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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

Or

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

For the transition period from _____ to _____

Commission file number: 001-34416

PennyMac Mortgage Investment Trust

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of

incorporation or organization)

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

27-0186273
(IRS Employer

Identification No.)

91361
(Zip Code)

(818) 224-7442

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer

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

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

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

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

PENNYMAC MORTGAGE INVESTMENT TRUST

FORM 10-Q

June 30, 2016

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

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

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

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

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

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

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

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

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

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

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

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

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

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

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

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

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

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

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

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

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

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

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

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

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1—Organization and Basis of Presentation

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

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

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

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

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

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

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

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

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

transactions have been eliminated.

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

Note 2—Concentration of Risks

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

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

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

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

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

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

Note 3—Transactions with Related Parties

Operating Activities

Correspondent Production Activities

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

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

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

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

Mortgage loans included in Mortgage loans acquired for

 sale at fair value pending sale to PLS \$619,008 \$ 669,288

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Mortgage Loan Servicing Activities

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

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

Management Fees

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

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

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

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Expense Reimbursement and Amounts Payable to and Receivable from PFSI

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

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

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

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

Amounts receivable and payable to PFSI are summarized below:

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

Investing Activities

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

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

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

Financing Activities

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

Note Payable to PLS

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

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

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

Conditional Reimbursement and Contingent Underwriting Fees

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

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

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

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

Note 4—Earnings Per Share

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

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

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

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

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

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Shares issuable under share-based

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

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

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

Note 5—Loan Sales and Variable Interest Entities

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

Unconsolidated VIEs with Continuing Involvement

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

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

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

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

(1) Net of guarantee fees.
Consolidated VIEs

Credit Risk Transfer Agreements

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

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

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

Following is a summary of the CRT Agreements:

	Quarter Ended	Six Months Ended
	June 30, 2016	June 30, 2016
	(in thousands)	
During the period:		
UPB of mortgage loans transferred and sold under		
CRT Agreements	\$3,162,746	\$5,084,744
Deposits of cash securing CRT Agreements	\$126,031	\$192,737
Gains (losses) recognized on CRT Agreements		
included in Net (loss) gain on investments		
Realized	\$3,859	\$6,395
Resulting from valuation changes	3,905	(2,774)
	\$7,764	\$3,621
Payments made to settle losses	\$—	\$—
	June 30, 2016	December 31, 2015
	(in thousands)	
UPB of mortgage loans subject to credit guarantee		
obligation	\$8,976,961	\$4,546,265
Delinquency status (in UPB):		
Current—89 days delinquent	\$8,976,093	\$4,546,265
90 or more days delinquent	\$868	\$—
Carrying value of CRT Agreements:		
Net derivative included in Derivative assets	\$—	\$593
Deposits securing credit risk transfer agreements	\$338,812	\$147,000
Interest-only security payable at fair value	\$1,663	\$—
Net derivative included in Derivative liabilities	\$199	\$—

Jumbo Mortgage Loan Financing

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

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

Note 6—Netting of Financial Instruments

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

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Offsetting of Derivative Assets

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

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

Derivative Assets and Collateral Held by Counterparty

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

June 30, 2016

December 31, 2015

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	Gross amounts not offset in the consolidated balance sheet			Gross amounts not offset in the consolidated balance sheet				
	Net amount of assets presented in the consolidated balance sheet (in thousands)	Cash	Financial instruments received	Net amount	Net amount of assets presented in the consolidated balance sheet (in thousands)	Cash	Financial instruments received	Net amount
Interest rate lock commitments	\$16,803	\$ —	\$ —	\$16,803	\$4,983	\$ —	\$ —	\$4,983
Fannie Mae Capital Markets	12,439	—	—	12,439	—	—	—	—
Jefferies Group LLC	3,015	—	—	3,015	541	—	—	541
RJ O'Brien & Associates, LLC	867	—	—	867	1,672	—	—	1,672
Morgan Stanley Bank, N.A.	863	—	—	863	464	—	—	464
Royal Bank of Canada	397	—	—	397	400	—	—	400
Nomura Securities International, Inc.	274	—	—	274	119	—	—	119
Barclays Capital	—	—	—	—	796	—	—	796
Ally Financial	—	—	—	—	209	—	—	209
Other	349	—	—	349	901	—	—	901
	\$35,007	\$ —	\$ —	\$35,007	\$10,085	\$ —	\$ —	\$10,085

Offsetting of Derivative Liabilities and Financial Liabilities

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

	June 30, 2016			December 31, 2015		
	Gross	Net	Gross	Gross	Net	Gross
	amounts	amounts	amounts	amounts	amounts	amounts
	of	of	of	of	of	of
	liabilities	liabilities	liabilities	liabilities	liabilities	liabilities
	recognized	recognized	recognized	recognized	recognized	recognized
	in the	in the	in the	in the	in the	in the
	consolidated	consolidated	consolidated	consolidated	consolidated	consolidated
	balance	balance	balance	balance	balance	balance
	sheet	sheet	sheet	sheet	sheet	sheet
	(in thousands)	(in thousands)	(in thousands)	(in thousands)	(in thousands)	(in thousands)
Derivative liabilities						
Not subject to master netting						
arrangements:						
Interest rate lock commitments	\$45	\$ —	\$45	\$337	\$ —	\$337
CRT Agreements	199	—	199	—	—	—
	244	—	244	337	—	337
Subject to master netting						
arrangements:						
Forward purchase contracts	19	—	19	3,774	—	3,774
Forward sales contracts	35,466	—	35,466	2,680	—	2,680
Put options on interest rate futures	79	—	79	39	—	39
Call options on interest rate futures	—	—	—	305	—	305
Netting	—	(31,914)	(31,914)	—	(3,978)	(3,978)
	35,564	(31,914)	3,650	6,798	(3,978)	2,820
	35,808	(31,914)	3,894	7,135	(3,978)	3,157
Assets sold under agreements to repurchase:						
UPB	3,276,854	—	3,276,854	3,130,328	—	3,130,328
Unamortized debt issuance costs	(1,163)	—	(1,163)	(1,548)	—	(1,548)
	3,275,691	—	3,275,691	3,128,780	—	3,128,780
	\$3,311,499	\$ (31,914)	\$3,279,585	\$3,135,915	\$ (3,978)	\$3,131,937

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Derivative Liabilities, Financial Liabilities and Collateral Pledged by Counterparty

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

	June 30, 2016			December 31, 2015		
	Gross amounts not offset in the consolidated balance sheet			Gross amounts not offset in the consolidated balance sheet		
Net amount of liabilities presented in the consolidated balance sheet (in thousands)	Cash collateral pledged	Financial instruments	Net amount	Cash collateral pledged	Financial instruments	Net amount
Interest rate lock commitments	\$45	\$—	\$ —	\$45	\$337	\$—
CRT Agreements	199	—	—	199	—	—
Credit Suisse First Boston Mortgage						
Capital LLC	972,451	(972,003)	—	448	893,947	(893,854)
Bank of America, N.A.	677,186	(676,971)	—	215	538,755	(538,515)
Citibank	559,029	(558,346)	—	683	817,089	(816,699)
JPMorgan Chase & Co.	488,624	(488,624)	—	—	467,427	(467,145)
Morgan Stanley Bank, N.A.	208,488	(208,488)	—	—	214,086	(214,086)
Daiwa Capital Markets	207,908	(207,908)	—	—	165,480	(165,480)
Wells Fargo, N.A.	66,458	(66,384)	—	74		
Barclays Capital	50,528	(50,528)	—	—	24,346	(24,346)
BNP Paribas	47,602	(47,602)	—	—	10,203	(10,203)
Bank of Oklahoma	646	—	—	646	—	—
	340	—	—	340	—	—

