

PENNYMAC FINANCIAL SERVICES, INC.

Form 10-Q

August 07, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

Or

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

For the transition period from to

Commission file number: 001-35916

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 No

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

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

company” in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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

Class	Outstanding at August 5, 2015
Class A Common Stock, \$0.0001 par value	21,792,701
Class B Common Stock, \$0.0001 par value	52

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PENNYMAC FINANCIAL SERVICES, INC.

FORM 10-Q

June 30, 2015

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SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

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

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

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

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

You should not place undue reliance on any forward looking statement and should consider the following uncertainties and risks, as well as the risks and uncertainties discussed elsewhere in this Report and the section entitled “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2014, filed with the SEC on March 13, 2015.

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

- the continually changing federal, state and local laws and regulations applicable to the highly regulated industry in which we operate;
- lawsuits or governmental actions if we do not comply with the laws and regulations applicable to our businesses;
- the mortgage lending and servicing-related regulations promulgated by the Consumer Financial Protection Bureau (“CFPB”) and its enforcement of these regulations;
- our dependence on U.S. government sponsored entities and changes in their current roles or their guarantees or guidelines;
- changes to government mortgage modification programs;

- the licensing and operational requirements of states and other jurisdictions applicable to our businesses, to which our bank competitors are not subject;
- foreclosure delays and changes in foreclosure practices;
- certain banking regulations that may limit our business activities;
- our dependence on the multi-family and commercial real estate sectors for future originations and investments in commercial mortgage loans and other commercial real estate related loans;
- changes in macroeconomic and U.S. real estate market conditions;
- difficulties inherent in growing loan production volume;
- difficulties inherent in adjusting the size of our operations to reflect changes in business levels;
- purchase opportunities for mortgage servicing rights (“MSRs”) and our success in winning bids;
- changes in prevailing interest rates;

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- increases in loan delinquencies and defaults;
- our reliance on PennyMac Mortgage Investment Trust (“PMT”) as a significant source of financing for, and revenue related to, our mortgage banking business;
- any required additional capital and liquidity to support business growth that may not be available on acceptable terms, if at all;
- our obligation to indemnify third party purchasers or repurchase loans if loans that we originate, acquire, service or assist in the fulfillment of, fail to meet certain criteria or characteristics or under other circumstances;
- our obligation to indemnify PMT and certain investment funds if our services fail to meet certain criteria or characteristics or under other circumstances;
- decreases in the historical returns on the assets that we select and manage for our clients, and our resulting management and incentive fees;
- the extensive amount of regulation applicable to our investment management segment;
- conflicts of interest in allocating our services and investment opportunities among ourselves and certain advised entities;
- the effect of public opinion on our reputation;
- our recent growth;
- our ability to effectively identify, manage, monitor and mitigate financial risks;
- our initiation of new business activities or expansion of existing business activities;
 - our ability to detect misconduct and fraud; and
- our ability to mitigate cybersecurity risks and cyber incidents.

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

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

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 30, 2015	December 31, 2014
	(in thousands, except share data)	
ASSETS		
Cash	\$ 74,728	\$ 76,256
Short-term investments at fair value	23,577	21,687
Mortgage loans held for sale at fair value (includes \$1,369,324 and \$976,772 pledged to secure mortgage loans sold under agreements to repurchase; and \$202,076 and \$148,133 pledged to secure mortgage loan participation and sale agreement)	1,594,262	1,147,884
Derivative assets	43,568	38,457
Servicing advances, net (includes \$21,589 and \$18,686 valuation allowance)	244,806	228,630
Carried Interest due from Investment Funds	68,713	67,298
Investment in PennyMac Mortgage Investment Trust at fair value	1,307	1,582
Mortgage servicing rights (includes \$581,269 and \$325,383 at fair value; \$536,172 and \$392,254 pledged to secure note payable; and \$359,102 and \$191,166 subject to excess servicing spread financing)	1,135,510	730,828
Furniture, fixtures, equipment and building improvements, net	11,773	11,339
Capitalized software, net	1,250	567
Note receivable from PennyMac Mortgage Investment Trust—secured	52,526	—
Receivable from PennyMac Mortgage Investment Trust	16,245	23,871
Receivable from Investment Funds	2,148	2,291
Deferred tax asset	34,165	46,038
Loans eligible for repurchase	77,529	72,539
Other	48,498	37,419
Total assets	\$ 3,430,605	\$ 2,506,686
LIABILITIES		
Mortgage loans sold under agreements to repurchase	\$ 1,263,248	\$ 822,182
Mortgage loan participation and sale agreement	195,959	143,638
Note payable	246,456	146,855
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	359,102	191,166
Derivative liabilities	13,584	6,513
Accounts payable and accrued expenses	84,357	62,715
Mortgage servicing liabilities at fair value	11,791	6,306
Payable to Investment Funds	31,255	35,908

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Payable to PennyMac Mortgage Investment Trust	139,699	123,315
Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement	71,895	75,024
Liability for loans eligible for repurchase	77,529	72,539
Liability for losses under representations and warranties	16,257	13,259
Total liabilities	2,511,132	1,699,420
Commitments and contingencies		
STOCKHOLDERS' EQUITY		
Class A common stock—authorized 200,000,000 shares of \$0.0001 par value; issued and outstanding, 21,790,666 and 21,577,686 shares, respectively	2	2
Class B common stock—authorized 1,000 shares of \$0.0001 par value; issued and outstanding, 52 and 54 shares, respectively	—	—
Additional paid-in capital	167,536	162,720
Retained earnings	73,019	51,242
Total stockholders' equity attributable to PennyMac Financial Services, Inc. common stockholders	240,557	213,964
Noncontrolling interest in Private National Mortgage Acceptance Company, LLC	678,916	593,302
Total stockholders' equity	919,473	807,266
Total liabilities and stockholders' equity	\$ 3,430,605	\$ 2,506,686

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

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Quarter ended June 30,		Six months ended	
	2015	2014	June 30, 2015	2014
	(in thousands, except earnings per share)			
Revenues				
Net gains on mortgage loans held for sale at fair value:				
From non-affiliates	\$ 85,411	\$ 42,230	\$ 162,078	\$ 78,666
Recapture payable to PennyMac Mortgage Investment Trust	(1,456)	(2,526)	(2,745)	(4,424)
	83,955	39,704	159,333	74,242
Loan origination fees	24,421	10,345	41,103	17,225
Fulfillment fees from PennyMac Mortgage Investment Trust	15,333	12,433	28,199	21,335
Net loan servicing fees:				
Loan servicing fees				
From non-affiliates	66,867	43,314	116,968	79,414
From PennyMac Mortgage Investment Trust	12,136	14,180	22,806	28,771
From Investment Funds	153	4,161	1,121	5,638
Ancillary and other fees	11,850	4,838	23,035	9,989
	91,006	66,493	163,930	123,812
Amortization, impairment and change in fair value of mortgage servicing rights	(15,324)	(19,586)	(69,008)	(37,933)
Change in fair value of excess servicing spread payable to PennyMac Mortgage Investment Trust	(7,133)	10,062	403	14,854
	(22,457)	(9,524)	(68,605)	(23,079)
Net loan servicing fees	68,549	56,969	95,325	100,733
Management fees:				
From PennyMac Mortgage Investment Trust	5,779	8,912	12,782	16,986
From Investment Funds	1,184	2,086	2,670	4,121
	6,963	10,998	15,452	21,107
Carried Interest from Investment Funds	182	1,834	1,415	3,991
Net interest expense:				
Interest income:				
To non-affiliates	12,651	6,252	21,584	10,362
To PennyMac Mortgage Investment Trust	533	—	533	—
	13,184	6,252	22,117	10,362
Interest expense:				
To non-affiliates	10,531	5,593	18,608	9,117
To PennyMac Mortgage Investment Trust	5,818	3,139	9,570	6,001
	16,349	8,732	28,178	15,118
Net interest expense	(3,165)	(2,480)	(6,061)	(4,756)
	(244)	(103)	(137)	12

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Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust				
Other	357	735	2,036	2,038
Total net revenue	196,351	130,435	336,665	235,927
Expenses				
Compensation	70,422	46,971	128,566	89,857
Servicing	28,603	11,694	38,338	14,784
Technology	6,490	3,741	11,428	6,564
Loan origination	4,148	1,998	8,499	3,415
Professional services	4,074	2,661	6,907	4,860
Other	7,815	5,323	14,890	9,339
Total expenses	121,552	72,388	208,628	128,819
Income before provision for income taxes	74,799	58,047	128,037	107,108
Provision for income taxes	8,619	6,630	14,733	12,153
Net income	66,180	51,417	113,304	94,955
Less: Net income attributable to noncontrolling interest	53,431	41,799	91,527	77,365
Net income attributable to PennyMac Financial Services, Inc. common stockholders	\$ 12,749	\$ 9,618	\$ 21,777	\$ 17,590
Earnings per share				
Basic	\$ 0.59	\$ 0.45	\$ 1.01	\$ 0.84
Diluted	\$ 0.59	\$ 0.45	\$ 1.01	\$ 0.83
Weighted average common shares outstanding				
Basic	21,700	21,142	21,647	21,005
Diluted	76,105	75,915	76,063	75,895

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

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

PennyMac Financial Services, Inc. Stockholders

	Number of shares		Common stock		Additional	Retained
	Class A	Class B	Class A	Class B	paid-in	earnings
	(in thousands)				capital	
2013	20,813	—	\$ 2	\$ —	\$ 153,000	\$ 14,400
	—	—	—	—	—	17,590
	32	—	—	—	1,596	—
	—	—	—	—	—	—
in	4	—	—	—	74	—
s						
of						
e						
.C to						
ces,	479	—	—	—	4,598	—
Class						
l						
ac	—	—	—	—	(291)	—
	21,328	—	\$ 2	\$ —	\$ 158,977	\$ 31,990
2014	21,578	—	\$ 2	\$ —	\$ 162,720	\$ 51,242
	—	—	—	—	—	21,777
	72	—	—	—	2,452	—
	—	—	—	—	—	—
in	8	—	—	—	149	—
s						
of						
e						
.C to						
ces,	133	—	—	—	2,432	—
Class	—	—	—	—	(217)	—
l						

ac
21,791 — \$ 2 \$ — \$ 167,536 \$ 73,019 \$

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

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six months ended June 30,	
	2015	2014
	(in thousands)	
Cash flow from operating activities		
Net income	\$ 113,304	\$ 94,955
Adjustments to reconcile net income to net cash used in operating activities:		
Net gains on mortgage loans held for sale at fair value	(159,333)	(74,242)
Accrual of servicing rebate to Investment Funds	1,114	563
Amortization, impairment and change in fair value of mortgage servicing rights and excess servicing spread	68,605	23,079
Carried Interest from Investment Funds	(1,415)	(3,991)
Accrual of interest on excess servicing spread financing	9,570	6,001
Amortization of debt issuance costs and commitment fees relating to financing facilities	3,631	2,646
Change in fair value of investment in common shares of PennyMac Mortgage Investment Trust	275	76
Stock and unit-based compensation expense	8,598	5,482
Provision for servicing advance losses	16,013	—
Depreciation and amortization	911	612
Purchase of mortgage loans held for sale from PennyMac Mortgage Investment Trust	(13,523,345)	(7,085,859)
Originations of mortgage loans held for sale	(2,052,648)	(728,040)
Purchase of mortgage loans from Ginnie Mae securities for modification and subsequent sale	(531,842)	(679,882)
Capitalization of interest on mortgage loans held for sale at fair value	(4,745)	—
Sale and principal payments of mortgage loans held for sale	15,619,191	8,022,045
Sale of mortgage loans held for sale to PennyMac Mortgage Investment Trust	10,828	—
Repurchase of mortgage loans by PennyMac Mortgage Investment Trust	8,777	—
Repurchase of mortgage loans subject to representations and warranties	(11,567)	(1,784)
Increase in servicing advances	(32,189)	(30,254)
Increase in receivable from Investment Funds	(971)	(2,302)
Decrease in receivable from PennyMac Mortgage Investment Trust	9,175	343
Decrease in deferred tax asset	12,826	10,721
Decrease in payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement	(4,299)	—

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Increase in other assets	(14,282)	(27,005)
Increase in accounts payable and accrued expenses	20,941	24,040
Decrease in payable to Investment Funds	(4,653)	(2,008)
Increase in payable to PennyMac Mortgage Investment Trust	16,120	13,360
Net cash used in operating activities	(421,410)	(431,444)
Cash flow from investing activities		
(Increase) decrease in short-term investments	(1,890)	96,191
Advance on note receivable from PennyMac Mortgage Investment Trust—secured	(71,072)	—
Repayment of note receivable from PennyMac Mortgage Investment Trust—secured	18,546	—
Purchase of mortgage servicing rights	(270,133)	(97,644)
Sale of mortgage servicing rights	—	10,881
Settlement of derivative financial instruments used for hedging	(8,293)	7,023
Purchase of furniture, fixtures, equipment and building improvements	(2,277)	(3,054)
Acquisition of capitalized software	(860)	(52)
Decrease (increase) in margin deposits and restricted cash	19,932	(7,733)
Net cash (used in) provided by investing activities	(316,047)	5,612
Cash flow from financing activities		
Sale of loans under agreements to repurchase	14,379,136	7,453,139
Repurchase of loans sold under agreements to repurchase	(13,937,711)	(7,099,464)
Issuance of mortgage loan participation certificates	7,937,026	—
Repayment of mortgage loan participation certificates	(7,884,705)	—
Borrowing on note payable	129,012	63,160
Repayment of note payable	(29,411)	—
Issuance of excess servicing spread financing	187,287	73,393
Repayment of excess servicing spread financing	(31,083)	(16,494)
Repayment of leases payable	(5)	—
Payment of debt issuance costs	(3,990)	—
Distribution to Private National Mortgage Acceptance Company, LLC partners	(9,627)	(7,731)
Net cash provided by financing activities	735,929	466,003
Net (decrease) increase in cash	(1,528)	40,171
Cash at beginning of period	76,256	30,639
Cash at end of period	\$ 74,728	\$ 70,810

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

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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 primary 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 consolidates the financial results of PennyMac and its 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 loan production (including correspondent production and consumer direct lending) and mortgage loan servicing. PennyMac’s investment management activities and a portion of its 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 (“PMT”), a publicly held real estate investment trust, PNMAC Mortgage Opportunity Fund, LLC and PNMAC Mortgage Opportunity Fund, L.P., both registered under the Investment Company Act of 1940, as amended, an affiliate of these funds, 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 and a lender/servicer with the Veterans Administration and U.S. Department of Agriculture. We refer to each of Fannie Mae, Freddie Mac and Ginnie Mae as an “Agency” and collectively the “Agencies.”
- PNMAC Opportunity Fund Associates, LLC (“PMOFA”)—a Delaware limited liability company and the general partner of PNMAC Mortgage Opportunity Fund, L.P. PMOFA is entitled to incentive fees representing allocations of profits (“Carried Interest”) from PNMAC Mortgage Opportunity Fund, L.P..

