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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 001-34416

PennyMac Mortgage Investment Trust

(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	27-0186273 (IRS Employer Identification No.)
3043 Townsgate Road, Westlake Village, California (Address of principal executive offices)	91361 (Zip Code)

(818) 224-7442

(Registrant’s telephone number, including area code)

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

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

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

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

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

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

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

Class	Outstanding at August 6, 2018
Common Shares of Beneficial Interest, $0.01 par value	60,950,754

PENNYMAC MORTGAGE INVESTMENT TRUST

FORM 10-Q

June 30, 2018

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

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

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

- the adequacy of our cash reserves and working capital;

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

- changes in governmental regulations, accounting treatment, tax rates and similar matters (including changes to laws governing the taxation of REITs, or the exclusions from registration as an investment company);
- our ability to make distributions to our shareholders in the future;
- our failure to deal appropriately with issues that may give rise to reputational risk; and
- our organizational structure and certain requirements in our charter documents.

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

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 30, 2018	December 31, 2017
	(in thousands, except share information)	
ASSETS		
Cash	$63,035	$ 77,647
Short-term investments at fair value	39,484	18,398
Mortgage-backed securities at fair value pledged to creditors	1,698,322	989,461
Mortgage loans acquired for sale at fair value (includes $1,753,825 and $1,249,277 pledged to creditors, respectively)	1,790,518	1,269,515
Mortgage loans at fair value (includes $701,047 and $1,081,893 pledged to creditors, respectively)	749,445	1,089,473
Excess servicing spread purchased from PennyMac Financial Services, Inc. at fair value pledged to secure Assets sold to PennyMac Financial Services, Inc. under agreements to repurchase	229,470	236,534
Derivative assets (includes $24,601 and $26,058 pledged to creditors, respectively)	133,239	113,881
Firm commitment to purchase credit risk transfer security at fair value	4,426	—
Real estate acquired in settlement of loans (includes $52,445 and $124,532 pledged to creditors, respectively)	109,271	162,865
Real estate held for investment (includes $25,158 and $31,128 pledged to creditors, respectively)	46,431	44,224
Mortgage servicing rights (includes $1,010,507 and $91,459 at fair value; $994,212 and $831,892 pledged to creditors)	1,010,507	844,781
Servicing advances	53,340	77,158
Deposits securing credit risk transfer agreements (includes $385,227 and $400,778 pledged to creditors, respectively)	651,204	588,867
Due from PennyMac Financial Services, Inc.	4,010	4,154
Other	94,147	87,975
Total assets	$6,676,849	$ 5,604,933
LIABILITIES		
Assets sold under agreements to repurchase	$3,780,204	$ 3,180,886
Mortgage loan participation purchase and sale agreements	87,751	44,488
Notes payable	445,062	—
Exchangeable senior notes	247,759	247,186
Asset-backed financing of a variable interest entity at fair value	287,719	307,419

Interest-only security payable at fair value	7,652	7,070
Assets sold to PennyMac Financial Services, Inc. under agreements to repurchase	138,582	144,128
Derivative liabilities	3,446	1,306
Accounts payable and accrued liabilities	58,612	64,751
Due to PennyMac Financial Services, Inc.	19,661	27,119
Income taxes payable	47,289	27,317
Liability for losses under representations and warranties	7,625	8,678
Total liabilities	5,131,362	4,060,348
Commitments and contingencies — Note 20		
SHAREHOLDERS' EQUITY		
Preferred shares of beneficial interest, $0.01 par value per share, authorized 100,000,000 shares, issued and outstanding 12,400,000 shares, liquidation preference $310,000,000	299,707	299,707
Common shares of beneficial interest—authorized, 500,000,000 common shares of $0.01 par value; issued and outstanding, 60,950,754 and 61,334,087 common shares, respectively	610	613
Additional paid-in capital	1,282,971	1,290,931
Accumulated deficit	(37,801)	(46,666)
Total shareholders' equity	1,545,487	1,544,585
Total liabilities and shareholders' equity	$6,676,849	$5,604,933

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

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

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

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

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

Dividends on preferred shares	6,234	2,336	12,468	2,907
Net income attributable to common shareholders	$30,191	$26,444	$52,143	$54,609
Earnings per common share				
Basic	$0.49	$0.39	$0.85	$0.81
Diluted	$0.47	$0.38	$0.82	$0.78
Weighted-average common shares outstanding				
Basic	60,903	66,761	60,844	66,740
Diluted	69,370	75,228	69,311	75,207
Dividends declared per common share	$0.47	$0.47	$0.94	$0.94

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

	Preferred shares		Common shares				
	Number of shares	Amount	Number of shares	Par value	Additional paid-in capital	Accumulated deficit	Total
	(in thousands, except per share amounts)						
Balance at December 31, 2016	—	$—	66,697	$667	$1,377,171	$(26,724)	$1,351,114
Net income	—	—	—	—	—	57,516	57,516
Share-based compensation	—	—	284	2	3,125	—	3,127
Issuance of preferred shares	4,600	115,000	—	—	—	—	115,000
Issuance costs relating to preferred shares	—	(3,828)	—	—	—	—	(3,828)
Dividends:							
Common shares ($0.94 per share)	—	—	—	—	—	(63,298)	(63,298)
Preferred shares	—	—	—	—	—	(2,492)	(2,492)
Repurchase of common shares	—	—	(139)	(1)	(2,306)	—	(2,307)
Balance at June 30, 2017	4,600	$111,172	66,842	$668	$1,377,990	$(34,998)	$1,454,832
Balance at December 31, 2017	12,400	$299,707	61,334	$613	$1,290,931	$(46,666)	$1,544,585
Cumulative effect of a change in accounting principle - Adoption of fair value accounting for mortgage servicing rights	—	—	—	—	—	14,361	14,361
Balance at January 1, 2018	12,400	299,707	61,334	613	1,290,931	(32,305)	1,558,946
Net income	—	—	—	—	—	64,611	64,611
Share-based compensation	—	—	288	3	2,753	—	2,756
Dividends:							
Common shares ($0.94 per share)	—	—	—	—	—	(57,635)	(57,635)
Preferred shares	—	—	—	—	—	(12,472)	(12,472)
Repurchase of common shares	—	—	(671)	(6)	(10,713)	—	(10,719)
Balance at June 30, 2018	12,400	$299,707	60,951	$610	$1,282,971	$(37,801)	$1,545,487

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six months ended June 30,	
	2018	2017
	(in thousands)	
Cash flows from operating activities		
Net income	$64,611	$57,516
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Net gain on mortgage loans acquired for sale at fair value	(16,769)	(36,317)
Net gain on investments	(25,527)	(44,313)
Change in fair value, amortization and impairment of mortgage servicing rights	18,228	52,666
Accrual of interest on excess servicing spread purchased from PennyMac Financial Services, Inc.	(7,844)	(9,013)
Capitalization of interest and fees on mortgage loans at fair value	(4,246)	(20,717)
Amortization of debt issuance premiums and costs, net	(727)	7,004
Accrual of unearned discounts and amortization of premiums on mortgage-backed securities, mortgage loans at fair value, and asset-backed secured financing of a VIE	1,462	3,007
Results of real estate acquired in settlement of loans	5,523	7,711
Share-based compensation expense	2,756	3,127
Purchase of mortgage loans acquired for sale at fair value from nonaffiliates	(29,026,386)	(31,573,356)
Purchase of mortgage loans acquired for sale at fair value from PennyMac Financial Services, Inc.	(1,427,637)	(40,222)
Repurchase of mortgage loans subject to representation and warranties	(5,603)	(6,079)
Sale and repayment of mortgage loans acquired for sale at fair value to nonaffiliates	10,556,931	10,647,450
Sale of mortgage loans acquired for sale to PennyMac Financial Services, Inc.	19,267,316	21,244,194
Settlement of repurchase agreement derivative	2,495	—
Decrease in servicing advances	32,628	4,218
Decrease in due from PennyMac Financial Services, Inc.	14	1,800
(Increase) decrease in other assets	(29,848)	23,970
Decrease in accounts payable and accrued liabilities	(5,812)	(33,496)
(Decrease) increase in due to PennyMac Financial Services, Inc.	(7,458)	1,309
Increase (decrease) in income taxes payable	14,620	(3,274)
Net cash (used in) provided by operating activities	(591,273)	287,185
Cash flows from investing activities		
Net (increase) decrease in short-term investments	(21,086)	44,722
Purchase of mortgage-backed securities at fair value	(814,792)	(251,872)
Sale and repayment of mortgage-backed securities at fair value	73,279	52,753
Sale and repayment of mortgage loans at fair value	293,535	175,016
Repayment of excess servicing spread by PennyMac Financial Services, Inc.	24,309	28,910
Net settlement of derivative financial instruments	1,898	288
Sale of real estate acquired in settlement of loans	63,685	101,609
Purchase of mortgage servicing rights	—	(69)

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

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

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

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

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1—Organization

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

The Company operates in four segments: correspondent production, credit sensitive strategies, interest rate sensitive strategies and corporate:

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

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

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

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

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

Note 2—Basis of Presentation

The accompanying consolidated financial statements have been prepared in compliance with accounting principles generally accepted in the United States ("GAAP") as codified in the Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") for interim financial information and with the Securities and Exchange

Commission’s instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these financial statements and notes do not include all of the information required by GAAP for complete financial statements. The interim consolidated information should be read together with the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (the “Annual Report”).

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

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

Note 3—Accounting Developments

Accounting Changes

Mortgage Servicing Rights

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

Revenue Recognition

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

Cash Flows

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

Recently Issued Accounting Pronouncement

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

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

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

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

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

Note 4—Concentration of Risks

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

Distressed Mortgage Loans

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

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

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

Most of the distressed mortgage loans and REO has been acquired by the Company in prior years from or through one or more subsidiaries of JPMorgan Chase & Co., Citigroup Inc., and Bank of America Corporation, as presented in the following summary:

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

CRT Agreements

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

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

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

Note 5—Transactions with Related Parties

Operating Activities

Correspondent Production Activities

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

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

The Company does not hold the Ginnie Mae approval required to issue securities guaranteed by Ginnie Mae MBS and act as a servicer. Accordingly, under the agreement, PLS currently purchases loans saleable in accordance with the Ginnie Mae MBS Guide "as is" and without recourse of any kind from the Company at cost less any administrative fees paid by the correspondent to the Company plus accrued interest and a sourcing fee ranging from two to three and one-half basis points, generally based on the average number of calendar days loans are held by the Company prior to purchase by PLS.

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

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

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

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

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

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

Mortgage Loan Servicing Activities

The Company, through its Operating Partnership, has an amended and restated mortgage loan servicing agreement with PLS dated as of September 12, 2016. The servicing agreement provides for servicing fees earned by PLS that are based on a percentage of the mortgage loan's unpaid principal balance or fixed per loan monthly amounts based on the delinquency, bankruptcy and/or foreclosure status of the serviced mortgage loan or the REO. PLS is also entitled to market-based fees and charges including boarding and deboarding fees, liquidation and disposition, assumption, modification and origination fees and a percentage of late charges relating to mortgage loans it services for the Company.

- The base servicing fee rates for distressed whole mortgage loans range from $30 per month for current loans up to $100 per month for loans where the borrower has declared bankruptcy. The base servicing fee rate for REO is $75 per month.
-

To the extent that the Company rents its REO under an REO rental program, the Company pays PLS an REO rental fee of $30 per month per REO, an REO property lease renewal fee of $100 per lease renewal, and a property management fee in an amount equal to PLS' cost if property management services and/or any related software costs are outsourced to a third-party property management firm or 9% of gross rental income if PLS provides property management services directly. PLS is also entitled to retain any tenant paid application fees and late rent fees and seek reimbursement for certain third party vendor fees.

- Except as otherwise provided in the MSR recapture agreement, when PLS effects a refinancing of a mortgage loan on behalf of the Company and not through a third-party lender and the resulting mortgage loan is readily saleable, or PLS originates a loan to facilitate the disposition of an REO, PLS is entitled to receive from the Company market-based fees and compensation consistent with pricing and terms PLS offers unaffiliated parties on a retail basis.
- PLS is required to provide a range of services and activities significantly greater in scope than the services provided in connection with a customary servicing arrangement because the Company has limited employees and infrastructure. For these services, PLS received a supplemental fee of $25 per month for each distressed whole loan. PLS is entitled to reimbursement for all customary, good faith reasonable and necessary out-of-pocket expenses incurred in the performance of its servicing obligations.
- PLS, on behalf of the Company, is entitled to retain any incentive payments made to it and to which it is entitled under the U.S. Department of Treasury's Home Affordable Modification Plan ("HAMP"); provided, however, that with respect to any such incentive payments paid to PLS under HAMP in connection with a mortgage loan modification for which the Company previously paid PLS a modification fee, PLS shall reimburse the Company an amount equal to the incentive payments.

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- PLS is also entitled to certain activity-based fees for distressed whole mortgage loans that are charged based on the achievement of certain events. These fees range from $750 for a streamline modification to $1,750 for a liquidation and $500 for a deed-in-lieu of foreclosure. PLS is not entitled to earn more than one liquidation fee, reperformance fee or modification fee per mortgage loan in any 18-month period.
- The base servicing fees for non-distressed mortgage loans subserviced by PLS on the Company's behalf are also calculated through a monthly per-loan dollar amount, with the actual dollar amount for each loan based on whether the mortgage loan is a fixed-rate or adjustable-rate loan. The base servicing fees for loans subserviced on the Company's behalf are $7.50 per month for fixed-rate loans and $8.50 per month for adjustable-rate mortgage loans.
- To the extent that these non-distressed mortgage loans become delinquent, PLS is entitled to an additional servicing fee per mortgage loan ranging from $10 to $55 per month and based on the delinquency, bankruptcy and foreclosure status of the mortgage loan or $75 per month if the underlying mortgaged property becomes REO. PLS is also entitled to customary ancillary income and certain market-based fees and charges, including boarding and deboarding fees, liquidation and disposition fees, assumption, modification and origination fees.

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

Pursuant to the terms of an amended and restated MSR recapture agreement, if PLS refinances mortgage loans for which the Company previously held the MSRs, PLS is generally required to transfer and convey to one of the Company's wholly-owned subsidiaries cash in an amount equal to 30% of the fair market value of the MSRs related to all the loans so originated. The MSR recapture agreement expires, unless terminated earlier in accordance with the agreement, on September 12, 2020, subject to automatic renewal for additional 18-month periods.

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

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Mortgage loans servicing fees:				
Mortgage loans acquired for sale at fair value:				
Base	$96	$82	$152	$147
Activity-based	149	176	271	319
	245	258	423	466
Mortgage loans at fair value:				
Distressed mortgage loans:				
Base	709	1,755	1,714	3,713
Activity-based	463	1,767	2,543	4,157
	1,172	3,522	4,257	7,870
Mortgage loans held in VIE:				
Base	34	11	68	42
Activity-based	—	—	—	—
	34	11	68	42
MSRs:				
Base	7,866	6,176	15,481	11,982
Activity-based	114	132	221	225
	7,980	6,308	15,702	12,207

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

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Management Fees

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

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

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

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

“Net income” is defined as net income or loss attributable to common shares of beneficial interest computed in accordance with GAAP and certain other non-cash charges determined after discussions between PCM and the Company’s independent trustees and after approval by a majority of the Company’s independent trustees.

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

The “high watermark” is the quarterly adjustment that reflects the amount by which the net income (stated as a percentage of return on equity) in that quarter exceeds or falls short of the lesser of 8% and the average Fannie Mae 30-year MBS yield (the target yield) for the four quarters then ended. The “high watermark” starts at zero and is adjusted quarterly. If the net income is lower than the target yield, the high watermark is increased by the difference. If the net income is higher than the target yield, the high watermark is reduced by the difference. Each time a performance incentive fee is earned, the high watermark returns to zero. As a result, the threshold amounts required for PCM to earn a performance incentive fee are adjusted cumulatively based on the performance of PMT’s net income over (or under) the target yield, until the net income in excess of the target yield exceeds the then-current cumulative high watermark amount, and a performance incentive fee is earned.