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Raymond James and Associates								
Deutsche Bank	263	—	—	263	—	—	—	—
Goldman Sachs	197	—	—	197	819	—	—	819
Fannie Mae Capital Markets	—	—	—	—	924	—	—	924
Other	784	—	—	784	72	—	—	72
Unamortized debt issuance costs	(1,163)	1,163	—	—	(1,548)	1,548	—	—
	\$3,279,585	\$(3,275,691)	\$	—\$3,894	\$3,131,937	\$(3,128,780)	\$	— \$3,157

Note 7—Fair Value

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

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

- Level 1—Quoted prices in active markets for identical financial statement items.
- Level 2—Prices determined or determinable using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing a financial statement item and are developed based on market data obtained from sources independent of the Company. These may include quoted prices for similar financial statement items, 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 (for example, when there is little or no market activity for a financial statement item at the end of the period) unobservable inputs may be used. Unobservable inputs reflect the Company’s own judgments about the factors that market participants use in pricing a financial statement item, and are based on the best information available in the circumstances.

As a result of the difficulty in observing certain significant valuation inputs affecting “Level 3” fair value financial statement items, 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 financial statement items and their fair values. Likewise, due to the general illiquidity of some of these financial statement items, subsequent transactions may be at values significantly different from those reported.

Fair Value Accounting Elections

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

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

For assets sold under agreements to repurchase and the Exchangeable Notes, the Manager has determined that historical cost accounting is more appropriate because under this method debt issuance costs are amortized over the term of the debt, thereby matching the debt issuance cost to the periods benefiting from the availability of the debt.

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Financial Statement Items Measured at Fair Value on a Recurring Basis

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

	June 30, 2016			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	\$16,877	\$—	\$—	\$16,877
Mortgage-backed securities at fair value	—	531,612	—	531,612
Mortgage loans acquired for sale at fair value	—	1,461,029	—	1,461,029
Mortgage loans at fair value	—	427,091	1,608,906	2,035,997
Excess servicing spread purchased from PFSI	—	—	294,551	294,551
Derivative assets:				
Interest rate lock commitments	—	—	16,803	16,803
MBS put options	—	593	—	593
Forward purchase contracts	—	35,768	—	35,768
Forward sales contracts	—	43	—	43
Put options on interest rate futures	453	—	—	453
Call options on interest rate futures	3,379	—	—	3,379
Total derivative assets before netting	3,832	36,404	16,803	57,039
Netting	—	—	—	(22,032)
Total derivative assets after netting	3,832	36,404	16,803	35,007
Mortgage servicing rights at fair value	—	—	57,977	57,977
	\$20,709	\$2,456,136	\$1,978,237	\$4,433,050
Liabilities:				
Asset-backed financing of a VIE at fair value	\$—	\$325,939	\$—	\$325,939
Interest-only security payable at fair value	—	—	1,663	1,663
Derivative liabilities:				
Interest rate lock commitments	—	—	45	45
CRT Agreements	—	—	199	199
Put options on interest rate futures	79	—	—	79
Forward purchase contracts	—	19	—	19
Forward sales contracts	—	35,466	—	35,466
Total derivative liabilities before netting	79	35,485	244	35,808
Netting	—	—	—	(31,914)
Total derivative liabilities after netting	79	35,485	244	3,894
	\$79	\$361,424	\$1,907	\$331,496

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

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

	Quarter ended June 30, 2016						
	Mortgage loans at fair value (in thousands)	Excess servicing spread	Interest rate lock commitments (1)	CRT Agreements (1)	Mortgage servicing rights	Interest-only security payable	Total
Balance, March 31, 2016	\$2,047,563	\$321,976	\$ 9,335	\$ (4,218)	\$ 61,071	\$ 675	\$2,436,402
Purchases and issuances	—	—	—	—	—	1,454	1,454
Repayments and sales	(387,661)	(17,400)	—	—	—	—	(405,061)
Capitalization of interest	16,421	5,713	—	—	—	—	22,134
ESS received pursuant to a recapture agreement with PFSI	—	1,690	—	—	—	—	1,690
Interest rate lock commitments issued, net	—	—	17,036	—	—	—	17,036
Servicing received as proceeds from sales of mortgage loans	—	—	—	—	1,847	—	1,847
Proceeds from CRT Agreements	—	—	—	(3,859)	—	—	(3,859)
Changes in fair value included in income arising from:							
Changes in instrument-specific credit risk	(22,287)	—	—	—	—	—	(22,287)
Other factors	8,824	(17,428)	27,076	7,878	(4,941)	(466)	20,943
	(13,463)	(17,428)	27,076	7,878	(4,941)	(466)	(1,344)
Transfers of mortgage loans to REO and real estate held for investment	(53,954)	—	—	—	—	—	(53,954)
Transfers of interest rate lock	—	—	(36,690)	—	—	—	(36,690)

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commitments to
mortgage

loans acquired for sale								
Balance, June 30, 2016	\$ 1,608,906	\$ 294,551	\$ 16,757	\$ (199) \$ 57,977	\$ 1,663	\$ 1,979,655	
Changes in fair value								

recognized during the
period

relating to assets still
held

at June 30, 2016	\$ (5,335) \$ (17,428) \$ 16,757	\$ 7,878	\$ (4,941) (466) \$ (3,535)
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(1) For the purpose of this table, the IRLC and CRT Agreement asset and liability positions are shown net.
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	Quarter ended June 30, 2015				
	Mortgage loans at fair value (in thousands)	Excess servicing spread	Interest rate lock commitments (1)	Mortgage servicing rights	Total
Balance, March 31, 2015	\$2,343,382	\$222,309	\$ 8,214	\$ 49,448	\$2,623,353
Purchases	—	140,874	—	—	140,874
Repayments and sales	(68,190)	(18,352)	—	—	(86,542)
Capitalization of interest	9,922	—	—	—	9,922
Accrual of interest	—	5,819	—	—	5,819
ESS received pursuant to a recapture agreement					
with PFSI	—	1,319	—	—	1,319
Interest rate lock commitments issued, net	—	—	11,683	—	11,683
Servicing received as proceeds from sales of					
mortgage loans	—	—	—	1,588	1,588
Changes in fair value included in income					
arising from:					
Changes in instrument-specific credit risk	7,489	—	—	—	7,489
Other factors	22,579	7,133	(23,411)	6,307	12,608
	30,068	7,133	(23,411)	6,307	20,097
Transfers of mortgage loans to REO	(68,238)	—	—	—	(68,238)
Transfers of interest rate lock commitments to					
mortgage loans acquired for sale	—	—	3,247	—	3,247
Balance, June 31, 2015	\$2,246,944	\$359,102	\$ (267)	\$ 57,343	\$2,663,122
Changes in fair value recognized during the					
period relating to assets still held at					
June 30, 2015	\$32,807	\$7,133	\$ (267)	\$ 6,307	\$45,980

(1)For the purpose of this table, the IRLC asset and liability positions are shown net.

