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PennyMac Mortgage Investment Trust
Form 10-Q
November 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

Or

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

For the transition period from _____ to _____

Commission file number: 001-34416

PennyMac Mortgage Investment Trust

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of

incorporation or organization)

3043 Townsgate Road, Westlake Village, California
(Address of principal executive offices)

27-0186273
(IRS Employer

Identification No.)

91361
(Zip Code)

(818) 224-7442

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically 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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

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 November 3, 2016
Common Shares of Beneficial Interest, \$0.01 par value	66,697,286

PENNYMAC MORTGAGE INVESTMENT TRUST

FORM 10-Q

September 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;

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)

	September 30, 2016	December 31, 2015
	(in thousands, except share amounts)	
ASSETS		
Cash	\$ 139,068	\$ 58,108
Short-term investments	33,353	41,865
Mortgage-backed securities at fair value pledged to creditors	708,862	322,473
Mortgage loans acquired for sale at fair value (includes \$2,018,292 and \$1,268,455 pledged to creditors, respectively)	2,043,453	1,283,795
Mortgage loans at fair value (includes \$1,947,425 and \$2,201,513 pledged to creditors, respectively)	1,957,117	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.	280,367	412,425
Derivative assets (includes \$8,268 pledged to creditors at September 30, 2016)	44,774	10,085
Real estate acquired in settlement of loans (includes \$221,153 and \$283,343 pledged to creditors, respectively)	288,348	341,846
Real estate held for investment	25,708	8,796
Mortgage servicing rights pledged to creditors (includes \$55,843 and \$66,584 carried at fair value, respectively)	524,529	459,741
Servicing advances	78,624	88,010
Deposits securing credit risk transfer agreements (includes \$416,163 pledged to creditors at September 30, 2016)	427,677	147,000
Due from PennyMac Financial Services, Inc.	5,776	8,806
Other	61,245	88,186
Total assets	\$ 6,618,901	\$ 5,826,924
LIABILITIES		
Assets sold under agreements to repurchase	\$ 4,041,085	\$ 3,128,780
Mortgage loan participation and sale agreements	88,458	—
Federal Home Loan Bank advances	—	183,000
Notes payable	196,132	236,015
Asset-backed financing of a variable interest entity at fair value	384,407	247,690
Exchangeable senior notes	245,824	245,054
Note payable to PennyMac Financial Services, Inc.	150,000	150,000
Interest-only security payable at fair value	1,699	—

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Derivative liabilities	1,620	3,157
Accounts payable and accrued liabilities	88,704	64,474
Due to PennyMac Financial Services, Inc.	14,747	18,965
Income taxes payable	36,380	33,505
Liability for losses under representations and warranties	14,927	20,171
Total liabilities	5,263,983	4,330,811
SHAREHOLDERS' EQUITY		
Common shares of beneficial interest—authorized, 500,000,000 common shares of \$0.01		
par value; issued and outstanding, 67,036,149 and 73,767,435 common shares	671	738
Additional paid-in capital	1,380,502	1,469,722
(Accumulated deficit) retained earnings	(26,255)	25,653
Total shareholders' equity	1,354,918	1,496,113
Total liabilities and shareholders' equity	\$6,618,901	\$ 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):

	September 30, 2016	December 31, 2015
	(in thousands)	
ASSETS		
Mortgage loans at fair value	\$397,740	\$ 455,394
Derivative assets	16,662	593
Deposits securing credit risk transfer agreements	427,677	147,000
Other—interest receivable	1,097	1,447
	\$843,176	\$ 604,434
LIABILITIES		
Asset-backed financing at fair value	\$384,407	\$ 247,690
Interest-only security payable at fair value	1,699	—
Accounts payable and accrued liabilities—interest payable	1,097	724
	\$387,203	\$ 248,414

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Quarter ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(in thousands, except per share amounts)			
Net investment income				
Interest income:				
From nonaffiliates	\$53,307	\$53,412	\$146,711	\$129,860
From PennyMac Financial Services, Inc.	4,827	8,026	17,555	17,596
	58,134	61,438	164,266	147,456
Interest expense:				
To nonaffiliates	38,356	36,471	103,129	91,423
To PennyMac Financial Services, Inc.	1,974	1,289	5,798	1,822
	40,330	37,760	108,927	93,245
Net interest income	17,804	23,678	55,339	54,211
Net gain on mortgage loans acquired for sale	43,858	13,884	83,133	35,219
Mortgage loan origination fees	12,684	9,135	28,104	21,701
Net gain (loss) on investments:				
From nonaffiliates	17,103	32,802	31,169	56,521
From PennyMac Financial Services, Inc.	(2,824)	(7,844)	(36,275)	(5,502)
	14,279	24,958	(5,106)	51,019
Net mortgage loan servicing fees	15,761	20,791	47,006	41,810
Results of real estate acquired in settlement of loans	(3,285)	(4,221)	(11,886)	(11,859)
Other	2,225	2,549	6,570	6,095
Net investment income	103,326	90,774	203,160	198,196
Expenses				
Earned by PennyMac Financial Services, Inc.:				
Mortgage loan fulfillment fees	27,255	17,553	59,301	45,752
Mortgage loan servicing fees	11,039	11,736	38,919	34,542
Management fees	5,025	5,742	15,576	18,524
Mortgage loan collection and liquidation	6,205	1,853	12,709	6,480
Professional services	1,134	1,759	5,438	5,249
Compensation	1,508	1,550	5,021	5,748
Other	6,146	5,474	18,297	15,526
Total expenses	58,312	45,667	155,261	131,821
Income before provision for (benefit from) income taxes	45,014	45,107	47,899	66,375
Provision for (benefit from) income taxes	9,606	6,295	3,262	(8,016)
Net income	\$35,408	\$38,812	\$44,637	\$74,391
Earnings per share				
Basic	\$0.52	\$0.51	\$0.63	\$0.98
Diluted	\$0.49	\$0.49	\$0.63	\$0.95
Weighted-average shares outstanding				
Basic	67,554	74,681	69,289	74,675
Diluted	76,329	83,411	69,289	83,486
Dividends declared per share	\$0.47	\$0.47	\$1.41	\$1.69