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

The management agreement expires on September 12, 2020, subject to automatic renewal for additional 18-month periods, unless terminated earlier in accordance with the terms of the agreement. In the event of termination of the management agreement between the Company and PCM, PCM may be entitled to a termination fee in certain circumstances. The termination fee is equal to three times the sum of (a) the average annual base management fee, and (b) the average annual performance incentive fee earned by PCM, in each case during the 24-month period immediately preceding the date of termination.

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

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

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

Expense Reimbursement and Amounts Payable to and Receivable from PCM

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

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

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

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

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

Investing Activities

Spread Acquisition and MSR Servicing Agreements

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

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

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

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

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

Financing Activities

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

Repurchase Agreement with PLS

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

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

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

Conditional Reimbursement of Initial Public Offering ("IPO") Underwriting Fees

In connection with its IPO, the Company conditionally agreed to reimburse PCM up to $2.9 million for underwriting fees paid to the IPO underwriters by PCM on the Company's behalf (the "Conditional Reimbursement"). Also in connection with its IPO, the Company agreed to pay the IPO underwriters up to $5.9 million in contingent underwriting fees. There were no reimbursements during the quarter and six months ended June 30, 2018 and 2017.

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

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

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

Amounts Receivable from and Payable to PFSI

Amounts receivable from and payable to PFSI are summarized below:

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

Note 6—Loan Sales and Variable Interest Entities

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

Unconsolidated VIEs with Continuing Involvement

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

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

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

(1) Net of guarantee fees

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

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

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

Consolidated VIEs

Credit Risk Transfer Transactions

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

The Company, through PennyMac Corp. ("PMC"), entered into CRT Agreements with Fannie Mae, pursuant to which PMC, through subsidiary trust entities, sells pools of mortgage loans into Fannie Mae-guaranteed securitizations while retaining the Recourse Obligations as part of the retention of an interest-only ownership interest in such mortgage loans. Transfers of mortgage loans subject to CRT Agreements received sale accounting treatment. The Deposits securing CRT Agreements represent the Company's maximum contractual exposure to claims under its Recourse Obligations and is the sole source of settlement of losses under the CRT Agreements. Gains and losses on derivatives related to CRT Agreements are included in Net gain (loss) on investments in the consolidated statements of income. The final sales of mortgage loans subject to the CRT Agreements were made during the quarter ended June 30, 2018.

Following is a summary of the CRT Agreements:

Quarter ended June 30,

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

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

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

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

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

	June 30, 2018

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

Jumbo Mortgage Loan Financing

On September 30, 2013, the Company completed a securitization transaction in which PMT Loan Trust 2013-J1, a VIE, issued $537.0 million in UPB of certificates backed by fixed-rate prime jumbo mortgage loans, at a 3.9% weighted yield. The fair value of the certificates retained by the Company was $14.3 million as of June 30, 2018. The Company includes the balance of certificates issued to nonaffiliates in Asset backed financing of a variable interest entity at fair value.

Note 7—Fair Value

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

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

- Level 1—Quoted prices in active markets for identical assets or liabilities.
- Level 2—Prices determined or determinable using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing the asset or liability and are developed based on market data obtained from sources independent of the Company. These may include quoted prices for similar assets or liabilities, interest rates, prepayment speeds, credit risk and other inputs.
- Level 3—Prices determined using significant unobservable inputs. In situations where significant observable inputs are unavailable, unobservable inputs may be used. Unobservable inputs reflect the Company's own judgments about the factors that market participants use in pricing assets and liabilities, and are based on the best information available in the circumstances.

As a result of the difficulty in observing certain significant valuation inputs affecting "Level 3" fair value assets and liabilities, the Manager is required to make judgments regarding these items' fair values. Different persons in possession of the same facts may reasonably arrive at different conclusions as to the inputs to be applied in valuing these assets and liabilities and to their fair values. Likewise, due to the general illiquidity of some of these assets and liabilities, subsequent transactions may be at values significantly different from those reported.

Fair Value Accounting Elections

The Manager identified all of the Company's non-cash financial assets, firm commitment to purchase credit risk transfer securities and MSRs to be accounted for at fair value. The Manager has elected to account for these assets at fair value so such changes in fair value will be reflected in income as they occur and more timely reflect the results of the Company's performance. Before January 1, 2018, originated MSRs backed by mortgage loans with initial interest rates of less than or equal to 4.5% were accounted for using the amortization method. Beginning January 1, 2018, the Company elected to account for all MSRs at fair value prospectively. The Manager determined that this change makes the accounting treatment for MSRs consistent with lender valuation under financing arrangements and simplifies hedging activities.

The Manager has also identified the Company's asset-backed financing of a VIE and interest only security payable at fair value to be accounted for at fair value to reflect the generally offsetting changes in fair value of these borrowings to changes in fair value of the assets at fair value collateralizing these financings. For other borrowings, the Manager has determined that historical cost accounting is more appropriate because under this method debt issuance costs are amortized over the term of the debt facility, thereby matching the debt issuance cost to the periods benefiting from the availability of the debt.

Financial Statement Items Measured at Fair Value on a Recurring Basis

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

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

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	$18,398	$—	$—	$18,398
Mortgage-backed securities at fair value	—	989,461	—	989,461
Mortgage loans acquired for sale at fair value	—	1,261,380	8,135	1,269,515
Mortgage loans at fair value	—	321,040	768,433	1,089,473
Excess servicing spread purchased from PFSI	—	—	236,534	236,534
Derivative assets:				
Interest rate lock commitments	—	—	4,859	4,859
CRT Agreements	—	—	98,640	98,640
Repurchase agreement derivatives	—	—	3,748	3,748
Forward purchase contracts	—	4,343	—	4,343
Forward sale contracts	—	387	—	387
MBS put options	—	3,170	—	3,170
Put options on interest rate futures	656	—	—	656
Total derivative assets before netting	656	7,900	107,247	115,803
Netting	—	—	—	(1,922)
Total derivative assets after netting	656	7,900	107,247	113,881
Mortgage servicing rights at fair value	—	—	91,459	91,459
	$19,054	$2,579,781	$1,211,808	$3,808,721
Liabilities:				
Asset-backed financing of a VIE at fair value	$—	$307,419	$—	$307,419
Interest-only security payable at fair value	—	—	7,070	7,070
Derivative liabilities:				
Interest rate lock commitments	—	—	227	227
Forward purchase contracts	—	248	—	248
Forward sales contracts	—	2,830	—	2,830
Total derivative liabilities before netting	—	3,078	227	3,305
Netting	—	—	—	(1,999)
Total derivative liabilities after netting	—	3,078	227	1,306
	$—	$310,497	$7,297	$315,795

The following is a summary of changes in items measured at fair value on a recurring basis using Level 3 inputs that are significant to the estimation of the fair values of the assets and liabilities at either the beginning or end of the years presented:

	Quarter ended June 30, 2018								
	Mortgage loans acquired for sale at fair value	Mortgage loans at fair value	Excess servicing spread	Interest rate lock commitments (1)	CRT Agreements	Repurchase agreement derivatives	Firm commitment to purchase CRT securities	Mortgage servicing rights	Total
	(in thousands)								
Assets:									
Balance, March 31, 2018	$7,690	$468,387	$236,002	$2,709	$103,995	$5,892	$—	$957,013	$1,781,688
Purchases and issuances	2,772	—	—	1,231	—	3,576	—	—	7,579
Repayments and sales	(4,421)	(10,511)	(12,018)	—	(22,211)	(2,487)	—	—	(51,648)
Capitalization of interest	—	2,066	3,910	—	—	—	—	—	5,976
Capitalization of advances	—	1,683	—	—	—	—	—	—	1,683
ESS received pursuant to a recapture agreement with PFSI	—	—	580	—	—	—	—	—	580
Amounts received as proceeds from sales of mortgage loans	—	—	—	—	—	—	4,426	65,408	69,834
Changes in fair value									

included in income arising from:									
Changes in instrument-specific credit risk	—	369	—	—	—	—	—	—	369
Other factors	45	(5,070)	996	(5,105)	37,385	(69)	—	(11,914)	16,268
	45	(4,701)	996	(5,105)	37,385	(69)	—	(11,914)	16,637
Transfers of mortgage loans to REO and real estate held for investment	—	(9,451)	—	—	—	—	—	—	(9,451)
Transfers of mortgage loans acquired for sale at fair value from "Level 2" to "Level 3" (2)	454	—	—	—	—	—	—	—	454
Transfers of interest rate lock commitments to mortgage loans acquired for sale	—	—	—	3,972	—	—	—	—	3,972
Balance, June 30, 2018	$6,540	$447,473	$229,470	$2,807	$119,169	$6,912	$4,426	$1,010,507	$1,827,304
Changes in fair value recognized during the	$(93)	$(4,424)	$996	$2,807	$15,174	$—	$—	$(11,914)	$2,546

quarter relating to assets still held at June 30, 2018

(1) For the purpose of this table, the interest rate lock commitment ("IRLC") asset and liability positions are shown net.
(2) During the quarter ended June 30, 2018, the Manager identified certain "Level 2" fair value mortgage loans acquired for sale that were not saleable into the prime mortgage market and therefore transferred them to "Level 3".

	Quarter ended June 30, 2018 Interest-only security payable (in thousands)
Liabilities:	
Balance, March 31, 2018	$ 7,796
Changes in fair value included in income arising from:	
Changes in instrument-specific credit risk	—
Other factors	(144)
	(144)
Balance, June 30, 2018	$ 7,652
Changes in fair value recognized during the quarter relating to liability outstanding at June 30, 2018	$ (144)

	Quarter ended June 30, 2017					
	Mortgage loans at fair value	Excess servicing spread	Interest rate lock commitments (1)	CRT Agreements	Mortgage servicing rights	Total
	(in thousands)					
Assets:						
Balance, March 31, 2017	$1,229,553	$277,484	$ 8,721	$ 25,629	$ 69,683	$1,611,070
Purchases and issuances	—	—	7,026	—	7	7,033
Repayments and sales	(32,433)	(14,278)	—	(11,361)	—	(58,072)
Capitalization of interest	10,814	4,366	—	—	—	15,180
Capitalization of advances	6,799	—	—	—	—	6,799
ESS received pursuant to a recapture agreement with PFSI	—	1,380	—	—	—	1,380
Servicing received as proceeds from sales of mortgage loans	—	—	—	—	12,334	12,334
Changes in fair value included in income arising from:						
Changes in instrument-specific credit risk	7,777	—	—	—	—	7,777

Other factors	(6,747)	(7,156)	17,346	38,448	(4,400)	37,491
	1,030	(7,156)	17,346	38,448	(4,400)	45,268
Transfers of mortgage loans to REO and real estate held for investment	(31,143)	—	—	—	—	(31,143)
Transfers of interest rate lock commitments to mortgage loans acquired for sale	—	—	(32,698)	—	—	(32,698)
Balance, June 30, 2017	$1,184,620	$261,796	$ 395	$ 52,716	$ 77,624	$1,577,151
Changes in fair value recognized during the quarter relating to assets still held at June 30, 2017	$3,037	$(7,156)	$ 395	$ 27,087	$ (4,400)	$18,963

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

	Quarter ended June 30, 2017 Interest-only security payable (in thousands)
Liabilities:	
Balance, March 31, 2017	$ 4,601
Changes in fair value included in income arising from:	
Changes in instrument-specific credit risk	—
Other factors	1,976
	1,976
Balance, June 30, 2017	$ 6,577
Changes in fair value recognized during the quarter relating to liability outstanding at June 30, 2017	$ 1,976

	Six months ended June 30, 2018								
	Mortgage loans acquired for sale at fair value	Mortgage loans at fair value	Excess servicing spread	Interest rate lock commitments (1)	CRT Agreements	Repurchase agreement derivatives	Firm commitment to purchase CRT securities	Mortgage servicing rights	Total
	(in thousands)								
Assets:									
Balance, December 31, 2017	$8,135	$768,433	$236,534	$4,632	$98,640	$3,748	$—	$91,459	$1,211,581
Cumulative effect of a change in accounting principle — Adoption of fair value accounting for mortgage servicing rights	—	—	—	—	—	—	—	773,035	773,035
Balance, January 1, 2018	8,135	768,433	236,534	4,632	98,640	3,748	—	864,494	1,984,616
Purchases and issuances	5,603	—	—	5,839	—	5,740	—	—	17,182
Repayments and sales	(7,960)	(283,024)	(24,309)	—	(41,540)	(2,495)	—	—	(359,328)
Capitalization of interest	—	4,246	7,844	—	—	—	—	—	12,090
Capitalization of advances	—	3,360	—	—	—	—	—	—	3,360
ESS received pursuant to a	—	—	1,484	—	—	—	—	—	1,484

recapture agreement with PFSI									
Amounts received as proceeds from sales of mortgage loans	—	—	—	—	—	—	4,426	131,954	136,380
Changes in fair value included in income arising from:									
Changes in instrument-specific credit risk	—	2,988	—	—	—	—	—	—	2,988
Other factors	148	(17,639)	7,917	(24,571)	62,069	(81)	—	14,059	41,902
	148	(14,651)	7,917	(24,571)	62,069	(81)	—	14,059	44,890
Transfers of mortgage loans to REO and real estate held for investment	—	(30,891)	—	—	—	—	—	—	(30,891)
Transfers of mortgage loans acquired for sale at fair value from "Level 2" to "Level 3" (2)	614	—	—	—	—	—	—	—	614
Transfers of interest rate	—	—	—	16,907	—	—	—	—	16,907

lock commitments to mortgage loans acquired for sale									
Balance, June 30, 2018	$6,540	$447,473	$229,470	$2,807	$119,169	$6,912	$4,426	$1,010,507	$1,827,304
Changes in fair value recognized during the period relating to assets still held at June 30, 2018	$(107)	$(12,716)	$7,917	$2,807	$20,529	$77	$—	$14,059	$32,566

(1) For the purpose of this table, the IRLC asset and liability positions are shown net.
(2) During the six months ended June 30, 2018, the Manager identified certain "Level 2" fair value mortgage loans acquired for sale that were not saleable into the prime mortgage market and therefore transferred them to "Level 3".

	Six months ended June 30, 2018 Interest-only security payable (in thousands)
Liabilities:	
Balance, December 31, 2017	$ 7,070
Changes in fair value included in income arising from:	
Changes in instrument- specific credit risk	—
Other factors	582
	582
Balance, June 30, 2018	$ 7,652
Changes in fair value recognized during the period relating to liability outstanding at June 30, 2018	$ 582

	Six months ended June 30, 2017					
	Mortgage loans at fair value	Excess servicing spread	Interest rate lock commitments (1)	CRT Agreements	Mortgage servicing rights	Total
	(in thousands)					
Assets:						
Balance, December 31, 2016	$1,354,572	$288,669	$ 3,777	$ 15,610	$64,136	$1,726,764
Purchases and issuances	—	—	16,920	—	69	16,989
Repayments and sales	(146,008)	(28,910)	—	(21,650)	—	(196,568)
Capitalization of interest	20,717	9,013	—	—	—	29,730
Capitalization of advances	13,148	—	—	—	—	13,148
ESS received pursuant to a recapture agreement with PFSI	—	2,953	—	—	—	2,953
Servicing received as proceeds from sales of mortgage loans	—	—	—	—	19,812	19,812
Changes in fair value included in income arising from:						
Changes in instrument-specific credit risk	13,934	—	—	—	—	13,934

Other factors	(9,688)	(9,929)	28,518	58,756	(6,393)	61,264
	4,246	(9,929)	28,518	58,756	(6,393)	75,198
Transfers of mortgage loans to REO and real estate held for investment	(62,055)	—	—	—	—	(62,055)
Transfers of interest rate lock commitments to mortgage loans acquired for sale	—	—	(48,820)	—	—	(48,820)
Balance, June 30, 2017	$1,184,620	$261,796	$ 395	$ 52,716	$ 77,624	$1,577,151
Changes in fair value recognized during the period relating to assets still held at June 30, 2017	$2,290	$(9,929)	$ 395	$ 37,106	$(6,393)	$23,469

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

	Six months ended June 30, 2017 Interest-only security payable (in thousands)
Liabilities:	
Balance, December 31, 2016	$ 4,114
Changes in fair value included in income arising from:	
Changes in instrument- specific credit risk	—
Other factors	2,463
	2,463
Balance, June 30, 2017	6,577
Changes in fair value recognized during the period relating to liability outstanding at June 30, 2017	$ 2,463

The Company had transfers among the fair value levels arising from transfers of IRLCs to mortgage loans held for sale at fair value upon purchase of the respective mortgage loans.

