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PennyMac Mortgage Investment Trust
Form 10-Q
August 07, 2018

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, 2018

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, 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	Smaller reporting company
(Do not check if a 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 6, 2018
Common Shares of Beneficial Interest, \$0.01 par value	60,950,754

PENNYMAC MORTGAGE INVESTMENT TRUST

FORM 10-Q

June 30, 2018

TABLE OF CONTENTS

	Page
<u>Special Note Regarding Forward-Looking Statements</u>	1
<u>PART I. FINANCIAL INFORMATION</u>	4
Item 1. <u>Financial Statements (Unaudited):</u>	4
<u>Consolidated Balance Sheets</u>	4
<u>Consolidated Statements of Operations</u>	6
<u>Consolidated Statements of Changes in Shareholders' Equity</u>	7
<u>Consolidated Statements of Cash Flows</u>	8
<u>Notes to Consolidated Financial Statements</u>	10
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	64
<u>Our Company</u>	64
<u>Results of Operations</u>	69
<u>Net Investment Income</u>	70
<u>Expenses</u>	85
<u>Balance Sheet Analysis</u>	88
<u>Asset Acquisitions</u>	89
<u>Investment Portfolio Composition</u>	90
<u>Cash Flows</u>	96
<u>Liquidity and Capital Resources</u>	97
<u>Off-Balance Sheet Arrangements and Aggregate Contractual Obligations</u>	99
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	101
Item 4. <u>Controls and Procedures</u>	103
<u>PART II. OTHER INFORMATION</u>	104
Item 1. <u>Legal Proceedings</u>	104
Item 1A. <u>Risk Factors</u>	104
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	104
Item 3. <u>Defaults Upon Senior Securities</u>	104
Item 4. <u>Mine Safety Disclosures</u>	104
Item 5. <u>Other Information</u>	104
Item 6. <u>Exhibits</u>	105

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, 2017, filed with the Securities and Exchange Commission (“SEC”) on March 1, 2018.

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;
- the occurrence of natural disasters or other events or circumstances that could impact our operations;
- 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;

1

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;

- 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;
- our failure to deal appropriately with issues that may give rise to reputational risk; 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, 2018	December 31, 2017
	(in thousands, except share information)	
ASSETS		
Cash	\$63,035	\$ 77,647
Short-term investments at fair value	39,484	18,398
Mortgage-backed securities at fair value pledged to creditors	1,698,322	989,461
Mortgage loans acquired for sale at fair value (includes \$1,753,825 and \$1,249,277 pledged to creditors, respectively)	1,790,518	1,269,515
Mortgage loans at fair value (includes \$701,047 and \$1,081,893 pledged to creditors, respectively)	749,445	1,089,473
Excess servicing spread purchased from PennyMac Financial Services, Inc. at fair value pledged to secure Assets sold to PennyMac Financial Services, Inc. under agreements to repurchase	229,470	236,534
Derivative assets (includes \$24,601 and \$26,058 pledged to creditors, respectively)	133,239	113,881
Firm commitment to purchase credit risk transfer security at fair value	4,426	—
Real estate acquired in settlement of loans (includes \$52,445 and \$124,532 pledged to creditors, respectively)	109,271	162,865
Real estate held for investment (includes \$25,158 and \$31,128 pledged to creditors, respectively)	46,431	44,224
Mortgage servicing rights (includes \$1,010,507 and \$91,459 at fair value; \$994,212 and \$831,892 pledged to creditors)	1,010,507	844,781
Servicing advances	53,340	77,158
Deposits securing credit risk transfer agreements (includes \$385,227 and \$400,778 pledged to creditors, respectively)	651,204	588,867
Due from PennyMac Financial Services, Inc.	4,010	4,154
Other	94,147	87,975
Total assets	\$6,676,849	\$ 5,604,933
LIABILITIES		
Assets sold under agreements to repurchase	\$3,780,204	\$ 3,180,886
Mortgage loan participation purchase and sale agreements	87,751	44,488
Notes payable	445,062	—
Exchangeable senior notes	247,759	247,186
Asset-backed financing of a variable interest entity at fair value	287,719	307,419

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Interest-only security payable at fair value	7,652	7,070
Assets sold to PennyMac Financial Services, Inc. under agreements to repurchase	138,582	144,128
Derivative liabilities	3,446	1,306
Accounts payable and accrued liabilities	58,612	64,751
Due to PennyMac Financial Services, Inc.	19,661	27,119
Income taxes payable	47,289	27,317
Liability for losses under representations and warranties	7,625	8,678
Total liabilities	5,131,362	4,060,348

Commitments and contingencies — Note 20

SHAREHOLDERS' EQUITY

Preferred shares of beneficial interest, \$0.01 par value per share, authorized 100,000,000 shares,

issued and outstanding 12,400,000 shares, liquidation preference \$310,000,000	299,707	299,707
Common shares of beneficial interest—authorized, 500,000,000 common shares of \$0.01 par value; issued and outstanding, 60,950,754 and 61,334,087 common shares, respectively	610	613
Additional paid-in capital	1,282,971	1,290,931
Accumulated deficit	(37,801)	(46,666)
Total shareholders' equity	1,545,487	1,544,585
Total liabilities and shareholders' equity	\$6,676,849	\$ 5,604,933