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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

	Common shares Number of shares (in thousands, except per share amounts)	Par value	Additional paid-in capital	(Accumulated deficit) retained earnings	Total
Balance at December 31, 2014	74,510	\$ 745	\$ 1,479,699	\$ 97,728	\$ 1,578,172
Net income	—	—	—	74,391	74,391
Share-based compensation	302	3	4,977	—	4,980
Common share dividends, \$1.69 per share	—	—	—	(127,166)	(127,166)
Issuance of common shares	—	—	8	—	8
Repurchase of common shares	(1,020)	(10)	(15,945)	—	(15,955)
Balance at September 30, 2015	73,792	\$ 738	\$ 1,468,739	\$ 44,953	\$ 1,514,430
Balance at December 31, 2015	73,767	\$ 738	\$ 1,469,722	\$ 25,653	\$ 1,496,113
Net income	—	—	—	44,637	44,637
Share-based compensation	298	3	4,139	—	4,142
Common share dividends, \$1.41 per share	—	—	—	(96,545)	(96,545)
Repurchase of common shares	(7,029)	(70)	(93,359)	—	(93,429)
Balance at September 30, 2016	67,036	\$ 671	\$ 1,380,502	\$ (26,255)	\$ 1,354,918

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine months ended September 30,	
	2016	2015
	(in thousands)	
Cash flows from operating activities		
Net income	\$44,637	\$74,391
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	1,628	(884)
Capitalization of interest on mortgage loans at fair value	(62,783)	(34,979)
Capitalization of interest on excess servicing spread	(17,555)	(17,596)
Amortization of debt issuance costs	9,798	8,491
Net gain on mortgage loans acquired for sale	(83,133)	(35,219)
Net loss (gain) on investments	5,106	(51,019)
Change in fair value, amortization and impairment of mortgage servicing rights	48,608	32,876
Results of real estate acquired in settlement of loans	11,886	11,859
Share-based compensation expense	4,142	4,980
Purchase of mortgage loans acquired for sale at fair value from nonaffiliates	(45,300,447)	(35,922,418)
Purchase of mortgage loans acquired for sale at fair value from PennyMac Financial Services, Inc.	(13,146)	(13,708)
Repurchase of mortgage loans subject to representation and warranties	(9,922)	(14,873)
Sale and repayment of mortgage loans acquired for sale at fair value to nonaffiliates	15,323,444	10,593,309
Sale of mortgage loans acquired for sale to PennyMac Financial Services, Inc.	29,154,270	24,877,077
Decrease (increase) in servicing advances	4,719	(16,930)
Decrease (increase) in due from PennyMac Financial Services, Inc.	2,699	(2,090)
Decrease (increase) in other assets	58,246	(14,891)
Increase in accounts payable and accrued liabilities	27,442	10,624
Decrease in due to PennyMac Financial Services, Inc.	(4,218)	(6,487)
Increase (decrease) in income taxes payable	2,875	(8,715)
Net cash used in operating activities	(791,704)	(526,202)
Cash flows from investing activities		
Net decrease in short-term investments	8,512	108,382
Purchase of mortgage-backed securities at fair value	(551,654)	(62,224)
Sale and repayment of mortgage-backed securities at fair value	172,470	52,520
Purchase of mortgage loans at fair value	—	(241,981)
Sale and repayment of mortgage loans at fair value	516,507	215,630
Purchase of excess servicing spread from PennyMac Financial Services, Inc.	—	(271,452)
Repayment of excess servicing spread by PennyMac Financial Services, Inc.	54,623	55,800
Sale of excess servicing spread to PennyMac Financial Services, Inc.	59,045	—
Net settlement of derivative financial instruments	(6,077)	(8,766)
Sale of mortgage loans at fair value to PennyMac Financial Services, Inc.	891	1,466

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Sale of real estate acquired in settlement of loans	180,416	174,784
Purchase of mortgage servicing rights	(2,602)	—
Sale of mortgage servicing rights	106	392
Deposit of cash securing credit risk transfer agreements	(282,434)	(87,891)
Distribution from credit risk transfer agreements	14,358	—
(Increase) decrease in margin deposits and restricted cash	(3,017)	1,438
Purchase of Federal Home Loan Bank capital stock	(225)	(7,330)
Redemption of Federal Home Loan Bank capital stock	7,320	—
Net cash provided by (used in) investing activities	168,239	(69,232)

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine months ended September 30,	
	2016	2015
	(in thousands)	
Cash flows from financing activities		
Sale of assets under agreements to repurchase	48,753,454	38,669,898
Repurchase of assets sold under agreements to repurchase	(47,841,632)	(38,534,306)
Sale of mortgage loan participation certificates	4,955,742	3,613,090
Repayment of mortgage loan participation certificates	(4,867,284)	(3,572,232)
Issuance of credit risk transfer financing	—	1,204,187
Repayment of credit risk transfer financing	—	(1,204,187)
Federal Home Loan Bank advances	28,000	461,484
Repayment of Federal Home Loan Bank advances	(211,000)	(278,484)
Advance under notes payable	103,554	346,179
Repayment under notes payable	(143,518)	(153,765)
Advance under notes payable to PennyMac Financial Services, Inc.	—	168,546
Repayment under notes payable to PennyMac Financial Services, Inc.	—	(18,546)
Issuance of asset-backed financing of a variable interest entity at fair value	182,400	85,206
Repayment of asset-backed financing of a variable interest entity at fair value	(53,641)	(15,590)
Payment of debt issuance costs	(8,464)	(8,436)
Issuance of common shares	—	8
Repurchase of common shares	(93,429)	(15,955)
Payment of contingent underwriting fees payable	—	(705)
Payment of dividends	(99,757)	(138,041)
Net cash provided by financing activities	704,425	608,351
Net increase in cash	80,960	12,917
Cash at beginning of period	58,108	76,386
Cash at end of period	\$ 139,068	\$ 89,303

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 mortgage 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, income, 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 were 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.