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

	June 30, 2018			December 31, 2017		
	Fair value	Principal amount due upon maturity	Difference	Fair value	Principal amount due upon maturity	Difference
	(in thousands)					
Mortgage loans acquired for sale at fair value:						
Current through 89 days delinquent	$1,790,153	$ 1,741,663	$48,490	$1,268,121	$ 1,221,125	$46,996
90 or more days delinquent:						
Not in foreclosure	365	445	(80)	950	1,120	(170)
In foreclosure	—	—	—	444	496	(52)
	365	445	(80)	1,394	1,616	(222)
	$1,790,518	$ 1,742,108	$48,410	$1,269,515	$ 1,222,741	$46,774
Mortgage loans at fair value:						
Mortgage loans held in a consolidated VIE:						
Current through 89 days delinquent	$301,972	$ 306,173	$(4,201)	$321,040	$ 316,684	$4,356
90 or more days delinquent:						
Not in foreclosure	—	—	—	—	—	—
In foreclosure	—	—	—	—	—	—
	—	—	—	—	—	—
	301,972	306,173	(4,201)	321,040	316,684	4,356
Distressed mortgage loans at fair value:						
Current through 89 days delinquent	263,850	338,578	(74,728)	414,785	519,009	(104,224)
90 or more days delinquent:						
Not in foreclosure	92,457	147,688	(55,231)	166,749	257,038	(90,289)
In foreclosure	91,166	132,656	(41,490)	186,899	267,911	(81,012)
	183,623	280,344	(96,721)	353,648	524,949	(171,301)
	447,473	618,922	(171,449)	768,433	1,043,958	(275,525)
	$749,445	$ 925,095	$(175,650)	$1,089,473	$ 1,360,642	$(271,169)

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

	Quarter ended June 30, 2018				
	Net gain on mortgage loans acquired for sale	Net gain (loss) on investments	Net mortgage loan servicing fees	Net interest income	Total
	(in thousands)				
Assets:					
Short-term investments at fair value	$—	$ —	$ —	$ —	$—
Mortgage-backed securities at fair value	—	(8,861)	—	(954)	(9,815)
Mortgage loans acquired for sale at fair value	(4,470)	—	—	—	(4,470)
Mortgage loans at fair value	—	(7,485)	—	2,277	(5,208)
ESS at fair value	—	996	—	3,910	4,906
Firm commitment to purchase credit risk transfer security at fair value	4,426	—	—	—	4,426
MSRs at fair value	—	—	(11,914)	—	(11,914)
	$(44)	$ (15,350)	$ (11,914)	$ 5,233	$(22,075)
Liabilities:					
Interest-only security payable at fair value	$—	$ 144	$ —	$ —	$144
Asset-backed financing of a VIE at fair value	—	2,960	—	(213)	2,747
	$—	$ 3,104	$ —	$ (213)	$2,891

	Quarter ended June 30, 2017				
	Net gain on mortgage loans acquired for sale	Net gain on investments	Net mortgage loan servicing fees	Net interest income	Total
	(in thousands)				
Assets:					
Short-term investments at fair value	$—	$ —	$ —	$ —	$—
Mortgage-backed securities at fair value	—	4,027	—	(1,478)	2,549
Mortgage loans acquired for sale at fair value	36,746	—	—	—	36,746
Mortgage loans at fair value	—	4,885	—	11,376	16,261
ESS at fair value	—	(7,156)	—	4,366	(2,790)
MSRs at fair value	—	—	(4,400)	—	(4,400)

	$36,746	$ 1,756	$ (4,400)	$ 14,264	$48,366
Liabilities:					
Interest-only security payable at fair value	$—	$ (1,976)	$ —	$ —	$(1,976)
Asset-backed financing of a VIE at fair value	—	(3,399)	—	(685)	(4,084)
	$—	$ (5,375)	$ —	$ (685)	$(6,060)

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	Six months ended June 30, 2018				
	Net gain on mortgage loans acquired for sale	Net gain (loss) on investments	Net mortgage loan servicing fees	Net interest income	Total
	(in thousands)				
Assets:					
Short-term investments at fair value	$—	$ —	$ —	$ —	$—
Mortgage-backed securities at fair value	—	(31,258)	—	(1,394)	(32,652)
Mortgage loans acquired for sale at fair value	(28,148)	—	—	—	(28,148)
Mortgage loans at fair value	—	(23,013)	—	4,051	(18,962)
ESS at fair value	—	7,917	—	7,844	15,761
Firm commitment to purchase credit risk transfer security at fair value	4,426	—	—	—	4,426
MSRs at fair value	—	—	14,059	—	14,059
	$(23,722)	$ (46,354)	$ 14,059	$ 10,501	$(45,516)
Liabilities:					
Interest-only security payable at fair value	$—	$ (582)	$ —	$ —	$(582)
Asset-backed financing of a VIE at fair value	—	9,142	—	126	9,268
	$—	$ 8,560	$ —	$ 126	$8,686

	Six months ended June 30, 2017				
	Net gain on mortgage loans acquired for sale	Net gain on investments	Net mortgage loan servicing fees	Net interest income	Total
	(in thousands)				
Assets:					
Short-term investments at fair value	$—	$ —	$ —	$ —	$—
Mortgage-backed securities at fair value	—	4,167	—	(2,796)	1,371
Mortgage loans acquired for sale at fair value	50,904	—	—	—	50,904
Mortgage loans at fair value	—	8,417	—	21,578	29,995
ESS at fair value	—	(9,929)	—	9,013	(916)
MSRs at fair value	—	—	(6,393)	—	(6,393)
	$50,904	$ 2,655	$ (6,393)	$ 27,795	$74,961
Liabilities:					
Interest-only security payable at fair value	$—	$ (2,463)	$ —	$ —	$(2,463)

Asset-backed financing of a VIE at fair value	—	(3,423)	—	(1,072)	(4,495)
	$—	$ (5,886)	$ —	$ (1,072)	$(6,958)

Financial Statement Items Measured at Fair Value on a Nonrecurring Basis

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

	June 30, 2018			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Real estate acquired in settlement of loans	$—	$ —	$41,473	$41,473
	$—	$ —	$41,473	$41,473

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Real estate acquired in settlement of loans	$—	$ —	$71,380	$71,380
MSRs at lower of amortized cost or fair value	—	—	312,995	312,995
	$—	$ —	$384,375	$384,375

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

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Real estate asset acquired in settlement of loans	$(3,914)	$(6,303)	$(6,023)	$(11,279)
MSRs at lower of amortized cost or fair value	—	(4,089)	—	(2,585)
	$(3,914)	$(10,392)	$(6,023)	$(13,864)

Real Estate Acquired in Settlement of Loans

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

Mortgage Servicing Rights at Lower of Amortized Cost or Fair Value

Before the Company adopted fair value accounting for all of its existing classes of MSRs on January 1, 2018, the Manager evaluated the Company's MSRs at lower of amortized cost or fair value for impairment with reference to the asset's fair value. For purposes of performing its MSR impairment evaluation, the Company stratified its MSRs at lower of amortized cost or fair value based on the interest rates borne by the mortgage loans underlying the MSRs. Mortgage loans were grouped into pools with 50 basis point interest rate ranges for fixed-rate mortgage loans with interest rates between 3.0% and 4.5% and a single pool for mortgage loans with interest rates below 3.0%. MSRs relating to adjustable rate mortgage loans with initial interest rates of 4.5% or less were evaluated in a single pool. If the fair value of MSRs in any of the interest rate pools was below the amortized cost of the MSRs, those MSRs were impaired.

When MSRs were impaired, the impairment was recognized in current-period income and the carrying value of the MSRs was adjusted using a valuation allowance. If the fair value of the MSRs subsequently increased, the increase in fair value was recognized in current period income only to the extent of the valuation allowance for the respective impairment stratum.

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

Fair Value of Financial Instruments Carried at Amortized Cost

Most of the Company's borrowings are carried at amortized cost. The Company's Assets sold under agreements to repurchase, Mortgage loan participation purchase and sale agreements, Exchangeable senior notes and Assets sold to PennyMac Financial Services, Inc. under agreements to repurchase are classified as "Level 3" fair value liabilities due to the Company's reliance on unobservable inputs to estimate these instruments' fair values.

The Manager has concluded that the fair values of Assets sold under agreements to repurchase, Mortgage loan participation purchase and sale agreements and Assets sold to PennyMac Financial Services, Inc. under agreements to repurchase approximate the agreements' carrying values due to the borrowing agreements' short terms and variable interest rates. The fair value of the Exchangeable senior notes at June 30, 2018 and December 31, 2017 was $251.2 million and $244.9 million, respectively. The fair value of the Exchangeable senior notes is estimated using a broker indication of fair value.

Valuation Governance

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

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

With respect to the non-IRLC "Level 3" valuations, the FAV group reports to the Company's senior management valuation committee, which oversees the valuations. The FAV group monitors the models used for valuation of the Company's "Level 3" fair value assets and liabilities, 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 the Company's executive chairman, chief executive, chief financial, chief risk and deputy chief financial officers.

The FAV group is responsible for reporting to the Manager's valuation committee on the changes in the valuation of the non-IRLC "Level 3" fair value assets and liabilities, including major factors affecting the valuation and any changes in model methods and inputs. To assess the reasonableness of its valuations, the FAV group presents an analysis of the effect on the valuation of changes to the significant inputs to the models.

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

Valuation Techniques and Inputs

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

Mortgage-Backed Securities

The Company categorizes its current holdings of MBS as "Level 2" fair value assets. Fair value of these MBS is established based on quoted market prices for the Company's MBS holdings or similar securities. Changes in the fair value of MBS are included in Net gain (loss) on investments in the consolidated statements of income.

Mortgage Loans

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

- Mortgage loans that are saleable into active markets, comprised of most of the Company's mortgage loans acquired for sale at fair value and mortgage loans at fair value held in a VIE, are categorized as "Level 2" fair value assets. The fair values of mortgage loans acquired for sale at fair value are established using their quoted market or contracted price or market price equivalent. For the mortgage loans at fair value held in a VIE, the quoted fair values of all of the individual securities issued by the securitization trust are used to derive a fair value for the mortgage loans. The Company obtains indications of fair value from nonaffiliated brokers based on comparable securities and validates the brokers' indications of fair value using pricing models and inputs the Manager believes are similar to the models and inputs used by other market participants.

- Mortgage loans that are not saleable into active markets, comprised primarily of distressed mortgage loans, are categorized as "Level 3" fair value assets and their fair values are estimated using a discounted cash flow approach. Inputs to the discounted cash flow model include current interest rates, loan amount, payment status, property type, discount rates and forecasts of future interest rates, home prices, prepayment speeds, default speeds, loss severities or contracted selling price when applicable.

The valuation process for "Level 3" fair value mortgage loans includes the computation by stratum of the mortgage loans' fair values and a review for reasonableness of various measures such as weighted average life, projected prepayment and default speeds, and projected default and loss percentages. The FAV group computes the effect on the valuation of changes in inputs such as interest rates, home prices, and delinquency status to assess the reasonableness of changes in the mortgage loan valuation.

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

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

Following is a quantitative summary of key inputs used in the valuation of the Company's "Level 3" mortgage loans at fair value:

Key inputs	June 30, 2018	December 31, 2017
Discount rate		
Range	2.8% – 15.0%	2.9% – 15.0%
Weighted average	6.5%	6.9%
Twelve-month projected housing price index change		
Range	2.9% – 4.2%	3.6% – 4.6%
Weighted average	4.0%	4.4%
Prepayment speed (1)		
Range	2.7% – 6.3%	3.2% – 11.0%
Weighted average	4.2%	4.2%
Total prepayment speed (2)		
Range	10.4% – 22.5%	10.8% – 23.8%
Weighted average	15.7%	16.5%

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

Excess Servicing Spread Purchased from PFSI

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

Changes in the fair value of ESS are included in Net gain (loss) on investments in the consolidated statements of income.

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

Key inputs	June 30, 2018	December 31, 2017
UPB of underlying mortgage loans (in thousands)	$25,123,598	$27,217,199
Average servicing fee rate (in basis points)	34	34
Average ESS rate (in basis points)	19	19
Pricing spread (1)		
Range	3.4% - 3.9%	3.8% - 4.3%
Weighted average	3.7%	4.1%
Annual total prepayment speed (2)		
Range	7.9% - 75.3%	8.4% - 41.4%
Weighted average	9.5%	10.8%
Life (in years)		
Range	0.6 - 7.9	1.4 - 7.7
Weighted average	6.9	6.5

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

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

Firm commitment to purchase credit risk transfer securities

The Company categorizes its firm commitment to purchase credit risk transfer securities as a "Level 3" fair value asset. The fair value of the firm commitment is estimated using a discounted cash flow approach to estimate the fair value of the credit risk transfer security to be purchased related to the loans subject to the commitment. Key inputs into the assessment are the discount rate and the voluntary and involuntary prepayment speeds.

Key inputs	June 30, 2018
Discount rate	7.3%
Voluntary Prepayment speed (1)	11.8%
Involuntary prepayment speed (2)	0.1%

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

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

Derivative Financial Instruments

Interest Rate Lock Commitments

The Company categorizes IRLCs as "Level 3" fair value assets and liabilities. The Company estimates the fair value of IRLCs based on quoted Agency MBS prices, its estimate of the fair value of the MSRs it expects to receive in the sale of the mortgage loan and the probability that the mortgage loan will be purchased under the commitment (the "pull-through rate").

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

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

Key inputs	June 30, 2018	December 31, 2017
Pull-through rate		
Range	39.7% – 100%	58.0% - 100%
Weighted average	90.4%	90.3%
MSR value expressed as		
Servicing fee multiple		
Range		2.1 - 5.8

	2.0 - 6.0	
Weighted average	4.5	4.9
Percentage of UPB		
Range	0.6% – 1.9%	0.0% - 2.4%
Weighted average	1.2%	1.3%

CRT Agreements

The Company categorizes CRT derivatives as “Level 3” fair value assets. The fair value of CRT Agreements is established based on whether the aggregation period has been completed and the CRT Agreements have been securitized. For securitized CRT Agreements, fair value is based on indications of fair value provided to the Company by nonaffiliated brokers for the certificates representing the beneficial interest in the deposits securing the CRT Agreements, which include the Recourse Obligations and the IO ownership interest. Together, the Recourse Obligations and the IO ownership comprise the CRT derivative. Fair value of the CRT derivative is derived by deducting the balance of the Deposits securing CRT Agreements from the indication of fair value of the certificates provided by the nonaffiliated brokers. For CRT Agreements that have not been securitized, fair value is estimated by the Manager’s FAV group using a discounted cash flow analysis.

The significant unobservable inputs into the valuation of CRT derivatives are the discount rate and voluntary and involuntary prepayment rates of the reference mortgage loans. Changes in fair value of CRT Agreements are included in Net gain (loss) on investments.

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

Key inputs	June 30, 2018	December 31, 2017
Discount rate		
Range	5.8% – 6.8%	5.1% – 6.2%
Weighted average	6.2%	5.6%
Voluntary Prepayment speed (1)		
Range	8.4% – 9.8%	12.1% – 15.0%
Weighted average	9.2%	13.0%
Involuntary prepayment speed (2)		
Range	0.3% – 0.3%	0.3% – 0.3%
Weighted average	0.3%	0.3%

(1) Voluntary prepayment speed is measured using Life Voluntary CPR.
(2) Involuntary prepayment speed is measured using Life Involuntary CPR.