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

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

	June 30, 2018	December 31, 2017
	(in thousands)	
ASSETS		
Mortgage loans at fair value	\$301,972	\$ 321,040
Derivative assets	119,169	98,640
Deposits securing credit risk transfer agreements	651,204	588,867
Other—interest receivable	873	904
	\$1,073,218	\$ 1,009,451
LIABILITIES		
Asset-backed financing at fair value	\$287,719	\$ 307,419
Interest-only security payable at fair value	7,652	7,070
Accounts payable and accrued liabilities—interest payable	873	904
	\$296,244	\$ 315,393

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		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
	(in thousands, except per share amounts)			
Net investment income				
Net gain on mortgage loans acquired for sale:				
From nonaffiliates	\$6,251	\$14,088	\$11,237	\$30,252
From PennyMac Financial Services, Inc.	2,891	3,204	5,532	6,065
	9,142	17,292	16,769	36,317
Mortgage loan origination fees	8,850	10,467	15,887	18,757
Net gain (loss) on investments:				
From nonaffiliates	23,989	33,477	16,256	51,568
From PennyMac Financial Services, Inc.	1,520	(5,885)	9,271	(7,255)
	25,509	27,592	25,527	44,313
Net mortgage loan servicing fees:				
From nonaffiliates	27,174	15,463	82,734	26,923
From PennyMac Financial Services, Inc.	412	234	1,007	526
	27,586	15,697	83,741	27,449
Interest income:				
From nonaffiliates	48,434	48,020	85,480	91,473
From PennyMac Financial Services, Inc.	3,910	4,366	7,844	9,013
	52,344	52,386	93,324	100,486
Interest expense:				
To nonaffiliates	38,167	36,401	71,007	71,775
To PennyMac Financial Services, Inc.	1,898	2,025	3,874	3,830
	40,065	38,426	74,881	75,605
Net interest income	12,279	13,960	18,443	24,881
Results of real estate acquired in settlement of loans	(2,297)	(3,465)	(5,523)	(7,711)
Other	1,922	2,416	3,820	4,427
Net investment income	82,991	83,959	158,664	148,433
Expenses				
Earned by PennyMac Financial Services, Inc.:				
Mortgage loan fulfillment fees	14,559	21,107	26,503	37,677
Mortgage loan servicing fees	9,431	10,099	20,450	20,585
Management fees	5,728	5,638	11,424	10,646
Mortgage loan collection and liquidation	1,923	3,338	4,152	3,692
Professional services	1,757	2,747	3,076	4,200
Mortgage loan origination	1,572	1,993	1,844	3,505
Compensation	2,220	1,959	3,488	3,851
Real estate held for investment	1,301	1,353	2,739	2,441
Other	2,214	3,899	4,864	7,403
Total expenses	40,705	52,133	78,540	94,000
Income before provision for (benefit from) income taxes	42,286	31,826	80,124	54,433
Provision for (benefit from) income taxes	5,861	3,046	15,513	(3,083)
Net income	36,425	28,780	64,611	57,516

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Dividends on preferred shares	6,234	2,336	12,468	2,907
Net income attributable to common shareholders	\$30,191	\$26,444	\$52,143	\$54,609
Earnings per common share				
Basic	\$0.49	\$0.39	\$0.85	\$0.81
Diluted	\$0.47	\$0.38	\$0.82	\$0.78
Weighted-average common shares outstanding				
Basic	60,903	66,761	60,844	66,740
Diluted	69,370	75,228	69,311	75,207
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)

	Preferred shares		Common shares			Accumulated deficit	Total
	Number of shares	Amount	Number of shares	Par value	Additional paid-in capital		
	(in thousands, except per share amounts)						
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 preferred shares	4,600	115,000	—	—	—	—	115,000
Issuance costs relating to preferred shares	—	(3,828)	—	—	—	—	(3,828)
Dividends:							
Common shares (\$0.94 per share)	—	—	—	—	—	(63,298)	(63,298)
Preferred shares	—	—	—	—	—	(2,492)	(2,492)
Repurchase of common shares	—	—	(139)	(1)	(2,306)	—	(2,307)
Balance at June 30, 2017	4,600	\$111,172	66,842	\$668	\$1,377,990	\$ (34,998)	\$1,454,832
Balance at December 31, 2017	12,400	\$299,707	61,334	\$613	\$1,290,931	\$ (46,666)	\$1,544,585
Cumulative effect of a change in accounting							
principle - Adoption of fair value							
accounting for mortgage servicing rights	—	—	—	—	—	14,361	14,361
Balance at January 1, 2018	12,400	299,707	61,334	613	1,290,931	(32,305)	1,558,946
Net income	—	—	—	—	—	64,611	64,611
Share-based compensation	—	—	288	3	2,753	—	2,756
Dividends:							
Common shares (\$0.94 per share)	—	—	—	—	—	(57,635)	(57,635)
Preferred shares	—	—	—	—	—	(12,472)	(12,472)
Repurchase of common shares	—	—	(671)	(6)	(10,713)	—	(10,719)
Balance at June 30, 2018	12,400	\$299,707	60,951	\$610	\$1,282,971	\$ (37,801)	\$1,545,487