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Due to the nature of the Company's investments, PMT is exposed, to a greater extent than traditional mortgage investors, to the risks associated with loan resolution, including 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 that fluctuations in the residential real estate market may affect 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;
- PFCM'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;
- PFCM'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:

	September 30, 2016	December 31, 2015
	(in thousands)	
Mortgage loans at fair value	\$601,572	\$ 855,691
REO	53,052	88,088
	\$654,624	\$ 943,779
Total carrying value of mortgage loans at fair value and REO	\$2,245,465	\$ 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 September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Fulfillment fees earned by PLS	\$27,255	\$17,553	\$59,301	\$45,752

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Unpaid principal balance (“UPB”) of mortgage loans

fulfilled by PLS	\$7,263,557	\$4,073,201	\$15,696,940	\$10,542,411
Sourcing fees received from PLS included in				
Net gain on mortgage loans acquired for sale	\$3,509	\$3,236	\$8,282	\$7,084
UPB of mortgage loans sold to PLS	\$11,694,065	\$10,783,882	\$27,599,186	\$23,602,020
Purchases of mortgage loans acquired for sale at				
fair value from PLS	\$5,007	\$2,880	\$13,146	\$13,708
Tax service fee paid to PLS included in Other				
expense	\$2,066	\$1,291	\$4,537	\$3,293
Early purchase program fees paid to PLS included				
in Mortgage loan servicing fees	\$5	\$—	\$7	\$—

September 30,
2016 December 31, 2015
(in thousands)

Mortgage loans included in Mortgage loans acquired for

sale at fair value pending sale to PLS

\$575,487 \$ 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 September 30, 2016		2015		Nine months ended September 30, 2016		2015	
	(in thousands)							
Mortgage loans acquired for sale at fair value:								
Base	\$90	\$130	\$225	\$198				
Activity-based	210	153	497	243				
	300	283	722	441				
Mortgage loans at fair value:								
Distressed mortgage loans								
Base	2,615	3,896	8,881	12,053				
Activity-based	3,014	2,961	14,981	8,948				
	5,629	6,857	23,862	21,001				
Mortgage loans held in VIE:								
Base	65	34	157	92				
Activity-based	1	—	1	—				
	66	34	158	92				
MSRs:								
Base	4,913	4,473	13,841	12,783				
Activity-based	131	89	336	225				
	5,044	4,562	14,177	13,008				
	\$11,039	\$11,736	\$38,919	\$34,542				
MSR recapture income recognized included in Net								
mortgage loan servicing fees	\$409	\$670	\$849	\$670				
Average investment in:								
Mortgage loans acquired for sale at fair value	\$1,607,564	\$1,783,011	\$1,317,230	\$1,189,754				
Mortgage loans at fair value:								
Distressed mortgage loans	\$1,579,246	\$2,201,533	\$1,810,779	\$2,268,538				
Mortgage loans held in a VIE	\$413,749	\$481,925	\$434,967	\$504,351				
Average MSR portfolio	\$48,997,875	\$38,172,371	\$46,125,926	\$36,446,663				

Management Fees

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

	Quarter ended September 30,	Nine months ended September 30,
--	--------------------------------	---------------------------------------

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	2016	2015	2016	2015
	(in thousands)			
Base management	\$5,025	\$5,742	\$15,576	\$17,181
Performance incentive	—	—	—	1,343
	\$5,025	\$5,742	\$15,576	\$18,524

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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		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(in thousands)			
Reimbursement of:				
Common overhead incurred by PCM and its affiliates	\$1,417	\$2,694	\$6,413	\$8,125
Expenses incurred on the Company's (PFSI's) behalf, net	13	(85)	(102)	377
	\$1,430	\$2,609	\$6,311	\$8,502
Payments and settlements during the year (1)	\$45,988	\$17,709	\$102,600	\$64,575

(1) 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 from and payable to PFSI are summarized below:

	September 30,	
	2016	2015
	(in thousands)	
Receivable from PFSI:		
MSR recapture receivable	\$450	\$ 781
Other	5,326	8,025
	\$5,776	\$ 8,806
Payable to PFSI:		
Management fees	\$5,025	\$ 5,670
Servicing fees	3,641	3,682
Allocated expenses and expenses paid by PFSI		
on PMT's behalf	3,227	4,490
Fulfillment fees	926	1,082
Conditional Reimbursement	900	900
Interest on Note payable to PFSI	536	412
Correspondent production fees	492	2,729
	\$14,747	\$ 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. The amount of ESS sold by the Company to PLS under these reacquisitions was \$59.0 million.

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

	Quarter ended		Nine months ended	
	September 30, 2016	2015	September 30, 2016	2015
	(in thousands)			
Mortgage loans at fair value for sale to PFSI	\$891	\$1,466	\$891	\$1,466
ESS:				
Purchases	\$—	\$84,165	\$—	\$271,452
Received pursuant to a recapture agreement	\$1,438	\$2,268	\$5,039	\$4,833
Repayments and sales	\$16,342	\$24,717	\$113,668	\$55,800
Interest income	\$4,827	\$8,026	\$17,555	\$17,596
Net (loss) gain included in Net (loss) gain on investments:				
Valuation changes	\$(4,107)	\$(10,272)	\$(40,984)	\$(10,675)
Recapture income	1,283	2,428	4,709	5,173
	\$(2,824)	\$(7,844)	\$(36,275)	\$(5,502)

Financing Activities

PFSI held 75,000 of the Company's common shares at both September 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 MSR's and servicing advance receivables and pledges to CSFB all of its rights and interests in any Ginnie Mae MSR's 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 and as further amended, 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 September 30, 2016 and December 31, 2015, the outstanding borrowings on the Underlying LSA totaled \$150 million.

