PennyMac Mortgage Investment Trust
Form 10-Q
August 08, 2017

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 June 30, 2017

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<br>(State or other jurisdiction of<br><br>incorporation or organization) | 27-0186273<br>(IRS Employer<br><br>Identification No.) |
| 3043 Townsgate Road, Westlake Village, California<br>(Address of principal executive offices) | 91361<br>(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 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | |
|---|---|---|
| Large accelerated filer | | Accelerated filer |
| Non-accelerated filer | (Do not check if a smaller reporting company) | Smaller reporting company |
| Emerging growth company | | |

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

Indicate by check mark whether the registrant 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 August 3, 2017 |
|---|---|
| Common Shares of Beneficial Interest, $0.01 par value | 66,842,495 |

PENNYMAC MORTGAGE INVESTMENT TRUST

FORM 10-Q

June 30, 2017

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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, 2016, filed with the Securities and Exchange Commission (“SEC”) on February 28, 2017.

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;
- the performance of mortgage loans underlying mortgage-backed securities ("MBS") in which we retain credit risk;
- our ability to foreclose on our investments in a timely manner or at all;
- increased prepayments of the mortgages and other loans underlying our 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;

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- 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, 2017 | December 31, 2016 |
|---|---|---|
| | (in thousands, except share information) | |
| ASSETS | | |
| Cash | $69,893 | $ 34,476 |
| Short-term investments | 77,366 | 122,088 |
| Mortgage-backed securities at fair value (includes $1,065,540 and $863,802 pledged to creditors, respectively) | 1,065,540 | 865,061 |
| Mortgage loans acquired for sale at fair value (includes $1,300,596 and $1,653,748 pledged to creditors, respectively) | 1,318,603 | 1,673,112 |
| Mortgage loans at fair value (includes $1,521,211 and $1,712,190 pledged to creditors, respectively) | 1,527,812 | 1,721,741 |
| Excess servicing spread purchased from PennyMac Financial Services, Inc. at fair value pledged to secure assets sold under agreements to repurchase to PennyMac Financial Services, Inc. | 261,796 | 288,669 |
| Derivative assets (includes $19,291 and $9,078 pledged to creditors, respectively) | 73,875 | 33,709 |
| Real estate acquired in settlement of loans (includes $108,353 and $215,713 pledged to creditors, respectively) | 207,034 | 274,069 |
| Real estate held for investment (includes $13,602 pledged to creditors at June 30, 2017) | 40,316 | 29,324 |
| Mortgage servicing rights (includes $77,624 and $64,136 at fair value; $723,896 and $656,567 pledged to creditors) | 734,800 | 656,567 |
| Servicing advances | 67,172 | 76,950 |
| Deposits securing credit risk transfer agreements (includes $410,512 and $414,610 pledged to creditors, respectively) | 503,108 | 450,059 |
| Due from PennyMac Financial Services, Inc. | 5,013 | 7,091 |
| Other | 57,916 | 124,586 |
| Total assets | $6,010,244 | $ 6,357,502 |
| LIABILITIES | | |
| Assets sold under agreements to repurchase | $3,497,999 | $ 3,784,001 |
| Mortgage loan participation and sale agreements | 38,345 | 25,917 |

| | | |
|---|---|---|
| Notes payable | 159,980 | 275,106 |
| Asset-backed financing of a variable interest entity at fair value | 329,459 | 353,898 |
| Exchangeable senior notes | 246,629 | 246,089 |
| Assets sold to PennyMac Financial Services, Inc. under agreement to repurchase | 150,000 | 150,000 |
| Interest-only security payable at fair value | 6,577 | 4,114 |
| Derivative liabilities | 8,856 | 9,573 |
| Accounts payable and accrued liabilities | 74,253 | 107,758 |
| Due to PennyMac Financial Services, Inc. | 17,725 | 16,416 |
| Income taxes payable | 14,892 | 18,166 |
| Liability for losses under representations and warranties | 10,697 | 15,350 |
| Total liabilities | 4,555,412 | 5,006,388 |
| | | |
| Commitments and contingencies — See Note 19 | | |
| | | |
| SHAREHOLDERS' EQUITY | | |
| 8.125% Series A fixed-to floating rate redeemable cumulative preferred shares of beneficial interest, $0.01 par value per share, 4,600,000 shares issued and outstanding, $115,000,000 aggregate liquidation preference | 46 | — |
| Common shares of beneficial interest—authorized, 500,000,000 common shares of $0.01 par value; issued and outstanding, 66,842,495 and 66,697,286 common shares, respectively | 668 | 667 |
| Additional paid-in capital | 1,489,116 | 1,377,171 |
| Accumulated deficit | (34,998) | (26,724) |
| Total shareholders' equity | 1,454,832 | 1,351,114 |
| Total liabilities and shareholders' equity | $6,010,244 | $6,357,502 |