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,	
	2018	2017
	(in thousands)	
Cash flows from operating activities		
Net income	\$64,611	\$57,516
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Net gain on mortgage loans acquired for sale at fair value	(16,769)	(36,317)
Net gain on investments	(25,527)	(44,313)
Change in fair value, amortization and impairment of mortgage servicing rights	18,228	52,666
Accrual of interest on excess servicing spread purchased from PennyMac Financial Services, Inc.	(7,844)	(9,013)
Capitalization of interest and fees on mortgage loans at fair value	(4,246)	(20,717)
Amortization of debt issuance premiums and costs, net	(727)	7,004
Accrual of unearned discounts and amortization of premiums on mortgage-backed securities, mortgage loans at fair value, and asset-backed secured financing of a VIE	1,462	3,007
Results of real estate acquired in settlement of loans	5,523	7,711
Share-based compensation expense	2,756	3,127
Purchase of mortgage loans acquired for sale at fair value from nonaffiliates	(29,026,386)	(31,573,356)
Purchase of mortgage loans acquired for sale at fair value from PennyMac Financial Services, Inc.	(1,427,637)	(40,222)
Repurchase of mortgage loans subject to representation and warranties	(5,603)	(6,079)
Sale and repayment of mortgage loans acquired for sale at fair value to nonaffiliates	10,556,931	10,647,450
Sale of mortgage loans acquired for sale to PennyMac Financial Services, Inc.	19,267,316	21,244,194
Settlement of repurchase agreement derivative	2,495	—
Decrease in servicing advances	32,628	4,218
Decrease in due from PennyMac Financial Services, Inc.	14	1,800
(Increase) decrease in other assets	(29,848)	23,970
Decrease in accounts payable and accrued liabilities	(5,812)	(33,496)
(Decrease) increase in due to PennyMac Financial Services, Inc.	(7,458)	1,309
Increase (decrease) in income taxes payable	14,620	(3,274)
Net cash (used in) provided by operating activities	(591,273)	287,185
Cash flows from investing activities		
Net (increase) decrease in short-term investments	(21,086)	44,722
Purchase of mortgage-backed securities at fair value	(814,792)	(251,872)
Sale and repayment of mortgage-backed securities at fair value	73,279	52,753
Sale and repayment of mortgage loans at fair value	293,535	175,016
Repayment of excess servicing spread by PennyMac Financial Services, Inc.	24,309	28,910
Net settlement of derivative financial instruments	1,898	288
Sale of real estate acquired in settlement of loans	63,685	101,609
Purchase of mortgage servicing rights	—	(69)

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Deposits to credit risk transfer agreements	(77,888)	(57,148)
Distribution from credit risk transfer agreements	57,091		29,923	
(Increase) decrease in margin deposits	(9,524)	5,132	
Net cash (used in) provided by investing activities	(409,493)	129,264	

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

8

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six months ended June 30,	
	2018	2017
	(in thousands)	
Cash flows from financing activities		
Sale of assets under agreements to repurchase	37,309,146	37,885,967
Repurchase of assets sold under agreements to repurchase	(36,710,604)	(38,171,465)
Issuance of mortgage loan participation certificates	2,402,527	3,660,014
Repayment of mortgage loan participation certificates	(2,359,327)	(3,647,460)
Advance under notes payable	450,000	—
Repayment of asset-backed financing of a variable interest entity at fair value	(10,431)	(28,934)
Sale of assets sold to PennyMac Financial Services, Inc. under		
agreement to repurchase	2,293	20,000
Repurchase of assets sold to PennyMac Financial Services, Inc. under		
agreement to repurchase	(7,839)	(135,000)
Payment of debt issuance costs	(8,457)	(7,220)
Issuance of preferred shares	—	115,000
Payment of issuance costs related to preferred shares	—	(3,828)
Payment of dividends to preferred shareholders	(12,472)	(2,492)
Payment of dividends to common shareholders	(57,963)	(63,307)
Repurchase of common shares	(10,719)	(2,307)
Net cash provided by (used in) financing activities	986,154	(381,032)
Net (decrease) increase in cash and restricted cash	(14,612)	35,417
Cash and restricted cash at beginning of period	77,647	34,476
Cash and restricted cash at end of period	\$63,035	\$69,893
Cash and restricted cash end of period are comprised of the following:		
Cash	\$63,035	\$69,893
Restricted cash	—	—
	\$63,035	\$69,893

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

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 (“GSEs”) 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 credit risk transfer agreements (“CRT Agreements”), distressed mortgage loans, real estate acquired in settlement of mortgage loans (“REO”), real estate held for investment, 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 purchased from PFSI (“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 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 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.

Note 2—Basis of Presentation

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

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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, 2017 (the "Annual Report").