Conditional Reimbursement and Contingent Underwriting Fees

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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		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(in thousands)			
Note payable—Interest expense	\$1,974	\$1,289	\$5,798	\$1,822
Conditional Reimbursements paid to PCM	\$—	\$7	\$—	\$237

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 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		Nine months	
	September 30,		ended	
	2016	2015	2016	2015
	(in thousands except per share amounts)			
Basic earnings per share:				
Net income	\$35,408	\$38,812	\$44,637	\$74,391
Effect of participating securities—share-based				
compensation awards	(341)	(361)	(1,026)	(1,352)
Net income attributable to common				
shareholders	\$35,067	\$38,451	\$43,611	\$73,039
Diluted earnings per share:				
Net income attributable to common				
shareholders	\$35,067	\$38,451	\$43,611	\$73,039
Interest on Exchangeable Notes, net of income				
taxes	2,181	2,123	—	6,364
Net income attributable to common diluted				
shareholders	\$37,248	\$40,574	\$43,611	\$79,403
Weighted-average basic shares outstanding	67,554	74,681	69,289	74,675
Dilutive securities:				

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Shares issuable under share-based				
compensation plan	308	316	—	397
Shares issuable pursuant to exchange of the				
Exchangeable Notes	8,467	8,414	—	8,414
Diluted weighted-average number of				
shares outstanding	76,329	83,411	69,289	83,486
Basic earnings per share	\$0.52	\$0.51	\$0.63	\$0.98
Diluted earnings per share	\$0.49	\$0.49	\$0.63	\$0.95

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

	Quarter ended September 30, 2015	Nine months ended September 30, 2016	Quarter ended September 30, 2015
(in thousands)			
Shares issuable under share-based compensation			
awards	—	717	—
Shares issuable pursuant to exchange of the			
Exchangeable Notes	—	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 September 30, 2016		Nine months ended September 30, 2016	
	2015	2015	2015	2015
	(in thousands)			
Cash flows:				
Proceeds from sales	\$6,857,691	\$4,885,668	\$15,323,444	\$10,593,309
Mortgage loan servicing fees received (1)	\$31,514	\$25,054	\$88,269	\$69,876

	September 30, December 31, 2016	
	2016	2015
	(in thousands)	
UPB of mortgage loans outstanding	\$50,908,319	\$42,300,338
Delinquent mortgage loans:		
30-89 days delinquent	\$217,191	\$175,599
90 or more days delinquent:		
Not in foreclosure or bankruptcy	45,096	38,669
In foreclosure or bankruptcy	53,772	31,386
	98,868	70,055
	\$316,059	\$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 cash-collateralized 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 because the activities of the subsidiary trust entities are established by the Company and PMT owns substantially all of the beneficial interests issued by the trust. 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 gain (loss) on investments in the consolidated statements of income.

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Following is a summary of the CRT Agreements:

	Quarter ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(in thousands)			
During the period:				
UPB of mortgage loans sold under CRT Agreements	\$3,357,443	\$2,400,433	\$8,442,187	\$2,400,433
Deposits of cash securing CRT Agreements	\$89,697	\$59,841	\$282,434	\$87,891
Gains recognized on CRT Agreements				
included in Net gain (loss) on investments				
Realized	\$6,206	\$—	\$12,601	\$—
Resulting from valuation changes	12,271	626	9,497	626
	\$18,477	\$626	\$22,098	\$626
Payments made to settle losses	\$28	\$—	\$28	\$—

	September 30, December 31,	
	2016	2015
	(in thousands)	
UPB of mortgage loans subject to credit guarantee		
obligations	\$12,196,636	\$4,546,265
Delinquency status (in UPB):		
Current—89 days delinquent	\$12,192,306	\$4,546,265
90 or more days delinquent	\$3,125	\$—
Foreclosure	\$1,205	\$—
Carrying value of CRT Agreements:		
Derivative assets	\$16,662	\$593
Deposits securing credit risk transfer agreements	\$427,677	\$147,000
Interest-only security payable at fair value	\$1,699	\$—
Commitments to fund Deposits securing credit risk		
transfer agreements	\$35,106	\$—

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 initially retained \$366.8 million in fair value of such certificates. During the year ended December 31, 2015 and nine months ended September 30, 2016, the Company sold \$111.0 million and \$208.8 million in UPB of those certificates, respectively, which reduced the fair value of the certificates retained by the Company to \$9.4 million as of September 30, 2016.

The VIE is consolidated by the Company as the Manager determined that PMT is the primary beneficiary of the VIE because it has 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 a 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 from (or posted 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 derivatives related to CRT Agreements. As of September 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.

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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.

	September 30, 2016			December 31, 2015		
	Gross amounts	offset in the consolidated balance sheet (in thousands)	Net amounts of assets presented in the consolidated balance sheet	Gross amounts	offset in the consolidated balance sheet	Net amounts of assets presented in the consolidated balance sheet
Derivative assets						
Not subject to master netting arrangements:						
Interest rate lock commitments	\$15,535	\$ —	\$ 15,535	\$4,983	\$ —	\$ 4,983
CRT Agreements	16,662	—	16,662	593	—	593
	32,197	—	32,197	5,576	—	5,576
Subject to master netting arrangements:						
MBS put options	3,441	—	3,441	93	—	93
Forward purchase contracts	21,031	—	21,031	2,444	—	2,444
Forward sale contracts	1,308	—	1,308	2,604	—	2,604
Put options on interest rate futures	2,480	—	2,480	1,512	—	1,512
Call options on interest rate futures	1,965	—	1,965	1,156	—	1,156
Netting	—	(17,648)	(17,648)	—	(3,300)	(3,300)
	30,225	(17,648)	12,577	7,809	(3,300)	4,509
	\$62,422	\$ (17,648)	\$ 44,774	\$13,385	\$ (3,300)	\$ 10,085

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Derivative Assets and Collateral Held by Counterparty

The following table summarizes by significant counterparty the amount of derivative asset positions after considering master netting arrangements and financial instruments or cash pledged that do not meet the accounting guidance qualifying for setoff accounting.