Repurchase Agreement Derivatives

The Company has a master repurchase agreement that includes incentives for financing mortgage loans approved for satisfying certain consumer relief characteristics. These incentives are classified as embedded derivatives for accounting purposes and are reported separate from the repurchase agreements. The Company classifies repurchase agreement derivatives as “Level 3” fair value assets. The significant unobservable input into the valuation of these derivative assets is the Company’s ratio of derivative fair value to outstanding receivable attributable to the time value of money and the expected approval rate of the mortgage loans financed under the master repurchase agreement. The ratio included in the Company’s fair value estimate was 97% at both June 30, 2018, and December 31, 2017.

Hedging Derivatives

Fair values of derivative financial instruments based on exchange traded market prices are categorized by the Company as “Level 1” fair value assets and liabilities; fair values of derivative financial instruments based on observable interest rates, volatilities and prices in the MBS market are categorized by the Company as “Level 2” fair value assets and liabilities. Changes in the fair value of hedging derivatives are included in Net gain on mortgage loans acquired for sale, Net gain (loss) on investments, or Net mortgage loan servicing fees, as applicable, in the consolidated statements of income.

Real Estate Acquired in Settlement of Loans

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

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

Mortgage Servicing Rights

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

MSRs are generally subject to loss in fair value when mortgage interest rates decrease. Decreasing mortgage interest rates normally encourage increased mortgage refinancing activity. Increased refinancing activity reduces the expected life of the underlying mortgage loans, thereby reducing the cash flows expected to accrue to the MSRs. Reductions in the fair value of MSRs affect income primarily through change in fair value and change in impairment. Through December 31, 2017, the Company accounted for certain of its MSRs using the amortization method. Beginning January 1, 2018, the Company accounts for all MSRs at fair value prospectively.

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

	Quarter ended June 30,		
	2018	2017	
	Fair value	Fair value	Amortized cost
	(MSR recognized and UPB of underlying mortgage loan amounts in thousands)		
MSR recognized	$65,408	$12,334	$53,501
Key inputs			
UPB of underlying mortgage loans	$5,282,564	$1,157,902	$4,477,209
Weighted-average annual servicing fee rate (in basis points)	26	25	25
Pricing spread (1)			
Range	7.3% – 12.3%	7.6% - 7.6%	7.6% - 12.6%
Weighted average	7.4%	7.6%	7.6%
Annual total prepayment speed (2)			
Range	3.2% – 30.8%	8.5% - 24.2%	3.6% - 26.0%
Weighted average	9.5%	10.8%	8.5%
Life (in years)			
Range	2.6 - 11.7	3.4 - 8.4	3.0 - 11.6
Weighted average	7.7	7.3	8.0
Annual per-loan cost of servicing			
Range	$77 - $79	$79 - $79	$79 - $79
Weighted average	$79	$79	$79

(1) The Company applies a pricing spread to the United States Dollar LIBOR curve for purposes of discounting cash flows relating to MSRs.
(2) Prepayment speed is measured using Life Total CPR.

	Six months ended June 30,		
	2018	2017	
	Fair value	Fair value	Amortized cost
	(MSR recognized and UPB of underlying mortgage loan amounts in thousands)		
MSR recognized	$131,954	$19,812	$104,711
Key inputs			
UPB of underlying mortgage loans	$10,397,305	$1,818,488	$8,573,815
Weighted-average annual servicing fee rate	26	25	25

(in basis points)			
Pricing spread (1)			
Range	7.3% – 12.6%	7.6% - 7.6%	7.6% - 12.6%
Weighted average	7.5%	7.6%	7.6%
Annual total prepayment speed (2)			
Range	3.2% – 30.8%	7.9% - 24.2%	3.2% - 28.7%
Weighted average	8.8%	10.8%	8.0%
Life (in years)			
Range	2.6 - 11.9	3.4 - 8.5	2.7 - 11.9
Weighted average	8.0	7.2	8.1
Annual per-loan cost of servicing			
Range	$77 - $79	$79 - $79	$79 - $79
Weighted average	$79	$79	$79

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

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

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

	June 30, 2018	December 31, 2017	
	Fair value	Fair value	Amortized cost
	(Carrying value, UPB of underlying mortgage loans and effect on fair value amounts in thousands)		
Carrying value	$1,010,507	$91,459	$753,322
Key inputs:			
UPB of underlying mortgage loans	$78,350,528	$8,273,696	$63,853,606
Weighted-average annual servicing fee rate (in basis points)	25	25	25
Weighted-average note interest rate	4.0%	4.7%	3.9%
Pricing spread (1)			
Range	7.3% – 12.9%	7.6% – 12.6%	7.6% – 13.1%
Weighted average	7.3%	7.6%	7.6%
Effect on fair value of (2):			
5% adverse change	$(15,002)	$(1,347)	$(11,848)
10% adverse change	$(29,582)	$(2,655)	$(23,352)
20% adverse change	$(57,541)	$(5,162)	$(45,379)
Prepayment speed (3)			
Range	6.4% – 28.0%	7.3% – 20.9%	7.1% – 27.1%
Weighted average	7.9%	11.1%	8.4%
Life (in years)			
Range	2.8 - 8.3	3.1 - 6.8	2.9 - 8.0
Weighted average	7.9	6.8	7.6
Effect on fair value of (2):			
5% adverse change	$(14,371)	$(1,954)	$(12,267)
10% adverse change	$(28,265)	$(3,827)	$(24,120)
20% adverse change	$(54,715)	$(7,352)	$(46,668)
Annual per-loan cost of servicing			
Range	$77 - $79	$77 – $79	$78 – $79
Weighted average	$79	$79	$79
Effect on fair value of (2):			
5% adverse change	$(7,257)	$(744)	$(5,721)
10% adverse change	$(14,514)	$(1,488)	$(11,441)
20% adverse change	$(29,029)	$(2,976)	$(22,883)

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

(2) For MSRs carried at fair value, an adverse change in one of the above-mentioned key inputs is expected to result in a recognized reduction in fair value which will be recorded in income. For MSRs carried at lower of amortized cost or fair value, an adverse change in one of the above-mentioned key inputs may have resulted in recognition of MSR impairment. The extent of the recognized MSR impairment depended on the relationship of fair value to the carrying value of such MSRs.

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

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

Note 8—Mortgage Backed Securities

Following is a summary of MBS:

	June 30, 2018				December 31, 2017			
	Principal balance	Net premiums	Accumulated valuation changes	Fair value	Principal balance	Net premiums	Accumulated valuation changes	Fair value
	(in thousands)							
Agency: (1)								
Fannie Mae	$1,308,720	$ 33,075	$ (31,902)	$1,309,893	$774,473	$ 30,355	$ (7,975)	$796,853
Freddie Mac	386,685	7,111	(5,367)	388,429	187,127	3,518	1,963	192,608
	$1,695,405	$ 40,186	$ (37,269)	$1,698,322	$961,600	$ 33,873	$ (6,012)	$989,461

(1) All MBS are fixed-rate pass-through securities.

All MBS are pledged to secure Assets sold under agreements to repurchase at both June 30, 2018 and December 31, 2017.

Note 9—Mortgage Loans Acquired for Sale at Fair Value

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

Loan type	June 30, 2018	December 31, 2017
	(in thousands)	
Agency-eligible	$1,607,538	$ 971,910
Held for sale to PLS — Government insured or guaranteed	162,856	279,571
Commercial real estate	8,548	9,898
Jumbo	5,036	—
Repurchased pursuant to representations and warranties	6,540	8,136
	$1,790,518	$ 1,269,515
Mortgage loans pledged to secure:		
Assets sold under agreements to repurchase	$1,663,192	$ 1,201,992
Mortgage loan participation purchase and sale agreements	90,633	47,285
	$1,753,825	$ 1,249,277

The Company is not approved by Ginnie Mae as an issuer of Ginnie Mae-guaranteed securities which are backed by government-insured or guaranteed mortgage loans. The Company transfers government-insured or guaranteed mortgage loans that it purchases from correspondent sellers to PLS, which is a Ginnie Mae-approved issuer, and earns a sourcing fee ranging from two to three and one-half basis points, generally based on the average number of calendar days that mortgage loans are held prior to purchase by PLS.

Note 10—Mortgage Loans at Fair Value

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

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

	June 30, 2018		December 31, 2017	
Loan type	Fair value	Unpaid principal balance	Fair value	Unpaid principal balance
	(in thousands)			
Distressed mortgage loans:				
Nonperforming mortgage loans	$183,623	$280,344	$353,648	$524,949
Performing mortgage loans:				
Interest rate step-up	143,340	192,153	189,724	242,335
Fixed interest rate	99,241	124,421	186,929	236,840
Adjustable-rate/hybrid	21,269	22,004	38,132	39,834
	263,850	338,578	414,785	519,009
	447,473	618,922	768,433	1,043,958
Fixed interest rate jumbo mortgage loans held in a VIE	301,972	306,173	321,040	316,684
	$749,445	$925,095	$1,089,473	$1,360,642
Mortgage loans at fair value pledged to secure:				
Assets sold under agreements to repurchase	$399,075		$760,853	
Asset-backed financing of a VIE at fair value	301,972		321,040	
	$701,047		$1,081,893	

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

Concentration	June 30, 2018	December 31, 2017
	(percentages are of fair value)	
Portion of mortgage loans originated between 2005 and 2007	73%	73%
Mortgage loans with unpaid-principal balance-to-current -property-value in excess of 100%	36%	38%
States contributing 5% or more of mortgage loans	New York California New Jersey Florida Massachusetts	New York California New Jersey Florida Massachusetts

Note 11—Derivative Activities

The Company holds and issues derivative financial instruments in connection with its operating activities. Derivative financial instruments are created as a result of certain of the Company's operations and the Company also enters into derivative transactions as part of its interest rate risk management activities.

Derivative financial instruments created as a result of the Company's operations include:

- IRLCs that are created when the Company commits to purchase mortgage loans acquired for sale;
- CRT Agreements whereby the Company retains a Recourse Obligation relating to certain mortgage loans it sells into Fannie Mae guaranteed securitizations as part of the retention of an IO ownership interest in such mortgage loans; and
- Derivatives that are embedded in a master repurchase agreement that provides for the Company to receive interest expense offsets if it finances mortgage loans approved as satisfying certain consumer credit relief characteristics under the master repurchase agreement.

The Company engages in interest rate risk management activities in an effort to reduce the variability of earnings caused by the effects of changes in interest rates on the fair value of certain of its assets and liabilities. The Company is exposed to price risk relative to the IRLCs it issues to correspondent sellers and to the mortgage loans it purchases as a result of issuing the IRLCs. The Company bears price risk from the time an IRLC is issued to a correspondent seller until the time the purchased mortgage loan is sold. The Company is exposed to loss if market mortgage interest rates increase, because market interest rate increases generally cause the fair value of the IRLC or mortgage loan acquired for sale to decrease. The Company is exposed to losses related to its investment in MSRs if market mortgage interest rates decrease, because market interest rate decreases generally encourage mortgage refinancing activity, which reduces the expected life of the mortgage loans underlying the MSRs, causing the fair value of MSRs to decrease.

To manage the price risk resulting from interest rate risk, the Company uses derivative financial instruments with the intention of moderating the risk that changes in market interest rates will result in unfavorable changes in the fair value of the Company's MBS, inventory of mortgage loans acquired for sale, mortgage loans held in a VIE, IRLCs and MSRs.

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

Derivative Notional Amounts and Fair Value of Derivatives

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

Instrument	June 30, 2018 Notional amount	June 30, 2018 Fair value Derivative assets	June 30, 2018 Fair value Derivative liabilities	December 31, 2017 Notional amount	December 31, 2017 Fair value Derivative assets	December 31, 2017 Fair value Derivative liabilities
	(in thousands)					
Derivatives not designated as hedging instruments:						
Not subject to master netting arrangements:						
Interest rate lock commitments	1,273,169	$3,561	$ 754	1,250,803	$4,859	$ 227
CRT Agreements	31,396,471	119,169	—	26,845,392	98,640	—
Repurchase agreement derivatives		6,912	—		3,748	—
Subject to master netting agreements used for hedging purposes:						
Forward purchase contracts	2,628,934	5,768	228	1,996,235	4,343	248
Forward sale contracts	3,793,355	696	7,733	2,565,271	387	2,830
MBS put options	1,550,000	143	—	2,375,000	3,170	—
Call options on interest rate futures	50,000	242	—	—	—	—
Put options on interest rate futures	600,000	199	—	550,000	656	—
Swap futures	—	—	—	275,000	—	—
Bond futures	815,000	—	—	—	—	—
Eurodollar future sale contracts	35,000	—	—	937,000	—	—
Total derivative instruments before netting		136,690	8,715		115,803	3,305
Netting		(3,451)	(5,269)		(1,922)	(1,999)
		$133,239	$ 3,446		$113,881	$ 1,306
Margin deposits placed with derivatives counterparties included in Other assets		$1,818			$76	
Derivative assets pledged to secure Assets sold under agreements to repurchase		$24,601			$26,058	

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

	Quarter ended June 30, 2018			
Instrument	Amount, beginning of quarter	Additions	Dispositions/ expirations	Amount, end of quarter
	(in thousands)			
Forward purchase contracts	2,510,700	20,709,134	(20,590,900)	2,628,934
Forward sales contracts	2,297,802	27,515,541	(26,019,988)	3,793,355
MBS put options	1,750,000	4,450,000	(4,650,000)	1,550,000
Call options on interest rate futures	150,000	175,000	(275,000)	50,000
Put options on interest rate futures	275,000	7,075,000	(6,750,000)	600,000
Bond futures	450,000	365,000	—	815,000
Eurodollar future sale contracts	847,664	—	(812,664)	35,000

Instrument	Quarter ended June 30, 2017 Amount, beginning of quarter	Additions	Dispositions/ expirations	Amount, end of quarter
	(in thousands)			
Forward purchase contracts	4,115,159	15,486,147	(17,667,916)	1,933,390
Forward sales contracts	5,673,414	21,590,830	(23,619,608)	3,644,636
MBS put options	950,000	525,000	—	1,475,000
MBS call options	—	200,000	—	200,000
Call options on interest rate futures	262,500	62,500	(125,000)	200,000
Put options on interest rate futures	500,000	1,625,000	(1,200,000)	925,000
Swap futures	150,000	550,000	(525,000)	175,000
Eurodollar future sale contracts	1,240,000	—	(101,000)	1,139,000
Treasury future buy contracts	—	6,400	(6,400)	—
Treasury future sale contracts	—	6,400	(6,400)	—

Instrument	Six months ended June 30, 2018 Amount, beginning of period	Additions	Dispositions/ expirations	Amount, end of period
	(in thousands)			
Forward purchase contracts	1,996,235	40,542,238	(39,909,539)	2,628,934
Forward sales contracts	2,565,271	51,925,875	(50,697,791)	3,793,355
MBS put options	2,375,000	8,575,000	(9,400,000)	1,550,000
Call options on interest rate futures	—	325,000	(275,000)	50,000
Put options on interest rate futures	550,000	10,400,000	(10,350,000)	600,000
Swap futures	275,000	—	(275,000)	—
Bond futures	—	815,000	—	815,000
Eurodollar future sale contracts	937,000	114,597	(1,016,597)	35,000

Instrument	Six months ended June 30, 2017 Amount, beginning of period	Additions	Dispositions/ expirations	Amount, end of period
	(in thousands)			
Forward purchase contracts	4,840,707	34,392,176	(37,299,493)	1,933,390
Forward sales contracts	6,148,242	45,815,933	(48,319,539)	3,644,636
MBS put options	925,000	1,925,000	(1,375,000)	1,475,000
MBS call option	750,000	200,000	(750,000)	200,000
Call options on interest rate futures	200,000	125,000	(125,000)	200,000
Put options on interest rate futures	550,000	3,375,000	(3,000,000)	925,000
Swap futures	150,000	850,000	(825,000)	175,000
Eurodollar future sale contracts	1,351,000	101,000	(313,000)	1,139,000
Treasury future buy contracts	—	55,700	(55,700)	—
Treasury future sale contracts	—	55,700	(55,700)	—

Netting of Financial Instruments

The Company has elected to net derivative asset and liability positions, and cash collateral placed with or received from its counterparties when subject to a legally enforceable master netting arrangement. The derivative financial instruments that are not subject to master netting arrangements are IRLCs, CRT Agreement derivatives and repurchase agreement derivatives. As of June 30, 2018 and December 31, 2017, the Company did not enter into reverse repurchase agreements or securities lending transactions that are required to be disclosed in the following tables.