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 3—Accounting Developments

Accounting Changes

Mortgage Servicing Rights

Effective January 1, 2018, the Company has elected to change the accounting for the classes of MSR's it accounted for using the amortization method through December 31, 2017, to the fair value method as allowed in the Transfers and Servicing topic of the ASC. The Manager determined that a single accounting treatment across all MSR's is consistent with lender valuation under its financing arrangements and simplifies hedging activities. As the result of this change, the Company recorded an adjustment to increase its investment in MSR's by \$19.7 million, an increase in its liability for income taxes payable of \$5.3 million and an increase in shareholders' equity of \$14.4 million.

Revenue Recognition

As disclosed in Note 33 – Recently Issued Accounting Pronouncements to the consolidated financial statements included in the Annual Report the Manager has concluded that the Company's revenues are not subject to ASU 2014-09 as they are financial instruments or other contractual rights and obligations accounted for under the Receivables, Investments and Debt and Equity Securities, Transfers and Servicing, Financial Instruments and Derivatives and Hedging topics of the ASC.

Cash Flows

During the six months ended June 30, 2018, the Company adopted FASB Accounting Standards Update 2016-18, Statement of Cash Flows (Topic 230) – Restricted Cash (“ASU 2016-18”). ASU 2016-18 requires that a statement of cash flows explain the change during the reporting period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. Accordingly, the Company retrospectively changed the presentation of its statements of cash flows to conform to the requirements of ASU 2016-18. The adoption of ASU 2016-18 had no effect on previously reported statements of cash flows.

Recently Issued Accounting Pronouncement

On June 20, 2018, the FASB issued ASU 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting (“ASU 2018-07”). ASU 2018-07 is intended to reduce cost and complexity and improve financial reporting for nonemployee share-based payments.

ASU 2018-07 expands the scope of the Compensation—Stock Compensation topic of the ASC, which currently provides accounting guidance relating to share-based payments issued to employees, to include share-based payments issued to nonemployees for goods or services. Consequently, under ASU 2018-07, the accounting for share-based payments to nonemployees and employees will be substantially aligned.

The Company issues share-based compensation to certain employees of the Manager. Presently, the Company accounts for share-based payments to employees of the Manager under the guidance of Equity – Equity-Based Payments to Non-Employees topic of the ASC. Under that topic, the measure of cost relating to such grants is established based on the fair value of the shares upon vesting of the share-based awards. Accordingly, the Manager's estimate of compensation costs, and by extension periodic expense amounts, fluctuates with movements in the Company's stock price during the period that expense relating to the grants is being recognized. This guidance is being replaced by ASU 2018-07. As a result of the adoption of ASU 2018-07, the cost of share-based grants made to employees of the Manager will be fixed at the date of the grant for restricted share units issued to employees of the

Manager and variable to the extent of changes in performance attainment expectations for performance share units issued to all grantees.

The amendments in this ASU are effective for the Company for the fiscal year ending December 31, 2019, including interim periods within that fiscal year. Upon adoption, the Company will record a cumulative effect adjustment to its accumulated deficit to reflect a change in accumulated compensation cost relating to nonvested restricted share units granted to employees of the Manager from an amount based on the then-current share price to an amount based on the grant date per unit fair value. The actual amount of the cumulative effect adjustment to its accumulated deficit the Company will recognize will be based primarily on the fair value of PMT's common shares of beneficial interest as of December 31, 2018. However, the Manager does not expect the adjustment will be material to the Company.

Note 4—Concentration of Risks

As discussed in Note 1 — Organization above, PMT’s operations and investing activities are centered in residential mortgage-related assets, including distressed mortgage loans and CRT Agreements.

Distressed Mortgage Loans

Due to the nature of the Company’s investments in distressed mortgage loans, PMT is exposed, to a greater extent than traditional mortgage investors, to the risks associated with loan performance and 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 fair values in the markets where the properties securing the Company’s distressed mortgage loans are located;
- PFCM’s ability to identify and PLS’ ability to execute optimal resolutions of distressed 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 distressed 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.

Most 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., Citigroup Inc., and Bank of America Corporation, as presented in the following summary:

	June 30, 2018	December 31, 2017
	(in thousands)	
JPMorgan Chase & Co.		
Mortgage loans at fair value	\$173,985	\$ 315,437
REO	50,702	66,294
	224,687	381,731
Citigroup Inc.		
Mortgage loans at fair value	175,382	280,488
REO	13,806	26,702
	189,188	307,190
Bank of America Corporation		
Mortgage loans at fair value	82,264	143,969
REO	18,503	27,970
	100,767	171,939
	\$514,642	\$ 860,860
Total carrying value of distressed mortgage loans at fair value and REO	\$556,744	\$ 931,298

CRT Agreements

As detailed in Note 6 — Loan Sales and Variable Interest Entities, the Company invests in CRT Agreements whereby it sells pools of recently-originated mortgage loans into Fannie Mae-guaranteed securitizations while retaining a portion of the credit risk underlying such mortgage loans (“Recourse Obligations”) either as part of the retention of an interest-only (“IO”) ownership interest in such mortgage loans or by entering into firm commitments to purchase credit risk transfer securities.