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

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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, 2017 | December 31, 2016 |
|---|---|---|
| | (in thousands) | |
| ASSETS | | |
| Mortgage loans at fair value | $343,192 | $ 367,169 |
| Derivative assets | 52,716 | 15,610 |
| Deposits securing credit risk transfer agreements | 503,108 | 450,059 |
| Other—interest receivable | 972 | 1,058 |
| | $899,988 | $ 833,896 |
| LIABILITIES | | |
| Asset-backed financing at fair value | $329,459 | $ 353,898 |
| Interest-only security payable at fair value | 6,577 | 4,114 |
| Accounts payable and accrued liabilities—interest payable | 972 | 1,058 |
| | $337,008 | $ 359,070 |

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, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands, except per share amounts) | | | |
| Net investment income: | | | | |
| Net gain on mortgage loans acquired for sale: | | | | |
| From nonaffiliates | $14,088 | $22,095 | $30,252 | $35,582 |
| From PennyMac Financial Services, Inc. | 3,204 | 2,131 | 6,065 | 3,693 |
| | 17,292 | 24,226 | 36,317 | 39,275 |
| Mortgage loan origination fees | 10,467 | 8,519 | 18,757 | 15,420 |
| Net gain (loss) on investments: | | | | |
| From nonaffiliates | 33,477 | 337 | 51,568 | 14,066 |
| From PennyMac Financial Services, Inc. | (5,885 ) | (15,824) | (7,255 ) | (33,451 ) |
| | 27,592 | (15,487) | 44,313 | (19,385 ) |
| Net mortgage loan servicing fees: | | | | |
| From nonaffiliates | 15,463 | 15,380 | 26,923 | 30,804 |
| From PennyMac Financial Services, Inc. | 234 | 311 | 526 | 441 |
| | 15,697 | 15,691 | 27,449 | 31,245 |
| Interest income: | | | | |
| From nonaffiliates | 48,020 | 46,053 | 91,473 | 93,404 |
| From PennyMac Financial Services, Inc. | 4,366 | 5,713 | 9,013 | 12,728 |
| | 52,386 | 51,766 | 100,486 | 106,132 |
| Interest expense: | | | | |
| To nonaffiliates | 36,401 | 34,371 | 71,775 | 64,773 |
| To PennyMac Financial Services, Inc. | 2,025 | 2,222 | 3,830 | 3,824 |
| | 38,426 | 36,593 | 75,605 | 68,597 |
| Net interest income | 13,960 | 15,173 | 24,881 | 37,535 |
| Results of real estate acquired in settlement of loans | (3,465 ) | (2,565 ) | (7,711 ) | (8,601 ) |
| Other | 2,416 | 2,061 | 4,427 | 4,345 |
| Net investment income | 83,959 | 47,618 | 148,433 | 99,834 |
| Expenses | | | | |
| Earned by PennyMac Financial Services, Inc.: | | | | |
| Mortgage loan fulfillment fees | 21,107 | 19,111 | 37,677 | 32,046 |
| Mortgage loan servicing fees | 10,099 | 16,427 | 20,585 | 27,880 |
| Management fees | 5,638 | 5,199 | 10,646 | 10,551 |
| Professional services | 2,747 | 2,011 | 4,200 | 4,304 |
| Compensation | 1,959 | 2,224 | 3,851 | 3,513 |
| Mortgage loan collection and liquidation | 3,338 | 4,290 | 3,692 | 6,504 |
| Mortgage loan origination | 1,993 | 1,557 | 3,505 | 2,678 |
| Other | 5,252 | 4,958 | 9,844 | 9,473 |
| Total expenses | 52,133 | 55,777 | 94,000 | 96,949 |
| Income (loss) before benefit from income taxes | 31,826 | (8,159 ) | 54,433 | 2,885 |
| Provision for (benefit from) income taxes | 3,046 | (2,892 ) | (3,083 ) | (6,344 ) |

| | | | | |
|---|---|---|---|---|
| Net income (loss) | 28,780 | (5,267) | 57,516 | 9,229 |
| Dividends on preferred stock | 2,336 | — | 2,907 | — |
| Net income attributable to common shareholders | $26,444 | $(5,267) | $54,609 | $9,229 |
| Earnings (loss) per common share | | | | |
| Basic | $0.39 | $(0.08) | $0.81 | $0.12 |
| Diluted | $0.38 | $(0.08) | $0.78 | $0.12 |
| Weighted-average common shares outstanding | | | | |
| Basic | 66,761 | 68,446 | 66,740 | 70,165 |
| Diluted | 75,228 | 68,446 | 75,207 | 70,165 |
| Dividends declared per common share | $0.47 | $0.47 | $0.94 | $0.94 |