The accompanying consolidated financial statements have been prepared in compliance with accounting principles generally accepted in the United States (“GAAP”) as codified in the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Codification for interim financial information and with the SEC’s instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these financial statements and notes do not include all of the information required by GAAP for complete financial statements. The interim consolidated information should be read together with the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

The accompanying unaudited consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, income, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year ending December 31, 2015. Intercompany accounts and transactions have been eliminated.

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

Reclassification of previously presented balances

In April of 2015, the FASB issued Accounting Standards Update (“ASU”) No. 2015-03, Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs (“ASU 2015-03”). The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability.

ASU 2015-03 specifies that its adoption be made on a retrospective basis. Accordingly, the Company has reclassified its debt issuance costs from Other assets as previously presented to Mortgage loans sold under agreements to repurchase to conform its December 31, 2014 balance sheet to the current presentation. The adoption of ASU 2015-03 did not result in changes to the Company’s previously presented consolidated statements of income or consolidated statements of cash flows.

Following is a summary of the balance sheet reclassifications:

	December 31, 2014		Reclassification
	As reported (in thousands)	As previously reported	
Assets:			
Other	\$ 37,419	\$ 37,858	\$ (439)
Total assets	\$ 2,506,686	\$ 2,507,125	\$ (439)
Liabilities:			
Mortgage loans sold under agreements to repurchase	\$ 822,182	\$ 822,621	\$ (439)
Total liabilities	\$ 1,699,420	\$ 1,699,859	\$ (439)
Total liabilities and stockholders' equity	\$ 2,506,686	\$ 2,507,125	\$ (439)

Note 2—Concentration of Risk

A substantial portion of the Company's activities relate to the Advised Entities. Fees charged to these entities (generally comprised of fulfillment fees, loan servicing fees, management fees and Carried Interest) totaled 10% and 37% of total net revenues for the quarters ended June 30, 2015 and 2014, respectively, and 17% and 36% for the six months ended June 30, 2015 and 2014, respectively.

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Note 3—Transactions with Affiliates

Transactions with PMT

Correspondent Production

Following is a summary of mortgage lending and sourcing activity between the Company and PMT:

	Quarter ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Fulfillment fee revenue	\$ 15,333	\$ 12,433	\$ 28,199	\$ 21,335
Unpaid principal balance of loans fulfilled for PennyMac Mortgage Investment Trust	\$ 3,579,078	\$ 2,991,764	\$ 6,469,210	\$ 4,911,342
Sourcing fees paid	\$ 2,427	\$ 1,125	\$ 3,848	\$ 2,017
Unpaid principal balance of loans purchased from PennyMac Mortgage Investment Trust	\$ 8,082,764	\$ 3,748,874	\$ 12,818,138	\$ 6,722,951
Proceeds from sale of mortgage loans held for sale to PennyMac Mortgage Investment Trust	\$ 2,423	\$ 1,985	\$ 10,828	\$ 1,985
Tax service fee receivable from PennyMac Mortgage Investment Trust	\$ 1,113	\$ 684	\$ 2,002	\$ 1,050
Mortgage servicing rights recapture recognized	\$ —	\$ 1	\$ —	\$ 9

Mortgage Loan Servicing

Following is a summary of mortgage loan servicing fees earned from PMT:

Quarter ended		Six months ended	
June 30,		June 30,	
2015	2014	2015	2014
(in thousands)			

Loan servicing fees relating to PennyMac Mortgage Investment

Trust:

Mortgage loans acquired for sale at fair value:

Base and supplemental	\$ 42	\$ 29	\$ 68	\$ 46
Activity-based	59	51	90	77
	101	80	158	123
Mortgage loans at fair value:				
Base and supplemental	4,183	4,975	8,215	9,941
Activity-based	3,093	5,746	5,987	12,132
	7,276	10,721	14,202	22,073
Mortgage servicing rights:				
Base and supplemental	4,654	3,323	8,310	6,471
Activity-based	105	56	136	104
	4,759	3,379	8,446	6,575
	\$ 12,136	\$ 14,180	\$ 22,806	\$ 28,771

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Management Fees

Following is a summary of the management fees earned from PMT:

	Quarter ended		Six months ended	
	June 30, 2015	2014	June 30, 2015	2014
	(in thousands)			
Management fees:				
Base	\$ 5,709	\$ 5,838	\$ 11,439	\$ 11,359
Performance incentive	70	3,074	1,343	5,627
	\$ 5,779	\$ 8,912	\$ 12,782	\$ 16,986

In the event of termination of the management agreement 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 performance incentive fee earned by the Company, in each case during the 24-month period before termination.

Investing and Financing Activities

Following is a summary of investing and financing activity between the Company and PMT:

	Quarter ended		Six months ended	
	June 30, 2015	2014	June 30, 2015	2014
	(in thousands)			
Issuance of excess servicing spread	\$ 140,875	\$ 52,867	\$ 187,287	\$ 73,393
Repayment of excess servicing spread	\$ 18,352	\$ 9,081	\$ 31,083	\$ 16,494
Change in fair value of excess servicing spread (gain) loss	\$ (7,133)	\$ 10,062	\$ 403	\$ 14,854
Interest expense from excess servicing spread	\$ 5,818	\$ 3,139	\$ 9,570	\$ 6,001
Excess servicing spread recapture recognized	\$ 1,456	\$ 2,525	\$ 2,745	\$ 4,415
Advance on note receivable from PennyMac Mortgage Investment Trust	\$ 71,072	\$ —	\$ 71,072	\$ —
	\$ 18,546	\$ —	\$ 18,546	\$ —

Repayment of note receivable from PennyMac Mortgage Investment Trust				
Interest income on note receivable from PennyMac Mortgage Investment Trust	\$ 535	\$ —	\$ 535	\$ —

On April 30, 2015, the Company entered into an amendment to its Third Amended and Restated Loan and Security Agreement, dated as of March 27, 2015, pursuant to which it may finance certain of its mortgage servicing rights (“MSRs”) and servicing advance receivables with Credit Suisse First Boston Mortgage Capital LLC (“CSFB”) (the “Loan and Security Agreement”).

Under the terms of the amendment, the maximum loan amount under the Loan and Security Agreement was increased from \$257 million to \$407 million. The \$150 million increase was implemented for the purpose of facilitating the financing of excess servicing spread (“ESS”) by PMT. The aggregate loan amount outstanding under the Loan and Security Agreement and relating to advances outstanding with PMT is guaranteed in full by PMT.

In connection with the amendment to the Loan and Security Agreement, the Company and PMT entered into an underlying loan and security agreement, dated as of April 30, 2015, pursuant to which PMT may borrow up to \$150 million from the Company for the purpose of financing ESS.

The principal amount of the borrowings under the Loan and Security Agreement is based upon a percentage of the market value of the ESS pledged by PMT, subject to the maximum loan amount described above. Pursuant to the underlying loan and security agreement, PMT granted to the Company a security interest in all of its right, title and interest in, to and under the ESS pledged to secure loans.

The Company and PMT have agreed that PMT is required to repay the Company the principal amount of such borrowings plus accrued interest to the date of such repayment, and the Company is required to repay CSFB the corresponding amount under the Loan and Security Agreement. PMT is also required to pay the Company a fee for the

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structuring of the Loan and Security Agreement in an amount equal to the portion of the corresponding fee paid by the Company to CSFB under the Loan and Security Agreement and allocable to the increase in the maximum loan amount resulting from the ESS financing.

The note matures on October 30, 2015 and interest accrues at a rate based on the lender's cost of funds. As of June 30, 2015, \$52.5 million of principal and interest was outstanding and included in Note receivable from PennyMac Mortgage Investment Trust secured on the accompanying consolidated balance sheets.

Other Transactions

In connection with the initial public offering ("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 PennyMac 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, the parties 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 \$73,000 and \$230,000 for the quarter and six months ended June 30, 2015, respectively, and \$0 and \$36,000 during the quarter and six months ended June 30, 2014, 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 June 30,		Six months ended	
	2015	2014	June 30,	2014
	(in thousands)		2015	
Reimbursement of:				
Common overhead incurred by the Company (1)	\$ 2,702	\$ 2,691	\$ 5,431	\$ 5,269
Expenses incurred on PMT's behalf	83	104	462	549

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	\$ 2,785	\$ 2,795	\$ 5,893	\$ 5,818
Payments and settlements during the period (2)	\$ 24,114	\$ 22,968	\$ 46,866	\$ 41,354

- (1) For the quarter ended June 30, 2015, in accordance with the terms of its management agreement with PMT, the Company provided PMT a discretionary waiver of \$700,000 of overhead expenses otherwise allocable to PMT.
- (2) Payments and settlements include payments for loan servicing fees, management fees, investment activities, financing activities and correspondent production 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:

	June 30, 2015	December 31, 2014
	(in thousands)	
Management fees	\$ 5,779	\$ 8,426
Allocated expenses	5,893	7,087
Servicing fees	3,666	3,385
Conditional Reimbursement	907	1,137
Unsettled excess servicing spread issuance	—	3,836
	\$ 16,245	\$ 23,871

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The Company holds an investment in PMT in the form of 75,000 common shares of beneficial interest as of June 30, 2015 and December 31, 2014. The common shares of beneficial interest had fair values of \$1.3 million and \$1.6 million as of June 30, 2015 and December 31, 2014, respectively.

Of the \$139.7 million payable to PMT as of June 30, 2015, \$130.4 million represents deposits made by PMT to fund servicing advances made by the Company, \$8.7 million represents other expenses and unsettled ESS financing activity, and \$640,000 represents MSR recapture payable to PMT.

Of the \$123.3 million payable to PMT as of December 31, 2014, \$116.7 million represents deposits made by PMT to fund servicing advances made by the Company, \$6.2 million represents other expenses and unsettled ESS financing activity, and \$460,000 represents MSR recapture payable to PMT.

Investment Funds

Amounts due from the Investment Funds are summarized below:

	June 30, 2015	December 31, 2014
	(in thousands)	
Carried Interest due from Investment Funds:		
PNMAC Mortgage Opportunity Fund, LLC	\$ 41,240	\$ 40,771
PNMAC Mortgage Opportunity Fund Investors, LLC	27,473	26,527
	\$ 68,713	\$ 67,298
Receivable from Investment Funds:		
Management fees	\$ 1,180	\$ 1,596
Loan servicing rebate	526	189
Loan servicing fees	308	476
Expense reimbursements	134	30
	\$ 2,148	\$ 2,291

Amounts due to the Investment Funds totaling \$31.3 million and \$35.9 million represent amounts advanced by the Investment Funds to fund servicing advances made by the Company as of June 30, 2015 and December 31, 2014, respectively.

Exchanged Private National Mortgage Acceptance Company, LLC Unitholders

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 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 of PennyMac's assets resulting from such unitholders' exchanges 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 exchanges to date, the Company has recorded a \$71.9 million Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement as of June 30, 2015. The Company made payments under the tax receivable agreement totaling \$0 and \$4.3 million during the quarter and six months ended June 30, 2015.

Note 4—Earnings Per Share of Common Stock

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

The Company applies the treasury stock method to determine the dilutive weighted average shares of common stock represented by the unvested stock-based compensation awards and the exchangeable PennyMac Class A units. The diluted earnings per share calculation assumes the exchange of these PennyMac Class A units for shares of common stock. Accordingly, earnings attributable to the Company's common stockholders is also adjusted to include the earnings

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allocated to the PennyMac Class A units after taking into account the income taxes applicable to the shares of common stock assumed to be exchanged.