The Company’s retention of credit risk subjects it to risks associated with delinquency and foreclosure similar to the risks associated with owning the underlying mortgage loans, and exposes the Company to risk of loss greater than the risks associated with selling the mortgage loans to Fannie Mae without the retention of such credit risk. Further, under agreements that include Recourse

Obligations, the risks associated with delinquency and foreclosure may in some instances be greater than the risks associated with owning the underlying mortgage loans because the structure of certain of the CRT Agreements provides that the Company may be required to realize losses in the event of delinquency or foreclosure even where there is ultimately no loss realized with respect to the underlying loan (e.g., as a result of a borrower's re-performance). In addition to the risks specific to credit, the Company is exposed to market risk and, as a result of prevailing market conditions or the economy generally, may be required to recognize losses associated with adverse changes to the fair value of the CRT Agreements, the firm commitment to purchase credit risk transfer securities and of the credit risk transfer securities.

Note 5—Transactions with Related Parties

Operating Activities

Correspondent Production Activities

The Company is provided fulfillment and other services by PLS under an amended and restated mortgage banking services agreement.

Pursuant to the terms of the agreement, the monthly fulfillment fee is an amount that shall equal (a) no greater than the product of (i) 0.35% and (ii) the aggregate initial unpaid principal balance (the "Initial UPB") of all mortgage loans purchased in such month, plus (b) in the case of all mortgage loans other than mortgage loans sold to or securitized through Fannie Mae or Freddie Mac, no greater than the product of (i) 0.50% and (ii) the aggregate Initial UPB of all such mortgage loans sold and securitized in such month; provided however, that no fulfillment fee shall be due or payable to PLS with respect to any mortgage loans underwritten to the Ginnie Mae MBS Guide.

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 saleable in accordance with the Ginnie Mae MBS Guide "as is" and without recourse of any kind from the Company at cost less any administrative fees paid by the correspondent to the Company 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.

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 administered by PLS, 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.

The Company purchases newly originated loans from PLS under a mortgage loan participation purchase and sale agreement and a flow commercial mortgage loan purchase agreement. Historically, the Company has used the mortgage loan participation purchase and sale agreement for the purpose of purchasing from PLS prime jumbo residential mortgage loans. Beginning in the quarter ended September 30, 2017, the Company also purchases non-government insured or guaranteed mortgage loans from PLS under the mortgage loan participation purchase and sale agreement. The Company uses the flow commercial mortgage loan purchase agreement for the purpose of purchasing from PLS small balance commercial mortgage loans, including multifamily mortgage loans, originated as part of PLS's commercial lending activities.

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

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Mortgage loans fulfillment fees earned by PLS	\$14,559	\$21,107	\$26,503	\$37,677
Unpaid principal balance ("UPB") of mortgage loans				
fulfilled by PLS	\$5,396,370	\$5,918,027	\$9,622,001	\$10,549,933
Sourcing fees received from PLS included in				
Net gain on mortgage loans acquired for sale	\$2,891	\$3,204	\$5,532	\$6,065
UPB of mortgage loans sold to PLS	\$9,639,495	\$10,641,243	\$18,487,368	\$20,215,960
Early purchase program fees paid to PLS included				
in Mortgage loan servicing fees	\$—	\$1	\$—	\$6
Purchases of mortgage loans acquired for sale from				
PLS	\$646,311	\$18,692	\$1,427,637	\$40,222
Tax service fee paid to PLS included in Other expense	\$1,542	\$1,891	\$2,750	\$3,269

	June 30,	December 31,
	2018	2017
	(in thousands)	
Mortgage loans included in Mortgage loans acquired for sale at fair value pending sale to PLS	\$162,856	\$279,571

Mortgage Loan Servicing Activities

The Company, through its Operating Partnership, has an amended and restated mortgage loan servicing agreement with PLS dated as of September 12, 2016. 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 a percentage of late charges relating to mortgage loans it services for the Company.

• The base servicing fee rates for distressed whole mortgage loans range from \$30 per month for current loans up to \$100 per month for loans where the borrower has declared bankruptcy. 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.

Except as otherwise provided in the MSR recapture agreement, when PLS effects a refinancing of a mortgage loan on behalf of the Company and not through a third-party lender and the resulting mortgage loan is readily saleable, or PLS originates a loan to facilitate the disposition of an REO, PLS is entitled to receive from the Company market-based fees and compensation consistent with pricing and terms PLS offers unaffiliated parties on a retail basis.

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 has limited employees and 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 the 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.

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PLS is also entitled to certain activity-based fees for distressed whole mortgage loans that are charged based on the achievement of certain events. These fees range from \$750 for a streamline modification to \$1,750 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 per mortgage loan in any 18-month period.

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.

The term of the servicing 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 servicing agreement.