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Six months ended June 30, 2016

	Mortgage loans at fair value (in thousands)	Excess servicing spread	Interest rate lock commitments (1)	CRT Agreements (1)	Mortgage servicing rights	Interest- only security payable	Total
Balance, December 31, 2015	\$2,100,394	\$412,425	\$ 4,646	\$ 593	\$66,584	\$—	\$2,584,642
Purchases and issuances	—	—	—	682	2,602	2,136	5,420
Repayments and sales	(419,726)	(97,326)	—	—	—	—	(517,052)
Capitalization of interest	39,715	12,728	—	—	—	—	52,443
ESS received pursuant to a recapture agreement with PFSI	—	3,601	—	—	—	—	3,601
Interest rate lock commitments issued, net	—	—	27,733	—	—	—	27,733
Servicing received as proceeds from sales of mortgage loans	—	—	—	—	5,147	—	5,147
Proceeds from CRT Agreements	—	—	—	(6,395)	—	—	(6,395)
Changes in fair value included in income arising from: Changes in instrument- specific credit risk	(19,004)	—	—	—	—	—	(19,004)
Other factors	19,936	(36,877)	47,742	4,921	(16,356)	(473)	18,893
	932	(36,877)	47,742	4,921	(16,356)	(473)	(111)
Transfers of mortgage loans to REO and real estate held for investment	(112,409)	—	—	—	—	—	(112,409)
Transfers of interest rate lock	—	—	(63,364)	—	—	—	(63,364)

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commitments to
mortgage

loans acquired for sale								
Balance, June 30, 2016	\$ 1,608,906	\$ 294,551	\$ 16,757	\$ (199)	\$ 57,977	\$ 1,663	\$ 1,979,655	
Changes in fair value								

recognized during the
period

relating to assets still
held

at June 30, 2016	\$ 654	\$(29,667)	\$ 16,757	\$ 4,921	\$(16,356)	(473)	\$(24,164)	
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(1) For the purpose of this table, the IRLC and CRT Agreement asset and liability positions are shown net.
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	Six months ended June 30, 2015				
	Mortgage loans at fair value (in thousands)	Excess servicing spread	Interest rate lock commitments (1)	Mortgage servicing rights	Total
Balance, December 31, 2014	\$2,199,583	\$191,166	\$ 5,661	\$ 57,358	\$2,453,768
Purchases	241,981	187,287	—	—	429,268
Repayments and sales	(114,070)	(31,083)	—	—	(145,153)
Capitalization of interest	20,130	—	—	—	20,130
Accrual of interest	—	9,570	—	—	9,570
ESS received pursuant to a recapture agreement with PFSI	—	2,565	—	—	2,565
Interest rate lock commitments issued, net	—	—	31,083	—	31,083
Servicing received as proceeds from sales of mortgage loans	—	—	—	3,495	3,495
Changes in fair value included in income arising from:					
Changes in instrument-specific credit risk	19,057	—	—	—	19,057
Other factors	28,196	(403)	(23,399)	(3,510)	884
	47,253	(403)	(23,399)	(3,510)	19,941
Transfers of mortgage loans to REO	(147,933)	—	—	—	(147,933)
Transfers of interest rate lock commitments to mortgage loans acquired for sale	—	—	(13,612)	—	(13,612)
Balance, June 31, 2015	\$2,246,944	\$359,102	\$ (267)	\$ 57,343	\$2,663,122
Changes in fair value recognized during the period relating to assets still held at June 30, 2015	\$54,574	\$(403)	\$ (267)	\$(3,510)	\$50,394

(1)For the purpose of this table, the IRLC asset and liability positions are shown net.

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

	June 30, 2016			December 31, 2015		
	Principal			Principal		
	amount due			amount due		
	Fair value	upon maturity	Difference	Fair value	upon maturity	Difference
	(in thousands)					
Mortgage loans acquired for sale at fair value:						
Current through 89 days delinquent	\$1,460,326	\$1,388,201	\$72,125	\$1,283,275	\$1,235,433	\$47,842
90 or more days delinquent						
Not in foreclosure	415	461	(46)	304	333	(29)
In foreclosure	288	338	(50)	216	253	(37)
	703	799	(96)	520	586	(66)
	\$1,461,029	\$1,389,000	\$72,029	\$1,283,795	\$1,236,019	\$47,776
Mortgage loans at fair value:						
Mortgage loans held in a consolidated VIE						
Current through 89 days delinquent	\$427,091	\$416,195	\$10,896	\$455,394	\$454,935	\$459
90 or more days delinquent						
Not in foreclosure	—	—	—	—	—	—
In foreclosure	—	—	—	—	—	—
	427,091	416,195	10,896	455,394	454,935	459
Other mortgage loans at fair value:						
Current through 89 days delinquent	656,762	873,422	(216,660)	877,438	1,134,560	(257,122)
90 or more days delinquent						
Not in foreclosure	363,328	510,475	(147,147)	459,060	640,343	(181,283)
In foreclosure	588,816	803,754	(214,938)	763,896	1,062,205	(298,309)
	952,144	1,314,229	(362,085)	1,222,956	1,702,548	(479,592)
	1,608,906	2,187,651	(578,745)	2,100,394	2,837,108	(736,714)
	\$2,035,997	\$2,603,846	\$(567,849)	\$2,555,788	\$3,292,043	\$(736,255)

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

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	Quarter ended June 30, 2016				
	Net gain on mortgage loans acquired for sale (in thousands)			Net mortgage loan servicing fees Total	
	Net interest income	Net gain on investments			
Assets:					
Short-term investments	\$—	\$—	\$—	\$—	\$—
Mortgage-backed securities at fair value	—	(750)	4,332	—	3,582
Mortgage loans acquired for sale at fair value	47,003	—	—	—	47,003
Mortgage loans at fair value	—	865	(13,511)	—	(12,646)
ESS at fair value	—	—	(17,428)	—	(17,428)
MSRs at fair value	—	—	—	(4,941)	(4,941)
	\$47,003	\$ 115	\$ (26,607)	\$ (4,941)	\$ 15,570
Liabilities:					
Asset-backed financing of a VIE at fair value	\$—	\$ (781)	\$ 890	\$—	\$ 109
	\$—	\$ (781)	\$ 890	\$—	\$ 109