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

	Quarter ended		Six months ended	
	June 30,	2014	June 30,	2014
	2015		2015	2014
	(in thousands, except per share data)			
Basic earnings per share of common stock:				
Net income attributable to PennyMac Financial Services, Inc. common stockholders	\$ 12,749	\$ 9,618	\$ 21,777	\$ 17,590
Weighted average shares of common stock outstanding	21,700	21,142	21,647	21,005
Basic earnings per share of common stock	\$ 0.59	\$ 0.45	\$ 1.01	\$ 0.84
Diluted earnings per share of common stock:				
Net income	\$ 12,749	\$ 9,618	\$ 21,777	\$ 17,590
Effect of net income attributable to noncontrolling interest, net of income taxes	31,925	24,743	54,688	45,754
Diluted net income attributable to common stockholders	\$ 44,674	\$ 34,361	\$ 76,465	\$ 63,344
Weighted average shares of common stock outstanding	21,700	21,142	21,647	21,005
Dilutive shares:				
PennyMac Class A units exchangeable to common stock	53,620	53,509	53,592	53,609
Non-vested PennyMac Class A units issuable under unit-based stock compensation plan and exchangeable to common stock	650	1,216	714	1,247
Shares issuable under stock-based compensation plans	135	48	110	34
Diluted weighted average shares of common stock outstanding	76,105	75,915	76,063	75,895
Diluted earnings per share of common stock	\$ 0.59	\$ 0.45	\$ 1.01	\$ 0.83

Note 5—Loan Sales and Servicing Activities

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

The following table summarizes cash flows between the Company and transferees as a result of the sale of mortgage loans in transactions where the Company maintains continuing involvement with the mortgage loans in the form of loan servicing arrangements and a liability for representations and warranties it makes to purchasers and insurers of the mortgage loans as well as unpaid principal balance information at period end.

	Quarter ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Cash flows:				
Sales proceeds	\$ 9,853,346	\$ 4,729,647	\$ 15,619,191	\$ 8,022,045
Servicing fees received	\$ 35,317	\$ 25,282	\$ 69,312	\$ 47,466
Net servicing advance recoveries	\$ (5,248)	\$ (3,730)	\$ (8,955)	\$ (4,338)
Period end information:				
Unpaid principal balance of mortgage loans outstanding at end of period	\$ 44,794,166	\$ 29,546,095		
Delinquencies:				
30-89 days	\$ 1,030,350	\$ 543,347		
90 days or more or in foreclosure or bankruptcy	\$ 293,284	\$ 120,560		

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The unpaid principal balance (“UPB”) of the Company’s mortgage servicing portfolio is summarized as follows:

	June 30, 2015		
	Servicing rights owned (in thousands)	Contract servicing and subservicing	Total loans serviced
Investor:			
Non-affiliated entities	\$ 91,497,836	\$ —	\$ 91,497,836
Affiliated entities	—	43,145,707	43,145,707
Mortgage loans held for sale	1,526,779	—	1,526,779
	\$ 93,024,615	\$ 43,145,707	\$ 136,170,322
Amount subserviced for the Company (1)	\$ —	\$ 21,388	\$ 21,388
Delinquent mortgage loans:			
30 days	\$ 2,027,394	\$ 315,422	\$ 2,342,816
60 days	625,385	147,600	772,985
90 days or more			
Not in foreclosure	923,790	986,192	1,909,982
In foreclosure	479,039	1,405,262	1,884,301
Foreclosed	23,321	547,110	570,431
	\$ 4,078,929	\$ 3,401,586	\$ 7,480,515
Custodial funds managed by the Company (2)	\$ 2,724,892	\$ 586,848	\$ 3,311,740

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- (1) Certain of the mortgage loans serviced by the Company are subserviced on the Company’s behalf by other mortgage loan servicers. Mortgage loans are subserviced for the Company 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 been transferred to the Company’s servicing system.
- (2) Borrower and investor custodial cash accounts relate to mortgage 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 mortgage loans investors, which is recorded as part of the interest income in the Company’s consolidated statements of income.

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	December 31, 2014		
	Servicing rights owned (in thousands)	Contract servicing and subservicing	Total loans serviced
Investor:			
Non-affiliated entities	\$ 65,169,194	\$ —	\$ 65,169,194
Affiliated entities	—	39,709,945	39,709,945
Mortgage loans held for sale	1,100,910	—	1,100,910
	\$ 66,270,104	\$ 39,709,945	\$ 105,980,049
Amount subserviced for the Company (1)	\$ —	\$ 330,768	\$ 330,768
Delinquent mortgage loans:			
30 days	\$ 1,372,915	\$ 302,091	\$ 1,675,006
60 days	434,428	135,777	570,205
90 days or more			
Not in foreclosure	779,129	1,057,973	1,837,102
In foreclosure	422,330	1,544,762	1,967,092
Foreclosed	32,444	533,067	565,511
	\$ 3,041,246	\$ 3,573,670	\$ 6,614,916
Custodial funds managed by the Company (2)	\$ 1,522,295	\$ 388,498	\$ 1,910,793

- (1) Certain of the mortgage loans serviced by the Company are subserviced on the Company's behalf by other mortgage loan servicers. Mortgage loans are subserviced for the Company 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 been transferred to the Company's servicing system.
- (2) Borrower and investor custodial cash accounts relate to mortgage 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 mortgage loans investors, which is recorded as part of the interest income in the Company's consolidated statements of income.

Following is a summary of the geographical distribution of mortgage loans included in the Company's servicing portfolio for the top five and all other states as measured by UPB:

State	June 30, 2015 (in thousands)	December 31, 2014
California	\$ 35,872,153	\$ 33,751,630
Texas	9,624,745	6,954,778
Virginia	7,979,310	6,360,171
Florida	7,743,502	5,573,215
Maryland	4,941,871	*
Washington	*	3,830,587
All other states	70,008,741	49,509,668

\$ 136,170,322 \$ 105,980,049

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

Note 6—Netting of Financial Instruments

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

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Following are summaries of derivative assets and related netting amounts.

Offsetting of Derivative Assets

	June 30, 2015			December 31, 2014		
	Gross amount of recognized assets (in thousands)	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
Derivatives subject to master netting arrangements:						
Forward purchase contracts	\$ 7,048	\$ —	\$ 7,048	\$ 9,060	\$ —	\$ 9,060
Forward sale contracts	26,652	—	26,652	320	—	320
MBS put options	1,426	—	1,426	476	—	476
MBS call options	253	—	253	—	—	—
Put options on interest rate futures purchase contracts	2,165	—	2,165	862	—	862
Call options on interest rate futures purchase contracts	3,031	—	3,031	2,193	—	2,193
Netting	—	(31,378)	(31,378)	—	(7,807)	(7,807)
	40,575	(31,378)	9,197	12,911	(7,807)	5,104
Derivatives not subject to master netting arrangements						
- IRLCs	34,371	—	34,371	33,353	—	33,353
	\$ 74,946	\$ (31,378)	\$ 43,568	\$ 46,264	\$ (7,807)	\$ 38,457

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 netting.

	June 30, 2015				December 31, 2014			
	Gross amount not offset in the consolidated balance sheet				Gross amount not offset in the consolidated balance sheet			
	Net amount of assets in the balance sheet (in thousands)	Cash	Financial collateral	Net amount	Net amount of assets in the balance sheet	Cash	Financial collateral	Net amount
Interest rate lock commitments	\$ 34,371	\$ —	\$ —	\$ 34,371	\$ 33,353	\$ —	\$ —	\$ 33,353
RJ O'Brien	3,810	—	—	3,810	2,005	—	—	2,005
Bank of Oklahoma	1,303	—	—	1,303	—	—	—	—
Jefferies & Co.	1,201	—	—	1,201	764	—	—	764
Bank of America, N.A.	1,093	—	—	1,093	—	—	—	—
JP Morgan	565	—	—	565	526	—	—	526
Citibank, N.A.	441	—	—	441	—	—	—	—
Others	784	—	—	784	1,809	—	—	1,809
	\$ 43,568	\$ —	\$ —	\$ 43,568	\$ 38,457	\$ —	\$ —	\$ 38,457

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Offsetting of Derivative Liabilities and Financial Liabilities

Following is a summary of net derivative liabilities and assets sold under agreements to repurchase and related netting amounts. As discussed above, all derivatives with the exception of IRLCs are subject to master netting arrangements. The mortgage loans sold under agreements to repurchase do not qualify for netting.

	June 30, 2015		Net amount of liabilities in the consolidated balance sheet	December 31, 2014		Net amount of liabilities in the consolidated balance sheet
	Gross amount of recognized liabilities (in thousands)	Gross amount offset in the consolidated balance sheet		Gross amount of recognized liabilities	Gross amount offset in the consolidated balance sheet	
Derivatives subject to a master netting arrangement:						
Forward purchase contracts	\$ 14,316	\$ —	\$ 14,316	\$ 141	\$ —	\$ 141
Forward sale contracts	7,093	—	7,093	16,110	—	16,110
Put options on interest rate futures sale contracts	—	—	—	8	—	8
Netting	—	(14,459)	(14,459)	—	(10,698)	(10,698)
	21,409	(14,459)	6,950	16,259	(10,698)	5,561
Derivatives not subject to a master netting arrangement - IRLCs	6,634	—	6,634	952	—	952
Total derivatives	28,043	(14,459)	13,584	17,211	(10,698)	6,513
Mortgage loans sold under agreements to repurchase:						
	1,264,046	—	1,264,046	822,621	—	822,621

Amount
outstanding
Unamortized
debt issuance
costs

(798)	—	(798)	(439)	—	(439)
1,263,248	—	1,263,248	822,182	—	822,182
\$ 1,291,291	\$ (14,459)	\$ 1,276,832	\$ 839,393	\$ (10,698)	\$ 828,695

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Derivative Liabilities, Financial Liabilities, and Collateral Held by Counterparty

The following table summarizes by significant counterparty the amount of derivative liabilities and mortgage loans sold under agreements to repurchase after considering master netting arrangements and financial instruments or cash pledged that do not qualify under the accounting guidance for netting. All assets sold under agreements to repurchase are secured by sufficient collateral or have fair value that exceeds the liability amount recorded on the consolidated balance sheets.

	June 30, 2015				December 31, 2014			
	Net amount of liabilities in the consolidated balance sheet (in thousands)	Gross amount not offset in the consolidated balance sheet Financial instruments	Cash collateral pledged	Net amount	Net amount of liabilities in the consolidated balance sheet	Gross amount not offset in the consolidated balance sheet Financial instruments	Cash collateral pledged	Net amount
Interest rate lock commitments	\$ 6,634	\$ —	\$ —	\$ 6,634	\$ 952	\$ —	\$ —	\$ 952
Credit Suisse								
First Boston Mortgage Capital LLC	491,115	(488,906)	—	2,209	464,737	(463,541)	—	1,196
Bank of America, N.A.	488,048	(488,048)	—	—	236,909	(236,771)	—	138
Morgan Stanley Bank, N.A.	192,091	(191,268)	—	823	122,148	(122,031)	—	117
Citibank, N.A.	95,824	(95,824)	—	—	699	(278)	—	421
Bank of New York Mellon	2,803	—	—	2,803	1,552	—	—	1,552
Others	1,115	—	—	1,115	2,137	—	—	2,137
	\$ 1,277,630	\$ (1,264,046)	\$ —	\$ 13,584	\$ 829,134	\$ (822,621)	\$ —	\$ 6,513

Note 7—Fair Value

The Company's consolidated financial statements include assets and liabilities that are measured based on their fair values. The application of fair value 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 fair value as discussed in the following paragraphs.

Fair Value Accounting Elections

Management identified all of its non-cash financial assets, its originated MSR's relating to loans with initial interest rates of more than 4.5% and MSR's purchased subject to ESS financing to be accounted for at fair value so changes in fair value will be reflected in income as they occur and more timely reflect the results of the Company's performance. Management has also identified its ESS financing to be accounted for at fair value as a means of hedging the related MSR's fair value risk.

For originated MSR's 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 MSR's 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' fair values. Management has identified these assets for accounting using the amortization method.

Management's risk management efforts in connection with MSR's 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' fair values.

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During the quarters and six months ended June 30, 2015 and 2014, derivatives were used to hedge the fair value changes of the MSR's.

Financial Statement Items Measured at Fair Value on a Recurring Basis

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

	June 30, 2015			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	\$ 23,577	\$ —	\$ —	\$ 23,577
Mortgage loans held for sale at fair value	—	1,560,177	34,085	1,594,262
Derivative assets:				
Interest rate lock commitments	—	—	34,371	34,371
Forward purchase contracts	—	7,048	—	7,048
Forward sales contracts	—	26,652	—	26,652
MBS put options	—	1,426	—	1,426
MBS call options	—	253	—	253
Put options on interest rate futures purchase contracts	2,165	—	—	2,165
Call options on interest rate futures purchase contracts	3,031	—	—	3,031
Total derivative assets before netting	5,196	35,379	34,371	74,946
Netting (1)	—	—	—	(31,378)
Total derivative assets	5,196	35,379	34,371	43,568
Investment in PennyMac Mortgage Investment Trust	1,307	—	—	1,307
Mortgage servicing rights at fair value	—	—	581,269	581,269
	\$ 30,080	\$ 1,595,556	\$ 649,725	\$ 2,243,983
Liabilities:				
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	\$ —	\$ —	\$ 359,102	\$ 359,102
Derivative liabilities:				
Interest rate lock commitments	—	—	6,634	6,634
Forward purchase contracts	—	14,316	—	14,316
Forward sales contracts	—	7,093	—	7,093
Total derivative liabilities before netting	—	21,409	6,634	28,043
Netting (1)	—	—	—	(14,459)
Total derivative liabilities	—	21,409	6,634	13,584
Mortgage servicing liabilities	—	—	11,791	11,791
	\$ —	\$ 21,409	\$ 377,527	\$ 384,477

(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.