Pursuant to the terms of an amended and restated 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 cash in an amount equal to 30% of the fair market value of the MSRs related to all the loans so originated. 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,	
	2018	2017	2018	2017
	(in thousands)			
Mortgage loans servicing fees:				
Mortgage loans acquired for sale at fair value:				
Base	\$96	\$82	\$152	\$147
Activity-based	149	176	271	319
	245	258	423	466
Mortgage loans at fair value:				
Distressed mortgage loans:				
Base	709	1,755	1,714	3,713
Activity-based	463	1,767	2,543	4,157
	1,172	3,522	4,257	7,870
Mortgage loans held in VIE:				
Base	34	11	68	42
Activity-based	—	—	—	—
	34	11	68	42
MSRs:				
Base	7,866	6,176	15,481	11,982
Activity-based	114	132	221	225
	7,980	6,308	15,702	12,207

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	\$9,431	\$10,099	\$20,450	\$20,585
Average investment in:				
Mortgage loans acquired for sale at fair value	\$1,495,921	\$1,274,817	\$1,271,110	\$1,174,417
Mortgage loans at fair value:				
Distressed mortgage loans	\$459,937	\$1,199,786	\$598,200	\$1,264,752
Mortgage loans held in a VIE	\$306,672	\$352,589	\$310,638	\$356,271
Average MSR portfolio	\$76,806,051	\$61,414,348	\$75,246,468	\$59,710,787
MSR recapture income recognized included in Net				
mortgage loan servicing fees from PennyMac				
Financial Services, Inc.	\$412	\$234	\$1,007	\$526

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 quarterly 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 equal to the sum of: (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 attributable to common shares of beneficial interest computed in accordance with GAAP and certain other non-cash charges determined after discussions between PCM and the Company's independent trustees and after approval by a majority of the Company's independent trustees.

"Equity" is the weighted average of the issue price per common share of all of the Company'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 average Fannie Mae 30-year MBS yield (the target yield) for the four quarters then ended. 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 the Company's common shares (subject to a limit of no more than 50% paid in common shares), at the Company's option.

The management 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. In the event of termination of the management agreement between the Company and PCM, PCM 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 PCM, in each case during the 24-month period immediately preceding the date of termination.

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

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	Quarter ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
	(in thousands)			
Base management	\$5,728	\$5,334	\$11,424	\$10,342
Performance incentive	—	304	—	304
	\$5,728	\$5,638	\$11,424	\$10,646

In the event of termination of the management agreement between the Company and PCM, PCM 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 PCM, in each case during the 24-month period before termination.

Expense Reimbursement and Amounts Payable to and Receivable from PCM

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 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 are 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.

Following is a summary of the Company’s reimbursements to PCM and its affiliates for expenses:

	Quarter ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
	(in thousands)			
Reimbursement of:				
Common overhead incurred by PCM and				
its affiliates	\$1,176	\$1,593	\$2,177	\$3,027
Compensation	120	—	240	—
Expenses incurred on the Company’s behalf, net	(514)	398	59	653
	\$782	\$1,991	\$2,476	\$3,680
Payments and settlements during the period (1)	\$15,957	\$16,070	\$23,615	\$40,463

(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.
Investing Activities

Spread Acquisition and MSR Servicing Agreements

On December 19, 2016, the Company, through a wholly-owned subsidiary, PennyMac Holdings, LLC (“PMH”), amended and restated a master spread acquisition and MSR servicing agreement with PLS (the “Spread Acquisition Agreement”), pursuant to which the Company may purchase from PLS, from time to time, the right to receive participation certificates representing beneficial ownership in ESS arising from Ginnie Mae MSRs acquired by PLS, in which case PLS generally would be required to service or subservice the related mortgage loans for Ginnie Mae. The primary purpose of the amendment and restatement was to facilitate the continued financing of the ESS owned by the Company in connection with the parties’ participation in the GNMA MSR Facility (as defined below).

To the extent PLS refinances any of the mortgage loans relating to the ESS the Company has acquired, the Spread Acquisition Agreement also contains recapture provisions requiring that PLS transfer to the Company, at no cost, the

ESS relating to a certain percentage of the unpaid principal balance of the newly originated mortgage loans. However, under the Spread Acquisition Agreement, in any month where the transferred ESS relating to newly originated Ginnie Mae mortgage loans is not equivalent to at least 90% of the product of the excess servicing fee rate and the unpaid principal balance of the refinanced mortgage loans, PLS is also required to transfer additional ESS or cash in the amount of such shortfall. Similarly, in any month where the transferred ESS relating to modified Ginnie Mae mortgage loans is not equivalent to at least 90% of the product of the excess servicing fee rate and the unpaid principal balance of the modified mortgage loans, the Spread Acquisition Agreement contains provisions that require PLS to transfer additional ESS or cash in the amount of such shortfall. To the extent the fair market value of the aggregate ESS to be transferred for the applicable month is less than \$200,000, PLS may, at its option, settle its recapture liability to the Company in cash in an amount equal to such fair market value in lieu of transferring such ESS.