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	Quarter ended June 30, 2015				
	Net gain on mortgage loans acquired for sale	Net interest income	Net gain on investments	Net mortgage loan servicing fees	Total
	(in thousands)				
Assets:					
Short-term investments	\$—	\$—	\$—	\$—	\$—
Mortgage-backed securities at fair value	—	(23)	(6,702)	—	(6,725)
Mortgage loans acquired for sale at fair value	(5,017)	—	—	—	(5,017)
Mortgage loans at fair value	—	(310)	17,991	—	17,681
ESS at fair value	—	—	8,589	—	8,589
MSRs at fair value	—	—	—	6,306	6,306
	\$ (5,017)	\$ (333)	\$ 19,878	\$ 6,306	\$ 20,834
Liabilities:					
Asset-backed financing of a VIE at fair value	\$—	\$ 51	\$ 3,991	\$—	\$ 4,042
	\$—	\$ 51	\$ 3,991	\$—	\$ 4,042

	Six months ended June 30, 2016				
	Net gain on mortgage loans acquired for sale	Net interest income	Net gain on investments	Net mortgage loan servicing fees	Total
	(in thousands)				
Assets:					
Short-term investments	\$—	\$—	\$—	\$—	\$—
Mortgage-backed securities at fair value	—	(738)	9,431	—	8,693
Mortgage loans acquired for sale at fair value	89,008	—	—	—	89,008
Mortgage loans at fair value	—	2,094	9,279	—	11,373
ESS at fair value	—	—	(36,877)	—	(36,877)
MSRs at fair value	—	—	—	(16,356)	(16,356)
	\$ 89,008	\$ 1,356	\$ (18,167)	\$ (16,356)	\$ 55,841
Liabilities:					
Asset-backed financing of a VIE at fair value	\$—	\$ 536	\$ (8,963)	\$—	\$ (8,427)
	\$—	\$ 536	\$ (8,963)	\$—	\$ (8,427)

	Six months ended June 30, 2015				
	Net gain on mortgage loans acquired for sale	Net interest income	Net gain on investments	Net mortgage loan servicing fees	Total

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(in thousands)

Assets:					
Short-term investments	\$—	\$—	\$—	\$—	\$—
Mortgage-backed securities at fair value	—	63	(5,186)	—	(5,123)
Mortgage loans acquired for sale at fair value	18,064	—	—	—	18,064
Mortgage loans at fair value	—	179	36,977	—	37,156
ESS at fair value	—	—	2,342	—	2,342
MSRs at fair value	—	—	—	(3,510)	(3,510)
	\$18,064	\$ 242	\$ 34,133	\$ (3,510)	\$48,929
Liabilities:					
Asset-backed financing of a VIE at fair value	\$—	\$ (122)	\$ 3,222	\$—	\$3,100
	\$—	\$ (122)	\$ 3,222	\$—	\$3,100

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Financial Statement Items Measured at Fair Value on a Nonrecurring Basis

Following is a summary of financial statement items that were re-measured at fair value on a nonrecurring basis during the periods presented:

	June 30, 2016				
	Level 1		Level 2	Level 3	Total
	1	2	Level 3		
	(in thousands)				
Real estate acquired in settlement of loans	\$—	\$—	\$136,062	\$136,062	
MSRs at lower of amortized cost or fair value	—	—	332,354	332,354	
	\$—	\$—	\$468,416	\$468,416	

	December 31, 2015				
	Level 1		Level 2	Level 3	Total
	1	2	Level 3		
	(in thousands)				
Real estate acquired in settlement of loans	\$—	\$—	\$173,662	\$173,662	
MSRs at lower of amortized cost or fair value	—	—	145,187	145,187	
	\$—	\$—	\$318,849	\$318,849	

The following table summarizes the fair value changes recognized during the period on assets held at period end that were measured at fair value on a nonrecurring basis:

	Quarter ended		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
	(in thousands)			
Real estate asset acquired in settlement of loans	\$(5,836)	\$(6,491)	\$(11,106)	\$(13,800)
MSRs at lower of amortized cost or fair value	(23,170)	7,082	(40,876)	703
	\$(29,006)	\$591	\$(51,982)	\$(13,097)

Real Estate Acquired in Settlement of Loans

The Company evaluates its REO for impairment with reference to the respective properties' fair values less cost to sell on a nonrecurring basis. The initial carrying value of the REO is measured at cost as indicated by the purchase price in the case of purchased REO or as measured by the fair value of the mortgage loan immediately before REO acquisition in the case of acquisition in settlement of a loan. REO may be subsequently revalued due to the Company receiving greater access to the property, the property being held for an extended period or receiving indications that the property's value may not be supported by developing market conditions. Any subsequent change in fair value to a level that is less than or equal to the property's cost is recognized in Results of real estate acquired in settlement of loans in the Company's consolidated statements of income.

Mortgage Servicing Rights at Lower of Amortized Cost or Fair Value

The Company evaluates its MSR at lower of amortized cost or fair value for impairment with reference to the asset's fair value. For purposes of performing its MSR impairment evaluation, the Company stratifies its MSR at lower of amortized cost or fair value based on the interest rates borne by the mortgage loans underlying the MSR. Mortgage loans are grouped into pools with 50 basis point interest rate ranges for fixed-rate mortgage loans with interest rates between 3.0% and 4.5% and a single pool for mortgage loans with interest rates below 3.0%. MSR relating to adjustable rate mortgage loans with initial interest rates of 4.5% or less are evaluated in a single pool. If the fair value of MSR in any of the interest rate pools is below the amortized cost of the MSR, those MSR are impaired.

When MSR are impaired, the impairment is recognized in current-period results of operations and the carrying value of the MSR is adjusted using a valuation allowance. If the fair value of the MSR subsequently increases, the increase in fair value is recognized in current period results of operations only to the extent of the valuation allowance for the respective impairment stratum.

The Manager periodically reviews the various impairment strata to determine whether the fair value of the impaired MSR in a given stratum is likely to recover. When the Manager deems recovery of fair value to be unlikely in the foreseeable future, a write-down of the cost of the MSR for that stratum to its estimated recoverable value is charged to the valuation allowance.

Fair Value of Financial Instruments Carried at Amortized Cost

The Company's Cash as well as certain of its borrowings are carried at amortized cost. Cash is measured using a "Level 1" fair value input. The Company's assets sold under agreements to repurchase and mortgage loan participation and sale agreement are classified as "Level 3" fair value financial statement items due to the Company's reliance on unobservable inputs to estimate these instruments' fair values.

The Manager has concluded that the fair values of Cash, Assets sold under agreements to repurchase, Mortgage loan participation and sale agreements, Federal Home Loan Bank advances and Notes payable approximate the agreements' carrying values due to the immediate realizability of Cash at its carrying amount and to the borrowing agreements' short terms and variable interest rates.

The Exchangeable Notes are carried at amortized cost. The fair value of the Exchangeable Notes at June 30, 2016 and December 31, 2015 was \$236.1 million and \$230.0 million, respectively. The fair value of the Exchangeable Notes is estimated using a broker indication of value. The Company has classified the Exchangeable Notes as "Level 3" fair value financial statement items as of June 30, 2016 due to the lack of current market activity.

Valuation Techniques and Inputs

Most of the Company's assets, its Derivative liabilities, the Asset-backed financing of a VIE and the Interest-only security payable are carried at fair value with changes in fair value recognized in current period results of operations. A substantial portion of these items are "Level 3" fair value financial statement items which require the use of unobservable inputs that are significant to the estimation of the items' fair values. Unobservable inputs reflect the Company's own judgments about the factors that market participants use in pricing an asset or liability, and are based on the best information available under the circumstances.

