PENNYMAC FINANCIAL SERVICES, INC.
Form 10-Q
November 14, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

Or

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

For the transition period from to

Commission file number: 001-35916

PennyMac Financial Services, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**80-0882793**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
6101 Condor Drive, Moorpark, California	**93021**
(Address of principal executive offices)	(Zip Code)

(818) 224-7442

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

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

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

Class	Outstanding at November 12, 2013
Class A Common Stock, $0.0001 par value	**18,887,777**
Class B Common Stock, $0.0001 par value	**61**

Table of Contents

PENNYMAC FINANCIAL SERVICES, INC.

FORM 10-Q

September 30, 2013

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

PENNYMAC FINANCIAL SERVICES, INC.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30, 2013	December 31, 2012
	(in thousands, except share data)	
ASSETS		
Cash	$ 56,398	$ 12,323
Short-term investments at fair value	127,487	53,164
Mortgage loans held for sale at fair value (includes $522,031 and $438,850 pledged to secure mortgage loans sold under agreements to repurchase)	530,248	448,384
Servicing advances (includes $6,865 and $7,430 pledged to secure note payable)	105,344	93,152
Derivative assets	24,066	27,290
Carried Interest due from Investment Funds	58,134	47,723
Investment in PennyMac Mortgage Investment Trust at fair value	1,701	1,897
Mortgage servicing rights at lower of amortized cost or fair value (includes $216,463 and $88,587 pledged to secure note payable)	226,090	89,177
Mortgage servicing rights at fair value (includes $10,125 and $12,370 pledged to secure note payable)	26,768	19,798
Receivable from Investment Funds	2,541	3,672
Receivable from PennyMac Mortgage Investment Trust	20,030	16,691
Furniture, fixtures, equipment and building improvements, net	8,498	5,065
Capitalized software, net	743	795
Deferred tax asset	54,530	
Other	11,806	13,032
Total assets	$ 1,254,384	$ 832,163
LIABILITIES		
Mortgage loans sold under agreements to repurchase	$ 387,883	$ 393,534
Note payable	56,775	53,013
Excess servicing spread financing at fair value	2,857	
Derivative liabilities	5,776	509
Accounts payable and accrued expenses	53,355	36,279
Payable to Investment Funds	36,424	36,795
Payable to PennyMac Mortgage Investment Trust	55,523	46,779
Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement	58,615	
Liability for losses under representations and warranties	7,215	3,504
Total liabilities	664,423	570,413
Commitments and contingencies		
STOCKHOLDERS EQUITY		
Class A Common Stock, par value $0.0001 per share, 200,000,000 shares authorized, 18,887,777 issued and outstanding at September 30, 2013	$ 2	$

Class B Common Stock, par value $0.0001 per share, 1,000 shares authorized, 61 issued and outstanding at September 30, 2013				
Additional paid-in capital		136,484		
Retained earnings		7,990		
Total PennyMac Financial Services, Inc. stockholders equity		144,476		
Members equity related to Private National Mortgage Acceptance Company, LLC				261,750
Noncontrolling interest in Private National Mortgage Acceptance Company, LLC		445,485		
Total equity		589,961		261,750
Total liabilities and stockholders equity	$	1,254,384	$	832,163

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

Table of Contents

PENNYMAC FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Quarter ended September 30, 2013	Quarter ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
	(in thousands, except per share data)			
Revenue				
Net gains on mortgage loans held for sale at fair value	$ 25,949	$ 39,760	$ 108,560	$ 68,487
Loan origination fees	6,280	2,752	18,260	5,439
Fulfillment fees from PennyMac Mortgage Investment Trust	18,327	17,258	68,625	31,097
Net servicing income:				
Loan servicing fees				
From non-affiliates	14,596	2,154	35,397	8,776
From PennyMac Mortgage Investment Trust	10,738	4,600	27,251	13,163
From Investment Funds	1,813	2,484	6,060	9,130
Mortgage servicing rebate (to) from Investment Funds	(362)	135	(535)	(360)
Ancillary and other fees	2,777	1,153	7,700	3,661
	29,562	10,526	75,873	34,370
Amortization, impairment and change in estimated fair value of mortgage servicing rights	(8,163)	(4,414)	(16,363)	(9,024)
Net servicing income	21,399	6,112	59,510	25,346
Management fees:				
From PennyMac Mortgage Investment Trust	8,539	3,672	23,486	7,964
From Investment Funds	2,001	2,442	5,889	7,199
	10,540	6,114	29,375	15,163
Carried Interest from Investment Funds	2,812	3,355	10,411	7,254
Net interest income (expense):				
Interest income	5,093	1,914	11,310	4,491
Interest expense	4,156	2,042	11,686	4,226
	937	(128)	(376)	265
Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust	165	314	(68)	630
Other	785	695	1,842	1,886
Total net revenue	87,194	76,232	296,139	155,567
Expenses				
Compensation	35,830	31,856	113,850	77,756
Professional services	2,831	1,287	7,901	3,538
Loan origination	2,802	1,787	7,825	1,803
Technology	2,587	1,057	6,203	3,161
Servicing	1,931	999	5,072	2,438
Occupancy	796	394	1,883	1,078
Other	5,500	989	12,966	2,890
Total expenses	52,277	38,369	155,700	92,664
Income before provision for income taxes	34,917	37,863	140,439	62,903
Provision for income taxes	3,493		5,531	
Net income	31,424	$ 37,863	134,908	$ 62,903
Less: Net income attributable to noncontrolling interest	26,227		126,918	

Net income attributable to PennyMac Financial Services, Inc. common stockholders	$ 5,197	$ 7,990
Earnings per common share		
Basic	$ 0.29	$ 0.50
Diluted	$ 0.28	$ 0.50
Weighted-average common shares outstanding		
Basic	17,958	16,042
Diluted	75,876	75,867

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

Table of Contents

PENNYMAC FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

	PennyMac Financial Services, Inc. Stockholders							Noncontrolling interest in Private	
	Number of Shares		Common stock		Additional	Retained	Members	National Mortgage Acceptance	
	Class A	Class B	Class A	Class B	paid-in capital	earnings	equity	Company, LLC	Total equity
						(in thousands)			
Balance at December 31, 2011			$	$	$	$	$ 123,915	$	$ 123,915
Capital:									
Contributions							15,058		15,058
Redemptions							(6)		(6)
Distributions							(11,369)		(11,369)
Unit-based compensation expense							13,880		13,880
Net income							62,903		62,903
Balance at September 30, 2012			$	$	$	$	$ 204,381	$	$ 204,381
Balance at December 31, 2012			$	$	$	$	$ 261,750	$	$ 261,750
Capital:									
Distributions							(19,623)		(19,623)
Unit-based compensation expense							238		238
Partner capital issuance costs							(3,745)		(3,745)
Net income							76,834		76,834
Exchange of existing member units to Class A units of Private National Mortgage Acceptance Company, LLC							(315,454)	315,454	
Balance post-reorganization								315,454	315,454
Issuance of common shares in initial public offering, net of issuance costs	12,778		1		229,999				230,000
Underwriting and offering costs					(13,290)			(196)	(13,486)
Dilution assumed with IPO					(127,160)			127,160	
Stock-based compensation expense					891			1,265	2,156
Distributions								(3,395)	(3,395)
Net income						7,990		50,084	58,074
Tax related impact to exchange of Class A Units of Private National Mortgage Acceptance Company, LLC to Class A stock of PennyMac Financial Services, Inc.					1,158				1,158
Exchange of Class A units of Private National Mortgage Acceptance Company, LLC to Class A stock of PennyMac Financial	6,110		1		44,886			(44,887)	

Services, Inc.																
Balance at September 30, 2013	18,888	$	2	$		$	136,484	$	7,990	$		$		445,485	$	589,961

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

Table of Contents

PENNYMAC FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine months ended September 30, 2013	2012
	(in thousands)	
Cash flow from operating activities:		
Net income	$ 134,908	$ 62,903
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net gain on mortgage loans held for sale at fair value	(108,560)	(68,487)
Accrual of servicing rebate to Investment Funds	535	360
Amortization, impairment and change in fair value of mortgage servicing rights	16,363	9,024
Carried Interest from Investment Funds	(10,411)	(7,255)
Change in fair value of investment in common shares of PennyMac Mortgage Investment Trust	196	(506)
Change in fair value of real estate acquired in settlement of loans	22	
Stock and unit-based compensation expense	2,394	13,880
Amortization of debt issuance costs and commitment fees relating to financing facilities	3,714	1,261
Depreciation and amortization	594	389
Purchase of mortgage loans held for sale from PennyMac Mortgage Investment Trust	(12,429,698)	(5,111,185)
Originations of mortgage loans held for sale	(895,405)	(304,402)
Sale and principal payments of mortgage loans held for sale	13,210,810	5,112,530
Increase in servicing advances	(12,192)	(12,989)
Increase in prepaid expenses	(9,094)	(3,457)
Repurchase of real estate acquired in settlement of loans subject to representations and warranties	(309)	
Sale of real estate acquired in settlement of loans subject to representations and warranties	287	
Decrease in receivable from Investment Funds	596	3,674
(Increase) decrease in receivable from PennyMac Mortgage Investment Trust	(1,790)	2,528
Decrease (increase) in other assets	4,087	(2,962)
Increase in accounts payable and accrued expenses	17,060	15,695
(Decrease) increase in payable to Investment Funds	(371)	4,821
Increase in payable to PennyMac Mortgage Investment Trust	8,158	10,325
Net cash used in operating activities	(68,106)	(273,853)
Cash flow from investing activities:		
Net (increase) decrease in short-term investment	(74,323)	12,625
Purchase of mortgage servicing rights	(5,124)	
Sale of mortgage servicing rights	550	
Purchase of furniture, fixtures, equipment and building improvements	(4,719)	(2,495)
Acquisition of capitalized software	(242)	(379)
Increase in margin deposits and restricted cash	5,349	(27,524)
Net cash used in investing activities	(78,509)	(17,773)
Cash flow from financing activities:		
Sale of loans under agreements to repurchase	12,225,201	4,924,895
Repurchase of loans sold under agreements to repurchase	(12,230,851)	(4,641,117)
Increase in note payable	3,762	15,433
Issuance of excess servicing spread financing	2,828	
Issuance of common stock	230,000	
Payment of common stock underwriting and offering costs	(13,486)	
Payment by noncontrolling interest of common stock issuance costs	(3,745)	
Noncontrolling interest repayments of partners capital contributions		15,058
Noncontrolling interest collection of subscriptions receivable		(6)

Noncontrolling interest distributions		(23,019)		(11,368)
Net cash provided by financing activities		190,690		302,895
Net increase in cash		44,075		11,269
Cash at beginning of period		12,323		16,465
Cash at end of period	$	56,398	$	27,734

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

Table of Contents

PENNYMAC FINANCIAL SERVICES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Organization and Basis of Presentation

PennyMac Financial Services, Inc. (PFSI or the Company) was formed as a Delaware corporation on December 31, 2012. Pursuant to a reorganization, the Company became a holding corporation and its sole asset is an equity interest in Private National Mortgage Acceptance Company, LLC (PennyMac). The Company is the managing member of PennyMac and operates and controls all of the businesses and affairs of PennyMac subject to the consent rights of other members under certain circumstances and, through PennyMac and its subsidiaries, continues to conduct the business previously conducted by these subsidiaries.

