PENNYMAC FINANCIAL SERVICES, INC.
Form 10-Q
November 14, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

Or

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

For the transition period from to

Commission file number: 001-35916

PennyMac Financial Services, Inc.

(Exact name of registrant as specified in its charter)

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

(818) 224-7442

(Registrant s telephone number, including area code)

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

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

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

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

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

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

Class	Outstanding at November 11, 2014
Class A Common Stock, $0.0001 par value	**21,538,012**
Class B Common Stock, $0.0001 par value	**58**

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PENNYMAC FINANCIAL SERVICES, INC.

FORM 10-Q

September 30, 2014

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30, 2014	December 31, 2013
	(in thousands, except share data)	
ASSETS		
Cash	$ 77,251	$ 30,639
Short-term investments at fair value	36,335	142,582
Mortgage loans held for sale at fair value (includes $1,087,425 and $512,350 pledged to secure mortgage loans sold under agreements to repurchase; and $146,798 and $ pledged to secure mortgage loan participation and sale agreement)	1,259,991	531,004
Derivative assets	28,400	21,540
Net servicing advances (includes $5,564 pledged to secure note payable at December 31, 2013)	195,246	154,328
Carried Interest due from Investment Funds	67,035	61,142
Investment in PennyMac Mortgage Investment Trust at fair value	1,607	1,722
Mortgage servicing rights (includes $319,149 and $224,913 mortgage servicing rights at fair value; $350,758 and $258,241 pledged to secure note payable; and $286,020 and $138,723 pledged to secure excess servicing spread financing)	677,413	483,664
Furniture, fixtures, equipment and building improvements, net	11,574	9,837
Capitalized software, net	580	764
Receivable from Investment Funds	2,702	2,915
Receivable from PennyMac Mortgage Investment Trust	21,420	18,636
Deferred tax asset	52,820	63,117
Loans eligible for repurchase	58,145	46,663
Other	48,108	15,922
Total assets	$ 2,538,627	$ 1,584,475
LIABILITIES		
Mortgage loans sold under agreements to repurchase	$ 929,747	$ 471,592
Mortgage loan participation and sale agreement	142,383	
Note payable	154,948	52,154
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	187,368	138,723
Derivative liabilities	4,440	2,462
Accounts payable and accrued expenses	62,712	46,387
Mortgage servicing liabilities at fair value	4,091	
Payable to Investment Funds	35,874	36,937
Payable to PennyMac Mortgage Investment Trust	104,783	81,174
Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement	75,925	71,056
Liability for loans eligible for repurchase	58,145	46,663
Liability for losses under representations and warranties	11,762	8,123
Total liabilities	1,772,178	955,271

Commitments and contingencies				
STOCKHOLDERS EQUITY				
Class A common stock authorized 200,000,000 shares of $0.0001 par value; issued and outstanding, 21,525,644 and 20,812,777 shares, respectively		2		2
Class B common stock authorized 1,000 shares of $0.0001 par value; 58 shares issued and outstanding				
Additional paid-in capital		161,309		153,000
Retained earnings		42,479		14,400
Total stockholders equity attributable to PennyMac Financial Services, Inc. common stockholders		203,790		167,402
Noncontrolling interest in Private National Mortgage Acceptance Company, LLC		562,659		461,802
Total stockholders equity		766,449		629,204
Total liabilities and stockholders equity	$	2,538,627	$	1,584,475