Due to the difficulty in estimating the fair values of "Level 3" fair value financial statement items, the Manager has assigned responsibility for estimating fair value of these items to specialized staff and subjects the valuation process to significant executive management oversight. The Manager's Financial Analysis and Valuation group (the "FAV group") is responsible for estimating the fair values of "Level 3" fair value financial statement items other than IRLCs and maintaining its valuation policies and procedures.

With respect to the Company's "Level 3" fair value financial statement items, the FAV group reports to PCM's valuation committee, which oversees and approves the valuations. The FAV group monitors the models used for valuation of the Company's non-IRLC "Level 3" fair value financial statement items, including the models' performance versus actual results, and reports those results to PCM's valuation committee. PCM's valuation committee includes PFSI's chief executive, financial, operating, risk, business development and asset/liability management officers.

The FAV group is responsible for reporting to PCM's valuation committee on a monthly basis on the changes in the valuation of the financial statement items, including major factors affecting the valuation and any changes in model methods and inputs. To assess the reasonableness of its valuations, the FAV group presents an analysis of the effect on the valuation of changes to the significant inputs to the models.

The fair value of the Company's IRLCs is developed by the Manager's Capital Markets Risk Management staff and is reviewed by the Manager's Capital Markets Operations group.

The following is a description of the techniques and inputs used in estimating the fair values of "Level 2" and "Level 3" fair value financial statement items:

Mortgage-Backed Securities

The Company's MBS include Agency and senior non-agency MBS. The Company categorizes its current holdings of MBS as "Level 2" fair value financial statement items. Fair value of these MBS is established based on quoted market prices for the Company's MBS or similar securities. Changes in the fair value of MBS are included in Net (loss) gain on investments in the consolidated statements of operations.

Mortgage Loans

Fair value of mortgage loans is estimated based on whether the mortgage loans are saleable into active markets:

- Mortgage loans that are saleable into active markets, comprised of the Company's mortgage loans acquired for sale at fair value and mortgage loans at fair value held in a VIE, are categorized as "Level 2" fair value financial statement items. The

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fair values of mortgage loans acquired for sale at fair value are established using their quoted market or contracted price or market price equivalent. For the mortgage loans at fair value held in a VIE, the fair values of all of the individual securities issued by the securitization trust are used to derive a fair value for the mortgage loans. The Company obtains indications of fair value from nonaffiliated brokers based on comparable securities and validates the brokers' indications of fair value using pricing models and inputs the Manager believes are similar to the models and inputs used by other market participants.

· Mortgage loans that are not saleable into active markets, comprised of mortgage loans at fair value held outside the VIE are categorized as "Level 3" fair value financial statement items and their fair values are estimated using a discounted cash flow approach. Inputs to the discounted cash flow model include current interest rates, loan amount, payment status, property type, discount rates and forecasts of future interest rates, home prices, prepayment speeds, default speeds, loss severities and contracted selling price where applicable.

The valuation process includes the computation by stratum of the mortgage loans' fair values and a review for reasonableness of various measures such as weighted average life, projected prepayment and default speeds, and projected default and loss percentages. The FAV group computes the effect on the valuation of changes in inputs such as interest rates, home prices, and delinquency status to assess the reasonableness of changes in the mortgage loan valuation.

Changes in fair value attributable to changes in instrument-specific credit risk are measured by the effect on fair value of the change in the respective mortgage loan's delinquency status and performance history at period-end from the later of the beginning of the period or acquisition date.

The significant unobservable inputs used in the fair value measurement of the Company's mortgage loans at fair value are discount rate, home price projections, voluntary prepayment speeds and default speeds. Significant changes in any of those inputs in isolation could result in a significant change to the mortgage loans' fair value measurement. Increases in home price projections are generally accompanied by an increase in voluntary prepayment speeds. Changes in the fair value of mortgage loans at fair value are included in Net (loss) gain on investments in the consolidated statements of operations.

Following is a quantitative summary of key inputs used in the valuation of mortgage loans at fair value:

Key inputs	June 30, 2016	December 31, 2015
Discount rate		
Range	2.5% – 15.0%	2.5% – 15.0%
Weighted average	6.7%	7.1%
Twelve-month projected housing price index		
change		
Range	2.7% – 5.2%	1.5% – 5.1%
Weighted average	4.0%	3.6%
Prepayment speed (1)		
Range	0.1% – 13.7%	0.1% – 9.6%
Weighted average	3.9%	3.7%
Total prepayment speed (2)		
Range	0.7% – 25.4%	0.5% – 27.2%
Weighted average	19.0%	19.6%

(1) Prepayment speed is measured using Life Voluntary Conditional Prepayment Rate ("CPR").

(2) Total prepayment speed is measured using Life Total CPR.
Excess Servicing Spread Purchased from PFSI

The Company categorizes ESS as a “Level 3” fair value financial statement item. The Company uses a discounted cash flow approach to estimate the fair value of ESS. The key inputs used in the estimation of the fair value of ESS include prepayment speed and discount rate. Significant changes to those inputs in isolation may result in a significant change in the ESS fair value measurement. Changes in these key inputs are not necessarily directly related.

ESS is generally subject to loss in fair value when interest rates decrease. Decreasing mortgage rates normally encourage increased mortgage refinancing activity. Increased refinancing activity reduces the life of the mortgage loans underlying the ESS, thereby reducing the cash flows expected to accrue to ESS. Reductions in the fair value of ESS affect results of operations primarily through change in fair value. Changes in the fair value of ESS are included in Net (loss) gain on investments in the consolidated statements of operations.

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Following are the key inputs used in determining the fair value of ESS:

Key inputs	June 30, 2016	December 31, 2015
UPB of underlying mortgage loans (in thousands)	\$36,151,940	\$51,966,405
Average servicing fee rate (in basis points)	34	32
Average ESS rate (in basis points)	19	17
Pricing spread (1)		
Range	4.7% – 5.9%	4.8% - 6.5%
Weighted average	5.5%	5.7%
Life (in years)		
Range	1.6 - 8.9	1.4 - 9.0
Weighted average	6.2	6.9
Annual total prepayment speed (2)		
Range	6.8% – 37.3%	5.2% - 52.4%
Weighted average	12.5%	9.6%

(1) Pricing spread represents a margin that is applied to a reference interest rate’s forward rate curve to develop periodic discount rates. The Company applies a pricing spread to the United States Dollar London Interbank Offered Rate (“LIBOR”) curve for purposes of discounting cash flows relating to ESS.

(2) Prepayment speed is measured using Life Total CPR.

Derivative Financial Instruments

Interest Rate Lock Commitments

The Company categorizes IRLCs as a “Level 3” fair value financial statement item. The Company estimates the fair value of IRLCs based on quoted Agency MBS prices, its estimate of the fair value of the MSR it expects to receive in the sale of the mortgage loans and the probability that the mortgage loan will be purchased under the commitment as a percentage of the commitments it has made (the “pull-through rate”).