PennyMac is a Delaware limited liability company which, through its subsidiaries, engages in mortgage banking and investment management activities. PennyMac s mortgage banking activities consist of residential mortgage lending (including correspondent lending and retail lending) and loan servicing. The investment management activities and a portion of the loan servicing activities are conducted on behalf of investment vehicles that invest in residential mortgage loans and related assets. PennyMac s primary wholly-owned subsidiaries are:

- *PNMAC Capital Management, LLC* (PCM) a Delaware limited liability company registered with the Securities and Exchange Commission (SEC) as an investment adviser under the Investment Advisers Act of 1940, as amended. PCM enters into investment management agreements with entities that invest in residential mortgage loans and related assets.

Presently, PCM has management agreements with PennyMac Mortgage Investment Trust, a publicly held real estate investment trust (PMT), and three investment funds: PNMAC Mortgage Opportunity Fund, LLC and PNMAC Mortgage Opportunity Fund, L.P., (the Master Fund), both registered under the Investment Company Act of 1940, as amended; and PNMAC Mortgage Opportunity Fund Investors, LLC (collectively, Investment Funds). Together, the Investment Funds and PMT are referred to as the Advised Entities.

- *PennyMac Loan Services, LLC* (PLS) a Delaware limited liability company that services portfolios of residential mortgage loans on behalf of non-affiliates or the Advised Entities, originates new prime credit quality residential mortgage loans, and engages in other mortgage banking activities for its own account and the account of PMT.

PLS is approved as a seller/servicer of mortgage loans by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) and as an issuer of securities guaranteed by the Government National Mortgage Association (Ginnie Mae). PLS is a licensed Federal Housing Administration Nonsupervised Title II Lender with the U.S. Department of Housing and Urban Development (HUD) and a lender/servicer with the Veterans Administration (VA) (each an Agency and collectively the Agencies).

- *PNMAC Opportunity Fund Associates, LLC* (PMOFA) a Delaware limited liability company and the general partner of the Master Fund. PMOFA is entitled to incentive fees representing allocations of profits (Carried Interest) from the Master Fund.

Initial Public Offering and Recapitalization

On May 14, 2013, PFSI completed an initial public offering (IPO) in which it sold approximately 12.8 million shares of its Class A common stock, at a public offering price of $18.00 per share. PFSI received net proceeds of $216.8 million, after deducting net underwriting discounts and commissions, from sales of its shares in the IPO. PFSI used these net proceeds to purchase approximately 12.8 million Class A Units of PennyMac. PFSI operates and controls all of the business and affairs and consolidates the financial results of PennyMac and its subsidiaries. The purchase of 12.8 million Class A Units of PennyMac has been accounted for as a transfer of interests under common control. Accordingly, the accompanying consolidated financial statements reflect a reclassification of members equity to noncontrolling interests in the Company of $315.5 million. This amount represents the carrying value in the Company of the existing owners of PennyMac that has been purchased for the Class A Units of PennyMac.

Table of Contents

Before the IPO, PennyMac completed a reorganization by amending its limited liability company agreement to convert all classes of ownership interests held by its existing owners to a single class of common units. The conversion of existing interests was based on the various interests liquidation priorities as specified in PennyMac s prior limited liability company agreement. In connection with that reorganization, PFSI became the sole managing member of PennyMac.

After the completion of the recapitalization and reorganization transactions, PennyMac is a consolidated subsidiary of the Company, accordingly, PennyMac s consolidated financial statements are the Company s historical financial statements. The historical consolidated financial statements of PennyMac are reflected herein based on the historical ownership interests of the existing owners of PennyMac.

Tax Receivable Agreement

As part of the IPO, PFSI entered into an Exchange Agreement with PennyMac s existing owners whereby the existing owners may exchange their PennyMac units for PFSI stock. Before 2013, PennyMac made an election pursuant to Section 754 of the Internal Revenue Code which remains in effect. An exchange results in a special adjustment for PFSI that may increase PFSI s tax basis of the assets of PennyMac that otherwise would not have been available. These increases in tax basis may reduce the amount of income tax that PFSI would otherwise be required to pay in the future. These increases in tax basis may also decrease gains (or increase losses) on future dispositions of certain assets to the extent tax basis is allocated to those assets.

PFSI entered into a tax receivable agreement with PennyMac s existing unitholders that will provide for the payment by PFSI to PennyMac exchanged unitholders an amount equal to 85% of the amount of the benefits, if any, that PFSI is deemed to realize as a result of (i) increases in tax basis resulting from exchanges and (ii) certain other tax benefits related to PFSI entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

The term of the tax receivable agreement will continue until all such tax benefits have been utilized or expired, unless PFSI exercises its right to terminate the tax receivable agreement. In the event of termination of the tax receivable agreement, the Company would be required to make an immediate payment equal to the present value of the anticipated future net tax benefits, which upfront payment may be made years in advance of the actual realization of such future benefits.

Basis of presentation

The Company s unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) and applicable rules and regulations of the SEC regarding interim financial reporting. The information included in this quarterly report on Form 10-Q should be read with the financial statements and accompanying notes included herein.

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 to be anticipated for the full year ending December 31, 2013.

Reclassification of previously presented balances

Net interest income:

Interest expense is presented along with *Interest income* as a new caption of *Net interest income* to better reflect our results due to growth in the Company s portfolio of interest-earning assets. Previously, *Interest expenses* were included within *Total expenses* whereby, the balance is presented within *Total net revenue* during the three and nine months ended September 30, 2013 and 2012.

Note 2 Concentration of Risk

A substantial portion of the Company s activities relate to the Advised Entities. Fees charged to these entities (comprised of management fees, loan servicing fees and loan servicing rebates, Carried Interest and fulfillment fees from PMT) totaled 50% and 45% of total net revenues for the quarters ended September 30, 2013 and 2012, respectively, and 48% for both the nine month periods ended September 30, 2013 and 2012.

Note 3 Significant Accounting Policies

The Company s updated accounting policies are summarized below.

Stock-Based Compensation

The Company s 2013 Equity Incentive Plan provides for awards of nonstatutory and incentive stock options (Stock Options), time-based restricted stock units, performance-based restricted stock units, stock appreciation rights, performance units and stock grants. The Company estimates the value of the Stock Options, time-based restricted stock units and performance-based restricted stock units awarded with reference to the value of its underlying common stock on the date of the award. Compensation costs are fixed, except for performance-based restricted stock units, at the estimated fair value as of the award date as all grantees are employees and directors of the Company or PennyMac. The Company amortizes the cost of time-based restricted stock unit awards to compensation expense over the vesting period using the graded vesting method. The Company amortizes performance-based restricted stock unit awards on a straight-line basis over the vesting period. Expense relating to awards is included in *Compensation* in the consolidated statements of income.

Table of Contents

Income Taxes

As a result of the PennyMac recapitalization and reorganization, the Company expects to benefit from amortization and other tax deductions due to an increase in tax basis due to the exchange of PennyMac Class A units. Those deductions will be allocated to the Company and will be taken into account in reporting the Company's taxable income. The Company has entered into an agreement with the unitholders of PennyMac that will provide for the additional payment by the Company to exchanging unitholders of PennyMac equal to 85% of the amount of cash savings, if any, in U.S. federal, state and local income tax that PFSI realizes due to (i) increases in tax basis resulting from exchanges of the then-existing unitholders and (ii) certain other tax benefits related to PFSI entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

The Company is subject to federal and state income taxes. Income taxes are provided using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

The effect on deferred taxes of a change in tax rates is recognized as income in the period in which the change occurs. A valuation allowance is established if, in management s judgment, it is not more likely than not that the deferred tax asset will be realized.

The Company recognizes tax benefits relating to its tax positions only if, in the opinion of management, it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority. A tax position that meets this standard is recognized as the largest amount that is greater than 50% likely to be realized upon ultimate settlement with the appropriate taxing authority. The Company will classify any penalties and interest as a component of provision for income taxes.

Note 4 Transactions with Affiliates

PennyMac Mortgage Investment Trust

Management Fees

Before February 1, 2013, under a management agreement, PennyMac received from PMT a base management fee. The base management fee was calculated at 1.5% per year of PMT s shareholders equity. The management agreement also provided for a performance incentive fee, which was calculated at 20% per year of the amount by which PMT s core earnings, on a rolling four-quarter basis and before the incentive fee, exceeded an 8% hurdle rate as defined in the management agreement. PennyMac did not earn a performance incentive fee before February 1, 2013.

Effective February 1, 2013, the management agreement was amended to provide that:

- The base management fee is calculated quarterly and is equal to the sum of (i) 1.5% per year of PMT s shareholders equity up to $2 billion, (ii) 1.375% per year of shareholders equity in excess of $2 billion and up to $5 billion, and (iii) 1.25% per year of PMT s shareholders equity in excess of $5 billion.

- The performance incentive fee is calculated at a defined annualized percentage of the amount by which PMT s net income, on a rolling four-quarter basis and before deducting the incentive fee, exceeds certain levels of return on equity.