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	December 31, 2014			Total
	Level 1 (in thousands)	Level 2	Level 3	
Assets:				
Short-term investments	\$ 21,687	\$ —	\$ —	\$ 21,687
Mortgage loans held for sale at fair value	—	937,976	209,908	1,147,884
Derivative assets:				
Interest rate lock commitments	—	—	33,353	33,353
Forward purchase contracts	—	9,060	—	9,060
Forward sales contracts	—	320	—	320
MBS put options	—	476	—	476
Put options on interest rate futures purchase contracts	862	—	—	862
Call options on interest rate futures purchase contracts	2,193	—	—	2,193
Total derivative assets before netting	3,055	9,856	33,353	46,264
Netting (1)	—	—	—	(7,807)
Total derivative assets	3,055	9,856	33,353	38,457
Investment in PennyMac Mortgage Investment Trust	1,582	—	—	1,582
Mortgage servicing rights at fair value	—	—	325,383	325,383
	\$ 26,324	\$ 947,832	\$ 568,644	\$ 1,534,993
Liabilities:				
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	\$ —	\$ —	\$ 191,166	\$ 191,166
Derivative liabilities:				
Interest rate lock commitments	—	—	952	952
Forward purchase contracts	—	141	—	141
Forward sales contracts	—	16,110	—	16,110
Put options on interest rate futures sale contracts	8	—	—	8
Total derivative liabilities before netting	8	16,251	952	17,211
Netting (1)	—	—	—	(10,698)
Total derivative liabilities	8	16,251	952	6,513
Mortgage servicing liabilities	—	—	6,306	6,306
	\$ 8	\$ 16,251	\$ 198,424	\$ 203,985

(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.

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As shown above, certain of the Company's mortgage loans held for sale, IRLCs, MSR's at fair value, mortgage servicing liabilities and ESS financing at fair value are measured using Level 3 inputs. Following are roll forwards of these items for the quarters and six months ended June 30, 2015 and 2014:

	Quarter ended June 30, 2015			Total
	Mortgage loans held for sale (in thousands)	Net interest rate lock commitments (1)	Mortgage servicing rights	
Assets:				
Balance, March 31, 2015	\$ 83,684	\$ 54,392	\$ 361,413	\$ 499,489
Purchases	400,705	—	206,996	607,701
Sales	(386,586)	—	—	(386,586)
Repayments	(11,610)	—	—	(11,610)
Interest rate lock commitments issued, net	—	61,365	—	61,365
Mortgage servicing rights resulting from mortgage loan sales	—	—	3,443	3,443
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk	1,739	—	—	1,739
Other factors	746	(10,245)	9,417	(82)
	2,485	(10,245)	9,417	1,657
Transfers of mortgage loans held for sale from Level 3 to Level 2 (2)	(54,593)	—	—	(54,593)
Transfers of interest rate lock commitments to mortgage loans held for sale	—	(77,775)	—	(77,775)
Balance, June 30, 2015	\$ 34,085	\$ 27,737	\$ 581,269	\$ 643,091
Changes in fair value recognized during the period relating to assets still held at June 30, 2015	\$ 481	\$ (10,245)	\$ 9,417	\$ (347)

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

(2) Mortgage loans held for sale are transferred from Level 3 to Level 2 as a result of the mortgage loan becoming saleable into active mortgage markets pursuant to a loan modification, borrower reperformance or resolution of deficiencies.

	Quarter ended June 30, 2015		
	Excess servicing spread financing (in thousands)	Mortgage servicing liabilities	Total
Liabilities:			
Balance, March 31, 2015	\$ 222,309	\$ 6,529	\$ 228,838
Issuance of excess servicing spread financing	140,875	—	140,875

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Mortgage servicing liabilities resulting from mortgage loan sales	—	9,156	9,156
Excess servicing spread financing issued pursuant to a recapture agreement with PennyMac Mortgage Investment Trust	1,319	—	1,319
Accrual of interest on excess servicing spread	5,818	—	5,818
Repayments	(18,352)	—	(18,352)
Changes in fair value included in income	7,133	(3,894)	3,239
Balance, June 30, 2015	\$ 359,102	\$ 11,791	\$ 370,893
Changes in fair value recognized during the period relating to liabilities still held at June 30, 2015	\$ 7,133	\$ (3,894)	\$ 3,239

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	Quarter ended June 30, 2014			
	Mortgage loans held for sale (in thousands)	Net interest rate lock commitments (1)	Mortgage servicing rights	Total
Assets:				
Balance, March 31, 2014	\$ 3,985	\$ 14,297	\$ 246,984	\$ 265,266
Purchases	679,882	—	71,778	751,660
Repayments	(15,033)	—	—	(15,033)
Interest rate lock commitments issued, net	—	46,394	—	46,394
Mortgage servicing rights resulting from mortgage loan sales	—	—	7,333	7,333
Sales	(407,133)	—	(10,881)	(418,014)
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk	—	—	—	—
Other factors	(2,789)	14,126	(6,615)	4,722
	(2,789)	14,126	(6,615)	4,722
Transfers of mortgage loans held for sale from Level 3 to Level 2 (2)	(4,256)	—	—	(4,256)
Transfers of interest rate lock commitments to mortgage loans held for sale	—	(45,067)	—	(45,067)
Balance, June 30, 2014	\$ 254,656	\$ 29,750	\$ 308,599	\$ 593,005
Changes in fair value recognized during the period relating to assets still held at June 30, 2014	\$ (2,789)	\$ 29,750	\$ (6,615)	\$ 20,346

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

(2) Mortgage loans held for sale are transferred from Level 3 to Level 2 as a result of the mortgage loan becoming saleable into active mortgage markets pursuant to a loan modification, borrower reperformance or resolution of deficiencies.

	Quarter ended June 30, 2014		
	Excess servicing spread financing (in thousands)	Mortgage servicing liabilities	Total
Liabilities:			
Balance, March 31, 2014	\$ 151,019	\$ —	\$ 151,019
Issuance of excess servicing spread financing	52,867	—	52,867
Excess servicing spread financing issued pursuant to a recapture agreement with PennyMac Mortgage Investment	2,362	—	2,362
Accrual of interest on excess servicing spread	3,139	—	3,139
Repayments	(9,081)	—	(9,081)

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Changes in fair value included in income	(10,062)	5,821	(4,241)
Balance, June 30, 2014	\$ 190,244	\$ 5,821	\$ 196,065
Changes in fair value recognized during the period relating to liabilities still held at June 30, 2014	\$ (10,062)	\$ 5,821	\$ (4,241)

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	Six months ended June 30, 2015			
	Mortgage loans held for sale (in thousands)	Net interest rate lock commitments (1)	Mortgage servicing rights	Total
Assets:				
Balance, December 31, 2014	\$ 209,908	\$ 32,401	\$ 325,383	\$ 567,692
Purchases	466,285	—	270,133	736,418
Sales	(511,854)	—	—	(511,854)
Repayments	(20,002)	—	—	(20,002)
Interest rate lock commitments issued, net	—	144,145	—	144,145
Mortgage servicing rights resulting from mortgage loan sales	—	—	6,118	6,118
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk	4,054	—	—	4,054
Other factors	(791)	(10,292)	(20,365)	(31,448)
	3,263	(10,292)	(20,365)	(27,394)
Transfers of mortgage loans held for sale from Level 3 to Level 2 (2)	(113,515)	—	—	(113,515)
Transfers of interest rate lock commitments to mortgage loans held for sale	—	(138,517)	—	(138,517)
Balance, June 30, 2015	\$ 34,085	\$ 27,737	\$ 581,269	\$ 643,091
Changes in fair value recognized during the period relating to assets still held at June 30, 2015	\$ 906	\$ (10,292)	\$ (20,365)	\$ (29,751)

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

(2) Mortgage loans held for sale are transferred from Level 3 to Level 2 as a result of the mortgage loan becoming saleable into active mortgage markets pursuant to a loan modification, borrower reperformance or resolution of deficiencies.

	Six months ended June 30, 2015		
	Excess servicing spread financing (in thousands)	Mortgage servicing liabilities	Total
Liabilities:			
Balance, December 31, 2014	\$ 191,166	\$ 6,306	\$ 197,472
Issuance of excess servicing spread financing	187,287	—	187,287
Mortgage servicing liabilities resulting from mortgage loan sales	—	12,084	12,084
Excess servicing spread financing issued pursuant to a recapture agreement with PennyMac Mortgage Investment Trust	2,565	—	2,565
Accrual of interest on excess servicing spread	9,570	—	9,570
Repayments	(31,083)	—	(31,083)
Changes in fair value included in income	(403)	(6,599)	(7,002)

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Balance, June 30, 2015	\$ 359,102	\$ 11,791	\$ 370,893
Changes in fair value recognized during the year relating to liabilities still held at June 30, 2015	\$ (403)	\$ (6,599)	\$ (7,002)

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	Six months ended June 30, 2014			
	Mortgage loans held for sale (in thousands)	Net interest rate lock commitments (1)	Mortgage servicing rights	Total
Assets:				
Balance December 31, 2013	\$ 3,933	\$ 6,761	\$ 224,913	\$ 235,607
Purchases	679,882	—	97,644	777,526
Repayments	(15,047)	—	—	(15,047)
Interest rate lock commitments issued, net	—	82,832	—	82,832
Mortgage servicing rights resulting from mortgage loan sales	—	—	14,266	14,266
Sales	(407,133)	—	(10,881)	(418,014)
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk	—	—	—	—
Other factors	(2,723)	19,479	(17,343)	(587)
	(2,723)	19,479	(17,343)	(587)
Transfers of mortgage loans held for sale from Level 3 to Level 2 (2)	(4,256)	—	—	(4,256)
Transfers of interest rate lock commitments to mortgage loans held for sale	—	(79,322)	—	(79,322)
Balance, June 30, 2014	\$ 254,656	\$ 29,750	\$ 308,599	\$ 593,005
Changes in fair value recognized during the period relating to assets still held at June 30, 2014	\$ (2,723)	\$ 29,750	\$ (17,343)	\$ 9,684

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

(2) Mortgage loans held for sale are transferred from Level 3 to Level 2 as a result of the mortgage loan becoming saleable into active mortgage markets pursuant to a loan modification, borrower reperformance or resolution of deficiencies.

	Six months ended June 30, 2014		
	Excess servicing spread financing (in thousands)	Mortgage servicing liabilities	Total
Liabilities:			
Balance December 31, 2013	\$ 138,723	\$ —	\$ 138,723
Issuance of excess servicing spread financing	73,393	—	73,393
Excess servicing spread financing issued pursuant to a recapture agreement with PennyMac Mortgage Investment Trust	3,475	—	3,475
Accrual of interest on excess servicing spread financing	6,001	—	6,001
Repayments	(16,494)	—	(16,494)
Changes in fair value included in income	(14,854)	5,821	(9,033)
Balance, June 30, 2014	\$ 190,244	\$ 5,821	\$ 196,065

Changes in fair value recognized during the period relating to liabilities still held at June 30, 2014	\$ (14,854)	\$ 5,821	\$ (9,033)
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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 transfers among the levels arising from transfers of IRLCs to mortgage loans held for sale at fair value upon purchase or funding of the respective mortgage loans and from the return to salability in the active secondary market of certain mortgage loans held for sale. Such loans became saleable into the active secondary market due to curing of the loans' defects through borrower reperformance, modification of the loan or resolution of deficiencies contained in the borrowers' credit file.