	September 30, 2016			December 31, 2015			
	Gross amounts			Gross amounts			
	not offset in the			not offset in the			
	consolidated			consolidated			
	balance sheet			balance sheet			
	Net amount			Net amount			
	of assets			of assets			
	presented			presented			
	in the			in the			
	consolidated	Cash		consolidated	Cash		
	balance	Financial	collateral	balance	Financial	collateral	
	sheet	instruments	received	sheet	instruments	received	
	amount		amount	amount		amount	
	(in thousands)			(in thousands)			
Interest rate lock commitments	\$ 15,535	\$ —	\$ —	\$ 15,535	\$ 4,983	\$ —	\$ —
CRT Agreements	16,662	—	—	16,662	593	—	—
Federal National Mortgage Association	3,401	—	—	3,401	—	—	—
RJ O'Brien & Associates, LLC	2,672	—	—	2,672	1,672	—	—
JPMorgan Chase & Co.	2,500	—	—	2,500	—	—	—
Jefferies Group LLC	1,285	—	—	1,285	541	—	—
Bank of America, N.A.	752	—	—	752	—	—	—
Goldman Sachs	593	—	—	593	—	—	—
Wells Fargo Bank, N.A.	537	—	—	537	99	—	—
Nomura Securities International, Inc.	409	—	—	409	119	—	—
Barclays Capital	277	—	—	277	796	—	—
Royal Bank of Canada	—	—	—	—	400	—	—
Morgan Stanley Bank, N.A.	—	—	—	—	464	—	—
Ally Financial	—	—	—	—	209	—	—
Other	151	—	—	151	209	—	—
	\$ 44,774	\$ —	\$ —	\$ 44,774	\$ 10,085	\$ —	\$ —

Offsetting of Derivative Liabilities and Financial Liabilities

Following is a summary of net derivative liabilities and assets sold under agreements to repurchase. As discussed above, all derivative liabilities with the exception of IRLCs and CRT Agreements are subject to master netting arrangements. Assets sold under agreements to repurchase do not qualify for setoff accounting.

	September 30, 2016		Net	December 31, 2015		Net
	Gross		amounts	Gross		amounts
	amounts		of liabilities	amounts		of liabilities
	Gross	offset	presented	Gross	offset	presented
	amounts	in the	in the	amounts	in the	in the
	of	consolidated	consolidated	of	consolidated	consolidated
	recognized	balance	balance	recognized	balance	balance
	liabilities	sheet	sheet	liabilities	sheet	sheet
	(in thousands)					
Derivative liabilities						
Not subject to master netting						
arrangements:						
Interest rate lock commitments	\$ 207	\$ —	\$ 207	\$ 337	\$ —	\$ 337
	207	—	207	337	—	337
Subject to master netting						
arrangements:						
Forward purchase contracts	808	—	808	3,774	—	3,774
Forward sales contracts	20,234	—	20,234	2,680	—	2,680
Put options on interest rate futures	188	—	188	39	—	39
Call options on interest rate futures	—	—	—	305	—	305
Netting	—	(19,817)	(19,817)	—	(3,978)	(3,978)
	21,230	(19,817)	1,413	6,798	(3,978)	2,820
	21,437	(19,817)	1,620	7,135	(3,978)	3,157
Assets sold under agreements to repurchase:						
UPB	4,042,150	—	4,042,150	3,130,328	—	3,130,328
Unamortized debt issuance costs	(1,065)	—	(1,065)	(1,548)	—	(1,548)
	4,041,085	—	4,041,085	3,128,780	—	3,128,780
	\$ 4,062,522	\$ (19,817)	\$ 4,042,705	\$ 3,135,915	\$ (3,978)	\$ 3,131,937

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Derivative Liabilities, Financial Liabilities and Collateral Pledged by Counterparty

The following table summarizes by significant counterparty the amount of derivative liabilities and assets sold under agreements to repurchase after considering master netting arrangements and financial instruments or cash pledged that do not meet the accounting guidance qualifying for setoff accounting. All assets sold under agreements to repurchase represent sufficient collateral or exceed the liability amount recorded on the consolidated balance sheet.

	September 30, 2016			December 31, 2015		
	Gross amounts not offset in the consolidated balance sheet			Gross amounts not offset in the consolidated balance sheet		
Net amount of liabilities presented in the consolidated balance sheet (in thousands)	Cash collateral	Financial instruments	Net amount	Cash collateral	Financial instruments	Net amount
Interest rate lock commitments	\$ 207	\$ —	\$ —	\$ 207	\$ 337	\$ —
Credit Suisse First Boston Mortgage						
Capital LLC	1,259,028	(1,258,630)	—	398	893,947	(893,854)
Citibank	899,840	(899,717)	—	123	817,089	(816,699)
Bank of America, N.A.	650,204	(650,204)	—	—	538,755	(538,515)
JPMorgan Chase & Co.	544,610	(544,610)	—	—	467,427	(467,145)
Daiwa Capital Markets	189,119	(188,949)	—	170	165,480	(165,480)
Barclays Capital	154,120	(154,120)	—	—	24,346	(24,346)
Wells Fargo, N.A.	122,453	(122,453)	—	—	—	—
Morgan Stanley Bank, N.A.	116,603	(116,579)	—	24	214,086	(214,086)
Royal Bank of Canada	60,424	(60,258)	—	166	—	—
BNP Paribas	46,630	(46,630)	—	—	10,203	(10,203)
Goldman Sachs	—	—	—	—	819	—
Federal National Mortgage Association	—	—	—	—	924	—