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

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Quarter ended September 30, 2014	Quarter ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
	(in thousands, except per share data)			
Revenue				
Net gains (losses) on mortgage loans held for sale at fair value:				
From non-affiliates	$ 50,276	$ 26,035	$ 128,942	$ 109,146
Mortgage servicing rights and excess servicing spread financing recapture payable to PennyMac Mortgage Investment Trust	(2,143)	(86)	(6,567)	(586)
	48,133	25,949	122,375	108,560
Loan origination fees	11,823	6,280	29,048	18,260
Fulfillment fees from PennyMac Mortgage Investment Trust	15,497	18,327	36,832	68,625
Net loan servicing fees:				
Loan servicing fees				
From non-affiliates	44,647	14,596	124,061	35,397
From PennyMac Mortgage Investment Trust	12,325	10,738	41,096	27,251
From Investment Funds	1,116	1,451	6,754	5,525
Ancillary and other fees	6,620	2,777	16,609	7,700
	64,708	29,562	188,520	75,873
Amortization, impairment and change in fair value of mortgage servicing rights:				
Related to servicing for non-affiliates	(20,339)	(8,134)	(58,271)	(16,334)
Change in fair value of excess servicing spread payable to PennyMac Mortgage Investment Trust	9,539	(29)	24,392	(29)
	(10,800)	(8,163)	(33,879)	(16,363)
Net loan servicing fees	53,908	21,399	154,641	59,510
Management fees:				
From PennyMac Mortgage Investment Trust	9,623	8,539	26,609	23,486
From Investment Funds	1,756	2,001	5,877	5,889
	11,379	10,540	32,486	29,375
Carried Interest from Investment Funds	1,902	2,812	5,893	10,411
Net interest (expense) income:				
Interest income	8,975	5,093	19,337	11,310
Interest expense:				
Payable to non-affiliates	8,136	4,156	17,253	11,686
Payable to PennyMac Mortgage Investment Trust	3,577		9,578	
	11,713	4,156	26,831	11,686
Net interest (expense) income	(2,738)	937	(7,494)	(376)
Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust	8	165	20	(68)
Other	713	785	2,751	1,842
Total net revenue	140,625	87,194	376,552	296,139
Expenses				
Compensation	48,375	35,830	138,232	113,850
Servicing	13,914	1,931	28,698	5,072
Technology	4,350	2,587	10,914	6,203
Professional services	3,290	2,831	8,150	7,901
Loan origination	2,537	2,802	5,952	7,825

Other		5,467		6,296		14,806		14,849
Total expenses		77,933		52,277		206,752		155,700
Income before provision for income taxes		62,692		34,917		169,800		140,439
Provision for income taxes		7,232		3,493		19,385		5,531
Net income		55,460		31,424		150,415		134,908
Less: Net income attributable to noncontrolling interest		44,971		26,227		122,336		126,918
Net income attributable to PennyMac Financial Services, Inc. common stockholders	$	10,489	$	5,197	$	28,079	$	7,990
Earnings per share								
Basic	$	0.49	$	0.29	$	1.33	$	0.50
Diluted	$	0.49	$	0.28	$	1.32	$	0.50
Weighted-average common shares outstanding								
Basic		21,432		17,958		21,149		16,042
Diluted		75,949		75,876		75,918		75,867

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

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

Balance at December 31, 2012	$ 261,750		$	$	$	$	$	$ 261,750
Net income	76,834							76,834
Unit-based compensation expense	238							238
Distributions	(19,623)							(19,623)
Partner capital issuance costs	(3,745)							(3,745)
Exchange of existing partner units to Class A units of Private National Mortgage Acceptance Company, LLC	(315,454)						315,454	
Balance post-reorganization							315,454	315,454
Net income						7,990	50,084	58,074
Stock and unit-based compensation					891		1,265	2,156
Distributions							(3,395)	(3,395)
Issuance of common shares in initial public offering, net of issuance costs		12,778	1		229,999			230,000
Underwriting and offering costs					(13,290)		(196)	(13,486)
Initial recognition of noncontrolling interest					(127,160)		127,160	
Exchange of Class A units of Private National Mortgage Acceptance Company, LLC to Class A stock of PennyMac Financial Services, Inc.		6,110	1		44,886		(44,887)	
Tax effect of exchange of Class A units of Private National Mortgage Acceptance Company, LLC to Class A stock of PennyMac Financial Services, Inc.					1,158			1,158
Balance at September 30, 2013		18,888	2		136,484	7,990	445,485	589,961
Balance at December 31, 2013	$	20,813	$ 2	$	$ 153,000	$ 14,400	$ 461,802	$ 629,204
Net income						28,079	122,336	150,415
Stock and unit-based compensation		32			2,086		5,393	7,479