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Net changes in fair values included in income for financial statement items carried at fair value as a result of management's election of the fair value option by income statement line item are summarized below:

	Quarter ended June 30, 2015			2014		
	Net gains on mortgage loans held for sale at fair value (in thousands)	Net loan servicing fees	Total	Net gains on mortgage loans held for sale at fair value	Net loan servicing fees	Total
Assets:						
Mortgage loans held for sale at fair value	\$ 68,503	\$ —	\$ 68,503	\$ 67,993	\$ —	\$ 67,993
Mortgage servicing rights at fair value	—	9,417	9,417	—	(6,615)	(6,615)
	\$ 68,503	\$ 9,417	\$ 77,920	\$ 67,993	\$ (6,615)	\$ 61,378
Liabilities:						
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	\$ —	\$ (7,133)	\$ (7,133)	\$ —	\$ 10,062	\$ 10,062
Mortgage servicing liabilities at fair value	—	3,894	3,894	—	(5,821)	(5,821)
	\$ —	\$ (3,239)	\$ (3,239)	\$ —	\$ 4,241	\$ 4,241

	Six months ended June 30, 2015			2014		
	Net gains on mortgage loans held for sale at fair value (in thousands)	Net servicing fees	Total	Net gains on mortgage loans held for sale at fair value	Net servicing fees	Total
Assets:						
Mortgage loans held for sale at fair value	\$ 149,817	\$ —	\$ 149,817	\$ 117,895	\$ —	\$ 117,895
Mortgage servicing rights at fair value	—	(20,365)	(20,365)	—	(17,343)	(17,343)
	\$ 149,817	\$ (20,365)	\$ 129,452	\$ 117,895	\$ (17,343)	\$ 100,552
Liabilities:						
Excess servicing spread financing at fair value payable	\$ —	\$ 403	\$ 403	\$ —	\$ 14,854	\$ 14,854

to PennyMac Mortgage
Investment Trust

Mortgage servicing liabilities at fair value	—	6,599	6,599	—	(5,821)	(5,821)
	\$ —	\$ 7,002	\$ 7,002	\$ —	\$ 9,033	\$ 9,033

Following are the fair value and related principal amounts due upon maturity of loans, long-term receivables and long-term debt instruments with contractual principal amounts accounted for under the fair value option:

	June 30, 2015		
	Fair value (in thousands)	Principal amount due upon maturity	Difference
Mortgage loans held for sale:			
Current through 89 days delinquent	\$ 1,575,185	\$ 1,503,666	\$ 71,519
90 days or more delinquent:			
Not in foreclosure	15,696	15,819	(123)
In foreclosure	3,381	3,922	(541)
	\$ 1,594,262	\$ 1,523,407	\$ 70,855

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	December 31, 2014		
	Fair value (in thousands)	Principal amount due upon maturity	Difference
Mortgage loans held for sale:			
Current through 89 days delinquent	\$ 950,697	\$ 894,924	\$ 55,773
90 days or more delinquent:			
Not in foreclosure	126,171	128,533	(2,362)
In foreclosure	71,016	72,039	(1,023)
	\$ 1,147,884	\$ 1,095,496	\$ 52,388

Financial Statement Items Measured at Fair Value on a Nonrecurring Basis

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

	June 30, 2015			Total
	Level 1 (in thousands)	Level 2	Level 3	
Mortgage servicing rights at lower of amortized cost or fair value	\$ —	\$ —	\$ 159,119	\$ 159,119
	\$ —	\$ —	\$ 159,119	\$ 159,119

	December 31, 2014			Total
	Level 1 (in thousands)	Level 2	Level 3	
Mortgage servicing rights at lower of amortized cost or fair value	\$ —	\$ —	\$ 139,505	\$ 139,505
	\$ —	\$ —	\$ 139,505	\$ 139,505

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

	Quarter ended		Six months ended	
	June 30, 2015	2014	June 30, 2015	2014
Mortgage servicing rights at lower of amortized cost or fair value	\$ 13,566	\$ (3,786)	\$ (18,126)	\$ (4,207)
	\$ 13,566	\$ (3,786)	\$ (18,126)	\$ (4,207)

Fair Value of Financial Instruments Carried at Amortized Cost

The Company's Cash as well as its Carried Interest due from Investment Funds, Note receivable from PennyMac Mortgage Investment Trust secured, Mortgage loans sold under agreements to repurchase, Mortgage loan participation and sale agreement, Note payable, and amounts receivable from and payable to the Advised Entities are carried at amortized cost.

Cash is measured using a "Level 1" input.

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.

The Company's Note receivable from PennyMac Mortgage Investment Trust, Mortgage loans sold under agreements to repurchase, Mortgage loan participation and sale agreement and Note payable are carried at amortized cost. These borrowings do not have observable inputs and fair value is measured using management's estimate of fair value, where the inputs into the determination of fair value require significant judgment or estimation. The Company has classified these financial instruments as "Level 3" financial statement items as of June 30, 2015 and December 31, 2014

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due to the lack of observable inputs to estimate the fair value. Management has concluded that the fair value of these financial statement items approximates their carrying values due to their short terms and variable interest rates.

The Company also carries the receivables from and payables to the Advised Entities at cost. Management has concluded that the fair value of such balances approximates their carrying values due to the short terms of such balances.

Valuation Techniques and Assumptions

Most of the Company's financial assets, a portion of its MSRs and its ESS liability 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 and ESS are "Level 3" financial statement items which require the use of unobservable inputs that are significant to the estimation of the items' fair values. Unobservable inputs reflect the Company's own 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.

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

With respect to the Level 3 valuations, 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 Company's senior management valuation committee includes PFSI's chief executive, financial, operating, credit and asset/liability management officers.

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 inputs. To assess the reasonableness of its valuations, the FAV group presents an analysis of the effect on the valuation of changes to the significant inputs to the models.

With respect to IRLCs, the Company has assigned responsibility for developing fair values to its Capital Markets Risk Management staff. The fair values developed by the Capital Markets Risk Management staff are submitted to the

Company's senior management Secondary Marketing Working Group. The Company's Secondary Marketing Working Group includes PFSI's chief executive, operating, institutional mortgage banking, capital markets, asset/liability management, portfolio risk and capital markets operations officers.

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

Mortgage Loans Held for Sale

A substantial portion of the Company's mortgage loans held for sale at fair value are saleable into active markets and are therefore categorized as "Level 2" fair value financial statement items and their fair values are determined using their quoted market or contracted price or market price equivalent.

Certain of the Company's mortgage loans may become non-saleable into active markets due to identification of a defect by the Company or to the repurchase of mortgage loans with identified defects. The Company may also purchase certain delinquent government guaranteed or insured mortgage loans from Ginnie Mae guaranteed pools in its servicing portfolio. The Company's right to purchase such mortgage loans arises as the result of the borrower's failure to make payments for at least three consecutive months preceding the month of repurchase by the Company and provides an alternative to the Company's obligation to continue advancing principal and interest at the coupon rate of the related Ginnie Mae security. To the extent such mortgage loans ("early buyout loans") have not become saleable into another Ginnie Mae guaranteed security by becoming current either through the borrower's reperformance or through completion of a modification of the mortgage loan's terms, the Company measures such mortgage loans along with other mortgage loans with identified defects using "Level 3" inputs.

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The significant unobservable inputs used in the fair value measurement of the Company's "Level 3" mortgage loans held for sale at fair value are discount rates, home price projections, voluntary prepayment speeds and total prepayment speeds. Significant changes in any of those inputs in isolation could result in a significant change to the mortgage loans' fair value measurement. Increases in home price projections are generally accompanied by an increase in voluntary prepayment speeds.

Following is a quantitative summary of key "Level 3" inputs used in the valuation of mortgage loans held for sale at fair value:

Key inputs	June 30, 2015	December 31, 2014
Discount rate		
Range	2.3% – 9.4%	2.3% – 9.6%
Weighted average	3.2%	2.4%
Twelve-month projected housing price index change		
Range	3.5% – 5.9%	4.2% – 5.4%
Weighted average	3.9%	4.5%
Prepayment/resale speed (1)		
Range	1.4% – 19.1%	1.3% – 15.5%
Weighted average	16.2%	15.1%
Total prepayment speed (2)		
Range	1.4% – 35.5%	2.1% – 38.1%
Weighted average	28.9%	35.7%

(1) Voluntary prepayment/resale 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 reference to the change in the respective loan's delinquency status at period end from the later of the beginning of the period or acquisition date. Changes in fair value of mortgage loans held for sale are included in Net gains on mortgage loans held for sale at fair value in the Company's consolidated statements of income.

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 mortgage-backed securities ("MBS") prices, its estimate of the fair value of the MSRs it expects to receive in the sale of the mortgage loans and the probability that the mortgage loan will fund or be purchased (the "pull-through rate").

The significant unobservable inputs used in the fair value measurement of the Company's IRLCs are the pull-through rate and the MSR component of the Company's estimate of the fair value of the mortgage loans it has committed to purchase. Significant changes in the pull-through rate or the MSR component of the IRLCs, in isolation, could result in significant changes in fair value measurement. The financial effects of changes in these inputs are generally inversely correlated as increasing interest rates have a positive effect on the fair value of the MSR component of IRLC fair value, but increase the pull-through rate for loans that have decreased in fair value.

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

Key inputs	June 30, 2015	December 31, 2014
Pull-through rate		
Range	51.5% – 100.0%	55.4% – 99.9%
Weighted average	92.8%	85.5%
Mortgage servicing rights value expressed as:		
Servicing fee multiple		
Range	1.2 – 5.1	2.0 – 5.0
Weighted average	4.0	3.7
Percentage of unpaid principal balance		
Range	0.2% – 3.7%	0.4% – 3.1%
Weighted average	1.4%	1.2%

Hedging Derivatives

The remaining derivative financial instruments held or issued by the Company are categorized as “Level 1” or “Level 2” financial statement items. For “Level 1” fair value derivative financial instruments, the Company determines fair value with reference to the respective derivatives’ quoted prices. For “Level 2” fair value derivative financial instruments, the Company estimates the fair value of commitments to sell or purchase loans based on observable MBS prices. The Company estimates the fair value of MBS options based on observed interest rate volatilities in the MBS market. Changes in fair value of IRLCs and hedging derivatives are included in Net gains on mortgage loans held for sale at fair value in the Company’s consolidated statements of income.

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 net servicing cash flows discounted at a rate that management believes market participants would use in their determinations of fair value. The key inputs 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 per-loan annual cost to service the respective mortgage loans. Changes in the fair value of MSRs are included in Net servicing fees—Amortization, impairment and change in fair value of mortgage servicing rights in the Company’s consolidated statements of income.

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Following are the key inputs used in determining the fair value of MSR's at the time of initial recognition, excluding MSR purchases:

	Quarter ended June 30,		2014	
	2015	2015	2014	2014
	Fair value	Amortized cost	Fair value	Amortized cost
	(Amount recognized and unpaid principal balance of underlying mortgage loans in thousands)			
MSR and pool characteristics:				
Amount recognized	\$3,443	\$125,561	\$7,333	\$42,327
Unpaid principal balance of underlying mortgage loans	\$280,613	\$8,762,024	\$600,196	\$3,550,411
Weighted average servicing fee rate (in basis points)	34	36	33	30
Key inputs:				
Pricing spread (1)				
Range	7.0% – 13.4%	6.8% – 15.7%	8.3% – 16.2%	6.8% – 15.2%
Weighted average	9.9%	9.0%	11.5%	10.9%
Annual total prepayment speed (2)				
Range	7.7% – 46.0%	7.7% – 34.0%	7.6% – 25.0%	7.6% – 43.6%
Weighted average	10.2%	8.3%	8.8%	8.2%
Life (in years)				
Range	1.5 – 7.3	2.1 – 7.3	2.1 – 7.5	1.5 – 7.3
Weighted average	6.6	7.0	7.0	7.1
Per-loan annual cost of servicing				
Range	\$59 – \$82	\$59 – \$82	\$53 – \$100	\$53 – \$100
Weighted average	\$74	\$75	\$88	\$90

(1) Pricing spread represents a margin that is applied to a reference interest rate's forward rate curve to develop periodic discount rates. The Company applies a pricing spread to the United States Dollar London Interbank Offered Rate ("LIBOR") curve for purposes of discounting cash flows relating to MSR's acquired as proceeds from the sale of mortgage loans.

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

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	Six months ended June 30,			
	2015		2014	
	Fair value	Amortized cost	Fair value	Amortized cost
	(Amount recognized and unpaid principal balance of underlying mortgage loans in thousands)			
MSR and pool characteristics:				
Amount recognized	\$6,118	\$192,842	\$14,266	\$72,908
Unpaid principal balance of underlying mortgage loans	\$522,130	\$13,899,109	\$1,111,663	\$6,174,010
Weighted average servicing fee rate (in basis points)	33	35	33	30
Key inputs:				
Pricing spread (1)				
Range	7.0% – 14.4%	6.8% – 15.9%	8.3% – 16.2%	6.8% – 15.2%
Weighted average	10.3%	9.3%	11.3%	10.7%
Annual total prepayment speed (2)				
Range	7.7% – 62.4%	7.6% – 39.4%	7.6% – 25.0%	7.6% – 45.3%
Weighted average	11.0%	8.5%	8.7%	8.1%
Life (in years)				
Range	1.1 – 7.3	1.8 – 7.3	2.1 – 7.5	1.5 – 7.5
Weighted average	6.4	7.0	7.1	7.1
Per-loan annual cost of servicing				
Range	\$59 – \$82	\$59 – \$82	\$53 – \$100	\$53 – \$100
Weighted average	\$74	\$75	\$92	\$94

(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 Life Total CPR.