Offsetting of Derivative Assets

Following is a summary of net derivative assets:

	June 30, 2018			December 31, 2017		
	Gross amounts of recognized assets	Gross amounts offset in the consolidated balance sheet	Net amounts of assets presented in the consolidated balance sheet	Gross amounts of recognized assets	Gross amounts offset in the consolidated balance sheet	Net amounts of assets presented in the consolidated balance sheet
	(in thousands)					
Derivative assets:						
Not subject to master netting arrangements:						
Interest rate lock commitments	$3,561	$ —	$ 3,561	$4,859	$ —	$ 4,859
CRT Agreement derivatives	119,169	—	119,169	98,640	—	98,640
Repurchase agreement derivatives	6,912	—	6,912	3,748	—	3,748
	129,642	—	129,642	107,247	—	107,247
Subject to master netting arrangements:						
Forward purchase contracts	5,768	—	5,768	4,343	—	4,343
Forward sale contracts	696	—	696	387	—	387
MBS put options	143	—	143	3,170	—	3,170
Call options on interest rate futures	242	—	242	—	—	—
Put options on interest rate futures	199	—	199	656	—	656
Netting	—	(3,451)	(3,451)	—	(1,922)	(1,922)
	7,048	(3,451)	3,597	8,556	(1,922)	6,634
	$136,690	$ (3,451)	$ 133,239	$115,803	$ (1,922)	$ 113,881

Derivative Assets, Financial Instruments and Collateral Held by Counterparty

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

	June 30, 2018				December 31, 2017			
	Net amount of assets presented in the consolidated balance sheet	Gross amounts not offset in the consolidated balance sheet			Net amount of assets presented in the consolidated balance sheet	Gross amounts not offset in the consolidated balance sheet		
		Financial instruments	Cash collateral received	Net amount		Financial instruments	Cash collateral received	Net amount
	(in thousands)							
CRT Agreements	$119,169	$ —	$ —	$119,169	$98,640	$ —	$ —	$98,640
Interest rate lock commitments	3,561	—	—	3,561	4,859	—	—	4,859
Deutsche Bank Securities LLC	6,912	—	—	6,912	3,748	—	—	3,748
Federal National Mortgage Association	889	—	—	889	1,606	—	—	1,606
Citigroup Global Markets Inc.	801	—	—	801	429	—	—	429
Goldman Sachs	538	—	—	538	—	—	—	—
Bank of America, N.A.	493	—	—	493	—	—	—	—
RJ O'Brien & Associates, LLC	441	—	—	441	656	—	—	656
Jefferies & Company, Inc.	5	—	—	5	160	—	—	160
J.P. Morgan Securities LLC	—	—	—	—	2,020	—	—	2,020
Credit Suisse Securities (USA) LLC	—	—	—	—	809	—	—	809
Morgan Stanley & Co. LLC	—	—	—	—	457	—	—	457
Mitsubishi UFJ Sec	—	—	—	—	193	—	—	193
Wells Fargo Securities, LLC	—	—	—	—	146	—	—	146
Other	430	—	—	430	158	—	—	158
	$133,239	$ —	$ —	$133,239	$113,881	$ —	$ —	$113,881

Offsetting of Derivative Liabilities and Financial Liabilities

Following is a summary of net derivative liabilities and assets sold under agreements to repurchase. Assets sold under agreements to repurchase do not qualify for setoff accounting.

	June 30, 2018			December 31, 2017		
	Gross amounts of recognized liabilities	Gross amounts offset in the consolidated balance sheet	Net amounts of liabilities presented in the consolidated balance sheet	Gross amounts of recognized liabilities	Gross amounts offset in the consolidated balance sheet	Net amounts of liabilities presented in the consolidated balance sheet
	(in thousands)					
Derivative liabilities:						
Not subject to master netting arrangements:						
Interest rate lock commitments	$754	$ —	$754	$227	$ —	$227
	754	—	754	227	—	227
Subject to master netting arrangements:						
Forward purchase contracts	228	—	228	248	—	248
Forward sales contracts	7,733	—	7,733	2,830	—	2,830
Netting	—	(5,269)	(5,269)	—	(1,999)	(1,999)
	7,961	(5,269)	2,692	3,078	(1,999)	1,079
	8,715	(5,269)	3,446	3,305	(1,999)	1,306
Assets sold under agreements to repurchase:						
UPB	3,780,351	—	3,780,351	3,182,504	—	3,182,504
Unamortized debt issuance costs	(147)	—	(147)	(1,618)	—	(1,618)
	3,780,204	—	3,780,204	3,180,886	—	3,180,886
	$3,788,919	$ (5,269)	$3,783,650	$3,184,191	$ (1,999)	$3,182,192

Derivative Liabilities, Financial Liabilities and Collateral Pledged by Counterparty

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

	June 30, 2018				December 31, 2017			
	Net amount of liabilities presented in the consolidated balance sheet	Gross amounts not offset in the consolidated balance sheet: Financial instruments	Cash collateral pledged	Net amount	Net amount of liabilities presented in the consolidated balance sheet	Gross amounts not offset in the consolidated balance sheet: Financial instruments	Cash collateral pledged	Net amount
	(in thousands)							
Interest rate lock commitments	$754	$—	$ —	$754	$227	$—	$ —	$227
Bank of America, N.A.	1,423,633	(1,423,633)	—	—	839,057	(838,771)	—	286
Credit Suisse Securities (USA) LLC	999,321	(998,952)	—	369	845,567	(845,567)	—	—
J.P. Morgan Securities LLC	400,325	(399,716)	—	609	373,186	(373,186)	—	—
Deutsche Bank Securities LLC	277,367	(277,367)	—	—	374,526	(374,526)	—	—
Daiwa Capital Markets	259,193	(259,121)	—	72	153,833	(153,730)	—	103
Morgan Stanley & Co. LLC	136,904	(136,512)	—	392	164,530	(164,530)	—	—
RBC Capital Markets, L.P.	103,802	(103,802)	—	—	92,014	(91,805)	—	209
Citigroup Global Markets Inc.	89,347	(88,894)	—	453	235,541	(235,319)	—	222
Wells Fargo Securities, LLC	46,487	(46,451)	—	36	50,360	(50,360)	—	—
BNP Paribas	41,912	(41,912)	—	—	45,411	(45,411)	—	—
Mizuho Securities	4,090	(3,991)	—	99				
Barclays Capital Inc.	—	—	—	—	9,374	(9,299)	—	75
Other	662	—	—	662	184	—	—	184
Unamortized debt issuance costs	(147)	147	—	—	(1,618)	1,618	—	—
	$3,783,650	$(3,780,204)	$ —	$3,446	$3,182,192	$(3,180,886)	$ —	$1,306

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

Derivative activity	Income statement line	Quarter ended June 30,		Six months ended June 30,	
		2018	2017	2018	2017
		(in thousands)			
Interest rate lock commitments	Net gain on mortgage loans acquired for sale	$(3,874)	$24,372	$(18,732)	$45,438
Hedged item:					
Interest rate lock commitments and mortgage loans acquired for sale	Net gain on mortgage loans acquired for sale	$8,424	$(11,773)	$41,234	$(15,365)
Mortgage servicing rights	Net mortgage loan servicing fees	$(11,438)	$2,391	$(32,286)	$(6,307)
Fixed-rate assets and LIBOR-indexed repurchase agreements	Net gain (loss) on investments	$(1,121)	$(4,889)	$338	$(9,033)
CRT agreements	Net gain (loss) on investments	$37,385	$38,448	$62,069	$58,756
Repurchase agreement derivatives	Interest expense	$(69)	$—	$(81)	$—

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Note 12—Real Estate Acquired in Settlement of Loans

Following is a summary of financial information relating to REO:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Balance at beginning of period	$141,506	$ 224,831	$162,865	$274,069
Transfers from mortgage loans at fair value and advances	2,358	29,154	18,721	54,030
Transfer of real estate acquired in settlement of mortgage loans to real estate held for investment	(1,048)	(5,101)	(3,107)	(11,745)
Results of REO:				
Valuation adjustments, net	(5,308)	(7,151)	(10,667)	(15,326)
Gain on sale, net	3,011	3,686	5,144	7,615
	(2,297)	(3,465)	(5,523)	(7,711)
Proceeds from sales	(31,248)	(38,385)	(63,685)	(101,609)
Balance at end of period	$109,271	$ 207,034	$109,271	$207,034

	June 30, 2018	December 31, 2017
	(in thousands)	
REO pledged to secure assets sold under agreements to repurchase	$29,433	$ 76,037
REO held in a consolidated subsidiary whose stock is pledged to secure financings of such properties	23,012	48,495
	$52,445	$ 124,532

Note 13—Mortgage Servicing Rights

Carried at Fair Value:

Following is a summary of MSRs carried at fair value:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Balance at beginning of period	$957,013	$ 69,683	$91,459	$64,136

Transfer of mortgage servicing rights from mortgage servicing rights carried at lower of amortized cost or fair value pursuant to a change in accounting principle	—	—	773,035	—
Balance after reclassification	957,013	69,683	864,494	64,136
Purchases	—	7	—	69
MSRs resulting from mortgage loan sales	65,408	12,334	131,954	19,812
Changes in fair value:				
Due to changes in valuation inputs used in valuation model (1)	16,084	(2,303)	68,695	(4,328)
Other changes in fair value (2)	(27,998)	(2,097)	(54,636)	(2,065)
	(11,914)	(4,400)	14,059	(6,393)
Balance at end of period	$1,010,507	$ 77,624	$1,010,507	$77,624

	June 30, 2018	December 31, 2017
	(in thousands)	
Fair value of mortgage servicing rights pledged to secure Assets sold under agreements to repurchase and Notes payable (3)	$994,212	$ 90,284

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(1) Principally reflects changes in pricing spread (discount rate) and prepayment speed inputs, primarily due to changes in market interest rates.
(2) Represents changes due to realization of expected cash flows.
(3) During 2018, beneficial interests in Fannie Mae MSRs are pledged as collateral for both Assets sold under agreements to repurchase and Notes payable as discussed in Note 16 – Notes Payable.

Carried at Lower of Amortized Cost or Fair Value:

Following is a summary of MSRs carried at lower of amortized cost or fair value:

	Quarter ended June 30, 2017	Six months ended June 30, 2018	2017
	(in thousands)		
Amortized Cost:			
Balance at beginning of period	$639,455	$772,870	$606,103
Transfer of mortgage servicing right to mortgage servicing rights carried at fair value pursuant to a change in accounting principle	—	(772,870)	—
Balance after reclassification	639,455	—	606,103
MSRs resulting from mortgage loan sales	53,501	—	104,711
Amortization	(19,523)	—	(37,381)
Balance at end of period	673,433	—	673,433
Valuation Allowance:			
Balance at beginning of period	(12,168)	(19,548)	(13,672)
Reduction resulting from change in accounting principle	—	19,548	—
Balance after reclassification	(12,168)	—	(13,672)
Additions to valuation allowance	(4,089)	—	(2,585)
Balance at end of period	(16,257)	—	(16,257)
MSRs, net	$657,176	$—	$657,176
Fair value at beginning of period	$662,584		$626,334
Fair value at end of period	$682,437		

	December 31, 2017
	(in thousands)
MSRs carried at lower of cost or fair value pledged to secure:	
Assets sold under agreements to repurchase	$584,762
Notes payable	156,846
	$741,608

Servicing fees relating to MSRs are recorded in Net mortgage loan servicing fees on the Company’s consolidated statements of income and are summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Contractually-specified servicing fees	$48,667	$39,705	$97,399	$76,986
Ancillary and other fees:				
Late charges	220	1,203	433	2,240
Other	1,639	176	3,129	363
	$50,526	$41,084	$100,961	$79,589

Note 14—Assets Sold Under Agreements to Repurchase

Following is a summary of financial information relating to assets sold under agreements to repurchase:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(dollars in thousands)			
Weighted-average interest rate (1)	3.10 %	2.82 %	3.14 %	2.70 %
Average balance	$3,462,865	$3,420,836	$3,271,453	$3,344,772
Total interest expense (2)	$25,473	$23,941	$49,981	$46,123
Maximum daily amount outstanding	$3,771,700	$4,361,565	$4,418,291	$4,563,762

(1) Excludes the effect of amortization of net issuance premiums of $1.5 million and $1.7 million for the quarter and six months ended June 30, 2018, respectively, and net debt issuance costs of $1.9 million and $4.2 million for the quarter and six months ended June 30, 2017, respectively.

(2) The Company's interest expense relating to assets sold under agreements to repurchase for the quarter and six months ended June 30, 2018 includes recognition of incentives it received for financing certain of its mortgage loans acquired for sale satisfying certain consumer debt relief characteristics under a master repurchase agreement. During the quarter and six months ended June 30, 2018, the Company recognized $3.5 million and $5.9 million, respectively, in such incentives as a reduction of interest expense. The master repurchase agreement is subject to a rolling six month term through August 18, 2019, unless terminated earlier at the option of the lender. There can be no assurance that the lender will not terminate this agreement prior to its stated maturity.

	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Carrying value:		
Unpaid principal balance	$3,780,351	$ 3,182,504
Unamortized debt issuance costs and premiums, net	(147)	(1,618)
	$3,780,204	$ 3,180,886
Weighted-average interest rate	3.12 %	2.77 %
Available borrowing capacity (1):		
Committed	$522,825	$ 749,650
Uncommitted	1,756,291	2,030,607
	$2,279,116	$ 2,780,257
Margin deposits placed with counterparties included in Other assets	$40,746	$ 28,154
Assets securing agreements to repurchase:		
Mortgage-backed securities	$1,698,322	$ 989,461
Mortgage loans acquired for sale at fair value	$1,663,192	$ 1,201,992
Mortgage loans at fair value	$399,075	$ 760,853
CRT Agreements:		
Deposits securing CRT agreements	$385,227	$ 400,778
Derivative assets	$24,601	$ 26,058
Real estate acquired in settlement of loans	$52,445	$ 124,532
Real estate held for investment	$25,158	$ 31,128
MSRs (2)	$994,212	$ 651,575

(1) The amount the Company is able to borrow under asset repurchase agreements is tied to the fair value of unencumbered assets eligible to secure those agreements and the Company's ability to fund the agreements' margin requirements relating to the assets financed.

(2) During 2018, beneficial interests in Fannie Mae MSRs are pledged as collateral for both Assets sold under agreements to repurchase and Notes payable as discussed in Note 16 – Notes Payable.