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)

| | Series A preferred shares Number of shares | Series A preferred shares Par value | Common shares Number of shares | Common shares Par value | Additional paid-in capital | Retained earnings (Accumulated deficit) | Total |
|---|---|---|---|---|---|---|---|
| | (in thousands, except per share amounts) | | | | | | |
| 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 |
| Balance at December 31, 2016 | — | $ — | 66,697 | $ 667 | $ 1,377,171 | $ (26,724) | $ 1,351,114 |
| Net income | — | — | — | — | — | 57,516 | 57,516 |
| Share-based compensation | — | — | 284 | 2 | 3,125 | — | 3,127 |
| Issuance of Series A preferred shares | 4,600 | 46 | — | — | 114,954 | — | 115,000 |
| Issuance costs relating to Series A preferred shares | — | — | — | — | (3,828) | — | (3,828) |
| Common share dividends, $0.94 per share | — | — | — | — | — | (63,298) | (63,298) |
| Series A preferred share dividends, $0.54 per share | — | — | — | — | — | (2,492) | (2,492) |
| Repurchase of common shares | — | — | (139) | (1) | (2,306) | — | (2,307) |
| Balance at June 30, 2017 | 4,600 | $ 46 | 66,842 | $ 668 | $ 1,489,116 | $ (34,998) | $ 1,454,832 |

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, 2017 | |
|---|---|---|
| | 2017 | 2016 |
| | (in thousands) | |
| Cash flows from operating activities | | |
| Net income | $57,516 | $9,229 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Net gain on mortgage loans acquired for sale | (36,317) | (39,275) |
| Net (gain) loss on investments | (44,313) | 19,385 |
| Change in fair value, amortization and impairment of mortgage servicing rights | 52,666 | 29,656 |
| 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 | 3,007 | (1,086) |
| Capitalization of interest on mortgage loans at fair value | (20,717) | (39,715) |
| Capitalization of interest on excess servicing spread | (9,013) | (12,728) |
| Amortization of debt issuance costs | 7,004 | 6,472 |
| Results of real estate acquired in settlement of loans | 7,711 | 8,601 |
| Share-based compensation expense | 3,127 | 3,013 |
| Purchase of mortgage loans acquired for sale at fair value from nonaffiliates | (31,573,356) | (25,461,808) |
| Purchase of mortgage loans acquired for sale at fair value from PennyMac Financial Services, Inc. | (40,222) | (8,139) |
| Repurchase of mortgage loans subject to representation and warranties | (6,079) | (6,654) |
| Sale and repayment of mortgage loans acquired for sale at fair value to nonaffiliates | 10,647,450 | 8,465,753 |
| Sale of mortgage loans acquired for sale to PennyMac Financial Services, Inc. | 21,244,194 | 16,790,189 |
| Decrease in servicing advances | 4,218 | 12,277 |
| Decrease (increase) in due from PennyMac Financial Services, Inc. | 1,800 | (2,688) |
| Decrease in other assets | 23,970 | 39,774 |
| (Decrease) increase in accounts payable and accrued liabilities | (33,496) | 14,084 |
| Increase in due to PennyMac Financial Services, Inc. | 1,309 | 2,032 |
| Decrease in income taxes payable | (3,274) | (6,731) |
| Net cash provided by (used in) operating activities | 287,185 | (178,359) |
| Cash flows from investing activities | | |
| Net decrease in short-term investments | 44,722 | 24,988 |
| Purchase of mortgage-backed securities at fair value | (251,872) | (249,925) |
| Sale and repayment of mortgage-backed securities at fair value | 52,753 | 49,141 |
| Sale and repayment of mortgage loans at fair value | 175,016 | 458,466 |
| Repayment of excess servicing spread by PennyMac Financial Services, Inc. | 28,910 | 38,281 |
| Sale of excess servicing spread to PennyMac Financial Services, Inc. | — | 59,045 |
| Net settlement of derivative financial instruments | 288 | (2,793) |

| | | |
|---|---|---|
| Sale of real estate acquired in settlement of loans | 101,609 | 135,573 |
| Purchase of mortgage servicing rights | (69) | (2,602) |
| Sale of mortgage servicing rights | — | 106 |
| Deposit of cash securing credit risk transfer agreements | (57,148) | (192,737) |
| Distribution from credit risk transfer agreements | 29,923 | 7,320 |
| Decrease (increase) in margin deposits and restricted cash | 5,132 | (16,769) |
| Purchase of Federal Home Loan Bank capital stock | — | (225) |
| Redemption of Federal Home Loan Bank capital stock | — | 7,320 |
| Net cash provided by investing activities | 129,264 | 315,189 |

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, 2017 | |
|---|---|---|
| | 2017 | 2016 |
| | (in thousands) | |
| Cash flows from financing activities | | |
| Sale of assets under agreements to repurchase | 37,885,967 | 27,426,511 |
| Repurchase of assets sold under agreements to repurchase | (38,171,465) | (27,279,985) |
| Issuance of mortgage loan participation certificates | 3,660,014 | 3,166,373 |
| Repayment of mortgage loan participation certificates | (3,647,460) | (3,070,038) |
| Federal Home Loan Bank advances | — | 28,000 |
| Repayment of Federal Home Loan Bank advances | — | (211,000) |
| Advance under notes payable | 20,000 | 69,282 |
| Repayment of notes payable | (135,000) | (141,386) |
| 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 | (28,934) | (30,479) |
| Payment of debt issuance costs | (7,220) | (5,512) |
| Issuance of preferred shares | 115,000 | — |
| Payment of issuance costs related to preferred shares | (3,828) | — |
| Payment of dividends to preferred shareholders | (2,492) | — |
| Repurchase of common shares | (2,307) | (82,834) |
| Payment of dividends to common shareholders | (63,307) | (67,664) |
| Net cash used in financing activities | (381,032) | (99,233) |
| Net increase in cash | 35,417 | 37,597 |
| Cash at beginning of period | 34,476 | 58,108 |
| Cash at end of period | $69,893 | $95,705 |