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Following is a quantitative summary of key inputs used in the valuation and assessment for impairment of the Company's MSR's at period end and the effect on fair value from adverse changes in those inputs (weighted averages are based upon UPB):

	June 30, 2015		December 31, 2014	
	Fair value	Amortized cost	Fair value	Amortized cost
	(Carrying value, unpaid principal balance of underlying mortgage loans and effect on fair value amounts in thousands)			
MSR and pool characteristics:				
Carrying value	\$581,269	\$554,241	\$325,383	\$405,445
Unpaid principal balance of underlying mortgage loans	\$48,725,042	\$41,956,370	\$30,945,000	\$33,745,613
Weighted average note interest rate	4.05%	3.80%	4.24%	3.82%
Weighted average servicing fee rate (in basis points)	32	31	31	30
Key inputs:				
Pricing spread (1) (2)				
Range	2.9% – 16.3%	6.3% – 16.2%	2.9% – 21.3%	6.3% – 15.3%
Weighted average	9.0%	8.8%	9.2%	9.7%
Effect on fair value of:				
5% adverse change	(\$10,987)	(\$11,667)	(\$5,550)	(\$8,710)
10% adverse change	(\$21,570)	(\$22,892)	(\$10,908)	(\$17,083)
20% adverse change	(\$41,609)	(\$44,110)	(\$21,084)	(\$32,890)
Average life (in years)				
Range	0.4 – 8.2	1.7 – 7.3	0.4 – 8.2	1.6 – 7.3
Weighted average	6.2	6.8	5.8	6.8
Prepayment speed (1) (3)				
Range	7.6% – 59.3%	7.7% – 34.1%	7.6% – 60.5%	7.6% – 42.8%
Weighted average	9.7%	8.5%	11.2%	8.5%
Effect on fair value of:				
5% adverse change	(\$11,286)	(\$10,346)	(\$7,052)	(\$7,359)
10% adverse change	(\$22,187)	(\$20,371)	(\$13,835)	(\$14,494)
20% adverse change	(\$42,914)	(\$39,513)	(\$26,654)	(\$28,132)
Annual per-loan cost of servicing (1)				
Range	\$59 – \$96	\$59 – \$81	\$59 – \$109	\$59 – \$81
Weighted average	\$77	\$75	\$76	\$75
Effect on fair value of:				
5% adverse change	(\$5,268)	(\$3,902)	(\$2,910)	(\$2,992)
10% adverse change	(\$10,536)	(\$7,804)	(\$5,819)	(\$5,983)
20% adverse change	(\$21,072)	(\$15,608)	(\$11,638)	(\$11,967)

(1) The effect on value of an adverse change in one of the above-mentioned key inputs will result in recognized change in fair value for MSR's carried at fair value and may result in recognition of MSR impairment for MSR's carried at the lower of amortized cost or fair value. The extent of the recognized MSR impairment will depend on the relationship of fair value to the carrying value of such MSR's.

- (2) 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 MSR's acquired as proceeds from the sale of mortgage loans and purchased MSR's not backed by pools of distressed mortgage loans.
- (3) Prepayment speed is measured using Life Total CPR.

The preceding sensitivity analyses are limited in that they were performed at a particular point in time; only contemplate the movements in the indicated inputs; do not incorporate changes to other inputs; 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 earnings forecasts.

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Excess Servicing Spread Financing at Fair Value

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

ESS is generally subject to fair value increases when mortgage interest rates increase. Increasing mortgage interest rates normally slow mortgage refinancing activity. Decreased refinancing activity increases the life of the loans underlying the ESS, thereby increasing ESS’ fair value, which is the liability owed to PMT. Increases in the fair value of ESS decrease income and are included in Amortization, impairment and change in fair value of mortgage servicing rights.

Interest expense for ESS is accrued using the interest method based upon the expected cash flows from the ESS through the expected life of the underlying mortgage loans. Other changes in fair value are recorded in Change in fair value of excess servicing spread payable to PennyMac Mortgage Investment Trust.

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

	June 30, 2015	December 31, 2014
ESS and pool characteristics:		
Unpaid principal balance of underlying loans (in thousands)	\$46,809,508	\$28,227,340
Average servicing fee rate (in basis points)	32	31
Average excess servicing spread (in basis points)	16	16
Key inputs:		
Pricing spread (1)		
Range	1.7% - 12.4%	1.7% - 12.0%
Weighted average	5.0%	5.3%
Average life (in years)		
Range	0.3 - 7.3	0.4 - 7.3
Weighted average	6.2	5.8
Annualized prepayment speed (2)		
Range	7.6% - 74.3%	7.6% - 74.6%
Weighted average	9.7%	11.2%

(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 ESS.

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

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Note 8—Mortgage Loans Held for Sale at Fair Value

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

	June 30, 2015	December 31, 2014
	(in thousands)	
Government-insured or guaranteed	\$ 1,508,666	\$ 866,148
Conventional conforming	51,511	66,229
Jumbo	—	5,599
Delinquent mortgage loans purchased from Ginnie Mae pools serviced by the Company	27,823	206,331
Mortgage loans repurchased pursuant to representations and warranties	6,262	3,577
	\$ 1,594,262	\$ 1,147,884
Fair value of mortgage loans pledged to secure mortgage loans sold under agreements to repurchase	\$ 1,369,324	\$ 976,772
Fair value of mortgage loans pledged to secure mortgage loan participation and sale agreement	\$ 202,076	\$ 148,133

Note 9—Derivative Financial Instruments

The Company is exposed to fair value risk relative to its mortgage loans held for sale as well as to its IRLCs and MSR. The Company bears fair value 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 fair value of its IRLCs and mortgage loans held for sale when market mortgage interest rates increase. The Company is exposed to loss in fair value of its MSR when market mortgage 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 fair value risk resulting from interest rate risk, the Company uses derivative financial instruments acquired with the intention of reducing the risk that changes in market interest rates will result in unfavorable changes in the fair value of the Company's IRLCs, inventory of mortgage loans held for sale and MSR.

The Company does not use derivative financial instruments for purposes other than in support of its risk management activities other than IRLCs, which are generated in the process of purchasing or originating mortgage loans held for

sale. The Company records all derivative financial instruments at fair value and records changes in fair value in current period income.

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

Instrument	June 30, 2015			December 31, 2014		
	Notional amount (in thousands)	Fair value Derivative assets	Derivative liabilities	Notional amount	Fair value Derivative assets	Derivative liabilities
Derivatives not designated as hedging instruments						
Free-standing derivatives:						
Interest rate lock commitments	4,296,134	\$ 34,371	\$ 6,634	1,765,597	\$ 33,353	\$ 952
Forward purchase contracts	6,202,418	7,048	14,316	2,634,218	9,060	141
Forward sales contracts	9,789,564	26,652	7,093	3,901,851	320	16,110
MBS put options	327,500	1,426	—	340,000	476	—
MBS call options	160,000	253	—	—	—	—
Put options on interest rate futures purchase contracts	2,019,500	2,165	—	755,000	862	—
Call options on interest rate futures purchase contracts	1,025,000	3,031	—	630,000	2,193	—
Put options on interest rate futures sale contracts	—	—	—	50,000	—	8
Total derivatives before netting		74,946	28,043		46,264	17,211
Netting		(31,378)	(14,459)		(7,807)	(10,698)
		\$ 43,568	\$ 13,584		\$ 38,457	\$ 6,513
Margin deposits with (collateral received from) derivative counterparties, net		\$ 16,919			\$ (2,891)	

The following table summarizes the notional value activity for derivative contracts used in the Company's hedging activities:

Instrument	Quarter ended June 30, 2015			Balance end of period
	Balance beginning of period (in thousands)	Additions	Dispositions/ expirations	
Forward purchase contracts	5,124,867	25,739,853	(24,662,302)	6,202,418
Forward sale contracts	7,464,527	37,634,838	(35,309,801)	9,789,564
MBS put options	450,000	457,500	(580,000)	327,500
MBS call options	—	160,000	—	160,000
	1,470,500	2,284,500	(1,735,500)	2,019,500

Put options on interest rate futures purchase contracts				
Call options on interest rate futures purchase contracts	870,000	2,170,000	(2,015,000)	1,025,000
Put options on interest rate futures sale contracts	100,000	—	(100,000)	—

Instrument	Quarter ended June 30, 2014			Balance end of period
	Balance beginning of period (in thousands)	Additions	Dispositions/ expirations	
Forward purchase contracts	1,506,667	10,611,283	(9,328,673)	2,789,277
Forward sale contracts	2,829,176	15,842,070	(14,054,146)	4,617,100
MBS put options	175,000	255,000	(205,000)	225,000
MBS call options	160,000	145,000	(210,000)	95,000
Put options on interest rate futures sales contracts	325,000	377,500	(325,000)	377,500
Call options on interest rate futures sales contracts	100,000	205,000	(135,000)	170,000
Treasury futures purchase contracts	—	56,700	(56,700)	—
Treasury futures sale contracts	—	56,700	(56,700)	—

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Instrument	Six months ended June 30, 2015			Balance end of period
	Balance beginning of period (in thousands)	Additions	Dispositions/ expirations	
Forward purchase contracts	2,634,218	45,375,703	(41,807,503)	6,202,418
Forward sale contracts	3,901,851	64,375,110	(58,487,397)	9,789,564
MBS put options	340,000	1,242,500	(1,255,000)	327,500
MBS call options	—	160,000	—	160,000
Put options on interest rate futures purchase contracts	755,000	3,825,000	(2,560,500)	2,019,500
Call options on interest rate futures purchase contracts	630,000	2,915,000	(2,520,000)	1,025,000
Put options on interest rate futures sale contracts	50,000	50,000	(100,000)	—
Call options on interest rate futures sale contracts	—	35,100	(35,100)	—

Instrument	Six months ended June 30, 2014			Balance end of period
	Balance beginning of period (in thousands)	Additions	Dispositions/ expirations	
Forward purchase contracts	1,418,527	17,510,671	(16,139,921)	2,789,277
Forward sale contracts	2,659,000	26,382,189	(24,424,089)	4,617,100
MBS put options	185,000	640,000	(600,000)	225,000
MBS call options	105,000	540,000	(550,000)	95,000
Put options on interest rate futures purchase contracts	—	702,500	(325,000)	377,500
Call options on interest rate futures purchase contracts	—	380,000	(210,000)	170,000
Treasury futures purchase contracts	—	78,300	(78,300)	—
Treasury futures sale contracts	—	87,400	(87,400)	—

The Company recorded net gains on derivative financial instruments used to hedge IRLCs and mortgage loans held for sale at fair value totaling \$45.0 million and \$19.2 million for the quarter and six months ended June 30, 2015, respectively, and net losses of \$38.8 million and \$58.8 million for the quarter and six months ended June 30, 2014, respectively. Net gains and losses on derivative financial instruments used to hedge IRLCs and mortgage loans held for sale at fair value are included in Net gains on mortgage loans held for sale at fair value in the Company's consolidated statements of income.

The Company recorded net losses on derivative financial instruments used to hedge fair value changes of MSR's totaling \$28.3 million and \$11.2 million for the quarter and six months ended June 30, 2015, respectively, and net gains on derivative financial instruments used to hedge fair value changes of MSR's totaling \$9.6 million and \$9.2 million for the quarter and six months ended June 30, 2014, respectively. Net gains and losses on derivative financial instruments used to hedge fair value changes of MSR's are included in Amortization, impairment and change in fair value of mortgage servicing rights in the Company's consolidated statements of income.

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Note 10—Mortgage Servicing Rights

Carried at Fair Value:

The activity in MSR's carried at fair value is as follows:

	Quarter ended June 30,		Six months ended	
	2015	2014	June 30, 2015	2014
	(in thousands)			
Balance at beginning of period	\$ 361,413	\$ 246,984	\$ 325,383	\$ 224,913
Additions:				
Purchases	206,996	71,778	270,133	97,644
Mortgage servicing rights resulting from mortgage loan sales	3,443	7,333	6,118	14,266
	210,439	79,111	276,251	111,910
Sales	—	(10,881)	—	(10,881)
Change in fair value due to:				
Changes in valuation inputs or assumptions used in valuation model (1)	26,308	2,511	8,593	(445)
Other changes in fair value (2)	(16,891)	(9,126)	(28,958)	(16,898)
Total change in fair value	9,417	(6,615)	(20,365)	(17,343)
Balance at end of period	\$ 581,269	\$ 308,599	\$ 581,269	\$ 308,599

- (1) Principally reflects changes in discount rates and prepayment speed inputs, primarily due to changes in market mortgage interest rates.
- (2) Represents changes due to realization of cash flows.

Carried at Lower of Amortized Cost or Fair Value:

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

	Quarter ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Amortized cost:				

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Balance at beginning of period	\$ 470,490	\$ 287,187	\$ 415,245	\$ 263,373
Mortgage servicing rights resulting from mortgage loan sales	125,561	42,327	192,842	72,908
Amortization	(14,493)	(7,603)	(26,529)	(14,370)
Application of valuation allowance to write down mortgage servicing rights with other-than-temporary impairment	—	—	—	—
Balance at end of period	581,558	321,911	581,558	321,911
Valuation allowance:				
Balance at beginning of period	(41,492)	(5,043)	(9,800)	(4,622)
Additions	14,175	(3,786)	(17,517)	(4,207)
Application of valuation allowance to write down mortgage servicing rights with other-than-temporary impairment	—	—	—	—
Balance at end of period	(27,317)	(8,829)	(27,317)	(8,829)
Mortgage servicing rights, net	\$ 554,241	\$ 313,082	\$ 554,241	\$ 313,082
Fair value of mortgage servicing rights at end of period	\$ 569,969	\$ 321,383	\$ 569,969	\$ 321,383
Fair value of mortgage servicing rights at beginning of period	\$ 437,824	\$ 291,535	\$ 416,802	\$ 269,422

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The fair value of mortgage servicing rights pledged to secure the note payable totaled \$536.2 million and \$303.8 million as of June 30, 2015 and 2014, respectively.