Distributions					(20,300)	(20,300)
Issuance of common stock in settlement of directors fees	9		147			147
Exchange of Class A units of Private National Mortgage Acceptance Company, LLC to Class A stock of PennyMac Financial Services, Inc.	672		6,572		(6,572)	
Tax effect of exchange of Class A units of Private National Mortgage Acceptance Company, LLC to Class A stock of PennyMac Financial Services, Inc.			(496)			(496)
Balance at September 30, 2014	$ 21,526	$ 2	$ 161,309	$ 42,479	$ 562,659	$ 766,449

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

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine months ended September 30, 2014	2013
	(in thousands)	
Cash flow from operating activities		
Net income	$ 150,415	$ 134,908
Adjustments to reconcile net income to net cash used in operating activities:		
Net gains on mortgage loans held for sale at fair value	(122,375)	(108,560)
Accrual of servicing rebate to Investment Funds	681	535
Amortization, impairment and change in fair value of mortgage servicing rights	33,879	16,363
Carried Interest from Investment Funds	(5,893)	(10,411)
Accrual of interest on excess servicing spread financing	9,578	
Amortization of debt issuance costs and commitment fees relating to financing facilities	4,217	3,714
Change in fair value of investment in common shares of PennyMac Mortgage Investment Trust	115	196
Change in fair value of real estate acquired in settlement of loans		22
Stock and unit-based compensation expense	7,479	2,394
Depreciation and amortization	972	594
Purchase of mortgage loans held for sale from PennyMac Mortgage Investment Trust	(11,947,251)	(12,429,698)
Purchase of mortgage loans from Ginnie Mae securities for modification and subsequent sale	(897,381)	
Originations of mortgage loans held for sale, net	(1,261,747)	(895,405)
Sale and principal payments of mortgage loans held for sale	13,362,317	13,198,471
Sale of mortgage loans held for sale to PennyMac Mortgage Investment Trust	4,955	12,339
Repurchase of loans subject to representations and warranties	(1,757)	
Repurchase of real estate acquired in settlement of loans subject to representations and warranties		(309)
Sale of real estate acquired in settlement of loans subject to representations and warranties		287
Increase in servicing advances	(46,331)	(12,192)
(Increase) decrease in receivable from Investment Funds	(468)	596
Increase in receivable from PennyMac Mortgage Investment Trust	(781)	(1,790)
Increase in other assets	(38,806)	(5,007)
Decrease in deferred tax asset	14,670	
Increase in accounts payable and accrued expenses	16,359	17,060
Decrease in payable to Investment Funds	(1,063)	(371)
Increase in payable to PennyMac Mortgage Investment Trust	23,136	8,158
Net cash used in operating activities	(695,080)	(68,106)
Cash flow from investing activities		
Decrease (increase) in short-term investments	106,247	(74,323)
Purchase of mortgage servicing rights	(113,348)	(5,124)
Sale of mortgage servicing rights	10,916	550
Settlements of derivative financial instruments used for hedging	3,048	
Purchase of furniture, fixtures, equipment and building improvements	(4,006)	(4,719)
Acquisition of capitalized software	(56)	(242)
(Increase) decrease in margin deposits and restricted cash	(1,620)	5,349
Net cash provided by (used in) investing activities	1,181	(78,509)
Cash flow from financing activities		
Sale of loans under agreements to repurchase	12,500,064	12,225,201
Repurchase of loans sold under agreements to repurchase	(12,041,909)	(12,230,851)