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 four segments: correspondent production, credit sensitive strategies, interest rate sensitive strategies and corporate:

- 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 credit sensitive strategies segment represents the Company's investments in distressed mortgage loans, real estate acquired in settlement of mortgage loans ("REO"), credit risk transfer agreements ("CRT Agreements"), non-Agency subordinated bonds and small balance commercial real estate mortgage loans.
- The interest rate sensitive strategies segment represents the Company's investments in mortgage servicing rights ("MSRs"), excess servicing spread ("ESS"), Agency and senior non-Agency MBS and the related interest rate hedging activities.
- The corporate segment includes certain interest income, management fee and corporate expense amounts.

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, 2016.

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 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.

Due to the nature of a substantial portion 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;
- 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 has been acquired by the Company in prior years from or through one or more subsidiaries of JPMorgan Chase & Co. and Citigroup Inc., as presented in the following summary:

| | June 30, 2017 | December 31, 2016 |
|---|---|---|
| | (in thousands) | |
| JPMorgan Chase & Co. | | |
| Mortgage loans at fair value | $437,101 | $ 505,167 |
| REO | 97,988 | 118,737 |
| | 535,089 | 623,904 |
| Citigroup Inc. | | |
| Mortgage loans at fair value | 476,517 | 519,698 |
| REO | 34,127 | 49,048 |
| | 510,644 | 568,746 |
| | $1,045,733 | $ 1,192,650 |
| Total carrying value of distressed mortgage loans at fair value and REO | $1,391,654 | $ 1,628,641 |

Note 3—Transactions with Related Parties

Operating Activities

Correspondent Production Activities

The Company is provided fulfillment and other services by PLS under a mortgage banking services agreement. The Company's mortgage banking services agreement provides for a fulfillment fee paid to PLS based on the type of mortgage loan that the Company acquires. The fulfillment fee is equal to a percentage of the unpaid principal balance of mortgage loans purchased by the Company. PLS has also agreed to provide such services exclusively for the Company's benefit, and PLS and its affiliates are prohibited from providing such services for any other party.

Before September 12, 2016, the applicable fulfillment fee percentages were (i) 0.50% for conventional mortgage loans, (ii) 0.88% for loans sold in accordance with the Ginnie Mae Mortgage-Backed Securities Guide, and (iii) 0.50% for all other mortgage loans not contemplated above; provided, however, that PLS was permitted, in its sole discretion, to reduce the amount of the applicable fulfillment fee and credit the amount of such reduction to any reimbursement that would have otherwise been due based on volumes tied to the aggregate unpaid principal balance of the mortgage loans purchased by the Company in the related month. This reduction was only credited to the reimbursement applicable to the month in which the related mortgage was funded.

Effective as of September 12, 2016, pursuant to the terms of an amended and restated mortgage banking services agreement the applicable fulfillment fee percentages are (i) 0.35% for mortgage loans sold or delivered to Fannie Mae or Freddie Mac, and (ii) 0.85% for all other mortgage loans; provided however, that no fulfillment fee shall be due or payable to PLS with respect to any mortgage loans underwritten to Ginnie Mae guidelines. The Company does not hold the Ginnie Mae approval required to issue securities guaranteed by Ginnie Mae MBS and act as a servicer. Accordingly, under the agreement, PLS currently purchases loans salable in accordance with the Ginnie Mae Mortgage-Backed Securities Guide “as is” and without recourse of any kind from the Company at cost less any administrative fees paid by the Correspondent to PMT plus accrued interest and a sourcing fee ranging from two to three and one-half basis points, generally based on the average number of calendar days loans are held by the Company prior to purchase by PLS. The discretionary reductions and volume reimbursements described above are no longer in effect.

In consideration for the mortgage banking services provided by PLS with respect to the Company’s acquisition of mortgage loans under PLS’s early purchase program, PLS is entitled to fees accruing (i) at a rate equal to $1,500 per annum per early purchase facility, and (ii) in the amount of $35 for each mortgage loan that the Company acquires.

The mortgage banking services agreement expires on September 12, 2020, subject to automatic renewal for additional 18-month periods, unless terminated earlier in accordance with the terms of the agreement.