The performance incentive fee is calculated quarterly and is equal to the sum of: (a) 10% of the amount by which PMT s net income for the quarter exceeds (i) an 8% return on equity plus the high watermark, up to (ii) a 12% return on PMT s equity; plus (b) 15% of the amount by which PMT s net income for the quarter exceeds (i) a 12% return on PMT s equity plus the high watermark, up to (ii) a 16% return on PMT s equity; plus (c) 20% of the amount by which PMT s net income for the quarter exceeds a 16% return on equity plus the high watermark.

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

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

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

The high watermark starts at zero and is adjusted quarterly. The quarterly adjustment reflects the amount by which the net income (stated as a percentage of return on equity) in that quarter exceeds or falls short of the lesser of 8% and the Fannie Mae Mortgage-Backed Security (MBS) yield (the target yield) for such quarter. If the net

Table of Contents

income is lower than the target yield, the high watermark is increased by the difference. If the net income is higher than the target yield, the high watermark is reduced by the difference. Each time a performance incentive fee is earned, the high watermark returns to zero. As a result, the threshold amounts required for the Company to earn a performance incentive fee are adjusted cumulatively based on the performance of PMT s net income over (or under) the target yield, until the net income in excess of the target yield exceeds the then-current cumulative high watermark amount, and a performance incentive fee is earned.

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

Following is a summary of the base management and performance incentive fees earned from PMT for the periods presented:

	Quarter ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
		(in thousands)		
Base management fee	$ 5,104	$ 3,672	$ 14,043	$ 7,964
Performance incentive fee	3,435		9,443	
	$ 8,539	$ 3,672	$ 23,486	$ 7,964

The term of the management agreement, as amended, expires on February 1, 2017, subject to automatic renewal for additional 18-month periods, unless terminated earlier in accordance with the terms of the management agreement.

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

Mortgage Loan Servicing

The Company has a loan servicing agreement with PMT. Before February 1, 2013, the servicing fee rates were based on the risk characteristics of the mortgage loans serviced and total servicing compensation was established at levels that management believed were competitive with those charged by other servicers or specialty servicers, as applicable.

- Servicing fee rates for nonperforming loans ranged between 50 and 100 basis points per year on the unpaid principal balance of the mortgage loans serviced on PMT s behalf. PennyMac was also entitled to certain customary market-based fees and charges, including boarding and deboarding fees, liquidation and disposition fees, assumption, modification and origination fees and late charges, as well as interest on funds on deposit in custodial accounts. In the event PennyMac either effected a refinancing of a loan on PMT s behalf and not through a third party lender and the resulting loan was readily saleable, or originated a loan to facilitate the disposition of real estate that PMT had acquired in settlement of a loan, PennyMac was entitled to receive from PMT market-based fees and compensation.

• For mortgage loans serviced by PMT as a result of acquisitions and sales with servicing rights retained in connection with PMT s correspondent lending business, PennyMac was entitled to base subservicing fees and other customary market-based fees and charges as described above.

Effective February 1, 2013, the servicing agreement was amended to provide for servicing fees payable to the Company that changed from being based on a percentage of the loan s unpaid principal balance to fixed per-loan monthly amounts based on the delinquency, bankruptcy and/or foreclosure status of the serviced loan or the real estate acquired in settlement of loans (REO). The Company also remains entitled to market-based fees and charges including boarding and deboarding fees, liquidation and disposition fees, assumption, modification and origination fees and late charges relating to loans it services for PMT.

• The base servicing fees for distressed whole loans are calculated based on a monthly per-loan dollar amount, with the actual dollar amount for each loan based on the delinquency, bankruptcy and/or foreclosure status of such loan or the related underlying real estate. Presently, the base servicing fees for distressed whole loans range from $30 per month for current loans up to $125 per month for loans that are severely delinquent and in foreclosure.

Table of Contents

• The base servicing fees for non-distressed loans subserviced by the Company on PMT s behalf are also calculated through a monthly per-loan dollar amount, with the actual dollar amount for each loan based on whether the mortgage loan is a fixed-rate or adjustable-rate loan. The base servicing fees for loans subserviced on PMT s behalf are $7.50 per month for fixed-rate loans and $8.50 per month for adjustable rate mortgage loans. To the extent that these loans become delinquent, the Company is entitled to an additional servicing fee per loan falling within a range of $10 to $75 per month based on the delinquency, bankruptcy and foreclosure status of the loan or the related underlying real estate. The Company is also entitled to customary ancillary income and certain market-based fees and charges, including boarding and deboarding fees, liquidation and disposition fees, assumption, modification and origination fees.

• The Company is required to provide a range of services and activities significantly greater in scope than the services provided in connection with a customary servicing arrangement because PMT does not have any employees or infrastructure. For these services, the Company receives a supplemental fee of $25 per month for each distressed whole loan and $3.25 per month for each non-distressed subserviced loan. The Company is entitled to reimbursement for all customary, good faith reasonable and necessary out-of-pocket expenses incurred in performance of its servicing obligations.

• The Company, on behalf of PMT, currently participates in the Home Affordable Modification Program (HAMP) of the U.S. Department of the Treasury and U.S. Department of Housing and Urban Development (HUD) (and other similar mortgage loan modification programs). HAMP establishes standard loan modification guidelines for at risk homeowners and provides incentive payments to certain participants, including loan servicers, for achieving modifications and successfully remaining in the program. The loan servicing agreement entitles the Company to retain any incentive payments made to it and to which it is entitled under HAMP; provided, however, that with respect to any such incentive payments paid to the Company under HAMP in connection with a mortgage loan modification for which PMT previously paid the Company a modification fee, the Company shall reimburse PMT an amount equal to the incentive payments.

Following is a summary of mortgage loan servicing fees earned from PMT for the periods presented:

	Quarter ended September 30, 2013	Quarter ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
	(in thousands)			
Loan servicing fees:				
Base	$ 7,139	$ 3,518	$ 19,005	$ 9,656
Activity-based	3,599	1,082	8,246	3,507
	$ 10,738	$ 4,600	$ 27,251	$ 13,163

The term of the servicing agreement, as amended, expires on February 1, 2017, subject to automatic renewal for additional 18-month periods, unless terminated earlier in accordance with the terms of the servicing agreement.

Correspondent Lending

Before February 1, 2013, PMT paid PennyMac a fulfillment fee of 50 basis points of the unpaid principal balance of mortgage loans sold to non-affiliates where PMT is approved or licensed to sell to such non-affiliate. Effective February 1, 2013, the mortgage banking and warehouse services agreement provides for a fulfillment fee paid to the Company based on the type of mortgage loan that PMT acquires. The fulfillment fee is equal to a percentage of the unpaid principal balance of mortgage loans purchased by PMT, with the addition of potential fee rate discounts applicable to PMT s monthly purchase volume in excess of designated thresholds. The Company has also agreed to provide such services exclusively for PMT s benefit, and the Company and its affiliates are prohibited from providing such services for any other third party.

The Company is entitled to a fulfillment fee based on the type of mortgage loan that PMT acquires and equal to a percentage of the unpaid principal balance of such mortgage loan. Presently, the applicable percentages are (i) 0.50% for conventional mortgage loans, (ii) 0.88% for loans salable in accordance with the Ginnie Mae Mortgage-Backed Securities Guide, (iii) 0.80% for the U.S. Department of the Treasury and HUD s Home Affordable Refinance Program (HARP) mortgage loans with a loan-to-value ratio of 105% or less, (iv) 1.20% for HARP mortgage loans with a loan-to-value ratio of greater than 105%, and (v) 0.50% for all other mortgage loans not contemplated above; provided, however, that the Company may, in its sole discretion, reduce the amount of the applicable fulfillment fee and credit the amount of such reduction to the reimbursement otherwise due as described below. This reduction may only be credited to the reimbursement applicable to the month in which the related mortgage was funded.

In the event that PMT purchases mortgage loans with an unpaid principal balance in any month totaling more than $2.5 billion and less than $5 billion, the Company has agreed to discount the amount of such fulfillment fees by reimbursing PMT an amount equal to the product of (i) 0.025%, (ii) the amount of unpaid principal balance in excess of $2.5 billion and (iii) the percentage of the total unpaid principal balance relating to mortgage loans for which the Company collected fulfillment fees in such month. In the event PMT purchases mortgage loans with an total unpaid principal balance in any month greater than $5 billion, the Company has agreed to further discount the amount of fulfillment fees by reimbursing PMT an amount equal to the product of (i) 0.05%, (ii) the amount of unpaid principal balance in excess of $5 billion and (iii) the percentage of the total unpaid principal balance relating to mortgage loans for which the Company collected fulfillment fees in such month.

PMT does not hold the Ginnie Mae approval required to issue Ginnie Mae MBS and act as a servicer. Accordingly, under the mortgage banking and warehouse services agreement, the Company currently purchases loans salable in accordance with the Ginnie Mae Mortgage-Backed Securities Guide as is and without recourse of any kind to PMT at its cost less fees collected by PMT from the seller, plus accrued interest and a sourcing fee of three basis points.

In consideration for the mortgage banking services provided by the Company with respect to PMT s acquisition of mortgage loans under PLS s early purchase program, the Company is entitled to fees (i) accruing at a rate equal to $25,000 per year per early purchase facility administered by the Company, and (ii) in the amount of $50 for each mortgage loan PMT acquires. In consideration for the warehouse services provided by the Company with respect to mortgage loans that PMT finances for its warehouse lending clients, with respect to each facility, the Company is entitled to fees (i) accruing at a rate equal to $25,000 per year, and (ii) in the amount of $50 for each mortgage loan that PMT finances thereunder. Where PMT has entered into both an early purchase agreement and a warehouse lending agreement with the same client, the Company shall only be entitled to one $25,000 per year fee and, with respect to any mortgage loan that becomes subject to both such agreements, only one $50 per loan fee.

The term of the mortgage banking and warehouse services agreement expires on February 1, 2017, subject to automatic renewal for additional 18-month periods, unless terminated earlier in accordance with the terms of the agreement.