Following is a summary of maturities of outstanding assets sold under agreements to repurchase by facility maturity date:

Remaining maturity at June 30, 2018	Contractual balance (in thousands)
Within 30 days	$1,579,398
Over 30 to 90 days	509,459
Over 90 days to 180 days	195,599
Over 180 days to 1 year	1,120,201
Over one year to two years	375,694
	$3,780,351
Weighted average maturity (in months)	4.6

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

The amount at risk (the fair value of the assets pledged plus the related margin deposit, less the amount advanced by the counterparty and interest payable) and maturity information relating to the Company's assets sold under agreements to repurchase is summarized by pledged asset and counterparty below as of June 30, 2018:

Mortgage loans acquired for sale, Mortgage loans, REO and MSRs sold under agreements to repurchase

Counterparty	Amount at risk (in thousands)	Weighted-average maturity	Facility maturity
Citibank, N.A.	$ 134,152	September 16, 2018	June 7, 2019
Credit Suisse First Boston Mortgage Capital LLC	$ 77,552	August 25, 2018	April 26, 2019
Bank of America, N.A.	$ 27,628	September 16, 2018	July 1, 2019
JPMorgan Chase & Co.	$ 30,879	March 14, 2019	March 14, 2019
Deutsche Bank	$ 15,149	September 15, 2018	December 31, 2018
Morgan Stanley	$ 12,504	August 5, 2018	August 24, 2018
JPMorgan Chase & Co.	$ 5,470	August 15, 2018	October 12, 2018
Royal Bank of Canada	$ 641	October 12, 2018	August 30, 2018

Securities sold under agreements to repurchase

Counterparty	Amount at risk	Weighted average maturity

	(in thousands)	
Bank of America, N.A.	$ 52,125	July 20, 2018
JPMorgan Chase & Co.	$ 12,403	August 28, 2018
Daiwa Capital Markets America Inc.	$ 17,411	July 20, 2018
Royal Bank of Canada	$ 7,490	August 6, 2018
Wells Fargo, N.A.	$ 2,433	July 12, 2018
Mizuho Securities	$ 175	July 12, 2018

CRT Agreements sold under agreements to repurchase

Counterparty	Amount at risk (in thousands)	Weighted average maturity
Credit Suisse First Boston Mortgage Capital LLC	$ 50,959	July 11, 2018
Bank of America, N.A.	$ 26,946	July 18, 2018
BNP Paribas Corporate & Institutional Banking	$ 17,525	July 9, 2018

Note 15—Mortgage Loan Participation Purchase and Sale Agreements

Certain borrowing facilities secured by mortgage loans acquired for sale are in the form of mortgage loan participation purchase and sale agreements. Participation certificates, each of which represents an undivided beneficial ownership interest in a pool of mortgage loans that have been pooled with Fannie Mae or Freddie Mac, are sold to a lender pending the securitization of such mortgage loans and the sale of the resulting security. The commitment between the Company and a nonaffiliate to sell such security is also assigned to the lender at the time a participation certificate is sold.

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. The holdback amount 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.

Mortgage loan participation purchase and sale agreements are summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(dollars in thousands)			
Weighted-average interest rate (1)	2.37 %	2.30 %	2.43 %	2.20 %
Average balance	$50,326	$71,724	$47,956	$68,131
Total interest expense	$343	$449	$658	$816
Maximum daily amount outstanding	$87,751	$98,721	$87,751	$98,721

(1) Excludes the effect of amortization of debt issuance costs of $45,000 and $76,000 for the quarter and six months ended June 30, 2018, respectively, and $31,000 and $63,000 for the quarter and six months ended June 30, 2017, respectively.

	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Carrying value:		
Amount outstanding	$87,751	$ 44,550
Unamortized debt issuance costs	—	(62)
	$87,751	$ 44,488
Weighted-average interest rate	3.34 %	2.82 %
Mortgage loans acquired for sale pledged to secure mortgage loan participation purchase and sale agreements	$90,633	$ 47,285

Note 16—Notes Payable

On April 25, 2018, the Company, through its indirect subsidiary, PMT ISSUER TRUST-FMSR ("FMSR Issuer Trust"), issued an aggregate principal amount of $450 million in secured term notes (the "2018-FT1 Notes") to qualified institutional buyers under Rule 144A of the Securities Act of 1933, as amended. The 2018-FT1 Notes bear interest at a rate equal to one-month LIBOR plus 2.35% per annum, payable each month beginning in May 2018, on the 25th day of such month or, if such 25th day is not a business day, the next business day.

The 2018-FT1 Notes mature on April 25, 2023 or, if extended pursuant to the terms of the related term note indenture supplement, April 25, 2025 (unless earlier redeemed in accordance with their terms). The 2018-FT1 Notes rank pari passu with the Series 2017-VF1 Note dated December 20, 2017 (the "FMSR VFN") pledged to Credit Suisse under an agreement to repurchase. The 2018-FT1 Notes and the FMSR VFN are secured by certain participation certificates relating to Fannie Mae MSRs and ESS relating to such MSRs.

On February 1, 2018, the Company, through PMC and PMH, entered into a Loan and Security Agreement with Credit Suisse First Boston Mortgage Capital LLC ("Credit Suisse"), pursuant to which PMC and PMH may finance certain mortgage servicing rights (inclusive of any related excess servicing spread arising therefrom and that may be transferred from PMC to PMH from time to time) relating to mortgage loans pooled into Freddie Mac securities (collectively, the "Freddie MSRs"), in an aggregate loan amount not to exceed $175 million, all of which is committed. The note matures on February 1, 2020.

On March 24, 2017, the Company, through PMC and PMH, entered into a second Amended and Restated Loan and Security Agreement with Citibank, N.A., pursuant to which PMC and PMH finance certain MSRs (inclusive of any related excess servicing spread and/or junior excess strips arising therefrom and that may be transferred from PMC to PMH from time to time) relating to mortgage loans pooled into Fannie Mae securities (collectively, the "Fannie MSRs") in an aggregate loan amount not to exceed $400 million, all of which is committed. The note was redeemed and terminated in December 2017.

On March 24, 2017, the Company, through PMC and PMH, entered into a Loan and Security Agreement with Barclays Bank PLC ("Barclays"), pursuant to which PMC and PMH may finance certain mortgage servicing rights (inclusive of any related excess servicing spread arising therefrom and that may be transferred from PMC to PMH from time to time) relating to mortgage loans pooled into Freddie Mac securities (collectively, the "Freddie MSRs"), in an aggregate loan amount not to exceed $170 million, all of which is committed. The note matured and was repaid on February 1, 2018.

Following is a summary of financial information relating to the notes payable:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(dollars in thousands)			
Weighted-average interest rate (1)	3.23 %	6.04 %	3.21 %	5.40 %
Average balance	$444,948	$119,447	$223,703	$189,526
Total interest expense	$3,681	$3,095	$3,681	$7,399
Maximum daily amount outstanding	$445,062	$160,106	$445,062	$275,106

(1) Excludes the effect of amortization of debt issuance costs of $170,000 for the quarter and six months ended June 30, 2018, and $1.3 million and $2.2 million for the quarter and six months ended June 30, 2017, respectively.

	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Carrying value:		
Amount outstanding	$450,000	$ —
Unamortized debt issuance costs	(4,938)	—
	$445,062	$ —
Weighted-average interest rate	4.34 %	—
MSRs pledged to secure notes payable (1)	$994,212	$ 180,317

(1) During 2018, beneficial interests in Fannie Mae MSRs are pledged as collateral for both Assets sold under agreements to repurchase and Notes payable as discussed above.

Note 17—Asset-Backed Financing of a Variable Interest Entity at Fair Value

Following is a summary of financial information relating to the asset-backed financing of a VIE:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(dollars in thousands)			
Weighted-average fair value	$289,803	$337,844	$293,720	$342,822
Total interest expense	$2,801	$3,596	$5,097	$7,005
Weighted-average interest rate	3.57 %	3.41 %	3.56 %	3.44 %

	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Fair value	$287,719	$ 307,419
UPB	$306,173	$ 316,684
Weighted-average interest rate	3.51 %	3.51 %

The asset-backed financing of a VIE is a non-recourse liability and secured solely by the assets of a consolidated VIE and not by any other assets of the Company. The assets of the VIE are the only source of funds for repayment of the certificates.

Note 18—Exchangeable Senior Notes

PMC issued in a private offering $250 million aggregate principal amount of exchangeable senior notes (“Exchangeable Notes”) due May 1, 2020. The Exchangeable Notes bear interest at a rate of 5.375% per year, payable semiannually. The Exchangeable Notes are exchangeable into common shares of the Company at a rate of 33.8667 common shares per $1,000 principal amount of the Exchangeable Notes as of June 30, 2018, which is an increase over the initial exchange rate of 33.5149. The increase in the calculated exchange rate was the result of quarterly cash dividends exceeding the quarterly dividend threshold amount of $0.57 per share in prior reporting periods, as provided in the related indenture.

Following is financial information relating to the Exchangeable Notes:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Average balance	$250,000	$250,000	$250,000	$250,000
Total interest expense	$3,648	$3,631	$7,292	$7,260

	June 30, 2018	December 31, 2017
	(in thousands)	
Carrying value:		
UPB	$250,000	$ 250,000
Unamortized debt issuance costs	(2,241)	(2,814)
	$247,759	$ 247,186

Note 19—Liability for Losses Under Representations and Warranties

Following is a summary of the Company’s liability for losses under representations and warranties:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Balance, beginning of period	$8,249	$11,447	$8,678	$15,350
Provision for losses:				
Pursuant to mortgage loan sales	516	607	1,088	1,280
Reduction in liability due to change in estimate	(1,140)	(1,305)	(2,182)	(5,881)
(Losses incurred) recoveries, net	—	(52)	41	(52)
Balance, end of period	$7,625	$10,697	$7,625	$10,697
UPB of mortgage loans subject to representations and	$77,655,085	$62,530,609		

warranties at end of period

Note 20—Commitments and Contingencies

Litigation

From time to time, the Company may be involved in various proceedings, claims and legal actions arising in the ordinary course of business. As of June 30, 2018, the Company was not involved in any such proceedings, claims or legal actions that in the Manager’s view would reasonably be likely to have a material adverse effect on the Company.

Commitments

The following table summarizes the Company’s outstanding contractual commitments:

	June 30, 2018 (in thousands)
Commitments to purchase mortgage loans acquired for sale	$1,273,169
Commitments to fund Deposits securing CRT agreements (1)	$597,066
Firm commitment to purchase credit risk transfer security	$57,823

(1) Certain deposits of cash collateral on CRT Agreements are made upon the first to occur of fulfillment of the aggregation obligation or the lapse of the aggregation period.

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Note 21—Shareholders' Equity

Preferred Shares of Beneficial Interest

Preferred shares of beneficial interest are summarized below:

Series	Description (1)	Number of shares (in thousands)	Liquidation preference	Issuance discount	Carrying value
A	8.125% fixed-to-floating rate cumulative redeemable preferred, issued March 2017	4,600	$ 115,000	$ 3,828	$ 111,172
B	8.00% fixed-to-floating rate cumulative redeemable preferred, issued July 2017	7,800	195,000	6,465	188,535
		12,400	$ 310,000	$ 10,293	$ 299,707

(1) Par value is $0.01 per share for both series.

During March 2017, the Company issued 4.6 million of its 8.125% Series A Fixed-to-Floating Rate Cumulative Redeemable Preferred Shares of Beneficial Interest, $0.01 par value per share (the "Series A Preferred Shares"). From, and including, the date of original issuance to, but not including, March 15, 2024, the Company pays cumulative dividends on the Series A Preferred Shares at a fixed rate of 8.125% per annum based on the $25.00 per share liquidation preference. From, and including, March 15, 2024 and thereafter, the Company will pay cumulative dividends on the Series A Preferred Shares at a floating rate equal to three-month LIBOR as calculated on each applicable dividend determination date plus a spread of 5.831% per annum based on the $25.00 per share liquidation preference. The Company paid dividends of $1.02 per Series A Preferred Share during the six months ended June 30, 2018.

During July 2017, the Company issued 7.8 million of its 8.00% Series B Fixed-to-Floating Rate Cumulative Redeemable Preferred Shares of Beneficial Interest, $0.01 par value per share (the "Series B Preferred Shares" and, together with the Series A Preferred Shares, the "Preferred Shares"). From, and including, the date of original issuance to, but not including, June 15, 2024, the Company pays cumulative dividends on the Series B Preferred Shares at a fixed rate of 8.00% per annum based on the $25.00 per share liquidation preference. From, and including, June 15, 2024 and thereafter, the Company will pay cumulative dividends on the Series B Preferred Shares at a floating rate equal to three-month LIBOR as calculated on each applicable dividend determination date plus a spread of 5.99% per annum based on the $25.00 per share liquidation preference. The Company paid dividends of $1.00 per Series B Preferred Share for the six months ended June 30, 2018.

The Company pays quarterly cumulative dividends on its Preferred Shares on the 15th day of each March, June, September and December, provided that if any dividend payment date is not a business day, then the dividend that would otherwise be payable on that dividend payment date may be paid on the following business day.

The Series A and Series B Preferred Shares will not be redeemable before March 15, 2024 and June 15, 2024, respectively, except in connection with the Company's qualification as a REIT for U.S. federal income tax purposes and upon the occurrence of a change of control. On or after the date the Preferred Shares become redeemable, or 120 days after the first date on which such change of control occurred, the Company may, at its option, redeem any or all of the Preferred Shares at $25.00 per share plus any accumulated and unpaid dividends thereon to, but not including, the redemption date. The Preferred Shares have no stated maturity, are not subject to any sinking fund or mandatory redemption and will remain outstanding indefinitely unless redeemed or repurchased by the Company or converted into common shares in connection with a change of control by the holders of the Preferred Shares.

Common Share Repurchases

During August 2015, the Company's board of trustees authorized a common share repurchase program. Under the program, as amended, the Company may repurchase up to $300 million of its outstanding common shares.

The following table summarizes the Company's share repurchase activity:

	Quarter ended June 30,		Six months ended June 30,		
	2018	2017	2018	2017	Cumulative total (1)
	(in thousands)				
Common shares repurchased	—	—	671	139	14,731
Cost of common shares repurchased	$—	$ —	$10,719	$2,307	$ 216,625

(1) Amounts represent the share repurchase program total from its inception in August 2015 through June 30, 2018.
The repurchased common shares were canceled upon settlement of the repurchase transactions and returned to the authorized but unissued common share pool.

Conditional Reimbursement of IPO Underwriting Costs

As more fully described in Note 5—Transactions with Related Parties, on February 1, 2013, the Company entered into a Reimbursement Agreement, by and among the Company, the Operating Partnership and the Manager. The Reimbursement Agreement provides that, to the extent the Company is required to pay the Manager performance incentive fees under the management agreement, the Company will reimburse the Manager for underwriting costs it paid on the IPO offering date at a rate of $10 in reimbursement for every $100 of performance incentive fees earned. The 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. No reimbursements were made during the quarter and six months ended June 30, 2018, or the quarter and six months ended June 30, 2017.

The Reimbursement Agreement also provides for the payment to the IPO underwriters of the amount that the Company agreed to pay to them at the time of the IPO if the Company satisfied certain performance measures over a specified period of time. As the Manager earns performance incentive fees under the management agreement, the IPO underwriters will be paid at a rate of $20 of payments for every $100 of performance incentive fees earned by PCM. The payment to the underwriters is subject to a maximum reimbursement in any particular 12-month period of $2.0 million and the maximum amount that may be paid under the agreement is $5.9 million. No payments were made during the quarter and six months ended June 30, 2018, or the quarter and six months ended June 30, 2017. The Reimbursement Agreement expires on February 1, 2019.