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

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | | |
| Mortgage loans fulfillment fees earned by PLS | $21,107 | $19,111 | $37,677 | $32,046 |
| Unpaid principal balance (“UPB”) of mortgage loans fulfilled by PLS | $5,918,027 | $5,174,020 | $10,549,933 | $8,433,383 |
| Sourcing fees received from PLS included in Net gain on mortgage loans acquired for sale | $3,204 | $2,824 | $6,065 | $4,773 |
| UPB of mortgage loans sold to PLS | $10,641,243 | $9,409,399 | $20,215,960 | $15,905,121 |
| Purchases of mortgage loans acquired for sale at fair value from PLS | $18,692 | $3,424 | $40,222 | $8,139 |
| Tax service fee paid to PLS included in Other expense | $1,891 | $1,464 | $3,269 | $2,471 |
| Early purchase program fees paid to PLS included in Mortgage loan servicing fees | $1 | $1 | $6 | $2 |

| | June 30, 2017 | December 31, 2016 |
|---|---|---|
| | (in thousands) | |
| Mortgage loans included in Mortgage loans acquired for sale at fair value pending sale to PLS | $246,259 | $ 804,616 |

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Mortgage Loan Servicing Activities

The Company, through its Operating Partnership, has a mortgage loan servicing agreement with PLS. The servicing agreement provides for servicing fees earned by PLS that are based on a percentage of the mortgage loan's unpaid principal balance or fixed per loan monthly amounts based on the delinquency, bankruptcy and/or foreclosure status of the serviced mortgage loan or the REO. PLS is also entitled to market-based fees and charges including boarding and deboarding fees, liquidation and disposition, assumption, modification and origination fees and late charges relating to mortgage loans it services for the Company. The servicing agreement was amended and restated as of September 12, 2016; however, the fee structure was not amended in any material respect.

- The base servicing fees for distressed mortgage loans are calculated based on a monthly per-loan dollar amount, with the actual dollar amount for each mortgage loan based on the delinquency, bankruptcy and/or foreclosure status of such mortgage loan or the related underlying real estate. Presently, the base servicing fees for distressed mortgage loans range from $30 per month for current mortgage loans up to $100 per month for mortgage loans where the borrower has declared bankruptcy. PLS is also entitled to certain activity-based fees for distressed mortgage loans that are charged based on the achievement of certain events. These fees range from 0.50% for a streamline modification to 1.50% for a liquidation and $500 for a deed-in-lieu of foreclosure. PLS is not entitled to earn more than one liquidation fee, reperformance fee or modification fee in any 18-month period.
- The base servicing fee rate for REO is $75 per month. To the extent that the Company rents its REO under an REO rental program, the Company pays PLS an REO rental fee of $30 per month per REO, an REO property lease renewal fee of $100 per lease renewal, and a property management fee in an amount equal to PLS' cost if property management services and/or any related software costs are outsourced to a third-party property management firm or 9% of gross rental income if PLS provides property management services directly. PLS is also entitled to retain any tenant paid application fees and late rent fees and seek reimbursement for certain third party vendor fees.
- The base servicing fees for non-distressed mortgage loans subserviced by PLS on the Company's behalf are also calculated through a monthly per-loan dollar amount, with the actual dollar amount for each loan based on whether the mortgage loan is a fixed-rate or adjustable-rate loan. The base servicing fees for loans subserviced on the Company's behalf are $7.50 per month for fixed-rate loans and $8.50 per month for adjustable-rate mortgage loans.
- To the extent that these non-distressed mortgage loans become delinquent, PLS is entitled to an additional servicing fee per mortgage loan ranging from $10 to $55 per month and based on the delinquency, bankruptcy and foreclosure status of the mortgage loan or $75 per month if the underlying mortgaged property becomes REO. PLS is also entitled to customary ancillary income and certain market-based fees and charges, including boarding and deboarding fees, liquidation and disposition fees, assumption, modification and origination fees.
- PLS is required to provide a range of services and activities significantly greater in scope than the services provided in connection with a customary servicing arrangement because the Company does not have any employees or infrastructure. For these services, PLS received a supplemental fee of $25 per month for each distressed whole loan. PLS is entitled to reimbursement for all customary, good faith reasonable and necessary out-of-pocket expenses incurred in performance of its servicing obligations.
- PLS, on behalf of the Company, is entitled to retain any incentive payments made to it and to which it is entitled under the U.S. Department of Treasury's Home Affordable Modification Plan ("HAMP"); provided, however, that with respect to any such incentive payments paid to PLS under HAMP in connection with a mortgage loan modification for which the Company previously paid PLS a modification fee, PLS shall reimburse the Company an amount equal to the incentive payments.

The term of the servicing agreement, as amended, expires on September 12, 2020, subject to automatic renewal for additional 18-month periods, unless terminated earlier in accordance with the terms of the servicing agreement.

Pursuant to the terms of an MSR recapture agreement, if PLS refinances mortgage loans for which the Company previously held the MSRs, PLS is generally required to transfer and convey to one of the Company's wholly-owned subsidiaries without cost to the Company, the MSRs with respect to new mortgage loans originated in those refinancings (or, under certain circumstances, other mortgage loans) that have an aggregate unpaid principal balance that is not less than 30% of the aggregate unpaid principal balance of all the loans so originated. Where the fair value of the aggregate MSRs to be transferred for the applicable month is less than $200,000, PLS may, at its option, pay cash to the Company in an amount equal to such fair value instead of transferring such MSRs.

The MSR recapture agreement was amended and restated as of September 12, 2016; however, the fee structure was not amended in any material respect. The MSR recapture agreement expires, unless terminated earlier in accordance with the agreement, on September 12, 2020, subject to automatic renewal for additional 18-month periods.