Following is a summary of correspondent lending activity between the Company and PMT for the periods presented:

	Quarter ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Sourcing fees paid	$ 1,204	$ 747	$ 3,563	$ 1,448
Fulfillment fee revenue	$ 18,327	$ 17,258	$ 68,625	$ 31,097
Unpaid principal balance of loans fulfilled for PMT	$ 3,681,771	$ 2,488,443	$ 12,792,482	$ 4,828,117
Fair value of loans purchased from PMT	$ 4,147,535	$ 2,650,097	$ 12,429,698	$ 5,111,185

Investment Activities

Pursuant to the terms of a mortgage servicing rights (MSR) recapture agreement, as amended, if the Company refinances through its retail lending business loans for which PMT previously held the MSRs, the Company is generally required to transfer and convey to one of PMT s wholly-owned subsidiaries, without cost to PMT, the MSRs with respect to new mortgage loans originated in those refinancings (or, under certain circumstances, other mortgage loans) that have a total unpaid principal balance that is not less than 30% of the total unpaid principal balance of all the loans so originated. Where the fair market value of the aggregate MSRs to be transferred for the applicable month is less than $200,000, the Company may, at its option, pay cash to PMT in an amount equal to such fair market value in lieu of transferring such MSRs. The MSR recapture agreement expires, unless terminated earlier in accordance with the agreement, on February 1, 2017, subject to automatic renewal for additional 18-month periods. The Company recorded MSR recapture totaling $86,000 and $586,000 for the quarter and nine months ended September 30, 2013, respectively, as a component of gain on mortgage loans held for sale.

Table of Contents

Pursuant to the terms of a master spread acquisition and MSR servicing agreement, as amended, PMT may acquire from the Company the rights to receive certain excess servicing spread arising from MSRs acquired by the Company, in which case the Company generally would be required to service or subservice the related mortgage loans. The terms of each transaction under the spread acquisition and MSR servicing agreement will be subject to the terms of such agreement as modified and supplemented by the terms of a confirmation executed in connection with such transaction.

Payable to Exchanged Private National Mortgage Acceptance Company, LLC Unitholders Under Tax Receivable Agreement

As discussed in Note 1, the Company entered into a tax receivable agreement with PennyMac s existing unitholders on the date of the IPO that will provide for the payment by PFSI to PennyMac s then-existing unitholders an amount equal to 85% of the amount of the benefits, if any, that PFSI is deemed to realize as a result of (i) increases in tax basis resulting from exchanges of the then-existing unitholders and (ii) certain other tax benefits related to entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement. Based on the PennyMac unitholder exchange during the period, the Company has recorded a $58.6 million liability and has not made a payment under the tax sharing agreement as of September 30, 2013.

Other Transactions

In connection with the IPO of PMT s common shares on August 4, 2009, the Company entered into an agreement with PMT pursuant to which PMT agreed to reimburse the Company for the $2.9 million payment that it made to the underwriters in such offering (the Conditional Reimbursement) if PMT satisfied certain performance measures over a specified period of time. Effective February 1, 2013, PMT amended the terms of the reimbursement agreement to provide for the reimbursement to the Company of the Conditional Reimbursement if PMT is required to pay the Company performance incentive fees under the management agreement at a rate of $10 in reimbursement for every $100 of performance incentive fees earned. The reimbursement of the Conditional Reimbursement is subject to a maximum reimbursement in any particular 12-month period of $1.0 million and the maximum amount that may be reimbursed under the agreement is $2.9 million. The Company received payments from PMT totaling $388,000 and $601,000 during the quarter and nine months ended September 30, 2013, respectively.

In the event the termination fee is payable to the Company under the management agreement and the Company has not received the full amount of the reimbursements and payments under the reimbursement agreement, such amount will be paid in full. The term of the reimbursement agreement expires on February 1, 2019.

PMT reimburses the Company for other expenses, including common overhead expenses incurred on its behalf by the Company, in accordance with the terms of its management agreement. Such amounts are summarized below:

	Quarter ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Reimbursement of expenses incurred on PMT s behalf	$ 1,934	$ 555	$ 3,767	$ 2,420
	2,552	1,244	8,359	2,474

Reimbursement of common overhead incurred by PCM and its affiliates	$	4,486	$	1,799	$	12,126	$	4,894
Payments and settlements during the period (1)	$	29,315	$	12,239	$	94,606	$	28,896

(1) Payments and settlements include payments for management fees and correspondent lending activities itemized in the preceding tables and netting settlements made pursuant to master netting agreements between the Company and PMT.

Amounts due from PMT are summarized below as of the dates presented:

	September 30, 2013		December 31, 2012	
	(in thousands)			
Management fees	$	8,539	$	4,473
Servicing fees		5,152		3,670
Underwriting fees		2,131		2,941
Allocated expenses		4,208		1,132
Loan purchases				4,475
	$	20,030	$	16,691

Table of Contents

The Company also holds an investment in PMT in the form of 75,000 common shares of beneficial interest as of September 30, 2013 and December 31, 2012. The shares had fair values of $1.7 million and $1.9 million as of September 30, 2013 and December 31, 2012, respectively.

Investment Funds

Amounts due from the Investment Funds are summarized below for the dates presented:

	September 30, 2013		December 31, 2012	
	(in thousands)			
Receivable from Investment Funds:				
Loan servicing fees	$	47	$	1,052
Loan servicing rebate		(123)		(239)
Management fees		2,001		2,164
Expense reimbursements		616		695
	$	2,541	$	3,672
Carried Interest due from Investment Funds:				
PNMAC Mortgage Opportunity Fund, LLC	$	36,357	$	29,785
PNMAC Mortgage Opportunity Fund Investors, LLC		21,777		17,938
	$	58,134	$	47,723

Amounts due to the Investment Funds totaling $36.4 million and $36.8 million represent amounts advanced by the Investment Funds to fund servicing advances made by the Company as of September 30, 2013 and December 31, 2012, respectively.

Note 5 Earnings Per Common Share

Basic earnings per common share is determined using net income divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share is determined by dividing net income attributable to common stockholders by the weighted-average of common shares outstanding, assuming all potentially dilutive common shares were issued.

The Company applies the treasury stock method to determine the dilutive weighted-average common shares represented by the unvested restricted stock units and the exchangeable PennyMac Class A units. The diluted earnings per share calculation assumes the exchange of these PennyMac Class A partnership units for shares of common stock. Accordingly, the numerator is also adjusted to include the earnings allocated to the PennyMac Class A units after taking into account the tax effect of such exchange.

Table of Contents

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

	Quarter ended September 30, 2013	Nine months ended September 30, 2013
	(in thousands, except per share amounts)	
Basic earnings per share of common stock:		
Net income attributable to common stockholders	$ 5,197	$ 7,990
Weighted-average shares outstanding	17,958	16,042
Basic earnings per share	$ 0.29	$ 0.50
Diluted earnings per share of common stock:		
Net income	$ 5,197	$ 7,990
Effect of net income attributable to noncontrolling interest, net of tax	15,685	29,595
Diluted net income attributable to common stockholders	$ 20,882	$ 37,585
Weighted-average common stock outstanding	17,958	16,042
Dilutive potential exchangeable PennyMac Class A common units to common stock	57,888	59,804
Dilutive potential common stock issuable under stock-based compensation plans	30	21
Diluted weighted-average common stock outstanding	75,876	75,867
Diluted earnings per share of common stock	$ 0.28	$ 0.50

Note 6 Loan Sales and Servicing Activities

The Company purchases and sells mortgage loans to the secondary mortgage market without recourse for credit losses. However, the Company maintains continuing involvement with the loans in the form of servicing arrangements and the liability under representations and warranties it makes to purchasers and insurers of the loans.

The following table summarizes cash flows between the Company and transferees upon sale of mortgage loans in transactions where the Company maintains continuing involvement with the mortgage loans (primarily the obligation to service the loans on behalf of the loans owners or owners agents):

	Quarter ended September 30, 2013	Quarter ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
	(in thousands)			
Cash flows:				
Sales proceeds	$ 4,515,106	$ 2,654,125	$ 13,210,810	$ 5,112,530
Servicing fees received	$ 16,403	$ 3,940	$ 38,104	$ 8,327
Net servicing advances	$ (717)	$ 1,009	$ (4,375)	$ 2,191
Quarter-end information:				
Unpaid principal balance of loans outstanding at period-end	$ 22,776,613	$ 6,444,618	$ 22,776,613	$ 6,444,618
Loans delinquent 30-89 days	$ 380,070	$ 93,069	$ 380,070	$ 93,069
Loans delinquent 90 or more days or in foreclosure or bankruptcy	$ 247,269	$ 39,950	$ 247,269	$ 39,950

Table of Contents

The Company s mortgage servicing portfolio is summarized as follows:

	Servicing rights owned	September 30, 2013 Contract servicing and subservicing (in thousands)	Total loans serviced
Affiliated entities	$	$ 29,555,254	$ 29,555,254
Agencies	21,725,393		21,725,393
Private investors	1,051,220	50,379	1,101,599
Mortgage loans held for sale	490,088		490,088
	$ 23,266,701	$ 29,605,633	$ 52,872,334
Amount subserviced for the Company	$ 42,201	$ 554,070	$ 596,271
Delinquent mortgage loans:			
30 days	$ 307,399	$ 265,806	$ 573,205
60 days	85,367	114,390	199,757
90 days or more	168,468	1,422,071	1,590,539
	561,234	1,802,267	2,363,501
Loans pending foreclosure	69,889	1,611,708	1,681,597
	$ 631,123	$ 3,413,975	$ 4,045,098
Custodial funds managed by the Company (1)	$ 389,267	$ 266,285	$ 655,552

	Servicing rights owned	December 31, 2012 Contract servicing and subservicing (in thousands)	Total loans serviced
Affiliated entities	$	$ 16,552,939	$ 16,552,939
Agencies	9,860,284		9,860,284
Private investors	1,321,584		1,321,584
Mortgage loans held for sale	417,742		417,742
	$ 11,599,610	$ 16,552,939	$ 28,152,549
Amount subserviced for the Company	$ 45,562	$ 375,818	$ 421,380
Delinquent mortgage loans:			
30 days	$ 191,884	$ 187,653	$ 379,537
60 days	60,886	122,564	183,450
90 days or more	112,847	851,851	964,698
	365,617	1,162,068	1,527,685
Loans pending foreclosure	75,329	1,290,687	1,366,016
	$ 440,946	$ 2,452,755	$ 2,893,701
Custodial funds managed by the Company (1)	$ 263,562	$ 150,080	$ 413,642

(1) Borrower and investor custodial cash accounts relate to loans serviced under the servicing agreements and are not recorded on the Company s consolidated balance sheets. The Company earns interest on custodial funds it manages on behalf of the loans investors, which is recorded as part of the interest income in the Company s consolidated statements of income.