Note 22—Net Gain on Mortgage Loans Acquired for Sale

Net gain on mortgage loans acquired for sale is summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
From non-affiliates:				
Cash loss:				
Mortgage loans	$(72,254)	$(26,688)	$(168,021)	$(82,595)
Hedging activities	4,642	(19,720)	38,388	(3,463)
	(67,612)	(46,408)	(129,633)	(86,058)
Non cash gain:				
Recognition of fair value of firm commitment to purchase credit risk transfer security	4,426	—	4,426	—
Receipt of MSRs in mortgage loan sale transactions	65,408	65,835	131,954	124,523
Provision for losses relating to representations and warranties provided in mortgage loan sales:				
Pursuant to mortgage loans sales	(516)	(607)	(1,088)	(1,280)
Reduction in liability due to change in estimate	1,140	1,305	2,182	5,881
	624	698	1,094	4,601
Change in fair value of financial instruments held at end of period:				
IRLCs	98	(8,327)	(1,826)	(3,383)
Mortgage loans	(475)	(5,657)	2,376	2,471
Hedging derivatives	3,782	7,947	2,846	(11,902)
	3,405	(6,037)	3,396	(12,814)
Total from non-affiliates	6,251	14,088	11,237	30,252
From PFSI—cash gain	2,891	3,204	5,532	6,065
	$9,142	$17,292	$16,769	$36,317

Note 23—Net Gain (Loss) on Investments

Net gain (loss) on investments is summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
From non-affiliates:				

Mortgage-backed securities at fair value	$(8,861)	$4,027	$(31,258)	$4,167
Mortgage loans at fair value:				
Distressed	(4,701)	1,030	(14,651)	4,246
Held in a VIE	(2,784)	3,855	(8,362)	4,171
CRT Agreements	38,496	32,853	61,047	51,440
Asset-backed financing of a VIE at fair value	2,960	(3,399)	9,142	(3,423)
Hedging derivatives	(1,121)	(4,889)	338	(9,033)
	23,989	33,477	16,256	51,568
From PFSI—ESS	1,520	(5,885)	9,271	(7,255)
	$25,509	$27,592	$25,527	$44,313

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Note 24—Net Mortgage Loan Servicing Fees

Net mortgage loan servicing fees are summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
From non-affiliates:				
Servicing fees (1)	$48,667	$39,705	$97,399	$76,986
Ancillary and other fees	1,859	1,379	3,562	2,603
Effect of MSRs:				
Carried at fair value—change in fair value				
Realization of cashflows	(27,998)	(2,097)	(54,636)	(2,065)
Other	16,084	(2,303)	68,695	(4,328)
	(11,914)	(4,400)	14,059	(6,393)
Carried at lower of amortized cost or fair value:				
Amortization	—	(19,523)	—	(37,381)
Additions to impairment valuation allowance	—	(4,089)	—	(2,585)
(Losses) gains on hedging derivatives	(11,438)	2,391	(32,286)	(6,307)
	(23,352)	(25,621)	(18,227)	(52,666)
	27,174	15,463	82,734	26,923
From PFSI—MSR recapture income	412	234	1,007	526
Net mortgage loan servicing fees	$27,586	$15,697	$83,741	$27,449
Average servicing portfolio	$76,806,051	$61,414,348	$75,246,468	$59,710,787

(1) Includes contractually specified servicing fees, net of Agency guarantee fees.

Note 25—Net Interest Income

Net interest income is summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Interest income:				
From nonaffiliates:				
Short-term investments	$ 198	$ 103	$ 271	$ 385
Mortgage-backed securities	12,433	7,734	21,224	14,506
Mortgage loans acquired for sale at fair value	17,951	12,995	29,283	24,497
Mortgage loans at fair value:				
Distressed	4,941	19,592	12,840	39,244
Held in a VIE	3,169	3,876	5,771	7,605
Placement fees relating to custodial funds	6,024	2,811	10,239	3,882
Deposits securing CRT Agreements	3,566	855	5,598	1,264
Other	152	54	254	90
	48,434	48,020	85,480	91,473
From PFSI—ESS	3,910	4,366	7,844	9,013
	52,344	52,386	93,324	100,486
Interest expense:				
To nonaffiliates:				
Assets sold under agreements to repurchase (1)	25,473	23,941	49,981	46,123
Mortgage loan participation purchase and sale agreements	343	449	658	816
Notes payable	3,681	3,095	3,681	7,399
Asset-backed financings of VIEs at fair value	2,801	3,596	5,097	7,005
Exchangeable Notes	3,648	3,631	7,292	7,260
Interest shortfall on repayments of mortgage loans serviced for Agency securitizations	1,803	1,368	3,397	2,430
Interest on mortgage loan impound deposits	418	321	901	742
	38,167	36,401	71,007	71,775
To PFSI—Assets sold under agreement to repurchase	1,898	2,025	3,874	3,830
	40,065	38,426	74,881	75,605
Net interest income	$ 12,279	$ 13,960	$ 18,443	$ 24,881

(1) In 2017, the Company entered into a master repurchase agreement that provides the Company with incentives to finance mortgage loans approved for satisfying certain consumer relief characteristics as provided in the agreement. During the quarter and six months ended June 30, 2018, the Company included $3.5 million and $5.9 million, respectively, of such incentives as a reduction of Interest expense. The master repurchase agreement is subject to a rolling six month term through August 18, 2019, unless terminated earlier at the option of the lender. There can be no assurance that the lender will not terminate this agreement prior to its stated maturity.

Note 26—Share-Based Compensation Plans

As of June 30, 2018 and December 31, 2017, the Company had one share-based compensation plan. The following table summarizes the Company's share-based compensation activity:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Grants:				
Restricted share units	—	—	129	134
Performance share units	—	—	116	126
Total share units granted	—	—	245	260
Grant date fair value:				
Restricted share units granted	$—	$—	$2,281	$2,281
Performance share units granted	—	—	1,542	1,722
Total fair value of share units granted	$—	$—	$3,823	$4,003
Vestings:				
Restricted share units	68	131	260	284
Performance share units	—	—	28	—
Total share units vested	68	131	288	284
Forfeitures:				
Restricted share units	—	13	—	13
Performance share units	—	37	—	37
Total share units forfeited	—	50	—	50
Compensation expense relating to share-based grants	$1,857	$1,600	$2,756	$3,127

Note 27—Other Expenses

Other expenses are summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Common overhead allocation from PFSI	$1,176	$1,592	$2,177	$3,026
Technology	345	396	723	714
Insurance	337	330	641	668
Other	356	1,581	1,323	2,995
	$2,214	$3,899	$4,864	$7,403

Note 28—Income Taxes

The Company’s effective tax rate was 13.9% and 19.4% for the quarter and six months ended June 30, 2018. The Company’s taxable REIT subsidiary (“TRS”) recognized a tax expense of $5.7 million on income of $20.9 million and a tax expense of $15.1 million on income of $55.5 million while the Company’s reported consolidated pretax income was $42.3 million and $80.1 million for the quarter and six months ended June 30, 2018, respectively. For the same periods in 2017, the Company’s TRS recognized tax expense of $2.8 million on income of $7.2 million and tax benefit of $3.8 million on a loss of $7.6 million, respectively, while the Company’s reported consolidated pretax income was $31.8 million and $54.4 million, respectively. The relative values between the tax benefit or expense at the TRS and the Company’s consolidated pretax income drive the fluctuation in the effective tax rate. The primary difference between the Company’s effective tax rate and the statutory tax rate is due to nontaxable REIT income resulting from the dividends paid deduction.

In general, cash dividends declared by the Company will be considered ordinary income to the shareholders for income tax purposes. Some portion of the dividends may be characterized as capital gain distributions or a return of capital. For tax years beginning after December 31, 2017, the 2017 Tax Cuts and Jobs Act (the “Tax Act”) (subject to certain limitations) provides a 20% deduction from taxable income for ordinary REIT dividends.

Note 29—Earnings Per Share

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

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

Diluted earnings per share is determined by dividing net income attributable to diluted shareholders, which adds back to net income the interest expense, net of applicable income taxes, on the Company's Exchangeable Notes, by the weighted-average common shares outstanding, assuming all dilutive securities were issued.

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

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands except per share amounts)			
Net income	$36,425	$28,780	$64,611	$57,516
Dividends on preferred shares	(6,234)	(2,336)	(12,468)	(2,907)
Effect of participating securities—share-based compensation awards	(170)	(230)	(372)	(529)
Net income attributable to common shareholders	$30,021	$26,214	$51,771	$54,080
Net income attributable to common shareholders	$30,021	$26,214	$51,771	$54,080
Interest on Exchangeable Notes, net of income taxes	2,655	2,188	5,312	4,374
Diluted net income attributable to common shareholders	$32,676	$28,402	$57,083	$58,454
Weighted-average basic shares outstanding	60,903	66,761	60,844	66,740
Dilutive securities:				
Shares issuable pursuant to exchange of the Exchangeable Notes	8,467	8,467	8,467	8,467
Diluted weighted-average number of shares outstanding	69,370	75,228	69,311	75,207
Basic earnings per share	$0.49	$0.39	$0.85	$0.81
Diluted earnings per share	$0.47	$0.38	$0.82	$0.78

Calculation of diluted earnings per share requires certain potentially dilutive shares to be excluded when the inclusion of such shares in the diluted earnings per share calculation would be antidilutive. The following table summarizes the potentially dilutive shares excluded from the diluted earnings per share calculation, as inclusion of such shares would have been antidilutive:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Shares issuable under share-based compensation plan	459	776	473	793

Note 30—Segments

The correspondent production segment includes the Company's operations aimed at serving as an intermediary between mortgage lenders and the capital markets by purchasing, pooling and reselling newly originated prime credit quality mortgage loans either directly or in the form of mortgage-backed securities. The credit sensitive investment strategies segment includes investments in distressed mortgage loans, REO, CRT Agreements, non-Agency subordinated bonds and small balance commercial real estate mortgage loans. The interest rate sensitive strategies segment includes investments in MSRs, ESS, Agency and senior non-Agency MBS and the related interest rate hedging activities. The corporate segment includes certain interest income, management fee and corporate expense amounts.

Financial highlights by operating segment are summarized below:

Quarter ended June 30, 2018	Correspondent production	Credit sensitive strategies	Interest rate sensitive strategies	Corporate	Total
	(in thousands)				
Net investment income:					
Net gain on mortgage loans acquired for sale	$4,714	$4,428	$—	$—	$9,142
Net gain (loss) on investments	—	34,037	(8,528)	—	25,509
Net mortgage loan servicing fees	—	16	27,570	—	27,586
Net interest income:					
Interest income	17,822	8,751	25,422	349	52,344
Interest expense	(10,533)	(9,443)	(20,089)	—	(40,065)
	7,289	(692)	5,333	349	12,279
Other income (loss)	8,895	(420)	—	—	8,475
	20,898	37,369	24,375	349	82,991
Expenses:					
Mortgage loan fulfillment and servicing fees payable to PFSI	14,559	1,172	8,259	—	23,990
Management fees	—	—	—	5,728	5,728
Other	1,823	3,544	(285)	5,905	10,987
	16,382	4,716	7,974	11,633	40,705
Pre-tax income (loss)	$4,516	$32,653	$16,401	$(11,284)	$42,286
Total assets at end of quarter	$1,816,331	$1,448,493	$3,304,685	$107,340	$6,676,849

Quarter ended June 30, 2017	Correspondent production	Credit sensitive strategies	Interest rate sensitive strategies	Corporate	Total
	(in thousands)				
Net investment income:					
Net gain on mortgage loans acquired for sale	$17,143	$149	$—	$—	$17,292
Net gain (loss) on investments	—	34,140	(6,548)	—	27,592
Net mortgage loan servicing fees	—	29	15,668	—	15,697
Net interest income:					
Interest income	12,820	20,739	18,672	155	52,386
Interest expense	(8,962)	(13,809)	(15,655)	—	(38,426)
	3,858	6,930	3,017	155	13,960
Other income (loss)	10,497	(1,079)	—	—	9,418
	31,498	40,169	12,137	155	83,959
Expenses:					
Mortgage loan fulfillment and servicing fees	21,108	3,522	6,576	—	31,206

payable to PFSI					
Management fees	—	—	—	5,638	5,638
Other	2,302	6,197	145	6,645	15,289
	23,410	9,719	6,721	12,283	52,133
Pre-tax income (loss)	$8,088	$30,450	$5,416	$(12,128)	$31,826
Total assets at end of quarter	$1,343,484	$2,108,662	$2,410,429	$147,669	$6,010,244

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Six months ended June 30, 2018	Correspondent production	Credit sensitive strategies	Interest rate sensitive strategies	Corporate	Total
	(in thousands)				
Net investment income:					
Net gain on mortgage loans acquired for sale	$12,314	$4,455	$—	$—	$16,769
Net gain (loss) on investments	—	46,451	(20,924)	—	25,527
Net mortgage loan servicing fees	—	23	83,718	—	83,741
Net interest income:					
Interest income	28,991	18,959	44,850	524	93,324
Interest expense	(17,331)	(20,107)	(37,443)	—	(74,881)
	11,660	(1,148)	7,407	524	18,443
Other income (loss)	15,968	(1,808)	—	24	14,184
	39,942	47,973	70,201	548	158,664
Expenses:					
Mortgage loan fulfillment and servicing fees payable to PFSI	26,503	4,257	16,193	—	46,953
Management fees	—	—	—	11,424	11,424
Other	2,293	7,458	(178)	10,590	20,163
	28,796	11,715	16,015	22,014	78,540
Pre-tax income (loss)	$11,146	$36,258	$54,186	$(21,466)	$80,124
Total assets at end of period	$1,816,331	$1,448,493	$3,304,685	$107,340	$6,676,849

Six months ended June 30, 2017	Correspondent production	Credit sensitive strategies	Interest rate sensitive strategies	Corporate	Total
	(in thousands)				
Net investment income:					
Net gain on mortgage loans acquired for sale	$36,154	$163	$—	$—	$36,317
Net gain (loss) on investments	—	56,133	(11,820)	—	44,313
Net mortgage loan servicing fees	—	44	27,405	—	27,449
Net interest income:					
Interest income	24,176	41,060	34,775	475	100,486
Interest expense	(16,863)	(28,082)	(30,660)	—	(75,605)
	7,313	12,978	4,115	475	24,881
Other income (loss)	18,813	(3,346)	—	6	15,473
	62,280	65,972	19,700	481	148,433
Expenses:					
Mortgage loan fulfillment and servicing fees payable to PFSI	37,682	7,870	12,710	—	58,262

Management fees	—	—	—	10,646	10,646
Other	4,039	8,225	830	11,998	25,092
	41,721	16,095	13,540	22,644	94,000
Pre-tax income (loss)	$20,559	$49,877	$6,160	$(22,163)	$54,433
Total assets at end of period	$1,343,484	$2,108,662	$2,410,429	$147,669	$6,010,244

Note 31—Supplemental Cash Flow Information

	Six months ended June 30,	
	2018	2017
	(in thousands)	
Income tax payments, net of refunds	$893	$191
Interest payments	$81,892	$78,021
Cumulative effect on accumulated deficit of conversion to fair value accounting	$14,361	$—
Non-cash investing activities:		
Transfer of mortgage loans and advances to real estate acquired in settlement of loans	$18,721	$54,030
Transfer of real estate acquired in settlement of mortgage loans to real estate held for investment	$3,107	$11,745
Receipt of mortgage servicing rights as proceeds from sales of mortgage loans	$131,954	$124,523
Receipt of excess servicing spread pursuant to recapture agreement with PennyMac Financial Services, Inc.	$1,484	$2,953
Capitalization of servicing advances pursuant to mortgage loan modifications	$3,360	$13,148
Non-cash financing activities:		
Recognition of financing premium arising from repurchase agreement derivatives	$5,740	$—
Dividends declared, not paid	$29,145	$31,655

Note 32—Regulatory Capital and Liquidity Requirements

PMC is a seller/servicer for Fannie Mae and Freddie Mac. The Company is required to comply with the following minimum capital and liquidity eligibility requirements to remain in good standing with each Agency:

- A minimum net worth of $2.5 million plus 25 basis points of UPB for all 1-4 unit residential mortgage loans serviced;
- A tangible net worth/total assets ratio greater than or equal to 6%; and
- Liquidity equal to or exceeding 3.5 basis points multiplied by the aggregate UPB of all mortgages secured by 1-4 unit residential properties serviced for Freddie Mac and Fannie Mae ("Agency Mortgage Servicing") plus 200 basis points multiplied by the sum of nonperforming (90 or more days delinquent) Agency Mortgage Servicing that exceeds 6% of Agency Mortgage Servicing.

Such Agencies' capital and liquidity amounts and requirements, the calculations of which are defined by each entity, are summarized below:

	June 30, 2018					
	Net Worth (1)		Tangible Net Worth / Total Assets Ratio (1)		Liquidity (1)	
Fannie Mae and Freddie Mac	Actual	Required	Actual	Required	Actual	Required
	(in thousands)				(in thousands)	
June 30, 2018	$542,306	$198,376	12%	6%	$53,210	$27,423
December 31, 2017	$487,535	$182,818	12%	6%	$73,252	$25,245

(1) Calculated in accordance with the Agencies' requirements.