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, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | | |
| Mortgage loans servicing fees: | | | | |
| Mortgage loans acquired for sale at fair value: | | | | |
| Base | $82 | $79 | $147 | $135 |
| Activity-based | 176 | 172 | 319 | 287 |
| | 258 | 251 | 466 | 422 |
| Mortgage loans at fair value: | | | | |
| Distressed mortgage loans | | | | |
| Base | 1,755 | 2,908 | 3,713 | 6,267 |
| Activity-based | 1,767 | 8,518 | 4,157 | 11,967 |
| | 3,522 | 11,426 | 7,870 | 18,234 |
| Mortgage loans held in VIE: | | | | |
| Base | 11 | 51 | 42 | 92 |
| Activity-based | — | — | — | — |
| | 11 | 51 | 42 | 92 |
| MSRs: | | | | |
| Base | 6,176 | 4,583 | 11,982 | 8,927 |
| Activity-based | 132 | 116 | 225 | 205 |
| | 6,308 | 4,699 | 12,207 | 9,132 |
| | $10,099 | $16,427 | $20,585 | $27,880 |
| MSR recapture income recognized included in Net mortgage loan servicing fees | $234 | $311 | $526 | $440 |
| Average investment in: | | | | |
| Mortgage loans acquired for sale at fair value | $1,274,817 | $1,422,945 | $1,174,417 | $1,170,720 |
| Mortgage loans at fair value: | | | | |
| Distressed mortgage loans | $1,199,786 | $1,791,429 | $1,264,752 | $1,925,605 |
| Mortgage loans held in a VIE | $352,589 | $437,542 | $356,271 | $446,013 |
| Average MSR portfolio | $61,414,348 | $45,647,524 | $59,710,787 | $44,531,795 |

Management Fees

Under a management agreement, the Company pays PCM management fees as follows:

- A base management fee that is calculated quarterly and is equal to the sum of (i) 1.5% per year of average shareholders' equity up to $2 billion, (ii) 1.375% per year of average shareholders' equity in excess of $2 billion and up to $5 billion, and (iii) 1.25% per year of average shareholders' equity in excess of $5 billion.
- A performance incentive fee that is calculated at a defined annualized percentage of the amount by which "net income," on a rolling four-quarter basis and before deducting the incentive fee, exceeds certain levels of return on "equity."

The performance incentive fee is calculated quarterly and is equal to: (a) 10% of the amount by which net income for the quarter exceeds (i) an 8% return on equity plus the high watermark, up to (ii) a 12% return on equity; plus (b) 15%

of the amount by which net income for the quarter exceeds (i) a 12% return on equity plus the high watermark, up to (ii) a 16% return on equity; plus (c) 20% of the amount by which net income for the quarter exceeds a 16% return on equity plus the high watermark.

For the purpose of determining the amount of the performance incentive fee:

"Net income" is defined as net income or loss computed in accordance with GAAP and certain other non-cash charges determined after discussions between PCM and PMT's independent trustees and after approval by a majority of PMT's independent trustees.

"Equity" is the weighted average of the issue price per common share of all of PMT's public offerings, multiplied by the weighted average number of common shares outstanding (including restricted share units) in the rolling four-quarter period.

The “high watermark” is the quarterly adjustment that reflects the amount by which the net income (stated as a percentage of return on equity) in that quarter exceeds or falls short of the lesser of 8% and the Fannie Mae MBS yield (the target yield) for such quarter. The “high watermark” starts at zero and is adjusted quarterly. If the net income is lower than the target yield, the high watermark is increased by the difference. If the net income is higher than the target yield, the high watermark is reduced by the difference. Each time a performance incentive fee is earned, the high watermark returns to zero. As a result, the threshold amounts required for PCM to earn a performance incentive fee are adjusted cumulatively based on the performance of PMT’s net income over (or under) the target yield, until the net income in excess of the target yield exceeds the then-current cumulative high watermark amount, and a performance incentive fee is earned.

The base management fee and the performance incentive fee are both payable quarterly in arrears. The performance incentive fee may be paid in cash or a combination of cash and PMT’s common shares (subject to a limit of no more than 50% paid in common shares), at the Company’s option.

The management agreement was amended and restated as of September 12, 2016; however, the fee structure was not amended in any material respect. 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, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | | |
| Base management | $5,334 | $5,199 | $10,342 | $10,551 |
| Performance incentive | 304 | — | 304 | — |
| | $5,638 | $5,199 | $10,646 | $10,551 |

In the event of termination of the management agreement between the Company and PFSI, PFSI may be entitled to a termination fee in certain circumstances. The termination fee is equal to three times the sum of (a) the average annual base management fee, and (b) the average annual performance incentive fee earned by PFSI, in each case during the 24-month period before termination.