Table of Contents

Following is a summary of the geographical distribution of loans included in the Company s servicing portfolio for the top five and all other states as measured by the total unpaid principal balance:

State	September 30, 2013	December 31, 2012
	(in thousands)	
California	$ 18,952,692	$ 10,696,508
Virginia	2,984,671	*
Texas	2,962,697	1,223,382
Florida	2,395,337	1,385,286
Colorado	2,109,970	1,299,295
Washington	*	1,143,849
All other states	23,466,967	12,404,229
	$ 52,872,334	$ 28,152,549

* State did not represent a top five state as of the respective date.

Certain of the loans serviced by the Company are subserviced on the Company s behalf by other mortgage loan servicers. Loans are subserviced for the Company when the loans are secured by property in the State of Massachusetts where the Company is not licensed and a license is required to perform such services, or on a transitional basis for loans where the Company has obtained the rights to service the loans but servicing of the loans has not yet transferred to the Company s servicing system.

Note 7 Netting of Financial Instruments

The Company uses derivative financial instruments to manage exposure to interest rate risk for the commitments it makes to purchase or originate mortgage loans at specified interest rates (interest rate lock commitments or IRLCs), its inventory of mortgage loans held for sale and MSRs. The Company has elected to net derivative asset and liability positions, and cash collateral obtained from (or posted to) its counterparties when subject to an enforceable master netting arrangement. In the event of default, all counterparties are subject to legally enforceable master netting agreements. The derivatives that are not subject to a master netting arrangement are IRLCs.

As of September 30, 2013 and December 31, 2012, the Company was not party to reverse repurchase agreements or securities lending transactions that are required to be disclosed in the following table.

Table of Contents

Offsetting of Derivative Assets

	September 30, 2013			December 31, 2012		
	Gross amount of recognized assets	Gross amount offset in the balance sheet	Net amount of assets in the balance sheet	Gross amount of recognized assets	Gross amount offset in the balance sheet	Net amount of assets in the balance sheet
	(in thousands)					
Derivatives subject to master netting arrangements:						
MBS put options	$	$	$	$ 967	$	$ 967
Forward purchase contracts	21,226		21,226	1,645		1,645
Forward sale contracts	505		505	1,818		1,818
Netting		(19,382)	(19,382)		(1,091)	(1,091)
	21,731	(19,382)	2,349	4,430	(1,091)	3,339
Derivatives not subject to master netting arrangements - IRLCs	21,717		21,717	23,951		23,951
	$ 43,448	$ (19,382)	$ 24,066	$ 28,381	$ (1,091)	$ 27,290

Derivative Assets, Financial Assets, and Collateral Held by Counterparty

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

	September 30, 2013				December 31, 2012			
		Gross amount not offfset in the consolidated balance sheet				Gross amount not offset in the consolidated balance sheet		
	Net amount of assets in the balance sheet	Financial instruments	Cash collateral received	Net amount	Net amount of assets in the balance sheet	Financial instruments	Cash collateral received	Net amount
	(in thousands)							
Interest rate lock commitments	$ 21,717	$	$	$ 21,717	$ 23,951	$	$	$ 23,951
Nomura	1,036			1,036				
Goldman Sachs	591			591				
Bank of America, N.A.					1,782			1,782
Citibank, N.A.					522			522
Bank of NY Mellon					311			311
Wells Fargo					18			18
Other	722			722	706			706
	$ 24,066	$	$	$ 24,066	$ 27,290	$	$	$ 27,290

Table of Contents

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 derivatives with the exception of IRLCs are subject to master netting arrangements. The assets sold under agreements to repurchase do not qualify for setoff accounting.

	September 30, 2013			December 31, 2012		
	Gross amount of recognized liabilities	Gross amount offset in the consolidated balance sheet	Net amount of liabilities in the consolidated balance sheet	Gross amount of recognized liabilities	Gross amount offset in the consolidated balance sheet	Net amount of liabilities in the consolidated balance sheet
	(in thousands)					
Derivatives:						
Subject to a master netting arrangement:						
Forward purchase contracts	$ 215	$	$ 215	$ 389	$	$ 389
Forward sale contracts	48,069		48,069	1,894		1,894
Netting		(42,667)	(42,667)		(1,785)	(1,785)
	48,284	(42,667)	5,617	2,283	(1,785)	498
Derivatives not subject to a master netting arrangement - IRLCs	159		159	11		11
Total derivatives	48,443	(42,667)	5,776	2,294	(1,785)	509
Mortgage loans sold under agreements to repurchase	387,883		387,883	393,534		393,534
	$ 436,326	$ (42,667)	$ 393,659	$ 395,828	$ (1,785)	$ 394,043

Derivative Liabilities, Financial Liabilities, and Collateral Held 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 does not qualify under the accounting guidance for setoff accounting. All assets sold under agreements to repurchase are secured by sufficient collateral or exceed the liability amount recorded on the consolidated balance sheets.

	September 30, 2013				December 31, 2012			
		Gross amount not offset in the consolidated balance sheet				Gross amount not offset in the consolidated balance sheet		
	Net amount of liabilities in the consolidated balance sheet	Financial instruments	Cash collateral pledged	Net amount	Net amount of liabilities in the consolidated balance sheet	Financial instruments	Cash collateral pledged	Net amount

(in thousands)

Interest rate lock commitments	$ 159	$	$	$ 159	$ 11	$	$	$ 11
Bank of America, N.A.	200,074	(199,423)		651	150,082	(150,082)		
Credit Suisse First Boston Mortgage Capital LLC	188,645	(188,460)		185	122,443	(122,252)		191
Daiwa Capital Markets	1,589			1,589	20			20
Morgan Stanley Bank, N.A.	543			543	53			53
Bank of NY Mellon	524			524				
Citibank, N.A.	34			34	121,200	(121,200)		
Other	2,091			2,091	234			,234
	$ 393,659	$ (387,883)	$	$ 5,776	$ 394,043	$ (393,534)	$	$ 509

Table of Contents

Note 8 Fair Value

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

Fair Value Accounting Elections

Management identified all of its non-cash financial assets and its originated MSRs relating to loans with initial interest rates of more than 4.5% to be accounted for at estimated fair value so changes in fair value will be reflected in results of operations as they occur and more timely reflect the results of the Company s performance. The Company s financial assets subject to this election include the short-term investments and mortgage loans held for sale.

For originated MSRs relating to mortgage loans with initial interest rates of less than or equal to 4.5%, management has concluded that such assets present different risks to the Company than originated MSRs relating to mortgage loans with initial interest rates of more than 4.5% and therefore require a different risk management approach. Management s risk management efforts relating to these assets are aimed at mainly moderating the effects of non-interest rate risks on fair value, such as the effect of changes in home prices on the assets values. Management has identified these assets for accounting using the amortization method.

Management s risk management efforts in connection with MSRs relating to mortgage loans with initial interest rates of more than 4.5% are aimed at mainly moderating the effects of changes in interest rates on the assets values. At times during the nine months ended September 30, 2013, a portion of the IRLCs, the fair value of which typically increases when prepayment speeds increase, were used to moderate the effect of changes in fair value of MSRs, which typically decreases as prepayment speeds increase.

Table of Contents

Financial Statement Items Measured at Fair Value on a Recurring Basis

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

	September 30, 2013			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investment	$ 127,487	$	$	$ 127,487
Mortgage loans held for sale at fair value		526,063	4,185	530,248
Investment in PMT	1,701			1,701
Mortgage servicing rights at fair value			26,768	26,768
Derivative assets:				
Interest rate lock commitments			21,717	21,717
Forward purchase contracts		21,226		21,226
Forward sales contracts		505		505
Total derivative assets before netting		21,731	21,717	43,448
Netting (1)				(19,382)
Total derivative assets		21,731	21,717	24,066
	$ 129,188	$ 547,794	$ 52,670	$ 710,270
Liabilities:				
Excess servicing spread financing at fair value	$	$	$ 2,857	$ 2,857
Derivative liabilities:				
Interest rate lock commitments			159	159
Forward purchase contracts		215		215
Forward sales contracts		48,069		48,069
Total derivative liabilities before netting		48,284	159	48,443
Netting (1)				(42,667)
Total derivative liabilities		48,284	159	5,776
	$	$ 48,284	$ 3,016	$ 8,633

(1) Derivatives are reported net of cash collateral received and paid and, to the extent that the criteria of the accounting guidance covering the offsetting of amounts related to certain contracts are met, positions with the same counterparty are netted as part of a legally enforceable master netting agreement.

Table of Contents

Assets:				
Short-term investment	$ 53,164	$	$	$ 53,164
Mortgage loans held for sale at fair value		448,384		448,384
Investment in PMT	1,897			1,897
Mortgage servicing rights at fair value			19,798	19,798
Derivative assets:				
Interest rate lock commitments			23,951	23,951
Forward purchase contracts		1,645		1,645
Forward sales contracts		1,818		1,818
MBS put options		967		967
Total derivative assets before netting		4,430	23,951	28,381
Netting (1)				(1,091)
Total derivative assets		4,430	23,951	27,290
	$ 55,061	$ 452,814	$ 43,749	$ 550,533
Liabilities:				
Derivative liabilities:				
Interest rate lock commitments	$	$	$ 11	$ 11
Forward purchase contracts		389		389
Forward sales contracts		1,894		1,894
Total derivative liabilities before netting		2,283	11	2,294
Netting (1)				(1,785)
Net derivative liabilities	$	$ 2,283	$ 11	$ 509

(1) Derivatives are reported net of cash collateral received and paid and, to the extent that the criteria of the accounting guidance covering the setoff of amounts related to certain contracts are met, positions with the same counterparty are netted as part of a legally enforceable master netting agreement.