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

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
ESS:				
Received pursuant to a recapture agreement	\$580	\$1,380	\$1,484	\$2,953
Repayments	\$12,018	\$14,278	\$24,309	\$28,910
Interest income	\$3,910	\$4,366	\$7,844	\$9,013
Net gain (loss) included in Net gain (loss) on investments:				
Valuation changes	\$996	\$(7,156)	\$7,917	\$(9,929)
Recapture income	524	1,271	1,354	2,674
	\$1,520	\$(5,885)	\$9,271	\$(7,255)

Financing Activities

PFSI held 75,000 of the Company's common shares at both June 30, 2018 and December 31, 2017.

Repurchase Agreement with PLS

On December 19, 2016, the Company, through 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 acquired from PLS under the Spread Acquisition Agreement. PLS then re-pledges such participation certificates to PNMAR 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 MSR and ESS relating to such MSR (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 MSR 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 "PNMAR 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 MSR and ESS. The maximum principal balance of the VFN is \$1 billion.

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.

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

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connection with its IPO, the Company agreed to pay the IPO underwriters up to \$5.9 million in contingent underwriting fees. There were no reimbursements during the quarter and six months ended June 30, 2018 and 2017.

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

	Quarter ended		Six months	
	June 30,		ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Interest expense	\$ 1,898	\$ 2,025	\$ 3,874	\$ 3,830

18

	June 30, 2018	December 31, 2017
	(in thousands)	
Assets sold to PFSI under agreement to repurchase	\$138,582	\$ 144,128
Conditional Reimbursement payable to PFSI included in Accounts payable and accrued liabilities	\$870	\$ 870
Amounts Receivable from and Payable to PFSI		

Amounts receivable from and payable to PFSI are summarized below:

	June 30, 2018	December 31, 2017
	(in thousands)	
Due from PFSI:		
MSR recapture receivable	\$153	\$ 282
Other	3,857	3,872
	\$4,010	\$ 4,154
Due to PFSI:		
Management fees	\$5,728	\$ 5,901
Fulfillment fees	4,696	346
Allocated expenses and expenses paid by PFSI on PMT's behalf	3,496	11,542
Mortgage loan servicing fees	3,110	6,583
Correspondent production fees	1,633	1,735
Conditional Reimbursement	870	870
Interest on Assets sold to PFSI under agreement to repurchase	128	142
	\$19,661	\$ 27,119

Note 6—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 and credit risk investment. 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:

Quarter ended June 30,		Six months ended June 30,	
2018	2017	2018	2017

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(in thousands)

Cash flows:				
Proceeds from sales	\$5,356,347	\$5,788,605	\$10,556,931	\$10,647,450
Mortgage loan servicing fees received (1)	\$48,667	\$39,705	\$97,399	\$76,986

(1) Net of guarantee fees

19

The following table summarizes collection status information for mortgage loans that are accounted for as sales for the dates presented:

	June 30, 2018	December 31, 2017
	(in thousands)	
UPB of mortgage loans outstanding	\$77,887,674	\$71,639,351
UPB of delinquent mortgage loans:		
30-89 days delinquent	\$390,763	\$532,673
90 or more days delinquent:		
Not in foreclosure	\$202,127	\$280,786
In foreclosure	\$30,995	\$25,258
UPB of mortgage loans in bankruptcy	\$65,072	\$52,202
Custodial funds managed by the Company (1)	\$1,182,119	\$879,321

(1) Custodial funds include borrower and investor custodial cash accounts relating to mortgage loans serviced under the servicing agreements and are not included 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 income.

Consolidated VIEs

Credit Risk Transfer Transactions

The Company has entered into mortgage loan sales arrangements pursuant to which it accepts credit risk relating to certain of its mortgage loan sales. These arrangements include CRT Agreements and sales of mortgage loans that include commitments to purchase credit risk transfer securities that absorb credit losses on such mortgage loans.

The Company, through 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 the Recourse Obligations as part of the retention of an interest-only ownership interest in such mortgage loans. Transfers of mortgage loans subject to CRT Agreements received sale accounting treatment. The Deposits securing CRT Agreements represent 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 (loss) on investments in the consolidated statements of income. The final sales of mortgage loans subject to the CRT Agreements were made during the quarter ended June 30, 2018.

Following is a summary of the CRT Agreements:

Quarter ended June 30,

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			Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
UPB of mortgage loans sold under CRT Agreements	\$2,336,499	\$3,760,825	\$5,546,977	\$5,595,121
Deposits securing CRT Agreements	\$36,099	\$41,355	\$77,888	\$57,148
Increase in commitments to fund Deposits securing CRT Agreements resulting from sale of mortgage loans under CRT Agreements	\$44,109	\$98,722	\$114,595	\$146,872
Interest earned on Deposits securing CRT Agreements	\$3,566	\$855	\$5,598	\$1,264
Gains recognized on CRT Agreements included in Net gain (loss) on investments				
Realized	\$22,211	\$11,361	\$41,540	\$21,650
Resulting from valuation changes	15,174	27,087	20,529	37,106
	37,385	38,448	62,069	58,756
Change in fair value of Interest-only security payable at fair value	1,111	(5,595)	(1,022)	(7,316)
	\$38,496	\$32,853	\$61,047	\$51,440
Payments made to settle losses	\$181	\$262	\$1,009	\$411