Expense Reimbursement and Amounts Payable to and Receivable from PFSI

Under the management agreement, PCM is entitled to reimbursement of its organizational and operating expenses, including third-party expenses, incurred on the Company’s behalf, it being understood that PCM and its affiliates shall allocate a portion of their personnel’s time to provide certain legal, tax and investor relations services for the direct benefit of the Company. With respect to the allocation of PCM’s and its affiliates personnel, from and after September 12, 2016, PCM shall be reimbursed $120,000 per fiscal quarter, such amount to be reviewed annually and to not preclude reimbursement for any other services performed by PCM or its affiliates.

The Company is required to pay PCM and its affiliates a pro rata portion of rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses of PCM and its affiliates required for the Company’s and its subsidiaries’ operations. These expenses will be allocated based on the ratio of the Company’s and its subsidiaries’ proportion of gross assets compared to all remaining gross assets managed by PCM as calculated at each fiscal quarter end:

The Company reimbursed PCM and its affiliates for expenses:

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | | |
| Reimbursement of: | | | | |
| Common overhead incurred by PCM and its affiliates | $1,593 | $2,435 | $3,027 | $4,996 |
| Expenses incurred on the Company's behalf, net | 398 | (169 ) | 653 | (114 ) |
| | $1,991 | $2,266 | $3,680 | $4,882 |
| Payments and settlements during the year (1) | $16,070 | $28,952 | $40,463 | $56,613 |

(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

Amounts receivable from and payable to PFSI are summarized below:

| | June 30, 2017 | December 31, 2016 |
|---|---|---|
| | (in thousands) | |
| Receivable from PFSI: | | |
| MSR recapture receivable | $428 | $ 707 |
| Other | 4,585 | 6,384 |
| | $5,013 | $ 7,091 |
| Payable to PFSI: | | |
| Management fees | $5,638 | $ 5,081 |
| Mortgage loan servicing fees | 4,231 | 5,465 |
| Correspondent production fees | 2,495 | 2,371 |
| Allocated expenses and expenses paid by PFSI on PMT's behalf | 2,324 | 1,046 |
| Fulfillment fees | 2,022 | 1,300 |
| Conditional Reimbursement | 900 | 900 |
| Interest on Assets sold to PFSI under agreement to repurchase and Note payable to PFSI | 115 | 253 |
| | $17,725 | $ 16,416 |

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.

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

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | | |
| ESS: | | | | |
| Received pursuant to a recapture agreement | $1,380 | $1,690 | $2,953 | $3,601 |
| Repayments and sales | $14,278 | $17,400 | $28,910 | $97,326 |
| Interest income | $4,366 | $5,713 | $9,013 | $12,728 |

| | | | | |
|---|---|---|---|---|
| Net (loss) gain included in Net (loss) gain on investments: | | | | |
| Valuation changes | $(7,156 ) | $(17,428) | $(9,929 ) | $(36,877) |
| Recapture income | 1,271 | 1,604 | 2,674 | 3,426 |
| | $(5,885 ) | $(15,824) | $(7,255 ) | $(33,451) |

Financing Activities

PFSI held 75,000 of the Company’s common shares at both June 30, 2017 and December 31, 2016.

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Repurchase Agreement with PLS

On December 19, 2016, the Company, through a wholly-owned subsidiary, PennyMac Holdings, LLC (“PMH”), entered into a master repurchase agreement with PLS (the “PMH Repurchase Agreement”), pursuant to which PMH may borrow from PLS for the purpose of financing PMH’s participation certificates representing beneficial ownership in ESS. PLS then re-pledges such participation certificates to PNMAC GMSR ISSUER TRUST (the “Issuer Trust”) under a master repurchase agreement by and among PLS, the Issuer Trust and Private National Mortgage Acceptance Company, LLC, as guarantor (the “PC Repurchase Agreement”). The Issuer Trust was formed for the purpose of allowing PLS to finance MSRs and ESS relating to such MSRs (the “GNMA MSR Facility”).

In connection with the GNMA MSR Facility, PLS pledges and/or sells to the Issuer Trust participation certificates representing beneficial interests in MSRs and ESS pursuant to the terms of the PC Repurchase Agreement. In return, the Issuer Trust (a) has issued to PLS, pursuant to the terms of an indenture, the Series 2016-MSRVF1 Variable Funding Note, dated December 19, 2016, known as the “PNMAC GMSR ISSUER TRUST MSR Collateralized Notes, Series 2016-MSRVF1” (the “VFN”), and (b) may, from time to time pursuant to the terms of any supplemental indenture, issue to institutional investors additional term notes (“Term Notes”), in each case secured on a pari passu basis by the participation certificates relating to the MSRs and ESS. The maximum principal balance of the VFN is $1,000,000,000.

The principal amount paid by PLS for the participation certificates under the PMH Repurchase Agreement is based upon a percentage of the market value of the underlying ESS. Upon PMH’s repurchase of the participation certificates, PMH is required to repay PLS the principal amount relating thereto plus accrued interest (at a rate reflective of the current market and consistent with the weighted average note rate of the VFN and any outstanding Term Notes) to the date of such repurchase. PLS is then required to repay the Issuer Trust the corresponding amount under the PC Repurchase Agreement.