Table of Contents

As shown above, certain of the Company s mortgage loans held for sale, MSRs at fair value, IRLCs, and excess servicing spread financing at fair value are measured using Level 3 inputs. Following is a roll forward of these items for the quarters and nine month periods ended September 30, 2013 and 2012 where Level 3 significant inputs were used on a recurring basis:

	Quarter ended September 30, 2013			
	Mortgage loans held for sale	Mortgage servicing rights	Net interest rate lock commitments (1)	Total
	(in thousands)			
Assets:				
Balance, June 30, 2013	$ 4,525	$ 23,070	$ (16,210)	$ 11,385
Repayments	(436)			(436)
Interest rate lock commitments issued, net			23,788	23,788
Purchases of MSR		1,116		1,116
Servicing received as proceeds from sales of mortgage loans		4,157		4,157
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk				
Other factors	96	(1,575)	10,585	9,106
	96	(1,575)	10,585	9,106
Transfers of interest rate lock commitments (asset) liability to mortgage loans acquired for sale			3,395	3,395
Balance, September 30, 2013	$ 4,185	$ 26,768	$ 21,558	$ 52,511
Changes in fair value recognized during the period relating to assets still held at September 30, 2013	$ 16	$ (1,575)	$ 21,558	
Accumulated changes in fair value relating to assets still held at September 30, 2013	$ 96		$ 21,558	

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

	Excess servicing spread financing (in thousands)
Liability:	
Balance, June 30, 2013	$
Initial proceeds received from financing of excess servicing spread	2,828
Changes in fair value included in income	29
Repayments	
Balance, September 30, 2013	$ 2,857
Changes in fair value recognized during the period relating to liability still held at September 30, 2013	$ 29
Accumulated changes in fair value relating to liability still held at September 30, 2013	$ 29

22

Table of Contents

	Quarter ended September 30, 2012		
	Mortgage servicing rights	Net interest rate lock commitments (in thousands)	Total
Balance, June 30, 2012	$ 23,449	$ 12,710	$ 36,159
Interest rate lock commitments issued, net		48,044	48,044
Servicing received as proceeds from sales of mortgage loans	30		30
Changes in fair value included in income arising from:			
Changes in instrument-specific credit risk			
Other factors	(2,239)	128	(2,111)
	(2,239)	128	(2,111)
Transfers of interest rate lock commitments (asset) liability to mortgage loans acquired for sale		(27,449)	(27,449)
Balance, September 30, 2012	$ 21,240	$ 33,433	$ 54,673
Changes in fair value recognized during the period relating to assets still held at September 30, 2012	$ (2,239)	$ 33,433	
Accumulated changes in fair value relating to assets still held at September 30, 2012		$ 33,433	

Table of Contents

	Nine months ended September 30, 2013			
	Mortgage loans held for sale	Mortgage servicing rights	Net interest rate lock commitments (1)	Total
	(in thousands)			
Assets:				
Balance, December 31, 2012	$	$ 19,798	$ 23,940	$ 43,738
Repurchases	5,529			5,529
Repayments	(1,059)			(1,059)
Interest rate lock commitments issued, net			78,722	78,722
Purchases of MSR		5,124		5,124
Sales of MSR		(550)		(550)
Servicing received as proceeds from sales of mortgage loans		4,177		4,177
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk				
Other factors	(285)	(1,781)	(15,289)	(17,355)
	(285)	(1,781)	(15,289)	(17,355)
Transfers of interest rate lock commitments (asset) liability to mortgage loans acquired for sale			(65,815)	(65,815)
Balance, September 30, 2013	$ 4,185	$ 26,768	$ 21,558	$ 52,511
Changes in fair value recognized during the period relating to assets still held at September 30, 2013	$ (344)	$ (1,781)	$ 21,558	
Accumulated changes in fair value relating to assets still held at September 30, 2013	$ (285)		$ 21,558	

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

	Excess servicing spread financing
	(in thousands)
Liability:	
Balance, December 31, 2012	$
Initial proceeds received from financing of excess servicing spread	2,828
Changes in fair value included in income	29
Repayments	
Balance, September 30, 2013	$ 2,857
Changes in fair value recognized during the period relating to liability still held at September 30, 2013	$ 29
Accumulated changes in fair value relating to liability still held at September 30, 2013	$ 29

Table of Contents

	Nine months ended September 30, 2012		
	Mortgage servicing rights	Net interest rate lock commitments (in thousands)	Total
Balance, December 31, 2011	$ 25,698	$ 7,905	$ 33,603
Interest rate lock commitments issued, net		65,192	65,192
Servicing received as proceeds from sales of mortgage loans	772		772
Changes in fair value included in income arising from:			
Changes in instrument-specific credit risk			
Other factors	(5,230)		(5,230)
	(5,230)		(5,230)
Transfers of interest rate lock commitments (asset) liability to mortgage loans acquired for sale		(39,664)	(39,664)
Balance, September 30, 2012	$ 21,240	$ 33,433	$ 54,673
Changes in fair value recognized during the period relating to assets still held at September 30, 2012	$ (5,230)	$ 33,433	
Accumulated changes in fair value relating to assets still held at September 30, 2012		$ 33,433	

The information used in the preceding roll forwards represents activity for any financial statement items identified as using Level 3 significant inputs at either the beginning or the end of the periods presented. The Company had no transfers in or out among the levels other than transfers of IRLCs to mortgage loans held for sale at fair value upon funding of the respective mortgage loans.

Gains (losses) from changes in estimated fair values included in earnings for financial statement items carried at estimated fair value as a result of management s election of the fair value option are summarized below:

	Quarter ended September 30, 2013			Quarter ended September 30, 2012		
	Change in fair value of mortgage loans held for sale at fair value	Net servicing income	Total	Change in fair value of mortgage loans held for sale at fair value	Net servicing income	Total
			(in thousands)			
Assets:						
Mortgage loans held for sale at fair value	$ (6,060)	$	$ (6,060)	$ 56,079	$	$ 56,079
Mortgage servicing rights at fair value		(1,575)	(1,575)		(2,239)	(2,239)
	$ (6,060)	$ (1,575)	$ (7,635)	$ 56,079	$ (2,239)	$ 53,840
Liabilities:						
Excess servicing spread financing at fair value	$	$ (29)	$ (29)	$	$	$
	$	$ (29)	$ (29)	$	$	$

Table of Contents

[redacted]						
Assets:						
[redacted]						
Mortgage servicing rights at fair value		(1,781)	(1,781)		(5,230)	(5,230)
[redacted]						
Liabilities:						
[redacted]						
	$	$ (29)	$ (29)	$	$	$

Following are the fair value and related principal amounts due upon maturity of assets and liabilities accounted for under the fair value option as of the dates presented:

	September 30, 2013		
	Fair value	Principal amount due upon maturity (in thousands)	Difference
Mortgage loans held for sale:			
Current through 89 days delinquent	$ 529,244	$ 496,853	$ 32,391
90 or more days delinquent	1,004	1,297	(293)
	$ 530,248	$ 498,150	$ 32,098

	December 31, 2012		
	Fair value	Principal amount due upon maturity (in thousands)	Difference
Mortgage loans held for sale:			
Current through 89 days delinquent	$ 447,889	$ 418,650	$ 29,239
90 or more days delinquent	495	623	(128)
	$ 448,384	$ 419,273	$ 29,111

Financial Statement Items Measured at Fair Value on a Nonrecurring Basis

Following is a summary of financial statement items that are measured at estimated fair value on a nonrecurring basis as of the dates presented:

	September 30, 2013 (in thousands)			
	Level 1	Level 2	Level 3	Total
Mortgage servicing rights at lower of amortized cost or fair value	$	$	$ 102,116	$ 102,116

$	$	$	102,116	$	102,116

Table of Contents

	December 31, 2012							
	Level 1		Level 2		Level 3		Total	
	(in thousands)							
Mortgage servicing rights at lower of amortized cost or fair value	$		$		$	51,180	$	51,180
	$		$		$	51,180	$	51,180

The following table summarizes the total gains (losses) on assets measured at estimated fair values on a nonrecurring basis:

	Quarter ended September 30,				Nine months ended September 30,			
	2013		2012		2013		2012	
	(in thousands)							
Mortgage servicing rights at lower of amortized cost or fair value	$	(1,164)	$	(1,000)	$	(521)	$	(1,784)
	$	(1,164)	$	(1,000)	$	(521)	$	(1,784)

The Company evaluates its MSRs at lower of amortized cost or fair value for impairment with reference to the assets fair values. For purposes of performing its MSR impairment evaluation, the Company stratifies its MSRs at lower of amortized cost or fair value based on the interest rates borne by the mortgage loans underlying the MSRs. Mortgage loans are grouped into note rate pools of 50 basis points for fixed-rate mortgage loans with note rates between 3% and 4.5% and a single pool for mortgage loans with note rates below 3%. MSRs 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 MSRs in any of the note rate pools is below the amortized cost of the MSRs for that pool reduced by any existing valuation allowance, those MSRs are impaired.

When MSRs are impaired, the impairment is recognized in current period income and the carrying value of the MSRs is adjusted using a valuation allowance. If the value of the MSRs subsequently increases, the increase in value is recognized in current period income only to the extent of the valuation allowance.

Management periodically reviews the various impairment strata to determine whether the value of the impaired MSRs in a given stratum is likely to recover. When management concludes that recovery of the value is unlikely in the foreseeable future, a write-down of the cost of the MSRs for that note rate pool to its estimated fair value is charged to the valuation allowance.

Fair Value of Financial Instruments Carried at Amortized Cost

The Company s *Cash* as well as its *Mortgage loans sold under agreements to repurchase, Note payable, Carried Interest due from Investment Funds*, and amounts receivable from and payable to the Advised Entities are carried at amortized cost.

Cash is measured using Level 1 significant inputs. The Company s borrowings carried at amortized cost do not have active markets or observable inputs and the fair value is measured using management s best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation. The Company has classified these financial instruments as Level 3 financial statement items as of September 30, 2013 and December 31, 2012 due to the lack of current market activity and the Company s reliance on unobservable inputs to estimate the fair value.

Management has concluded that the carrying value of the *Carried Interest due from Investment Funds* approximates its fair value as the balance represents the amount distributable to the Company at the balance sheet date assuming liquidation of the Investment Funds. Management has concluded that the estimated fair value of the *Note payable* approximates the agreements carrying value due to the agreements short term and variable interest rates.

The Company also carries the receivable from and payable to the Advised Entities at cost. Management has concluded that the estimated fair value of such balances approximates the carrying value due to the short terms of such balances.

Table of Contents

Valuation Techniques and Assumptions

Most of the Company s financial assets are carried at fair value with changes in fair value recognized in current period income. Certain of the Company s financial assets and all of its MSRs are Level 3 financial statement items which require the use of significant unobservable inputs in the estimation of the assets values. Unobservable inputs reflect the Company s own assumptions about the factors that market participants use in pricing an asset or liability, and are based on the best information available under the circumstances.