Sale of mortgage loan participation certificates		180,062		
Repayment of mortgage loan participation certificates		(37,679)		
Increase in note payable		102,794		3,762
Issuance of excess servicing spread financing to PennyMac Mortgage Investment Trust		82,646		2,828
Repayment of excess servicing spread financing to PennyMac Mortgage Investment Trust		(25,280)		
Issuance of common stock				230,000
Payment of common stock underwriting and offering costs				(13,486)
Payment by noncontrolling interest of common stock issuance costs				(3,745)
Distributions to Private National Mortgage Acceptance Company, LLC partners		(20,187)		(23,019)
Net cash provided by financing activities		740,511		190,690
Net increase in cash		46,612		44,075
Cash at beginning of period		30,639		12,323
Cash at end of period	$	77,251	$	56,398

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

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PENNYMAC FINANCIAL SERVICES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Organization and Basis of Presentation

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

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

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

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

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

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

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

Initial Public Offering and Recapitalization

On May 14, 2013, PFSI completed an initial public offering (IPO) in which it sold approximately 12.8 million shares of its Class A common stock, at a public offering price of $18.00 per share. PFSI received net proceeds of $216.8 million, after deducting underwriting discounts and commissions, from sales of its shares in the IPO. PFSI used these net proceeds to purchase approximately 12.8 million Class A units of PennyMac. PFSI operates and controls all of the business and affairs and consolidates the financial results of PennyMac and its subsidiaries.

The purchase of 12.8 million Class A units of PennyMac has been accounted for as a transfer of interests under common control. Accordingly, the accompanying consolidated financial statements reflect a reclassification of members equity to noncontrolling interests in the Company of $315.5 million. This amount represents the carrying value in the Company of the existing owners of PennyMac on the date of the IPO.

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

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After the completion of the recapitalization and reorganization transactions, PennyMac became a consolidated subsidiary of the Company. Accordingly, PennyMac s consolidated financial statements are the Company s historical financial statements. The historical consolidated financial statements of PennyMac are reflected herein based on the historical ownership interests of the then-existing PennyMac unitholders.

Tax Receivable Agreement

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

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

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

Basis of Presentation

The accompanying consolidated financial statements have been prepared in compliance with accounting principles generally accepted in the United States (U.S. GAAP) as codified in the Financial Accounting Standards Board s (FASB) *Accounting Standards Codification* (Codification) for interim financial information and with the SEC s instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these financial statements and notes do not include all of the information required by U.S. GAAP for complete financial statements. The interim consolidated information should be read together with the Company s Annual Report on Form 10-K for the year ended December 31, 2013. Intercompany accounts and transactions have been eliminated.

The accompanying unaudited consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, income, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year ending December 31, 2014.

Note 2 Concentration of Risk

A substantial portion of the Company s activities relate to the Advised Entities. Fees charged to these entities (generally comprised of management fees, loan servicing fees, Carried Interest and fulfillment fees) totaled 33% and 50% of total net revenues for the quarters ended September 30, 2014 and 2013, respectively, and 35% and 47% for the nine months ended September 30, 2014 and 2013, respectively.

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Note 3 Transactions with Affiliates

Transactions with PMT

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

	Quarter ended September 30, 2014	Quarter ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
	(in thousands)			
Fulfillment fee revenue	$ 15,497	$ 18,327	$ 36,832	$ 68,625
Unpaid principal balance of loans fulfilled for PennyMac Mortgage Investment Trust	$ 3,677,613	$ 3,681,771	$ 8,588,955	$ 12,792,482
Sourcing fees paid	$ 1,384	$ 1,204	$ 3,401	$ 3,563
Fair value of loans purchased from PennyMac Mortgage Investment Trust	$ 4,861,392	$ 4,147,535	$ 11,947,251	$ 12,429,698
Sale of mortgage loans held for sale to PennyMac Mortgage Investment Trust	$ 2,970	$ 7,059	$ 4,955	$ 12,339
MSR recapture recognized	$	$ 86	$ 9	$ 586