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Other	532	—	—	532	72	—	—	72
Unamortized debt issuance costs	(1,065)	1,065	—	—	(1,548)	1,548	—	—
	\$4,042,705	\$(4,041,085)	\$	—\$1,620	\$3,131,937	\$(3,128,780)	\$	—\$3,157

Note 7—Fair Value

The Company's consolidated financial statements include assets and liabilities that are measured based on their fair values. Measurement at fair value may be on a recurring or nonrecurring basis depending on the accounting principles applicable to the specific asset or liability and whether the Manager has elected to carry the item at its fair value as discussed in the following paragraphs.

The Company groups its assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the observability of the inputs used to determine fair value. These levels are:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Prices determined or determinable using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing the asset or liability and are developed based on market data obtained from sources independent of the Company. These may include quoted prices for similar assets or liabilities, interest rates, prepayment speeds, credit risk and other inputs.

Level 3—Prices determined using significant unobservable inputs. In situations where significant observable inputs are unavailable unobservable inputs may be used. Unobservable inputs reflect the Company's own judgments about the factors that market participants use in pricing an asset or liability financial statement item, and are based on the best information available in the circumstances.

As a result of the difficulty in observing certain significant valuation inputs affecting “Level 3” fair value assets or liabilities, the Manager is required to make judgments regarding these items’ fair values. Different persons in possession of the same facts may reasonably arrive at different conclusions as to the inputs to be applied in valuing these assets or liabilities and to their fair values. Likewise, due to the general illiquidity of some of these assets or liabilities, subsequent transactions may be at values significantly different from those reported.

Fair Value Accounting Elections

The Manager identified all of the Company’s non-cash financial assets and MSRs relating to non-commercial real estate secured mortgage loans with initial interest rates of more than 4.5%, to be accounted for at fair value. The Manager has elected to account for these assets at fair value so such changes in fair value will be reflected in income as they occur and more timely reflect the results of the Company’s performance.

The Manager has also identified the Company’s CRT financing and asset-backed financing of a VIE to be accounted for at fair value to reflect the generally offsetting changes in fair value of these borrowings to changes in fair value of mortgage loans at fair value collateralizing these financings.

For other borrowings, the Manager has determined that historical cost accounting is more appropriate because under this method debt issuance costs are amortized over the term of the debt, thereby matching the debt issuance cost to the periods benefiting from the availability of the debt.

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Financial Statement Items Measured at Fair Value on a Recurring Basis

Following is a summary of financial statement items that are measured at fair value on a recurring basis:

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	\$33,353	\$—	\$—	\$33,353
Mortgage-backed securities at fair value	—	708,862	—	708,862
Mortgage loans acquired for sale at fair value	—	2,043,453	—	2,043,453
Mortgage loans at fair value	—	397,740	1,559,377	1,957,117
Excess servicing spread purchased from PFSI	—	—	280,367	280,367
Derivative assets:				
Interest rate lock commitments	—	—	15,535	15,535
CRT Agreements	—	—	16,662	16,662
MBS call options	—	3,441	—	3,441
Forward sales contracts	—	1,308	—	1,308
Forward purchase contracts	—	21,031	—	21,031
Call options on interest rate futures	1,965	—	—	1,965
Put options on interest rate futures	2,480	—	—	2,480
Total derivative assets before netting	4,445	25,780	32,197	62,422
Netting	—	—	—	(17,648)
Total derivative assets after netting	4,445	25,780	32,197	44,774
Mortgage servicing rights at fair value	—	—	55,843	55,843
	\$37,798	\$3,175,835	\$1,927,784	\$5,123,769
Liabilities:				
Asset-backed financing of a VIE at fair value	\$—	\$384,407	\$—	\$384,407
Interest-only security payable at fair value	—	—	1,699	1,699
Derivative liabilities:				
Interest rate lock commitments	—	—	207	207
Forward purchase contracts	—	808	—	808
Forward sales contracts	—	20,234	—	20,234
Put options on interest rate futures	188	—	—	188
Total derivative liabilities before netting	188	21,042	207	21,437
Netting	—	—	—	(19,817)
Total derivative liabilities after netting	188	21,042	207	1,620
	\$188	\$405,449	\$1,906	\$387,726

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	December 31, 2015			Total
	Level 1	Level 2	Level 3	
	(in thousands)			
Assets:				
Short-term investments	\$41,865	\$—	\$—	\$41,865
Mortgage-backed securities at fair value	—	322,473	—	322,473
Mortgage loans acquired for sale at fair value	—	1,283,795	—	1,283,795
Mortgage loans at fair value	—	455,394	2,100,394	2,555,788
Excess servicing spread purchased from PFSI	—	—	412,425	412,425
Derivative assets:				
Interest rate lock commitments	—	—	4,983	4,983
CRT Agreements	—	—	593	593
MBS put options	—	93	—	93
Forward purchase contracts	—	2,444	—	2,444
Forward sales contracts	—	2,604	—	2,604
Put options on interest rate futures	1,512	—	—	1,512
Call options on interest rate futures	1,156	—	—	1,156
Total derivative assets	2,668	5,141	5,576	13,385
Netting	—	—	—	(3,300)
Total derivative assets after netting	2,668	5,141	5,576	10,085
Mortgage servicing rights at fair value	—	—	66,584	66,584
	\$44,533	\$2,066,803	\$2,584,979	\$4,693,015
Liabilities:				
Asset-backed financing of the VIE at fair value	\$—	\$247,690	\$—	\$247,690
Derivative liabilities:				
Interest rate lock commitments	—	—	337	337
Put options on interest rate futures	39	—	—	39
Call options on interest rate futures	305	—	—	305
Forward purchase contracts	—	3,774	—	3,774
Forward sales contracts	—	2,680	—	2,680
Total derivative liabilities	344	6,454	337	7,135
Netting	—	—	—	(3,978)
Total derivative liabilities after netting	344	6,454	337	3,157
	\$344	\$254,144	\$337	\$250,847