The Company has assigned the responsibility for estimating the fair values of Level 3 financial statement items to its Financial Analysis and Valuation group (the FAV group), which is responsible for valuing and monitoring the Company s investment portfolios and maintenance of its valuation policies and procedures.

The FAV group reports to the Company s senior management valuation committee, which oversees and approves the valuations. The FAV group monitors the models used for valuation of the Company s Level 3 financial statement items, including the models performance versus actual results and reports those results to the Company s senior management valuation committee. The results developed in the FAV group s monitoring activities may be used to calibrate subsequent projections used for valuation.

The FAV group is responsible for reporting to the Company s senior management valuation committee on a monthly basis on the changes in the valuation of the portfolio, including major factors affecting the valuation and any changes in model methods and assumptions. 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.

Following is a description of the techniques and assumptions used in estimating the fair values of Level 2 and Level 3 fair value financial statement items:

Mortgage Loans Held for Sale

Most of the Company s mortgage loans held for sale at fair value are salable into active markets and are therefore categorized as Level 2 fair value financial statement items and their fair values are estimated using their quoted market or contracted price or market price equivalent.

Certain of the Company s mortgage loans may become non-salable into active markets due to identification of a defect by the Company or to the repurchase of a mortgage loan with an identified defect. Because such loans are generally not salable into active mortgage markets, they are classified as Level 3 financial statement items. The significant unobservable inputs used in the fair value measurement of the Company s non-salable mortgage loans held for sale at fair value are discount rates, 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 loans fair value measurement. Increases in home price projections are generally accompanied by an increase in voluntary prepayment speeds.

The Company did not hold Level 3 mortgage loans held for sale before 2013. Following is a quantitative summary of key inputs used in the valuation of Level 3 mortgage loans held for sale at fair value:

	September 30, 2013 Range (Weighted average)
Key Inputs	
Discount rate	7.8% - 13.4%
	(9.2%)
Twelve-month projected housing price index change	6.7% - 7.3%
	(6.8%)
Prepayment speed (1)	2.1% - 5.6%
	(4.8%)
Total prepayment speed (2)	3.4% - 5.7%
	(5.1%)

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

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

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

Table of Contents

Derivative Financial Instruments

The Company categorizes IRLCs as a Level 3 financial statement item. The Company estimates the fair value of an IRLC based on quoted Agency MBS prices, its estimate of the fair value of the MSRs it expects to receive in the sale of the loans and the probability that the mortgage loan will fund or be purchased as a percentage of the commitment 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 value of the mortgage loans it has committed to purchase. Significant changes in the pull-through rate and the MSR component of the IRLCs, in isolation, could result in a significant change in fair value measurement. The financial effects of changes in these assumptions 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 loans that have decreased in fair value in comparison to the agreed-upon purchase price.

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

	September 30, 2013	**December 31, 2012**
	Range (Weighted average)	
Key Inputs		
Pull-through rate	56.6% - 98.0%	61.6% 98.1%
	(78.3%)	(79.1%)
MSR value expressed as:		
Servicing fee multiple	2.1 - 5.0	3.2 4.2
	(4.0)	(4.0)
Percentage of unpaid principal balance	0.4% - 2.6%	0.6% 2.2%
	(1.1%)	(0.9%)

The Company estimates the fair value of commitments to sell loans based on quoted MBS prices. The Company estimates the fair value of the MBS options and futures it purchases and sells based on observed interest rate volatilities in the MBS market.

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. This approach consists of projecting servicing cash flows discounted at a rate that management believes market participants would use in their determinations of value. The key assumptions used in the estimation of the fair value of MSRs include prepayment rates of the underlying loans, the applicable discount rate or pricing spread, and the cost to service loans.

The results of the estimates of fair value of MSRs are reported to the Company s senior management valuation committee as part of their review and approval of monthly valuation results. Changes in the fair value of MSRs are included in the consolidated statements of income under the caption *Net servicing income Amortization, impairment and change in estimated fair value of mortgage servicing rights*.

Table of Contents

Key assumptions used in determining the fair value of MSRs at the time of initial recognition are as follows:

	Quarter ended September 30,			
	2013		2012	
	Range (Weighted average)			
	Fair value	Amortized cost	Fair value	Amortized cost
Unpaid principal balance of underlying loans	$315,869	$4,120,962	$4,217	$2,485,982
Weighted-average servicing fee rate (in basis points)	31	30	27	27
Pricing spread (1)	7.4% - 13.1%	5.4% - 15.9%	7.5% - 9.9%	7.5% - 9.9%
	(9.9%)	(8.2%)	(7.8%)	(9.8%)
Annual total prepayment speed (2)	8.8% - 17.2%	8.5% - 14.7%	8.4% - 9.5%	8.4% - 9.5%
	(9.2%)	(8.8%)	(9.2%)	(8.4%)
Life (in years)	3.6 7.0	2.9 6.9	6.4 6.7	6.4 6.7
	(6.9)	(6.7)	(6.4)	(6.7)
Cost of servicing	$68 $120	$68 $120	$68 $100	$68 $100
	($101)	($104)	($71)	($99)

	Nine months ended September 30,			
	2013		2012	
	Range (Weighted average)			
	Fair value	Amortized cost	Fair value	Amortized cost
Unpaid principal balance of underlying loans	$318,066	$12,350,104	$17,504	$4,811,328
Weighted-average servicing fee rate (in basis points)	31	29	28	27
Pricing spread (1)	7.4% - 13.1%	5.4% - 15.9%	7.5% - 9.9%	7.5% - 9.9%
	(9.9%)	(8.2%)	(8.4%)	(9.8%)
Annual total prepayment speed (2)	8.8% - 17.2%	8.5% - 18.5%	7.8% - 9.5%	7.8% - 9.5%
	(9.2%)	(8.8%)	(8.6%)	(8.3%)
Life (in years)	3.6 7.0	2.9 6.9	5.9 6.9	5.9 6.9
	(6.9)	(6.7)	(6.4)	(6.7)
Cost of servicing	$68 $120	$68 $120	$68 $100	$68 $100
	($101)	($102)	($77)	($99)

(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 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 CPR.

Following is a quantitative summary of key inputs used in the valuation of the Company s MSRs at period end and the effect on the estimated fair value from adverse changes in those assumptions (weighted averages are based upon unpaid principal balance):

30

Table of Contents

Purchased MSRs backed by distressed mortgage loans

[redacted]		
Carrying value	$10,125	$12,370
Unpaid principal balance of underlying loans	$1,051,220	$1,271,478
Weighted-average note rate	5.88%	6.01%
Weighted-average servicing fee rate (in basis points)	50	50
Discount rate	15.3% 15.3%	15.3% 15.3%
	(15.3%)	(15.3%)
Effect on value of 5% adverse change	($252)	($302)
Effect on value of 10% adverse change	($494)	($590)
Effect on value of 20% adverse change	($945)	($1,130)
Life (in years)	4.8 4.8	5.0 5.0
	(4.8)	(5.0)
Prepayment speed (1)	11.7% 11.7%	10.7% 10.7%
	(11.7%)	(10.7%)
Effect on value of 5% adverse change	($252)	($273)
Effect on value of 10% adverse change	($492)	($529)
Effect on value of 20% adverse change	($951)	($1,040)
Per-loan cost of servicing	$250 $250	$270 $270
	($250)	($270)
Effect on value of 5% adverse change	($223)	($290)
Effect on value of 10% adverse change	($447)	($580)
Effect on value of 20% adverse change	($893)	($1,159)

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

Table of Contents

All other MSRs

	September 30, 2013		December 31, 2012	
	Range (Weighted average)			
	Fair value	Amortized cost	Fair value	Amortized cost
	(Unpaid principal balance of underlying loans and effect on value amounts in thousands)			
Carrying value	$16,643	$226,090	$7,428	$89,177
Unpaid principal balance of underlying loans	$1,700,612	$20,024,781	$1,166,765	$8,730,686
Weighted-average note rate	4.68%	3.57%	5.22%	3.65%
Weighted-average servicing fee rate (in basis points)	27	28	26	28
Pricing spread (1)	6.4% 17.5%	5.4% 15.9%	7.5% 19.5%	7.5% 16.5%
	(8.9%)	(7.6%)	(10.6%)	(9.8%)
Effect on value of 5% adverse change	($303)	($4,833)	($113)	($1,814)
Effect on value of 10% adverse change	($596)	($9,488)	($222)	($3,562)
Effect on value of 20% adverse change	($1,153)	($18,303)	($430)	($6,870)
Average life (in years)	0.2 14.4	2.6 6.9	0.2 14.4	2.5 6.9
	(6.6)	(6.7)	(5.0)	(6.6)
Prepayment speed (2)	8.7% 72.8%	8.5% 16.0%	9.0% 84.2%	8.7% 28.3%
	(10.6%)	(9.0%)	(19.2%)	(9.2%)
Effect on value of 5% adverse change	($376)	($4,696)	($238)	($1,751)
Effect on value of 10% adverse change	($738)	($9,238)	($462)	($3,446)
Effect on value of 20% adverse change	($1,423)	($17,891)	($877)	($6,674)
Per-loan cost of servicing	$68 $120	$68 $120	$68 $140	$68 $140
	($77)	($102)	($76)	($99)
Effect on value of 5% adverse change	($150)	($2,383)	($77)	($963)
Effect on value of 10% adverse change	($300)	($4,766)	($153)	($1,926)
Effect on value of 20% adverse change	($601)	($9,531)	($307)	($3,852)

(1) Pricing spread represents a margin that is applied to a reference interest rate s forward curve to develop periodic discount rates. 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 and purchased MSRs not backed by pools of distressed mortgage loans.

(2) Prepayment speed is measured using CPR.

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

Table of Contents

Excess Servicing Spread Financing at Fair Value

The Company categorizes excess servicing spread financing as a Level 3 financial statement item. The Company uses a discounted cash flow approach to estimate the fair value of excess servicing spread financing. The key assumptions used in the fair value estimate of excess servicing spread financing include pricing spread, average life, and prepayment speed. Significant changes to any of those inputs in isolation could result in a significant change in the excess servicing spread financing fair value measurement. Changes in these key assumptions are not necessarily directly related.