20

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	June 30, 2018	December 31, 2017
	(in thousands)	
UPB of mortgage loans subject to credit guarantee obligations	\$31,396,471	\$26,845,392
Collection status (in UPB):		
Current	\$31,163,422	\$26,540,953
30—89 days delinquent	\$142,504	\$179,144
90—180 days delinquent	\$35,663	\$101,114
180 or more days delinquent	\$28,140	\$5,146
Foreclosure	\$6,804	\$5,463
Bankruptcy	\$19,938	\$13,572
Carrying value of CRT Agreements:		
Derivative assets	\$119,169	\$98,640
Deposits securing CRT agreements	\$651,204	\$588,867
Interest-only security payable at fair value	\$7,652	\$7,070
CRT Agreement assets pledged to secure Assets sold under agreements to repurchase:		
Deposits securing CRT Agreements	\$385,227	\$400,778
Derivative assets	\$24,601	\$26,058
Commitments to fund Deposits securing credit risk transfer agreements	\$597,066	\$482,471

Effective in June 2018, the Company began selling mortgage loans subject to agreements that require the Company to purchase securities that absorb credit losses on such mortgage loans. The Company has elected to account for the firm commitments to purchase such securities at fair value. The Company recognizes these purchase commitments initially as a component of Gain on sale of mortgage loans; subsequent changes in fair value are recognized in Net gain (loss) on investments.

Following is a summary of activity under these purchase commitments during the quarter and six months ended June 30, 2018:

	Periods ended June 30, 2018	
	Quarter	Six months
	(in thousands)	
UPB of mortgage loans sold	\$1,535,372	\$1,535,372
UPB of firm commitment to purchase securities backed by mortgage loans sold	\$57,823	\$57,823
Fair value of firm commitment recognized in Gain on sale of mortgage loans	\$4,426	\$4,426

June 30,
2018

	(in thousands)
UPB of mortgage loans subject to credit guarantee obligations	\$1,535,372
Delinquency status (in UPB):	
Current	\$1,535,372
30—89 days delinquent	\$—
90—180 days delinquent	\$—
180 or more days delinquent	\$—
Foreclosure	\$—
Bankruptcy	\$—

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 fair value of the certificates retained by the Company was \$14.3 million as of June 30, 2018. The Company includes the balance of certificates issued to nonaffiliates in Asset backed financing of a variable interest entity at fair value.

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 assets and liabilities, 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 and 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 and liabilities and to their fair values. Likewise, due to the general illiquidity of some of these assets and 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, firm commitment to purchase credit risk transfer securities and MSR 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. Before January 1, 2018, originated MSRs backed by mortgage loans with initial interest rates of less than or equal to 4.5% were accounted for using the amortization method. Beginning January 1, 2018, the Company elected to account for all MSRs at fair value prospectively. The Manager determined that this change makes the accounting treatment for MSRs consistent with lender valuation under financing arrangements and simplifies hedging activities.

The Manager has also identified the Company's asset-backed financing of a VIE and interest only security payable at fair value 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 the assets 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 facility, 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:

	June 30, 2018			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	\$39,484	\$—	\$—	\$39,484
Mortgage-backed securities at fair value	—	1,698,322	—	1,698,322
Mortgage loans acquired for sale at fair value	—	1,783,978	6,540	1,790,518
Mortgage loans at fair value	—	301,972	447,473	749,445
Excess servicing spread purchased from PFSI	—	—	229,470	229,470
Firm commitment to purchase credit risk transfer security at fair value	—	—	4,426	4,426
Derivative assets:				
Interest rate lock commitments	—	—	3,561	3,561
CRT Agreements	—	—	119,169	119,169
Repurchase agreement derivatives	—	—	6,912	6,912
Forward purchase contracts	—	5,768	—	5,768
Forward sale contracts	—	696	—	696
MBS put options	—	143	—	143
Call options on interest rate futures	242	—	—	242
Put options on interest rate futures	199	—	—	199
Total derivative assets before netting	441	6,607	129,642	136,690
Netting	—	—	—	(3,451)
Total derivative assets after netting	441	6,607	129,642	133,239
Mortgage servicing rights at fair value	—	—	1,010,507	1,010,507
	\$39,925	\$3,790,879	\$1,828,058	\$5,655,411
Liabilities:				
Asset-backed financing of a VIE at fair value	\$—	\$287,719	\$—	\$287,719
Interest-only security payable at fair value	—	—	7,652	7,652
Derivative liabilities:				
Interest rate lock commitments	—	—	754	754
Forward purchase contracts	—	228	—	228
Forward sales contracts	—	7,733	—	7,733
Total derivative liabilities before netting	—	7,961	754	8,715
Netting	—	—	—	(5,269)
Total derivative liabilities after netting	—	7,961	754	3,446
	\$—	\$295,680	\$8,406	\$298,817

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	December 31, 2017			Total
	Level 1	Level 2	Level 3	
	(in thousands)			
Assets:				
Short-term investments	\$18,398	\$—	\$ —	\$18,398
Mortgage-backed securities at fair value	—	989,461	—	989,461
Mortgage loans acquired for sale at fair value	—	1,261,380		