Noncompliance with the Agencies' capital and liquidity requirements can result in the Agencies taking various remedial actions up to and including removing the Company's ability to sell loans to and service loans on behalf of the Agencies.

Note 33—Subsequent Events

Management has evaluated all events and transactions through the date the Company issued these consolidated financial statements. During this period:

- During July 2018, the Company entered into a letter of intent to sell $99 million in UPB of performing loans from its distressed portfolio. This transaction is subject to continuing due diligence and customary closing conditions and there can be no assurance regarding the size of the transaction or that the transaction will be completed at all.
- On July 30, 2018, the Company”), through its indirect controlled subsidiary, PMC, executed a Temporary Increase Letter (the “DB Temporary Increase”) in connection with that certain Master Repurchase Agreement, dated as of August 21, 2017, by and among Deutsche Bank AG, Cayman Islands Branch (“Deutsche Bank”) and PMC (the “Repurchase Agreement). Pursuant to the terms of the DB Temporary Increase, the maximum aggregate principal amount outstanding provided for thereunder was temporarily increased from $750 million to $950 million. The period for the DB Temporary Increase commenced on July 30, 2018 and will expire on September 28, 2018. Upon the expiration of the DB Temporary Increase, the maximum aggregate principal amount outstanding will revert back to $750 million. All other terms and conditions of the Repurchase Agreement and the related guaranty remain the same in all material respects. The Repurchase Agreement is set to expire on August 18, 2019, unless terminated earlier in accordance with its terms.
- On July 30, 2018, the Company, through PMC, executed a Temporary Increase Letter (the “BANA Temporary Increase”) in connection with that certain Mortgage Loan Participation Purchase and Sale Agreement, dated December 23, 2011, by and among Bank of America, N.A. (“BANA”) and the Company (the “BANA Participation Agreement”). Pursuant to the terms of the BANA Temporary Increase, the aggregate transaction limit of purchase prices for participation certificates owned by BANA provided for thereunder was temporarily increased from $100 million to $300 million. The period for the BANA Temporary Increase commenced on July 30, 2018 and will expire on September 15, 2018. Upon the expiration of the BANA Temporary Increase, the aggregate transaction limit of purchase prices will revert back to $100 million. All other terms and conditions of the BANA Participation Agreement remain the same in all material respects.
- On August 3, 2018, the Company, through two of its wholly-owned subsidiaries, PMC and PennyMac Operating Partnership, L.P. (“POP,” and together with PMC, the “Sellers”), entered into a master repurchase agreement, by and among BNP Paribas (“BNP”), on the one hand, and the Sellers, on the other hand (the “BNP Repurchase Agreement”), pursuant to which Sellers may sell to, and later repurchase from, BNP newly originated mortgage loans in an aggregate principal amount of up to $200 million, of which $100 million is committed. The obligations of the Sellers under the BNP Repurchase Agreement are fully guaranteed by the Company. The BNP Repurchase Agreement is set to expire on August 2, 2019.
- All agreements to repurchase assets that matured between June 30, 2018 and the date of this Report were extended or renewed.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations should be read with the consolidated financial statements and the related notes of PennyMac Mortgage Investment Trust ("PMT") included within this Quarterly Report on Form 10-Q.

Statements contained in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties and other factors, which may cause actual results to be materially different from those expressed or implied in such statements. You can identify these forward-looking statements by words such as "may," "will," "should," "expect," "anticipate," "believe," "estimate," "intend," "plan" and other similar expressions. You should consider our forward-looking statements in light of the risks discussed under the heading "Risk Factors," as well as our consolidated financial statements, related notes, and the other financial information appearing elsewhere in this Quarterly Report on Form 10-Q and our other filings with the United States Securities and Exchange Commission ("SEC"). The forward-looking statements contained in this Quarterly Report on Form 10-Q are made as of the date hereof and we assume no obligation to update or supplement any forward-looking statements.

The following discussion and analysis provides information that we believe is relevant to an assessment and understanding of our consolidated results of operations and financial condition. Unless the context indicates otherwise, references in this Quarterly Report on Form 10-Q to the words "we," "us," "our" and the "Company" refer to PMT.

Our Company

We are a specialty finance company that invests primarily in residential mortgage loans and mortgage-related assets. Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. Our investment focus is on mortgage-related assets that we create through our correspondent production activities, including mortgage servicing rights ("MSRs"), credit risk transfer agreements ("CRT Agreements") and credit risk transfer securities that absorb credit losses on certain of the mortgage loans we sell. We have also invested in mortgage-backed securities ("MBS"), and hold excess servicing spread ("ESS") on MSRs acquired by PennyMac Loan Services, LLC ("PLS"). We have also historically invested in distressed mortgage assets (mortgage loans, real estate acquired in settlement of mortgage loans, commercial real estate loans that finance multifamily and other commercial real estate), which are no longer our primary focus for new investments.

We are externally managed by PNMAC Capital Management, LLC ("PCM"), an investment adviser that specializes in and focuses on U.S. mortgage assets. Most of our mortgage loan portfolio is serviced by PLS.

Correspondent Production

Our correspondent production activities involve the acquisition and sale of newly originated prime credit quality residential mortgage loans. Correspondent production serves as the source of our investments in MSRs, CRT Agreements and commitments to purchase credit risk transfer securities, and are summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(in thousands)			
Sales of mortgage loans acquired for sale:				
To nonaffiliates	$5,356,347	$5,788,605	$10,556,931	$10,647,450
To PennyMac Financial Services, Inc.	10,055,128	11,227,406	19,267,316	21,244,194

	$15,411,475	$17,016,011	$29,824,247	$31,891,644
Net gain on mortgage loans acquired for sale	$9,142	$17,292	$16,769	$36,317
Sourcing fees received from PLS included in Net gain on mortgage loans acquired for sale	$2,891	$3,204	$5,532	$6,065
Investment activities driven by correspondent production:				
Receipt of MSRs as proceeds from sales of mortgage loans	$65,408	$65,835	$131,954	$124,523
Deposits of cash securing CRT Agreements	$36,099	$41,355	$77,888	$57,148
Increase in commitments to fund Deposits securing CRT Agreements resulting from sale of mortgage loans under CRT Agreements	$44,109	$98,722	$114,595	$146,872
UPB of firm commitment to purchase credit risk transfer securities	$57,823	$—	$57,823	$—

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To the extent that we purchase mortgage loans that are insured by the U.S. Department of Housing and Urban Development ("HUD") through the Federal Housing Administration (the "FHA"), or insured or guaranteed by the Veterans Administration (the "VA") or U.S. Department of Agriculture ("USDA"), we and PLS have agreed that PLS will fulfill and purchase such mortgage loans, as PLS is a Ginnie Mae-approved issuer and we are not. This arrangement has enabled us to compete with other correspondent aggregators that purchase both government and conventional mortgage loans. We receive a sourcing fee from PLS ranging from two to three and one-half basis points, generally based on the average number of calendar days that mortgage loans are held by us prior to purchase by PLS, on the unpaid principal balance ("UPB") of each mortgage loan that we sell to PLS.

We have transferred certain correspondent production loans into a private label securitization, and retained a portion of the securities created in the securitization transaction. Our private label securitization is accounted for as a financing arrangement. Sales of securities included in the securitization are treated as issuances of debt.

Credit Sensitive Investments

CRT Agreements

We believe that CRT Agreements and credit risk transfer securities are long-term investments that can produce attractive risk-adjusted returns through our own mortgage production while aligning with Fannie Mae's strategic goal to attract private capital investment in credit risk of the government–sponsored entities ("GSEs"). We believe there is significant potential for investment in front-end credit risk transfer and MSRs that result from our correspondent production activities as we reinvest capital from the liquidation of distressed mortgage loans. During the quarter and six months ended June 30, 2018, we made investments in CRT Agreements totaling $36.1 million and $77.9 million, respectively, and held CRT-related investments (composed of deposits securing CRT Agreements and derivative assets) totaling $770.4 million at June 30, 2018.

During the quarter ended June 30, 2018, we fulfilled our commitments to sell mortgage loans into CRT Agreements. During the quarter ended June 30, 2018, we began selling mortgage loans into mortgage-backed securities that include commitments to purchase credit risk transfer securities that absorb credit losses on such mortgage loans and recognized $4.4 million at fair value related to the firm commitment to purchase the credit risk transfer security.

Distressed Mortgage Assets

We have invested in distressed mortgage loans through direct acquisitions of mortgage loan portfolios from institutions such as banks and mortgage companies. We seek to maximize the fair value of the distressed mortgage loans that we acquire using means that are appropriate for the particular loan, including both proprietary and nonproprietary loan modification programs, special servicing and other initiatives focused on avoiding foreclosure, when possible. When we are unable to effect a cure for a mortgage loan delinquency, our objective is timely acquisition and/or liquidation of the property securing the mortgage loan through the use, in part, of short sales and deed-in-lieu-of-foreclosure programs.

We may elect to hold certain real estate acquired in settlement of loans ("REO") as income-producing properties for extended periods as a means of maximizing our returns on such properties. In addition to individual loan and property resolutions, we consider bulk sale opportunities from our existing distressed portfolio investments. During the quarter and six months ended June 30, 2018, we received proceeds from liquidations, payoffs, paydowns and sales from our portfolio of distressed mortgage loans and REO totaling $41.8 million and $346.7 million, respectively, including loan sales totaling $1.0 million and $259.2 million, respectively, in fair value of distressed mortgage loans.

Other

At June 30, 2018, we held $8.5 million of commercial real estate loans.

Interest Rate Sensitive Investments

Our interest rate sensitive investments include:

- Mortgage servicing rights. During the quarter and six months ended June 30, 2018, we received $65.4 million and $132.0 million, respectively, of MSRs as proceeds from sales of mortgage loans acquired for sale. We held $1,010.5 million of MSRs at fair value at June 30, 2018.
- REIT-eligible mortgage-backed or mortgage-related securities. During the quarter and six months ended June 30, 2018, we purchased MBS at fair value totaling $314.2 million and $814.8 million, respectively. We held MBS with fair values totaling $1.7 billion at June 30, 2018.

• ESS relating to MSRs held by PFSI. During the quarter and six months ended June 30, 2018, we did not purchase any ESS from PFSI. However, pursuant to a recapture agreement with PLS, we received ESS with fair value totaling $580,000 and $1.5 million, respectively, during the quarter and six months ended June 30, 2018. We held ESS with a fair value totaling $229.5 million at June 30, 2018.

Capital Structure

Our board of trustees has authorized a repurchase program under which we may repurchase up to $300 million of our outstanding common shares. During the six months ended June 30, 2018, we repurchased approximately 671,000 common shares at a cost of $10.7 million. All of our repurchases were made during the quarter ended March 31, 2018. We have repurchased a cumulative total of 14.7 million common shares at a cost of $216.6 million under the program. The repurchased common shares were canceled upon settlement of the repurchase transactions and returned to the authorized but unissued share pool.

Taxation

We believe that we qualify to be taxed as a REIT and as such will not be subject to federal income tax on that portion of our income that is distributed to shareholders as long as we meet applicable REIT asset, income and share ownership tests. If we fail to qualify as a REIT, and do not qualify for certain statutory relief provisions, our profits will be subject to income taxes and we may be precluded from qualifying as a REIT for the four tax years following the year we lose our REIT qualification. A portion of our activities, including our correspondent production business, is conducted in our TRS, which is subject to corporate federal and state income taxes. Accordingly, we have made a provision for income taxes with respect to the operations of our TRS. We expect that the effective rate for the provision for income taxes may be volatile in future periods. Our goal is to manage the business to take full advantage of the tax benefits afforded to us as a REIT.

Non-Cash Income

A substantial portion of our net investment income includes non-cash items, including fair value adjustments, recognition of the fair value of assets created and liabilities incurred in mortgage loan sale transactions and the capitalization and amortization of certain assets and liabilities. Because we have elected, or are required by generally accepted accounting principles, to record our financial assets (comprised of MBS, mortgage loans acquired for sale at fair value, mortgage loans at fair value and ESS), our firm commitment to purchase credit risk transfer securities, our MSRs, our derivatives, and our asset-backed financing and interest-only security payable at fair value, a substantial portion of the income or loss we record with respect to such assets and liabilities results from non-cash changes in fair value.

The amounts of non-cash income (loss) items included in net investment income are as follows:

	Quarter ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
	(dollars in thousands)			
Net gain on mortgage loans acquired for sale:				
Receipt of MSRs in mortgage loan sale transactions	$65,408	$65,835	$131,954	$124,523
Fair value of commitment to purchase credit risk transfer securities	4,426	—	4,426	—
Provision for losses relating to representations and warranties provided in mortgage loan sales:				
Pursuant to mortgage loans sales	(516)	(607)	(1,088)	(1,280)
Reduction in liability due to change in estimate	1,140	1,305	2,182	5,881
Change in fair value during the period of financial instruments held at period end:				
IRLCs	98	(8,327)	(1,826)	(3,383)
Mortgage loans acquired for sale	(475)	(5,657)	2,376	2,471
Hedging derivatives	3,782	7,947	2,846	(11,902)
	73,863	60,496	140,870	116,310
Net gain (loss) on investments:				
Mortgage-backed securities	(8,861)	4,027	(31,258)	4,167
Mortgage loans:				
Distressed	(4,846)	(284)	(14,117)	2,517
Held in a variable interest entity	(2,784)	3,855	(8,362)	4,171
ESS	1,520	(5,885)	9,271	(7,255)
CRT Agreements	15,174	27,087	20,529	37,106
Interest-only security payable at fair value	1,111	(5,595)	(1,022)	(7,316)
Asset-backed financing of a VIE	2,960	(3,399)	9,142	(3,423)
	4,274	19,806	(15,817)	29,967
Net mortgage loan servicing fees—MSR valuation adjustments	16,084	(6,185)	68,695	(4,650)
Net interest income—Capitalization of interest pursuant to mortgage loan modifications	2,066	10,814	4,246	20,717
	$96,287	$84,931	$197,994	$162,344
Net investment income	$82,991	$83,959	$158,664	$148,433
Non-cash items as a percentage of net investment	116 %	101 %	125 %	109 %

income

Cash is generated when mortgage loan investments are paid down, paid off or sold, when payments of principal and interest occur on such mortgage loans or when the property securing the mortgage loan has been sold. We receive proceeds on the sale of mortgage loans acquired for sale that include both cash and our estimate of the fair value of MSRs and we recognize a liability for potential losses relating to representations and warranties created in the mortgage loan sales transactions. We receive cash related to MSRs in the form of mortgage loan servicing fees and we pay cash relating to our provision for representations and warranties when we repurchase mortgage loans or settle loss claims from investors. Cash flows relating to hedging instruments are generally produced when the instruments mature or when we effectively cancel the transactions through an offsetting trade. Cash is generated with respect to CRT Agreements through a portion of both the interest payments collected on mortgage loans in the CRT Agreements' reference pools and the deposits securing the agreements that are released as principal on such mortgage loans is repaid.

The following table illustrates the proceeds received during the period from dispositions and paydowns of distressed mortgage loan and REO investments, net gain in fair value that we accumulated over the period during which we owned such investments liquidated during the period, and additional net gain realized upon liquidation of such assets:

	Quarter ended June 30,					
	2018			2017		
	Proceeds	Accumulated gains (losses) (1)	Net gain (loss) on liquidation (2)	Proceeds	Accumulated gains (losses) (1)	Net gain (loss) on liquidation (2)
	(in thousands)					
Mortgage loans	$9,541	$ 843	$ 562	$32,257	$ 3,832	$ 1,385
REO	31,248	(5,497)	2,482	38,386	(4,229)	2,636
	40,789	(4,654)	3,044	70,643	(397)	4,021
Distressed mortgage loan sales	958	(128)	(416)	492	3	(72)
	$41,747	$ (4,782)	$ 2,628	$71,135	$ (394)	