Excess servicing spread is generally subject to loss in value when mortgage rates decrease. Decreasing mortgage rates normally encourage increased mortgage refinancing activity. Increased refinancing activity reduces the life of the loans underlying the excess servicing spread, thereby reducing excess servicing spread financing s value. Reductions in the value of excess servicing spread financing affect income primarily through change in fair value.

Interest expense for excess servicing spread financing is accrued using the interest method based upon the expected income from the excess servicing spread through the expected life of the underlying mortgages. Changes to expected cash flows result in a change in fair value which is recorded in *Amortization, impairment and change in estimated fair value of mortgage servicing rights*.

Following are the key inputs used in determining the fair value of excess servicing spread financing at the time of initial recognition:

Key Inputs	
Pricing spread	6.80%
Average life	6.7
Prepayment speed	9.1%

Note 9 Mortgage Loans Held for Sale at Fair Value

Mortgage loans held for sale at fair value include the following:

	September 30, 2013	December 31, 2012
	(in thousands)	
Conforming	$ 57,651	$ 50,003
Government-insured or guaranteed	468,412	398,381
Repurchased mortgage loans	4,185	
	$ 530,248	$ 448,384
Fair value of mortgage loans pledged to secure mortgage loans sold under agreements to repurchase	$ 522,031	$ 438,850

Note 10 Derivative Instruments

The Company is exposed to price risk relative to its mortgage loans held for sale as well as to its IRLCs. The Company bears price risk from the time an IRLC is made to PMT or a loan applicant to the time the mortgage loan is sold. The Company is exposed to loss in value of its IRLCs and mortgage loans held for sale when mortgage rates increase. The Company is also exposed to loss in value of its MSRs when interest rates decrease.

The Company engages in interest rate risk management activities in an effort to reduce the variability of earnings caused by changes in market interest rates. To manage this 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 value of the Company s IRLCs, inventory of mortgage loans held for sale and MSRs. The Company does not use derivative financial instruments for purposes other than in support of its risk management activities.

Table of Contents

The Company had the following derivative financial instruments recorded on its consolidated balance sheets:

Instrument	September 30, 2013 Notional amount	Fair value Derivative assets	Fair value Derivative liabilities	December 31, 2012 Notional amount	Fair value Derivative assets	Fair value Derivative liabilities
	(in thousands)					
Derivatives not designated as hedging instruments						
Free-standing derivatives:						
Interest rate lock commitments	1,163,531	$ 21,717	$ 159	1,576,174	$ 23,951	$ 11
Forward purchase contracts	1,580,434	21,226	215	1,021,981	1,645	389
Forward sales contracts	3,086,889	505	48,069	2,621,948	1,818	1,894
MBS put options				500,000	967	
Total derivatives before netting		43,448	48,443		28,381	2,294
Netting		(19,382)	(42,667)		(1,091)	(1,785)
		$ 24,066	$ 5,776		$ 27,290	$ 509

The following table summarizes the activity for derivative contracts used to hedge the Company s IRLCs and inventory of mortgage loans held for sale at notional value:

Period/Instrument	Balance beginning of period	Additions	Dispositions/ expirations	Balance end of period
	(in thousands)			
Quarter ended September 30, 2013				
Forward purchase contracts	2,071,590	13,386,366	(13,877,522)	1,580,434
Forward sales contracts	4,226,940	18,727,428	(19,867,479)	3,086,889
MBS call options	625,000	300,000	(925,000)	
MBS put options	260,000	50,000	(310,000)	

Period/Instrument	Balance beginning of period	Additions	Dispositions/ expirations	Balance end of period
	(in thousands)			
Quarter ended September 30, 2012				
Forward purchase contracts	545,175	5,707,334	(5,351,309)	901,200
Forward sales contracts	1,522,674	8,324,782	(7,336,268)	2,511,188
MBS call options	5,000	5,000	(10,000)	
MBS put options	210,000	512,000	(387,000)	335,000

Period/Instrument	Balance beginning of period	Additions	Dispositions/ expirations	Balance end of period

		(in thousands)		
Nine months ended September 30, 2013				
Forward purchase contracts	1,021,981	35,012,198	(34,453,745)	1,580,434
Forward sales contracts	2,621,948	51,199,986	(50,735,045)	3,086,889
MBS call options		2,100,000	(2,100,000)	
MBS put options	500,000	2,210,000	(2,710,000)	

Table of Contents

Period/Instrument	Balance beginning of period	Additions	Dispositions/ expirations	Balance end of period
		(in thousands)		
Nine months ended September 30, 2012				
Forward purchase contracts	130,900	10,197,428	(9,427,128)	901,200
Forward sales contracts	510,569	16,424,121	(14,423,502)	2,511,188
MBS call options	3,000	168,000	(171,000)	
MBS put options	29,000	885,000	(579,000)	335,000

The Company recorded net losses on derivative financial instruments used to hedge the Company s IRLCs and mortgage loans held for sale at fair value totaling $4.6 million and $39.0 million for the quarters ended September 30, 2013 and September 30, 2012, respectively. The Company recorded net gains on derivative financial instruments totaling $101.9 million for the nine months ended September 30, 2013 and net losses totaling $64.5 million for the nine months ended September 30, 2012. Derivative gains and losses are included in *Net gains on mortgage loans held for sale at fair value* in the Company s consolidated statements of income.

The Company did not record any net gains or losses on derivative financial instruments used as economic hedges of MSRs for the quarter ended September 30, 2013. The Company recorded net losses on derivative financial instruments used as economic hedges of MSRs totaling $1.3 million for the nine months ended September 30, 2013. The derivative losses are included in *Amortization, impairment and change in estimated fair value of mortgage servicing rights* in the Company s consolidated statements of income.

Note 11 Mortgage Servicing Rights

Carried at Fair Value:

The activity in MSRs carried at fair value is as follows:

	Quarter ended September 30, 2013	Quarter ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
	(in thousands)			
Balance at beginning of period	$ 23,070	$ 23,449	$ 19,798	$ 25,698
Additions:				
Servicing resulting from MSR purchases	1,116		5,124	
Servicing resulting from loan sales	4,157	30	4,177	772
Sales			(550)	
Change in fair value:				
Due to changes in valuation inputs or assumptions used in valuation model (1)	(635)	(882)	1,233	(1,218)
Other changes in fair value (2)	(940)	(1,357)	(3,014)	(4,012)
Total change in fair value	(1,575)	(2,239)	(1,781)	(5,230)
Balance at end of period	$ 26,768	$ 21,240	$ 26,768	$ 21,240

(1) Principally reflects changes in discount rates and prepayment speed assumptions, primarily due to changes in interest rates.

(2) Represents changes due to realization of cash flows.

Table of Contents

Carried at Lower of Amortized Cost or Fair Value:

The activity in MSRs carried at the lower of amortized cost or fair value is summarized below:

	Quarter ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Amortized cost:				
Balance at beginning of period	$ 179,003	$ 30,305	$ 92,155	$ 6,496
Additions:				
Servicing resulting from loan sales	55,981	25,590	150,175	50,234
Amortization	(5,367)	(1,127)	(12,713)	(1,962)
Application of valuation allowance to write down MSRs with other-than-temporary impairment				
Balance at end of period	229,617	54,768	229,617	54,768
Valuation allowance for impairment of MSRs:				
Balance at beginning of period	(2,335)	(854)	(2,978)	(70)
Additions	(1,192)	(1,000)	(549)	(1,784)
Application of valuation allowance to write down MSRs with other-than-temporary impairment				
Balance at end of period	(3,527)	(1,854)	(3,527)	(1,854)
MSRs, net	$ 226,090	$ 52,914	$ 226,090	$ 52,914
Estimated fair value of MSRs at end of period	$ 239,326	$ 53,419	$ 239,326	$ 53,419

The following table summarizes the Company s estimate of future amortization of its existing MSRs. This projection was developed using the assumptions made by management in its September 30, 2013 valuation of MSRs. The assumptions underlying the following estimate will change as market conditions and portfolio composition and behavior change, causing both actual and projected amortization levels to change over time.

12-month period ending September 30,	Estimated MSR amortization (in thousands)
2014	$ 22,633
2015	21,637
2016	20,658
2017	19,910
2018	18,859
Thereafter	125,920
Total	$ 229,617

Servicing fees relating to MSRs are recorded in *Net servicing income Loan servicing fees From non-affiliates* on the consolidated statements of income; late charges, ancillary and other fees are recorded in *Net servicing income Loan servicing fees Ancillary and other fees* on the consolidated statements of income and are summarized below:

	Quarter ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Contractual servicing fees	$ 14,596	$ 2,154	$ 35,397	$ 8,776
Late charges	527	209	1,336	682
Ancillary and other fees	140	72	374	194
	$ 15,263	$ 2,435	$ 37,107	$ 9,652

Table of Contents

Note 12 Carried Interest Due from Investment Funds

The activity in the Company s Carried Interest due from Investment Funds is summarized as follows:

	Quarter ended September 30, 2013	Quarter ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
		(in thousands)		
Balance at beginning of period	$ 55,322	$ 41,149	$ 47,723	$ 37,250
Carried Interest recognized during the period	2,812	3,355	10,411	7,254
Proceeds received during the period				
Balance at end of period	$ 58,134	$ 44,504	$ 58,134	$ 44,504

The amount of the Carried Interest received by the Company depends on the Investment Funds future performance. As a result, the amount of Carried Interest recorded by the Company at period end is subject to adjustment based on future results of the Investment Funds and may be reduced in future periods. However, the Company is not required to pay guaranteed returns to the Investment Funds and the amount of Carried Interest will only be reduced to the extent of amounts previously recognized.

Management expects the Carried Interest to be collected by the Company when the Investment Funds liquidate. The investment period for the Investment Funds ended on December 31, 2011. The Investment Funds will continue in existence through December 31, 2016, subject to three one-year extensions by PCM at its discretion as specified in the limited liability company and limited partnership agreements that govern the Investment Funds.

Note 13 Investment in PennyMac Mortgage Investment Trust at Fair Value

Following is a summary of *Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust:*

	Quarter ended September 30, 2013	Quarter ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
		(in thousands)		
Dividends	$ 43	$ 41	$ 128	$ 124
Change in fair value	122	273	(196)	506
	$ 165	$ 314	$ (68)	$ 630

Fair value of PMT shares at period end	$ 1,701