The following table summarizes the Company's estimate of future amortization of its existing MSR's. This estimate was developed with the inputs used in the June 30, 2015 valuation of MSR's. The inputs 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.

Twelve month period ending June 30,	Estimated MSR amortization (in thousands)
2016	\$ 56,195
2017	55,880
2018	52,838
2019	49,207
2020	45,351
Thereafter	322,087
	\$ 581,558

Servicing fees relating to MSR's are recorded in Net servicing fees—Loan servicing fees—From non-affiliates on the consolidated statements of income; late charges and other ancillary fees relating to MSR's are recorded in Net servicing fees—Loan servicing fees—Ancillary and other fees on the Company's consolidated statements of income. The fees are summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Contractual servicing fees	\$ 66,867	\$ 43,314	\$ 116,968	\$ 79,414
Ancillary and other fees:				
Late charges	1,467	963	3,118	1,850
Other	691	248	1,402	424
	\$ 69,025	\$ 44,525	\$ 121,488	\$ 81,688

Mortgage Servicing Liabilities Carried at Fair Value:

The activity in mortgage servicing liabilities carried at fair value is summarized below:

	Quarter ended		Six months ended	
	June 30,		June 30,	
	2015	2014	2015	2014
	(in thousands)			
Balance at beginning of period	\$ 6,529	\$ —	\$ 6,306	\$ —
Mortgage servicing liabilities resulting from mortgage loan sales	9,156	—	12,084	—
Change in fair value	(3,894)	5,821	(6,599)	5,821
Balance at end of period	\$ 11,791	\$ 5,821	\$ 11,791	\$ 5,821

Note 11—Carried Interest Due from Investment Funds

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

	Quarter ended		Six months ended	
	June 30,		June 30,	
	2015	2014	2015	2014
	(in thousands)			
Balance at beginning of period	\$ 68,531	\$ 63,299	\$ 67,298	\$ 61,142
Carried Interest recognized during the period	182	1,834	1,415	3,991
Proceeds received during the period	—	—	—	—
Balance at end of period	\$ 68,713	\$ 65,133	\$ 68,713	\$ 65,133

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The amount of the Carried Interest that will be received by the Company depends on the Investment Funds' future performance. As a result, the amount of Carried Interest recorded by the Company is based on the cash flows that would be produced assuming termination of the Investment Funds at period end and may be reduced in future periods based on the performance of the Investment Funds in those periods. However, the Company is not required to pay guaranteed returns to the Investment Funds and the amount of any reduction to Carried Interest will be limited to the amounts previously recognized.

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

Note 12—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 June 30,		Six months ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Dividends received from PennyMac Mortgage Investment Trust	\$ 46	\$ 44	\$ 138	\$ 88
Change in fair value of investment in PennyMac Mortgage Investment Trust	(290)	(147)	(275)	(76)
	\$ (244)	\$ (103)	\$ (137)	\$ 12
Fair value of PennyMac Mortgage Investment Trust shares at period end	\$ 1,307	\$ 1,646		

Note 13—Borrowings

As of June 30, 2015, the Company maintained six borrowing facilities: four repurchase facilities that provide funding for mortgage loans held for sale; one repurchase mortgage loan participation and sale agreement; and one note payable secured by MSRs and servicing advances made relating to certain loans in the Company's mortgage loan servicing portfolio.

The borrowing facilities contain various covenants, including financial covenants governing PLS's net worth, debt to equity ratio, profitability and liquidity. Management believes that PLS was in compliance with these requirements as of June 30, 2015.

Mortgage Loans Sold Under Agreement to Repurchase

The borrowing facilities secured by mortgage loans held for sale are in the form of mortgage loan sale and repurchase agreements. Eligible mortgage loans are sold at advance rates based on the loan type. Interest is charged at a rate based on the buyer's overnight cost of funds rate for one agreement and on LIBOR for the other three agreements. Mortgage loans financed under these agreements may be re-pledged by the lenders. One facility also provides financing for government-insured loans purchased out of Ginnie Mae securities for modification or default resolution.

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Financial data pertaining to mortgage loans sold under agreements to repurchase are as follows:

	Quarter ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Period end:				
Balance (1)	\$ 1,264,046	\$ 825,267		
Unused amount (2)	\$ 35,954	\$ 674,733		
Weighted average interest rate (3)	1.80 %	1.85 %		
Fair value of mortgage loans securing agreements to repurchase	\$ 1,369,324	\$ 997,506		
Margin deposits placed with counterparties (4)	\$ 2,500	\$ 1,500		
During the period:				
Average balance of mortgage loans sold under agreements to repurchase	\$ 819,988	\$ 527,990	\$ 719,003	\$ 410,196
Weighted average interest rate (3)	1.80 %	1.83 %	1.80 %	1.81 %
Total interest expense	\$ 4,758	\$ 3,682	\$ 8,498	\$ 6,011
Maximum daily amount outstanding	\$ 1,264,046	\$ 873,301	\$ 1,264,046	\$ 873,301

- (1) Excludes unamortized debt issuance costs of \$798,000 and \$230,000 as of June 30, 2015 and 2014, respectively.
- (2) The amount the Company is able to borrow under mortgage loan repurchase agreements is tied to the fair value of unencumbered mortgage loans eligible to secure those agreements and the Company's ability to fund the agreements' margin requirements relating to the mortgage loans sold.
- (3) Excludes the effect of amortization of commitment fees totaling \$1.0 million and \$1.2 million for the quarters ended June 30, 2015 and 2014, respectively, and \$2.0 million and \$2.3 million for the six months ended June 30, 2015 and 2014, respectively.
- (4) Margin deposits are included in Other assets on the consolidated balance sheet.

Following is a summary of maturities of outstanding advances under repurchase agreements by maturity date:

Remaining maturity at June 30, 2015	Balance (in thousands)
Within 30 days	\$ 3,553
Over 30 to 90 days	1,227,598
Over 90 days	32,895
	1,264,046
Debt issuance costs	(798)
Total loans sold under agreements to repurchase	\$ 1,263,248
Weighted average maturity (in months)	2.3

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The amount at risk (the fair value of the assets pledged plus the related margin deposit, less the amount advanced by the counterparty and accrued interest) relating to the Company's mortgage loans held for sale sold under agreements to repurchase is summarized by counterparty below as of June 30, 2015:

Counterparty	Amount at risk (in thousands)	Weighted average maturity of advances under repurchase agreement	Facility maturity
Credit Suisse First Boston Mortgage Capital LLC	\$ 40,155	September 18, 2015	October 30, 2015
Bank of America, N.A.	\$ 44,354	September 17, 2015	January 29, 2016
Morgan Stanley Bank, N.A.	\$ 12,685	July 28, 2015	July 29, 2015
Citibank, N.A.	\$ 8,569	August 7, 2015	September 7, 2015

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The Company is subject to margin calls during the period the agreements are outstanding and therefore may be required to repay a portion of the borrowings before the respective agreements mature if the fair value (as determined by the applicable lender) of the mortgage loans securing those agreements decreases.

Mortgage Loan Participation and Sale Agreement

Under the mortgage loan participation and sale agreement, participation certificates, each of which represents an undivided beneficial ownership interest in mortgage loans that have been pooled with Fannie Mae, Freddie Mac or Ginnie Mae, are sold to the lender pending the securitization of the mortgage loans and sale of the resulting securities. A commitment to sell the securities resulting from the pending securitization between the Company and a non-affiliate is also assigned to the lender as part of the sale of the participation certificate.

The purchase price paid by the lender for each participation certificate is based on the trade price of the security, plus an amount of interest expected to accrue on the security to its anticipated delivery date, minus a present value adjustment, any related hedging costs and a holdback amount that is based on a percentage of the purchase price and is not required to be paid to the Company until the settlement of the security and its delivery to the lender.

The mortgage loan participation and sale agreement is summarized below:

	Quarter ended June 30, 2015 (in thousands)	Six months ended June 30, 2015
Period end:		
Mortgage loan participation and sale agreement secured by mortgage loan participation certificates	\$ 195,959	
Mortgage loans pledged to secure mortgage loan participation and sale agreement	\$ 202,076	
During the period:		
Average balance	\$ 162,150	\$ 144,484
Weighted average interest rate (1)	1.43 %	1.43 %
Total interest expense	\$ 651	\$ 1,239

(1) Excludes the effect of amortization of commitment fees totaling \$63,000 and \$130,000 million for the quarter and six months ended June 30, 2015.

Note Payable

The note payable is summarized below:

	Quarter ended June 30,		Six months ended	
	2015	2014	June 30,	2014
	(in thousands)			
Period end:				
Note payable secured by:				
Mortgage servicing rights	\$ 246,456	\$ 115,314		
Servicing advances	—	—		
	\$ 246,456	\$ 115,314		
Assets pledged to secure note payable:				
Mortgage servicing rights	\$ 536,172	\$ 303,831		
Servicing advances	\$ —	\$ —		
During the period:				
Average balance	\$ 214,618	\$ 78,177	\$ 178,152	\$ 65,337
Weighted average interest rate	3.00 %	2.95 %	2.98 %	2.94 %
Total interest expense	\$ 2,463	\$ 861	\$ 4,098	\$ 1,520

The note payable is secured by servicing advances and MSRs relating to certain mortgage loans in the Company's mortgage loan servicing portfolio, and currently provides for advance rates of 50% of the carrying value of

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MSRs pledged and 85% of the amount of the servicing advances pledged. Interest is charged at a rate based on the lender's overnight cost of funds.

On April 30, 2015, the maximum loan amount of the note payable was increased from \$257 million to \$407 million. In connection with this increase, the Company entered into an agreement with PMT pursuant to which PMT may borrow up to \$150 million from the Company for the purpose of financing ESS. The Company then re-pledges the ESS to secure the note payable. At June 30, 2015, PMT had advances payable to the Company totaling \$52.5 million under this arrangement.

Excess Servicing Spread Financing

In conjunction with the Company's purchase from non-affiliates of certain MSRs on pools of Agency-backed residential mortgage loans, the Company has entered into sale and assignment agreements with PMT which are treated as financings and are carried at fair value with changes in fair value recognized in current period income. Under these agreements, the Company sold to PMT the right to receive ESS cash flows relating to certain MSRs. The Company retained a fixed base servicing fee and all ancillary income associated with servicing the mortgage loans. The Company continues to be the servicer of the mortgage loans and provides all servicing functions, including responsibility to make servicing advances.

Following is a summary of ESS:

	Quarter ended June 30,		Six months ended	
	2015	2014	June 30,	2014
	(in thousands)			
Balance at beginning of period	\$ 222,309	\$ 151,019	\$ 191,166	\$ 138,723
Issuances of excess servicing spread to PennyMac Mortgage Investment Trust:				
For cash	140,875	52,867	187,287	73,393
Pursuant to a recapture agreement	1,319	2,362	2,565	3,475
Accrual of interest	5,818	3,139	9,570	6,001
Repayments	(18,352)	(9,081)	(31,083)	(16,494)
Change in fair value	7,133	(10,062)	(403)	(14,854)
Balance at end of period	\$ 359,102	\$ 190,244	\$ 359,102	\$ 190,244

Note 14—Liability for Losses Under Representations and Warranties

Following is a summary of activity in the Company's liability for representations and warranties:

	Quarter ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Balance at beginning of period	\$ 14,689	\$ 8,974	\$ 13,259	\$ 8,123
Provision for losses on loans sold	1,748	1,204	3,243	2,055
Incurred losses	(180)	—	(245)	—
Balance at end of period	\$ 16,257	\$ 10,178	\$ 16,257	\$ 10,178
Unpaid principal balance of mortgage loans subject to representations and warranties at period end	\$ 44,794,166	\$ 29,882,252		

Note 15—Income Taxes

The Company's effective tax rate was 11.5% for both the quarter and six months ended June 30, 2015. For the quarter and six months ended June 30, 2014, the Company's effective tax rates were 11.4% and 11.3%, respectively. The difference between the Company's effective tax rate and the statutory rate is primarily due to the allocation of earnings to the noncontrolling interest unitholders. As the noncontrolling interest unitholders convert their ownership units into the Company's shares, the portion of the Company's income that will be subject to corporate federal and state statutory tax rates will increase, which will in turn increase the Company's effective income tax rate.

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Note 16—Noncontrolling Interest

During the quarter and six months ended June 30, 2015, respectively, PennyMac unitholders exchanged 89,388 and 133,388 Class A units for the Company's Class A common stock. The effect of the exchanges reduced the percentage of the Noncontrolling interest in Private National Mortgage Acceptance Company, LLC from 71.6% at December 31, 2014 to 71.3% at June 30, 2015.

During the quarter and six months ended June 30, 2014, respectively, PennyMac unitholders exchanged 412,500 and 479,209 Class A units for the Company's Class A common stock. The effect of the exchanges reduced the percentage of the Noncontrolling interest in Private National Mortgage Acceptance Company, LLC from 72.6% at December 31, 2013 to 71.9% at June 30, 2014.