The significant unobservable inputs used in the fair value measurement of the Company’s IRLCs are the pull-through rate and the MSR component of the Company’s estimate of the fair value of the mortgage loans it has committed to purchase. Significant changes in the pull-through rate or the MSR component of the IRLCs, in isolation, may result in a significant change in fair value. The financial effects of changes in these inputs are generally inversely correlated as increasing interest rates have a positive effect on the fair value of the MSR component of IRLC value, but increase the pull-through rate for mortgage loan principal and interest payment cash flows that have decreased in fair value. Changes in fair value of IRLCs are included in Net gains on mortgage loans acquired for sale at fair value in the consolidated statements of operations.

Following is a quantitative summary of key unobservable inputs used in the valuation of IRLCs:

Key inputs	June 30, 2016	December 31, 2015
Pull-through rate		
Range	74.9% – 100.0%	60.2% - 100.0%

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Weighted average	88.0%	92.4%
MSR value expressed as:		
Servicing fee multiple		
Range	1.8 - 5.7	2.1 - 6.2
Weighted average	4.5	4.9
Percentage of UPB		
Range	0.0% – 1.4%	0.5% - 3.8%
Weighted average	1.1%	1.2%

Hedging Derivatives

The Company estimates the fair value of commitments to sell mortgage loans based on quoted MBS prices. These derivative financial instruments are categorized by the Company as “Level 1” fair value financial statement items for those based on exchange traded market prices or as “Level 2” fair value financial statement items for those based on observable interest rate volatilities in the

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MBS market. Changes in the fair value of hedging derivatives are included in Net gains on mortgage loans acquired for sale at fair value, Net (loss) gain on investments, or Net mortgage loan servicing fees, as applicable, in the consolidated statements of operations.

Real Estate Acquired in Settlement of Loans

REO is measured based on its fair value on a nonrecurring basis and is categorized as a “Level 3” fair value financial statement item. Fair value of REO is established by using a current estimate of fair value from a broker’s price opinion or a full appraisal, or the price given in a current contract of sale.

REO fair values are reviewed by the Manager’s staff appraisers when the Company obtains multiple indications of fair value and there is a significant difference between the fair values received. PCM’s staff appraisers will attempt to resolve the difference between the indications of fair value. In circumstances where the appraisers are not able to generate adequate data to support a fair value conclusion, the staff appraisers will order an additional appraisal to determine the fair value. Changes in the fair value of REO are included in Results of real estate acquired in settlement of loans in the consolidated statements of operations.

Mortgage Servicing Rights

MSRs are categorized as “Level 3” fair value financial statement items. The Company uses a discounted cash flow approach to estimate the fair value of MSRs. The key inputs used in the estimation of the fair value of MSRs include the applicable pricing spread, prepayment and default rates of the underlying mortgage loans, and annual per-loan cost to service mortgage loans, all of which are unobservable. Significant changes to any of those inputs in isolation could result in a significant change in the MSR fair value measurement. Changes in these key inputs are not necessarily directly related. Changes in the fair value of MSRs are included in Net mortgage loan servicing fees in the consolidated statements of operations.

MSRs are generally subject to loss in fair value when mortgage interest rates decrease. Decreasing mortgage interest rates normally encourage increased mortgage refinancing activity. Increased refinancing activity reduces the life of the underlying mortgage loans, thereby reducing the cash flows expected to accrue to the MSRs. Reductions in the fair value of MSRs affect income primarily through change in fair value and change in impairment. For MSRs backed by mortgage loans with historically low interest rates, factors other than interest rates (such as housing price changes) take on increasing influence on prepayment behavior of the underlying mortgage loans.

Following are the key inputs used in determining the fair value of MSRs at the time of initial recognition:

	Quarter ended June 30,			
	2016		2015	
	Amortized	Fair	Amortized	Fair
	cost	value	cost	value
	(MSR recognized and UPB of underlying mortgage loan amounts in thousands)			
MSR recognized	\$58,262	\$ 1,847	\$30,587	\$1,589
Key inputs				
UPB of underlying mortgage loans	\$4,846,994	\$ 200,495	\$3,346,010	\$176,404
Weighted-average annual servicing				
fee rate (in basis points)	25	25	25	25

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Pricing spread (1)				
Range			6.5%	9.0% –
	7.2% – 12.6%	7.2% – 7.6%	–13.0%	16.3%
Weighted average	7.4%	7.3	8.1%	10.1%
Life (in years)				
Range	1.5 - 12.2	2.0 - 9.3	2.6 – 7.3	2.3 – 7.3
Weighted average	7.6	6.0	6.7	6.8
Annual total prepayment speed (2)				
Range			7.6% –	8.3% –
	3.4% – 47.4%	7.3% – 38.0%	28.6%	34.2%
Weighted average	9.4%	14.2%	8.3%	10.6%
Annual per-loan cost of servicing				
Range	\$68 – \$79	\$68 – \$79	\$62 – \$62	\$62 – \$62
Weighted average	\$76	\$74	\$62	\$62

(1) The Company applies a pricing spread to the United States Dollar LIBOR curve for purposes of discounting cash flows relating to MSRs acquired as proceeds from the sale of mortgage loans.

(2) Prepayment speed is measured using Life Total CPR.

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	Six months ended June 30,			
	2016		2015	
	Amortized	Fair	Amortized	Fair
	cost	value	cost	value
	(MSR recognized and UPB of underlying mortgage loan amounts in thousands)			
MSR recognized	\$91,124	\$ 5,147	\$56,141	\$3,495
Key inputs				
UPB of underlying mortgage loans	\$7,606,539	\$ 527,519	\$5,628,766	\$400,057
Weighted-average annual servicing				
fee rate (in basis points)	25	26	26	26
Pricing spread (1)				
Range			6.5%	9.0% –
	7.2% – 12.6%	7.2% – 7.6%	–17.5%	16.3%
Weighted average	7.3%	7.3%	8.3%	10.6%
Life (in years)				
Range	1.4 - 12.3	2.0 - 9.4	1.3 – 7.7	2.3 – 7.3
Weighted average	7.4	5.7	6.6	6.3
Annual total prepayment speed (2)				
Range			7.6% –	8.3% –
	3.4% – 49.2%	7.2% – 38.0%	51.0%	34.2%
Weighted average	9.8%	15.1%	8.7%	12.3%
Annual per-loan cost of servicing				
Range	\$68 – \$79	\$68 – \$79	\$62 – \$134	\$62 – \$62
Weighted average	\$73	\$71	\$63	\$62

(1) The Company applies a pricing spread to the United States Dollar LIBOR curve for purposes of discounting cash flows relating to MSRs acquired as proceeds from the sale of mortgage loans.

(2) Prepayment speed is measured using Life Total CPR.