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The following is a summary of changes in items measured using Level 3 inputs on a recurring basis:

	Quarter ended September 30, 2016						
	Mortgage loans at fair value (in thousands)	Excess servicing spread	Interest rate lock commitments (in thousands)	CRT Agreements (in thousands)	Mortgage servicing rights	Interest-only security payable	Total
Balance, June 30, 2016	\$1,608,906	\$294,551	\$ 16,757	\$ (199)	\$57,977	\$ (1,663)	\$1,976,329
Purchases and issuances	—	—	30,429	—	—	—	30,429
Repayments and sales	(29,921)	(16,342)	—	—	—	—	(46,263)
Capitalization of interest	23,068	4,827	—	—	—	—	27,895
ESS received pursuant to a recapture agreement with PFSI	—	1,438	—	—	—	—	1,438
Servicing received as proceeds from sales of mortgage loans	—	—	—	—	1,068	—	1,068
Proceeds from CRT Agreements	—	—	—	(6,206)	—	—	(6,206)
Changes in fair value included in income arising from: Changes in instrument- specific credit risk	9,699	—	—	—	—	—	9,699
Other factors	(13,099)	(4,107)	23,390	23,067	(3,202)	(36)	26,013
	(3,400)	(4,107)	23,390	23,067	(3,202)	(36)	35,712
Transfers of mortgage loans to REO and real estate held for investment	(39,276)	—	—	—	—	—	(39,276)
Transfers of interest rate lock commitments to mortgage loans acquired for sale	—	—	(55,248)	—	—	—	(55,248)
	\$1,559,377	\$280,367	\$ 15,328	\$ 16,662	\$55,843	\$ (1,699)	\$1,925,878

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Balance, September 30,
2016

Changes in fair value

recognized during the
period

relating to assets still
held

at September 30, 2016	\$ (820)	\$ (4,107)	\$ 15,328	\$ 16,662	\$ (3,202)	(36)	\$ 23,825
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(1) For the purpose of this table, the IRLC and CRT Agreement "Level 3" asset and liability positions are shown net.
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	Quarter ended September 30, 2015					
	Mortgage loans at fair value (in thousands)	Excess servicing spread	Interest rate lock commitments (1)	CRT Agreements (1)	Mortgage servicing rights	Total
Balance, June 30, 2015	\$2,246,944	\$359,102	\$ (267)	\$ —	\$ 57,343	\$2,663,122
Purchases and issuances	—	84,165	11,834	—	—	95,999
Repayments and sales	(57,022)	(24,717)	—	—	—	(81,739)
Capitalization of interest	14,849	8,026	—	—	—	22,875
ESS received pursuant to a recapture agreement with PFSI	—	2,268	—	—	—	2,268
Servicing received as proceeds from sales of mortgage loans	—	—	—	—	5,674	5,674
Changes in fair value included in income arising from: Changes in instrument- specific credit risk	9,255	—	—	—	—	9,255
Other factors	22,638	(10,272)	16,458	626	(5,266)	24,184
	31,893	(10,272)	16,458	626	(5,266)	33,439
Transfers of mortgage loans to REO	(76,205)	—	—	—	—	(76,205)
Transfers of interest rate lock commitments to mortgage loans acquired for sale	—	—	(19,218)	—	—	(19,218)
Balance, September 31, 2015	\$2,160,459	\$418,572	\$ 8,807	\$ 626	\$ 57,751	\$2,646,215
Changes in fair value recognized during the period relating to assets still held at September 30, 2015	\$32,971	\$(10,272)	\$ 8,807	\$ 626	\$(5,266)	\$26,866

(1)For the purpose of this table, the IRLC and CRT Agreement “Level 3” asset and liability positions are shown net.

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	Nine months ended September 30, 2016						
	Mortgage loans at fair value (in thousands)	Excess servicing spread	Interest rate lock commitments (in thousands)	CRT Agreements (in thousands)	Mortgage servicing rights	Interest-only security payable	Total
Balance, December 31, 2015	\$2,100,394	\$412,425	\$ 4,646	\$ 593	\$66,584	\$ —	\$2,584,642
Purchases and issuances	—	—	58,475	—	2,602	(2,136)	58,941
Repayments and sales	(449,647)	(113,668)	—	—	—	—	(563,315)
Capitalization of interest	62,783	17,555	—	—	—	—	80,338
ESS received pursuant to a recapture agreement with PFSI	—	5,039	—	—	—	—	5,039
Servicing received as proceeds from sales of mortgage loans	—	—	—	—	6,215	—	6,215
Proceeds from CRT Agreements	—	—	—	(12,601)	—	—	(12,601)
Changes in fair value included in income arising from:							
Changes in instrument-specific credit risk	29,480	—	—	—	—	—	29,480
Other factors	(31,948)	(40,984)	71,286	28,670	(19,558)	437	7,903
	(2,468)	(40,984)	71,286	28,670	(19,558)	437	37,383
Transfers of mortgage loans to REO and real estate held for investment	(151,685)	—	—	—	—	—	(151,685)
Transfers of interest rate lock commitments to mortgage	—	—	(119,079)	—	—	—	(119,079)

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loans acquired for sale								
Balance, September 30, 2016	\$ 1,559,377	\$ 280,367	\$ 15,328	\$ 16,662	\$ 55,843	\$ (1,699)	\$ 1,925,878	
Changes in fair value								
recognized during the period								
relating to assets still held								
at September 30, 2016	\$ (2,399)	\$ (33,774)	\$ 15,328	\$ 16,662	\$ (19,558)	\$ 437	\$ (23,304)	