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

	Quarter ended September 30, 2014	Quarter ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
	(in thousands)			
Loan servicing fees relating to PMT s:				
Mortgage loans acquired for sale at fair value:				
Base and supplemental	$ 28	$ 62	$ 74	$ 231
Activity-based	35	77	112	260
	63	139	186	491
Distressed mortgage loans:				
Base and supplemental	4,679	4,166	14,620	11,737
Activity-based	4,076	3,414	16,208	7,739
	8,755	7,580	30,828	19,476
MSRs:				
Base and supplemental	3,459	2,911	9,930	7,037
Activity-based	48	108	152	247
	3,507	3,019	10,082	7,284
	$ 12,325	$ 10,738	$ 41,096	$ 27,251

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

[redacted]

Management fees:				
[redacted]				
Performance incentive	3,590	3,435	9,217	9,443
[redacted]				

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

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

	Quarter ended September 30,				Nine months ended September 30,			
	2014		2013		2014		2013	
			(in thousands)					
Issuance of excess servicing spread	$	9,253	$	2,828	$	82,646	$	2,828
Change in fair value of excess servicing spread financing	$	9,539	$	(29)	$	24,392	$	(29)
Interest expense from excess servicing spread financing	$	3,577	$		$	9,578	$	
Excess servicing spread recapture recognized	$	2,143	$		$	6,558	$	

Other Transactions

In connection with the IPO of PMT s common shares on August 4, 2009, the Company entered into an agreement with PMT pursuant to which PMT agreed to reimburse PennyMac for the $2.9 million payment that it made to the underwriters in such offering (the Conditional Reimbursement) if PMT satisfied certain performance measures over a specified period of time. Effective February 1, 2013, the parties amended the terms of the reimbursement agreement to provide for the reimbursement to the Company of the Conditional Reimbursement if PMT is required to pay the Company performance incentive fees under the management agreement at a rate of $10 in reimbursement for every $100 of performance incentive fees earned. The reimbursement of the Conditional Reimbursement is subject to a maximum reimbursement in any particular 12 month period of $1.0 million and the maximum amount that may be reimbursed under the agreement is $2.9 million. The Company received payments from PMT totaling $256,000 and $292,000, respectively, during the quarter and nine months ended September 30, 2014.

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

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

	Quarter ended September 30,				Nine months ended September 30,			
	2014		2013		2014		2013	
			(in thousands)					
Reimbursement of:								
Common overhead incurred by the Company	$	2,912	$	2,552	$	8,181	$	8,359
Expenses incurred on PMT s behalf		122		1,934		671		3,767
	$	3,034	$	4,486	$	8,852	$	12,126
Payments and settlements during the year (1)	$	31,621	$	29,315	$	72,975	$	94,606

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

Amounts due from PMT are summarized below:

	September 30, 2014	December 31, 2013
	(in thousands)	
Management fees	$ 9,623	$ 8,924
Servicing fees	6,942	5,915
Allocated expenses	3,360	2,009
Underwriting fees	1,495	1,788
	$ 21,420	$ 18,636

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The Company also holds an investment in PMT in the form of 75,000 common shares of beneficial interest as of September 30, 2014 and December 31, 2013. The common shares of beneficial interest had fair values of $1.6 million and $1.7 million as of September 30, 2014 and December 31, 2013, respectively.

Of the $104.8 million and $81.2 million payable to PMT, $100.5 million and $75.2 million represent deposits made by PMT to fund servicing advances made by the Company on PMT s behalf as of September 30, 2014 and December 31, 2013, respectively.