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Following is a quantitative summary of key inputs used in the valuation of MSRs as of the dates presented, and the effect on the fair value from adverse changes in those inputs:

	June 30, 2016		December 31, 2015	
	Amortized cost	Fair value	Amortized cost	Fair value
	(Carrying value, UPB of underlying mortgage loans and effect on fair value)			
	amounts in thousands)			
Carrying value	\$413,481	\$57,977	\$393,157	\$66,584
Key inputs:				
UPB of underlying mortgage loans	\$40,590,719	\$6,496,712	\$35,841,654	\$6,458,684
Weighted-average annual servicing fee rate (in basis points)	25	25	26	25
Weighted-average note interest rate	3.9%	4.7%	3.9%	4.7%
Pricing spread (1)				
Range	7.6% – 13.1%	7.6% – 12.6%	7.2% – 10.7%	7.2% – 10.2%
Weighted average	7.6%	7.6	7.3%	7.2%
Effect on fair value of (2):				
5% adverse change	\$(6,312)	\$(854)	\$(6,411)	\$(944)
10% adverse change	\$(12,441)	\$(1,683)	\$(12,635)	\$(1,862)
20% adverse change	\$(24,175)	\$(3,271)	\$(24,553)	\$(3,621)
Weighted average life (in years)				
Range	3.0 - 6.8	3.2 - 5.7	1.3 - 7.7	2.5 - 6.1
Weighted average	6.5	5.7	7.2	6.1
Prepayment speed (3)				
Range	8.7% – 26.8%	8.3% – 21.9%	8.1% – 51.5%	9.2% – 32.5%
Weighted average	10.8%	14.3%	9.6%	13.2%
Effect on fair value of (2):				
5% adverse change	\$(9,341)	\$(1,739)	\$(8,159)	\$(1,793)
10% adverse change	\$(18,315)	\$(3,395)	\$(16,024)	\$(3,502)
20% adverse change	\$(35,243)	\$(6,475)	\$(30,938)	\$(6,692)
Annual per-loan cost of servicing				
Range	\$77 – \$78	\$77 – \$78	\$68 – \$68	\$68 – \$68
Weighted average	\$78	\$78	\$68	\$68
Effect on fair value of (2):				
5% adverse change	\$(3,334)	\$(519)	\$(2,742)	\$(470)
10% adverse change	\$(6,669)	\$(1,038)	\$(5,484)	\$(940)
20% adverse change	\$(13,337)	\$(2,076)	\$(10,968)	\$(1,880)

(1)The Company applies a pricing spread to the United States Dollar LIBOR curve for purposes of discounting cash flows relating to MSRs.

(2)

For MSR's carried at fair value, an adverse change in one of the above-mentioned key inputs is expected to result in a reduction in fair value which will be recognized in results of operations. For MSR's carried at lower of amortized cost or fair value, an adverse change in one of the above-mentioned key inputs may result in recognition of MSR impairment. The extent of the recognized MSR impairment will depend on the relationship of fair value to the carrying value of such MSR's.

(3) Prepayment speed is measured using Life Total CPR.

The preceding sensitivity analyses are limited in that they were performed at a particular point in time; only account for the estimated effect of the movements in the indicated inputs; do not incorporate changes in the inputs in relation to other inputs; are subject to the accuracy of various models and inputs used; and do not incorporate other factors that would affect the Company's overall financial performance in such scenarios, including operational adjustments made by the Manager to account for changing circumstances. For these reasons, the preceding estimates should not be viewed as earnings forecasts.

Securities Sold Under Agreements to Repurchase

Fair value of securities sold under agreements to repurchase is based on the accrued cost of the agreements, which approximates the fair values of the agreements, due to the short maturities of such agreements.

Note 8—Mortgage Loans Acquired for Sale at Fair Value

Mortgage loans acquired for sale at fair value is comprised of recently originated mortgage loans purchased by the Company for resale. Following is a summary of the distribution of the Company's mortgage loans acquired for sale at fair value:

Loan type	June 30, 2016		December 31, 2015	
	Fair value	Unpaid principal balance	Fair value	Unpaid principal balance
	(in thousands)			
Conventional:				
Agency-eligible	\$816,248	\$776,828	\$540,947	\$525,192
Jumbo	8,088	8,009	54,613	54,096
Held for sale to PLS — Government insured or				
guaranteed	619,008	585,919	669,288	637,666
Commercial real estate	12,132	12,263	14,590	14,461
Mortgage loans repurchased pursuant to representations				
and warranties	5,553	5,980	4,357	4,604
	\$1,461,029	\$1,388,999	\$1,283,795	\$1,236,019
Mortgage loans pledged to secure:				
Assets sold under agreements to repurchase	\$1,341,459		\$1,204,462	
Mortgage loan participation and sale agreements	\$100,497		\$—	
Federal Home Loan Bank (“FHLB”) advances	\$—		\$63,993	

The Company is not approved by Ginnie Mae as an issuer of Ginnie Mae-guaranteed securities which are backed by government-insured or guaranteed mortgage loans. The Company transfers government-insured or guaranteed mortgage loans that it purchases from correspondent lenders to PLS, which is a Ginnie Mae-approved issuer, and earns a sourcing fee of three basis points on the UPB plus interest earned during the period it holds each such mortgage loan.

Note 9—Derivative Financial Instruments

The Company enters into CRT Agreements whereby it retains a portion of the credit risk relating to mortgage loans it sells into Fannie Mae guaranteed securitizations in exchange for a portion of the contractual guarantee fee related to such securitizations. The fair values of the credit guarantees and the Company's right to the related guarantee fee are accounted for as a derivative financial instrument. IRLCs are generated in the normal course of business when the

Company commits to purchase mortgage loans acquired for sale. The Company's remaining derivative financial instrument transactions are in support of its interest rate risk management activities.

The Company engages in interest rate risk management activities in an effort to reduce the variability of earnings caused by changes in interest rates. To manage the price risk resulting from interest rate risk, the Company uses derivative financial instruments acquired with the intention of moderating the risk that changes in market interest rates will result in unfavorable changes in the fair value of the Company's MBS, inventory of mortgage loans acquired for sale, mortgage loans held by VIE, ESS, IRLCs and MSRs. The Company records all derivative financial instruments at fair value and records changes in fair value in current period results of operations.

The Company is exposed to price risk relative to the IRLCs it issues to correspondent lenders and to the mortgage loans it purchases as a result of issuing the IRLCs. The Company bears price risk from the time an IRLC is issued to a correspondent lender to the time the purchased mortgage loan is sold. The Company is exposed to loss if mortgage interest rates increase, because interest rate increases generally cause the fair value of the purchase commitment or mortgage loan acquired for sale to decrease.

