,300)
	40,236	(22,032)	18,204	7,809	(3,300)	4,509
	$57,039	$ (22,032)	$ 35,007	$13,385	$ (3,300)	$ 10,085

Derivative Assets and Collateral Held by Counterparty