Net income attributable to the Company's common stockholders and the effects of changes in noncontrolling ownership interest in PennyMac is summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
	(in thousands, except share amounts)			
Net income attributable to PennyMac Financial Services, Inc. common stockholders	\$ 12,749	\$ 9,618	\$ 21,777	\$ 17,590
Increase in the Company's additional paid-in capital for exchanges of Class A units of Private National Mortgage Acceptance Company, LLC to Class A stock of PennyMac Financial Services, Inc. (Class A shares issued, 89,388 and 133,388 during the quarter and six months ended June 30, 2015, respectively, and 412,500 and 479,209 during the quarter and six months ended June 30, 2014, respectively)	\$ 1,640	\$ 4,035	\$ 2,432	\$ 4,598

Note 17—Net Gains on Mortgage Loans Held for Sale

Net gains on mortgage loans held for sale at fair value is summarized below:

	Quarter ended June 30,		Six months ended	
	2015	2014	June 30,	2014
	(in thousands)			
Cash (loss) gain:				
Sales proceeds	\$ (38,944)	\$ 10,241	\$ (36,214)	\$ 14,722
Hedging activities	17,995	(25,549)	(334)	(35,805)
	(20,949)	(15,308)	(36,548)	(21,083)
Non-cash gain:				
Mortgage servicing rights resulting from mortgage loan sales	129,004	49,660	198,960	87,174
Mortgage servicing liabilities resulting from mortgage loan sales	(9,156)	—	(12,084)	—
MSR and ESS recapture payable to PennyMac Mortgage Investment Trust	(1,456)	(2,526)	(2,745)	(4,424)
Provision for losses relating to representations and warranties on loans sold	(1,748)	(1,204)	(3,243)	(2,055)
Change in fair value relating to loans and hedging derivatives held at period end:				
Interest rate lock commitments	(26,654)	15,453	(4,663)	22,989
Mortgage loans	(12,120)	6,830	81	14,658
Hedging derivatives	27,034	(13,201)	19,575	(23,017)
	\$ 83,955	\$ 39,704	\$ 159,333	\$ 74,242

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Note 18—Net Interest Expense

Net interest expense is summarized below:

	Quarter ended		Six months ended	
	June 30,		June 30,	
	2015	2014	2015	2014
	(in thousands)			
Interest income:				
From non-affiliates:				
Short-term investments	\$ 933	\$ 325	\$ 1,445	\$ 526
Mortgage loans held for sale at fair value	11,718	5,927	20,139	9,836
	12,651	6,252	21,584	10,362
From PennyMac Mortgage Investment Trust—Note receivable	533	—	533	—
	13,184	6,252	22,117	10,362
Interest expense:				
To non-affiliates:				
Mortgage loans sold under agreements to repurchase	4,758	3,682	8,498	6,011
Mortgage loan participation and sale agreement	651	—	1,239	—
Note payable	2,463	861	4,098	1,520
Interest shortfall on repayments of mortgage loans serviced for Agency securitizations	1,676	375	3,200	593
Interest on mortgage loan impound deposits	983	675	1,573	993
	10,531	5,593	18,608	9,117
To PennyMac Mortgage Investment Trust—Excess servicing spread financing at fair value	5,818	3,139	9,570	6,001
	16,349	8,732	28,178	15,118
	\$ (3,165)	\$ (2,480)	\$ (6,061)	\$ (4,756)

Note 19—Stock-based Compensation

The Company's 2013 Equity Incentive Plan provides for grants of stock options, time-based and performance-based restricted stock units ("RSUs"), stock appreciation rights, performance units and stock grants. As of June 30, 2015, the Company has 1.9 million units available for future awards. The Company estimates the cost of the stock options, time-based RSUs and performance-based RSUs awarded with reference to the fair value of the Company's Class A common stock on the date of the grants. Compensation costs are fixed, except for the performance-based RSUs, at the grant's estimated fair value on the grant date as all grantees are employees of PennyMac or directors of the Company. Expense relating to grants is included in Compensation in the Company's consolidated statements of income.

Following is a summary of the stock-based compensation expense by instrument awarded:

	Quarter ended		Six months ended	
	June 30, 2015	2014	June 30, 2015	2014
	(in thousands)			
Stock options	\$ 1,516	\$ 1,375	\$ 2,996	\$ 2,562
Performance-based RSUs	2,474	1,112	4,345	1,874
Time-based RSUs	602	437	1,137	873
	\$ 4,592	\$ 2,924	\$ 8,478	\$ 5,309

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Following is a summary of equity awards:

	Quarter ended June 30, 2015		
		Performance-	Time-based
	Stock options (in thousands)	based RSUs	RSUs
March 31, 2015	1,881	2,398	289
Granted	—	—	32
Vested (1)	—	—	(40)
Exercised	—	—	—
Forfeited or canceled	(12)	(17)	(5)
June 30, 2015	1,869	2,381	276

	Quarter ended June 30, 2014		
		Performance-	Time-based
	Stock options (in thousands)	based RSUs	RSUs
March 31, 2014	1,169	1,102	198
Granted	—	—	38
Vested (1)	—	—	(31)
Exercised	—	—	—
Forfeited or canceled	(7)	(2)	(3)
June 30, 2014	1,162	1,100	202

	Six months ended June 30, 2015		
		Performance-	Time-based
	Stock options (in thousands)	based RSUs	RSUs
December 31, 2014	1,167	1,257	202
Granted	715	1,143	150
Vested (1)	—	—	(71)
Expired or canceled	(13)	(19)	(5)
June 30, 2015	1,869	2,381	276

	Six months ended June 30, 2014		
	Stock	Performance-	Time-based
	options	based RSUs	RSUs
	(in thousands)		
December 31, 2013	422	496	100
Granted	753	614	138
Vested (1)		—	(31)
Expired or canceled	(13)	(10)	(5)
June 30, 2014	1,162	1,100	202

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(1) Not applicable to a rollforward of stock options outstanding.

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Note 20—Supplemental Cash Flow Information

	Six months ended June 30,	
	2015	2014
	(in thousands)	
Cash paid for interest	\$ 27,231	\$ 14,243
Cash paid for income taxes	\$ 1,907	\$ 1,432
Non-cash investing activity:		
Mortgage servicing rights resulting from mortgage loan sales	\$ 198,960	\$ 87,174
Mortgage servicing liabilities resulting from mortgage loan sales	\$ 12,084	\$ —
Non-cash financing activity:		
Transfer of excess servicing spread pursuant to recapture agreement with PennyMac Mortgage Investment Trust	\$ 2,565	\$ 3,475
Issuance of common stock in settlement of director fees	\$ 149	\$ 74

Note 21—Regulatory Net Worth and Agency Capital Requirements

The Company, through PLS and PennyMac, is required to maintain specified levels of equity to remain a seller/servicer in good standing with the Agencies. Such equity requirements generally are tied to the size of the Company's loan servicing portfolio or loan origination volume.

The Agencies' capital requirements, the calculations of which are specified by each Agency, are summarized below:

Agency—company subject to requirement	Agency capital June 30, 2015		December 31, 2014	
	Balance (1)	Requirement	Balance (1)	Requirement
	(in thousands)			
Fannie Mae—PLS	\$ 697,123	\$ 342,926	\$ 583,686	\$ 35,507
Freddie Mac—PLS	\$ 697,799	\$ 4,386	\$ 583,819	\$ 3,721
Ginnie Mae—PLS	\$ 643,515	\$ 177,531	\$ 536,009	\$ 111,457
Ginnie Mae—PennyMac	\$ 883,662	\$ 213,037	\$ 763,907	\$ 133,748
HUD—PLS	\$ 643,515	\$ 2,500	\$ 539,844	\$ 2,500

(1) Calculated in compliance with the respective Agency's requirements.

Noncompliance with the respective Agencies' capital requirements can result in the respective Agency taking various remedial actions up to and including removing PennyMac's ability to sell loans to and service loans on behalf of the respective Agency. PennyMac and PLS had Agency capital in excess of the respective Agencies' requirements at June 30, 2015.

Note 22—Commitments and Contingencies

Litigation

The business of the Company involves the collection of numerous accounts, as well as the validation of liens and compliance with various state and federal lending and servicing laws. Accordingly, the Company may be involved in proceedings, claims, and legal actions arising in the ordinary course of business. As of June 30, 2015, the Company was not involved in any legal proceedings, claims, or actions that in management's view would be reasonably likely to have a material adverse effect on the Company.

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Commitments to Fund and Sell Mortgage Loans

	June 30, 2015 (in thousands)
Commitments to purchase mortgage loans from PennyMac Mortgage Investment Trust	\$ 3,237,518
Commitments to fund mortgage loans	1,058,616
	\$ 4,296,134
Commitments to sell mortgage loans	\$ 9,789,564

Note 23—Segments and Related Information

The Company operates in three segments: loan production, loan servicing and investment management.

Two of the segments are in the mortgage banking business: loan production and loan servicing. The loan production segment performs origination, acquisition and sale activities. The loan servicing segment performs servicing of newly originated mortgage loans, execution and management of early buyout loans and servicing of mortgage loans sourced and managed by the investment management segment, including executing the loan resolution strategy identified by the investment management segment relating to distressed mortgage loans.

The investment management segment represents the activities of the Company's investment manager, which include sourcing, performing diligence, bidding and closing investment asset acquisitions, managing correspondent lending activities for PMT and managing the acquired assets for the Advised Entities.

During the quarter ended June 30, 2015, the Company updated its method for allocating incentive compensation for executive management and shared services to each segment. Incentive compensation for executive management and shared services is now allocated to each segment based on its contribution to earnings rather than on usage of such executive management and shared services. The financial highlights below reflect the change in expense allocation method for the periods ended June 30, 2015. The financial highlights for the periods ended June 30, 2014 have not been restated. Following is a summary of the effect of the change in allocation on the segments' expenses for the periods ended June 30, 2014:

	Quarter ended	Six months ended
	June 30, 2014	
	(in thousands)	
Increase (decrease) in segment expenses:		
Mortgage banking		
Production	\$ 453	\$ 513
Servicing	1,441	3,223
	1,894	3,736
Investment management	(1,894)	(3,736)
	\$ —	\$ —

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Financial highlights by segment are as follows:

	Quarter ended June 30, 2015			Investment Management	Total
	Mortgage Banking Production	Servicing	Total		
	(in thousands)				
Revenues (1)					
Net gains (losses) on mortgage loans held for sale at fair value	\$ 86,377	\$ (2,422)	\$ 83,955	\$ —	\$ 83,955
Loan origination fees	24,421	—	24,421	—	24,421
Fulfillment fees from PennyMac Mortgage Investment Trust	15,333	—	15,333	—	15,333
Net servicing fees	—	68,549	68,549	—	68,549
Management fees	—	—	—	6,963	6,963
Carried Interest from Investment Funds	—	—	—	182	182
Net interest income (expense):					
Interest income	10,200	2,984	13,184	—	13,184
Interest expense	5,200	11,149	16,349	—	16,349
	5,000	(8,165)	(3,165)	—	(3,165)
Other	235	101	336	(223)	113
Total net revenue	131,366	58,063	189,429	6,922	196,351
Expenses	55,085	60,508	115,593	5,959	121,552
Income (loss) before provision for income taxes	\$ 76,281	\$ (2,445)	\$ 73,836	\$ 963	\$ 74,799
Segment assets at period end (2)	\$ 1,631,661	\$ 1,671,371	\$ 3,303,032	\$ 88,050	\$ 3,391,082

(1) All revenues are from external customers.

(2) Excludes parent Company assets, which consist primarily of deferred tax asset of \$34.2 million.

	Quarter ended June 30, 2014			Investment Management	Total
	Mortgage Banking Production	Servicing	Total		
	(in thousands)				
Revenues (1)					
Net gains on mortgage loans held for sale at fair value	\$ 38,101	\$ 1,603	\$ 39,704	\$ —	\$ 39,704
Loan origination fees	10,345	—	10,345	—	10,345
Fulfillment fees from PennyMac Mortgage Investment Trust	12,433	—	12,433	—	12,433
Net servicing fees	—	56,969	56,969	—	56,969
Management fees	—	—	—	10,998	10,998
Carried Interest from Investment Funds	—	—	—	1,834	1,834

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Net interest income (expense):					
Interest income	5,697	554	6,251	1	6,252
Interest expense	3,072	5,660	8,732	—	8,732
	2,625	(5,106)	(2,481)	1	(2,480)
Other	383	265	648	(16)	632
Total net revenue	63,887	53,731	117,618	12,817	130,435
Expenses	31,126	33,772	64,898	7,490	72,388
Income before provision for income taxes	\$ 32,761	\$ 19,959	\$ 52,720	\$ 5,327	\$ 58,047
Segment assets at period end (2)	\$ 1,117,090	\$ 895,169	\$ 2,012,259	\$ 111,285	\$ 2,123,544

(1) All revenues are from external customers.

(2) Excludes parent Company assets, which consist primarily of deferred tax assets of \$55.8 million.

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	Six months ended June 30, 2015			Investment Management	Total
	Mortgage Banking Production	Servicing	Total		
	(in thousands)				
Revenues (1)					
Net gains (losses) on mortgage loans held for sale at fair value	\$ 163,356	\$ (4,023)	\$ 159,333	\$ —	\$ 159,333
Loan origination fees	41,103	—	41,103	—	41,103
Fulfillment fees from PennyMac Mortgage Investment Trust	28,199	—	28,199	—	28,199
Net servicing fees	—	95,325	95,325	—	95,325
Management fees	—	—	—	15,452	15,452
Carried Interest from Investment Funds	—	—	—	—	—