Note Payable to PLS

Before entering into the PMH Repurchase Agreement, PLS was a party to a repurchase agreement between it and Credit Suisse First Boston Mortgage Capital LLC (“CSFB”) (the “MSR Repo”), pursuant to which PLS financed Ginnie Mae MSRs and servicing advance receivables and pledged all of its rights and interests in any Ginnie Mae MSRs it owned to CSFB, and a separate acknowledgement agreement with respect thereto, by and among Ginnie Mae, CSFB and PLS. In connection with the MSR Repo, the Company was party to an underlying loan and security agreement with PLS, pursuant to which the Company was able to 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 was 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. Interest accrued 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 underlying LSA was terminated in connection with the execution of the PMH Agreement.

Conditional Reimbursement of Initial Public Offering (“IPO”) Underwriting Fees

In connection with its 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, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | | |
| Interest expense | $2,025 | $2,222 | $3,830 | $3,824 |
| Conditional Reimbursements paid to PCM | $— | $— | $— | $— |

| | June 30, 2017 | December 31, 2016 |
|---|---|---|
| | (in thousands) | |
| Assets sold to PFSI under agreement to repurchase | $150,000 | $ 150,000 |
| Conditional Reimbursement payable to PFSI included in | | |
| Accounts payable and accrued liabilities | $900 | $ 900 |

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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 June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands except per share amounts) | | | |
| Net income | $28,780 | $(5,267) | $57,516 | $9,229 |
| Preferred share dividends | (2,336) | — | (2,907) | — |
| Effect of participating securities—share-based compensation awards | (230) | (307) | (529) | (718) |
| Net income available to common shareholders | $26,214 | $(5,574) | $54,080 | $8,511 |
| | | | | |
| Net income available to common shareholders | $26,214 | $(5,574) | $54,080 | $8,511 |
| Interest on Exchangeable Notes, net of income taxes | 2,188 | — | 4,374 | — |
| Diluted net income attributable to common shareholders | $28,402 | $(5,574) | $58,454 | $8,511 |
| Weighted-average basic shares outstanding | 66,761 | 68,446 | 66,740 | 70,165 |
| Dilutive securities: | | | | |
| Shares issuable pursuant to exchange of the Exchangeable Notes | 8,467 | — | 8,467 | — |
| Diluted weighted-average number of shares outstanding | 75,228 | 68,446 | 75,207 | 70,165 |
| Basic earnings (loss) per share | $0.39 | $(0.08) | $0.81 | $0.12 |

| | | | | |
|---|---|---|---|---|
| Diluted earnings (loss) per share | $0.38 | $(0.08 ) | $0.78 | $0.12 |

Calculation of diluted earnings per share requires certain potentially dilutive shares to be excluded based on whether the inclusion of such shares in the diluted earnings per share calculation would be antidilutive. 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 June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | | |
| Shares issuable under share-based compensation awards | 776 | 766 | 793 | 766 |
| Shares issuable pursuant to exchange of the Exchangeable Notes | — | 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 distinguished 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 end of period:

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | | |
| Cash flows: | | | | |
| Proceeds from sales | $5,788,605 | $5,231,974 | $10,647,450 | $8,465,753 |
| Mortgage loan servicing fees received (1) | $39,705 | $29,179 | $76,986 | $56,755 |

(1) Net of guarantee fees

| | June 30, 2017 | December 31, 2016 |
|---|---|---|
| | (in thousands) | |
| UPB of mortgage loans outstanding | $62,751,484 | $56,303,664 |
| Delinquent mortgage loans: | | |
| 30-89 days delinquent | $281,790 | $262,467 |
| 90 or more days delinquent: | | |
| Not in foreclosure | $83,821 | $53,200 |
| In foreclosure | $20,194 | $25,180 |
| Bankruptcy | $42,173 | $36,357 |
| Custodial funds managed by the Company (1) | $972,911 | $736,398 |

(1) Custodial funds include borrower and investor custodial cash accounts relating to mortgage loans serviced under the servicing agreements and are not recorded on the Company’s consolidated balance sheets. The Company earns placement fees on certain of the custodial funds it manages on behalf of the mortgage loans’ investors, which are included in Interest income in the Company’s consolidated statements of operations.

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 (“Recourse Obligations”) as part of the retention of an interest-only ownership interest in such mortgage loans.  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. 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 ASC. The pledged cash represents the Company’s maximum contractual exposure to claims under its Recourse Obligations and is the sole source of settlement of losses under the CRT Agreements. Gains and losses on derivatives related to CRT Agreements are included in Net gain on investments in the consolidated statements of operations.

Following is a summary of the CRT Agreements:

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | | |
| UPB of mortgage loans sold under CRT Agreements | $3,760,825 | $3,162,746 | $5,595,121 | $5,084,744 |
| Deposits of cash securing CRT Agreements | $41,355 | $126,031 | $57,148 | $192,737 |
| Increase in commitments to fund Deposits securing CRT Agreements resulting from sale of mortgage loans under CRT Agreements | $98,722 | $— | $146,872 | $— |
| Interest earned on Deposits securing CRT Agreements | $855 | $235 | $1,264 | $375 |
| Gains recognized on CRT Agreements included in Net gain (loss) on investments | | | | |