(1) For the purpose of this table, the IRLC and CRT Agreement "Level 3" asset and liability positions are shown net.
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	Nine months ended September 30, 2015					
	Mortgage loans at fair value (in thousands)	Excess servicing spread	Interest rate lock commitments (1)	CRT Agreements (1)	Mortgage servicing rights	Total
Balance, December 31, 2014	\$2,199,583	\$191,166	\$ 5,661	\$ —	\$57,358	\$2,453,768
Purchases and issuances	241,981	271,452	42,917	—	—	556,350
Repayments and sales	(171,093)	(55,800)	—	—	—	(226,893)
Capitalization of interest	34,979	17,596	—	—	—	52,575
ESS received pursuant to a recapture agreement with PFSI	—	4,833	—	—	—	4,833
Servicing received as proceeds from sales of mortgage loans	—	—	—	—	9,169	9,169
Changes in fair value included in income arising from: Changes in instrument- specific credit risk	29,563	—	—	—	—	29,563
Other factors	49,584	(10,675)	(6,941)	626	(8,776)	23,818
	79,147	(10,675)	(6,941)	626	(8,776)	53,381
Transfers of mortgage loans to REO	(224,138)	—	—	—	—	(224,138)
Transfers of interest rate lock commitments to mortgage loans acquired for sale	—	—	(32,830)	—	—	(32,830)
Balance, September 30, 2015	\$2,160,459	\$418,572	\$ 8,807	\$ 626	\$57,751	\$2,646,215
Changes in fair value recognized during the period relating to assets still held at September 30, 2015	\$80,885	\$(10,675)	\$ 8,807	\$ 626	\$(8,776)	\$70,867

(1)For the purpose of this table, the IRLC and CRT Agreement “Level 3” asset and liability positions are shown net.

The information used in the preceding roll forwards represents activity for financial statement items measured at fair value on a recurring basis and identified as using “Level 3” significant fair value inputs at either the beginning or the end of the periods presented. The Company had transfers among the fair value levels arising from transfers of IRLCs to mortgage loans held for sale at fair value upon purchase of the respective mortgage loans.

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Following are the fair values and related principal amounts due upon maturity of mortgage loans accounted for under the fair value option (including mortgage loans acquired for sale, mortgage loans held in a consolidated VIE, and other mortgage loans at fair value):

	September 30, 2016			December 31, 2015		
	Principal			Principal		
	amount due			amount due		
	Fair value	upon maturity	Difference	Fair value	upon maturity	Difference
	(in thousands)					
Mortgage loans acquired for sale at fair value:						
Current through 89 days delinquent	\$2,042,569	\$1,950,907	\$91,662	\$1,283,275	\$1,235,433	\$47,842
90 or more days delinquent						
Not in foreclosure	631	665	(34)	304	333	(29)
In foreclosure	253	307	(54)	216	253	(37)
	884	972	(88)	520	586	(66)
	\$2,043,453	\$1,951,879	\$91,574	\$1,283,795	\$1,236,019	\$47,776
Mortgage loans at fair value:						
Mortgage loans held in a consolidated VIE:						
Current through 89 days delinquent	\$397,740	\$388,543	\$9,197	\$455,394	\$454,935	\$459
90 or more days delinquent						
Not in foreclosure	—	—	—	—	—	—
In foreclosure	—	—	—	—	—	—
	397,740	388,543	9,197	455,394	454,935	459
Other mortgage loans at fair value:						
Current through 89 days delinquent	705,618	939,853	(234,235)	877,438	1,134,560	(257,122)
90 or more days delinquent						
Not in foreclosure	334,850	463,405	(128,555)	459,060	640,343	(181,283)
In foreclosure	518,909	699,091	(180,182)	763,896	1,062,205	(298,309)
	853,759	1,162,496	(308,737)	1,222,956	1,702,548	(479,592)
	1,559,377	2,102,349	(542,972)	2,100,394	2,837,108	(736,714)
	\$1,957,117	\$2,490,892	\$(533,775)	\$2,555,788	\$3,292,043	\$(736,255)

Following are the changes in fair value included in current period income by consolidated statement of income line item for financial statement items accounted for under the fair value option:

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Quarter ended September 30, 2016

	Net gain on mortgage loans acquired for sale (in thousands)	Net interest income	Net gain on investments	Net mortgage loan servicing fees	Total
Assets:					
Short-term investments	\$—	\$—	\$ —	\$ —	\$—
Mortgage-backed securities at fair value	—	(1,193)	517	—	(676)
Mortgage loans acquired for sale at fair value	58,128	—	—	—	58,128
Mortgage loans at fair value	—	193	(3,936)	—	(3,743)
ESS at fair value	—	—	(4,107)	—	(4,107)
MSRs at fair value	—	—	—	(3,202)	(3,202)
	\$58,128	\$(1,000)	\$ (7,526)	\$(3,202)	\$46,400
Liabilities:					
Asset-backed financing of a VIE at fair value	\$—	\$(2,520)	\$ 2,990	\$ —	\$470
	\$—	\$(2,520)	\$ 2,990	\$ —	\$470

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	Quarter ended September 30, 2015				
	Net gain			Net	
	on	Net	Net gain	mortgage	
	mortgage	interest	on	loan	
	loans	income	investments	servicing	Total
	acquired	for sale	fees		
	(in thousands)				
Assets:					
Short-term investments	\$—	\$—	\$—	\$—	\$—
Mortgage-backed securities at fair value	—	91	3,564	—	3,655
Mortgage loans acquired for sale at fair value	39,504	—	—	—	39,504
Mortgage loans at fair value	—	1,024	39,273		