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The Company had the following derivative assets and liabilities and related margin deposits recorded within Derivative assets and Derivative liabilities on the consolidated balance sheets:

Instrument	June 30, 2016			December 31, 2015		
	Notional amount (in thousands)	Fair value Derivative assets	Derivative liabilities	Notional amount	Fair value Derivative assets	Derivative liabilities
Derivatives not designated as hedging instruments:						
Free-standing derivatives:						
Interest rate lock commitments	1,658,813	\$ 16,803	\$ 45	970,067	\$ 4,983	\$ 337
Used for hedging purposes:						
Forward sale contracts	4,347,526	43	35,466	2,450,642	2,604	2,680
Forward purchase contracts	4,190,349	35,768	19	2,469,550	2,444	3,774
MBS call options	1,525,000	593	—	375,000	93	—
Swap futures	12,500	—	—	—	—	—
Eurodollar future sales contracts	1,543,000	—	—	1,755,000	—	—
Call options on interest rate futures	525,000	3,379	—	50,000	1,156	305
Put options on interest rate futures	425,000	453	79	1,600,000	1,512	39
CRT Agreements	8,976,961	—	199	4,546,265	593	—
Total derivative instruments before netting		57,039	35,808		13,385	7,135
Netting		(22,032)	(31,914)		(3,300)	(3,978)
		\$ 35,007	\$ 3,894		\$ 10,085	\$ 3,157
Margin deposits with derivatives counterparties						
		\$ 9,882			\$ 678	

The following tables summarize the notional amount activity for derivatives arising from CRT Agreements and derivative contracts used to hedge the Company's MBS, inventory of mortgage loans acquired for sale, mortgage loans at fair value held in a VIE, IRLCs and MSRs.

Instrument	Quarter ended June 30, 2016			Balance, end of period
	Balance, beginning of period	Additions	Dispositions/ expirations	
Forward sales contracts	3,466,697	21,138,542	(20,257,713)	4,347,526
Forward purchase contracts	2,981,134	15,361,702	(14,152,487)	4,190,349
MBS call options	425,000	1,975,000	(875,000)	1,525,000
Swap futures	12,500	12,500	(12,500)	12,500
Eurodollar future sale contracts	1,734,000	—	(191,000)	1,543,000
Call options on interest rate futures	1,250,000	275,000	(1,000,000)	525,000
Put options on interest rate futures	1,525,000	550,000	(1,650,000)	425,000
CRT Agreements	5,931,409	3,162,746	(117,194)	8,976,961

Instrument	Quarter ended June 30, 2015			Balance, end of period
	Balance, beginning of period (in thousands)	Additions	Dispositions/ expirations	
Forward sales contracts	2,958,492	14,047,534	(13,753,740)	3,252,286
Forward purchase contracts	2,132,616	9,885,504	(9,754,498)	2,263,622
MBS put option	190,000	587,500	(410,000)	367,500
MBS call option	—	140,000	(100,000)	40,000
Eurodollar future sale contracts	6,355,000	185,000	(556,000)	5,984,000
Treasury future sale contracts	85,000	65,000	(110,000)	40,000
Call options on interest rate futures	1,165,000	1,635,000	(1,665,000)	1,135,000
Put options on interest rate futures	1,020,000	1,548,000	(1,295,000)	1,273,000
CRT Agreements	—	740,153	—	740,153

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Instrument	Six months ended June 30, 2016			
	Balance, beginning of period (in thousands)	Additions	Dispositions/ expirations	Balance, end of period
Forward sales contracts	2,450,642	35,292,415	(33,395,531)	4,347,526
Forward purchase contracts	2,469,550	25,430,142	(23,709,343)	4,190,349
MBS call options	375,000	2,725,000	(1,575,000)	1,525,000
Swap futures	—	25,000	(12,500)	12,500
Eurodollar future sale contracts	1,755,000	80,000	(292,000)	1,543,000
Call options on interest rate futures	50,000	1,575,000	(1,100,000)	525,000
Put options on interest rate futures	1,600,000	2,600,000	(3,775,000)	425,000
CRT Agreements	4,546,265	5,084,744	(654,048)	8,976,961

Instrument	Six months ended June 30, 2015			
	Balance, beginning of period (in thousands)	Additions	Dispositions/ expirations	Balance, end of period
Forward sales contracts	1,601,283	23,877,061	(22,226,058)	3,252,286
Forward purchase contracts	1,100,700	16,933,180	(15,770,258)	2,263,622
MBS put option	340,000	992,500	(965,000)	367,500
MBS call option	—	140,000	(100,000)	40,000
Eurodollar future sale contracts	7,426,000	285,000	(1,727,000)	5,984,000
Eurodollar future purchase contracts	800,000	—	(800,000)	—
Treasury future sale contracts	85,000	161,500	(206,500)	40,000
Call options on interest rate futures	1,030,000	2,275,000	(2,170,000)	1,135,000
Put options on interest rate futures	275,000	2,668,000	(1,670,000)	1,273,000
CRT Agreements	—	740,153	—	740,153

Following are the net gains (losses) recognized by the Company on derivative financial instruments and the consolidated statements of operations line items where such gains and losses are included:

Income statement line	Quarter ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Interest rate lock commitments	(in thousands)			
Net gain on mortgage loans acquired for sale	\$44,112	\$(11,728)	\$75,475	\$7,684
Hedged item:				
Interest rate lock commitments and mortgage acquired for sale	\$(29,210)	\$25,566	\$(59,882)	\$10,455

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loans acquired for sale					
Mortgage servicing rights	Net loan servicing fees	\$27,433	\$(16,270)	\$57,394	\$(5,193)
Fixed-rate assets and					
LIBOR- indexed repurchase					
agreements	Net gain on investments	\$862	\$(1,255)	\$698	\$(11,294)
CRT agreements	Net gain on investments	\$7,764	\$—	\$3,621	\$—

Note 10—Mortgage Loans at Fair Value

Mortgage loans at fair value are comprised of mortgage loans that are not acquired for sale and, to the extent they are not held in a VIE securing an asset-backed financing, may be sold at a later date pursuant to a management determination that such a sale represents the most advantageous liquidation strategy for the identified mortgage loan.

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Following is a summary of the distribution of the Company's mortgage loans at fair value:

Loan type	June 30, 2016		December 31, 2015	
	Fair value (in thousands)	Unpaid principal balance	Fair value	Unpaid principal balance
Distressed mortgage loans				
Nonperforming mortgage loans	\$952,144	\$1,314,229	\$1,222,956	\$1,702,548
Performing mortgage loans:				
Fixed interest rate	313,064	413,063	417,658	535,610
Interest rate step-up	233,925	333,517	299,569	412,749
Adjustable-rate/hybrid	109,773	126,842	160,051	185,997
Balloon	—	—	160	204
	656,762	873,422	877,438	1,134,560
Fixed interest rate jumbo mortgage loans held in a				
VIE	427,091	416,195	455,394	454,935
	\$2,035,997	\$2,603,846	\$2,555,788	\$3,292,043
Mortgage loans at fair value pledged to secure:				
Assets sold under agreements to repurchase	\$1,589,798		\$2,067,341	
Asset-backed financing of a VIE at fair value and				
FHLB advances	\$427,091		\$455,394	

Following is a summary of certain concentrations of credit risk in the portfolio of distressed mortgage loans at fair value:

Concentration	June 30, 2016	December 31, 2015
Portion of mortgage loans originated between 2005 and 2007	71%	72%
Percentage of fair value of mortgage loans with unpaid-principal balance-to-current-property-value in excess of 100%	42%	48%
States contributing 5% or more of mortgage loans	New York	California New York California New Jersey

	New Jersey	Florida
		Florida
		Massachusetts

Note 11—Real Estate Acquired in Settlement of Loans

Following is a summary of financial information relating to REO:

	Quarter ended June 30, 2016	2015	Six months ended June 30, 2016	2015
Balance at beginning of period	\$327,212			