Investment Funds

Amounts due from the Investment Funds are summarized below:

	September 30, 2014	December 31, 2013
	(in thousands)	
Carried Interest due from Investment Funds:		
PNMAC Mortgage Opportunity Fund, LLC	$ 40,845	$ 37,702
PNMAC Mortgage Opportunity Fund Investors, LLC	26,190	23,440
	$ 67,035	$ 61,142
Receivable from Investment Funds:		
Management fees	$ 1,755	$ 2,031
Loan servicing fees	545	727
Expense reimbursements	220	21
Loan servicing rebate	182	136
	$ 2,702	$ 2,915

Amounts due to the Investment Funds totaling $35.9 million and $36.9 million represent amounts advanced by the Investment Funds to fund servicing advances made by the Company as of September 30, 2014 and December 31, 2013, respectively.

Exchanged Private National Mortgage Acceptance Company, LLC Unitholders

As discussed in Note 1, *Organization and Basis of Presentation,* the Company entered into a tax receivable agreement with PennyMac s existing unitholders on the date of the IPO that will provide for the payment by PFSI to PennyMac s exchanged unitholders an amount equal to 85% of the amount of the benefits, if any, that PFSI is deemed to realize as a result of (i) increases in tax basis resulting from such unitholders exchanges and (ii) certain other tax benefits related to entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement. Based on the PennyMac unitholder exchanges to date, the Company has recorded a $75.9 million *Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement* and it has not made any payments under such agreement as of September 30, 2014.

Note 4 Earnings Per Share of Common Stock

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

The Company applies the treasury stock method to determine the dilutive weighted average shares of common stock represented by the unvested stock-based compensation awards and the exchangeable PennyMac Class A units. The diluted earnings per share calculation assumes the exchange of these PennyMac Class A units for shares of common stock. Accordingly, earnings attributable to the Company s common stockholders is also adjusted to include the earnings allocated to the PennyMac Class A units after taking into account the income taxes applicable to the shares of common stock assumed to be exchanged.

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

	Quarter ended September 30, 2014	Quarter ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
	(in thousands, except per share data)			
Basic earnings per share of common stock:				
Net income attributable to PennyMac Financial Services, Inc. common stockholders	$ 10,489	$ 5,197	$ 28,079	$ 7,990
Weighted-average shares of common stock outstanding	21,432	17,958	21,149	16,042
Basic earnings per share of common stock	$ 0.49	$ 0.29	$ 1.33	$ 0.50
Diluted earnings per share of common stock:				
Net income	$ 10,489	$ 5,197	$ 28,079	$ 7,990
Effect of net income attributable to noncontrolling interest, net of income taxes	26,620	15,685	72,374	29,595
Diluted net income attributable to common stockholders	$ 37,109	$ 20,882	$ 100,453	$ 37,585
Weighted-average shares of common stock outstanding	21,432	17,958	21,149	16,042
Dilutive shares:				
PennyMac Class A units exchangeable to common stock	53,492	56,524	53,569	58,440
Non-vested PennyMac Class A units issuable under unit-based stock compensation plan and exchangeable to common stock	975	1,364	1,155	1,364
Shares issuable under stock-based compensation plans	50	30	45	21
Diluted weighted-average shares of common stock outstanding	75,949	75,876	75,918	75,867
Diluted earnings per share of common stock	$ 0.49	$ 0.28	$ 1.32	$ 0.50

Note 5 Loan Sales and Servicing Activities

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

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

	Quarter ended September 30, 2014	Quarter ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
	(in thousands)			
Cash flows:				

Sales proceeds	$ 5,345,227	$ 4,515,106	$ 13,367,272	$ 13,210,810
Servicing fees received	$ 30,609	$ 16,403	$ 78,075	$ 38,104
Net servicing advances (recoveries)	$ 6,520	$ (717)	$ 2,182	$ (4,375)
Period end information:				
Unpaid principal balance of loans outstanding at end of period	$ 33,297,161	$ 22,776,613		
Delinquencies:				
30-89 days	$ 662,863	$ 380,070		
90 days or more or in foreclosure or bankruptcy	$ 168,503	$ 247,269		

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The Company s mortgage servicing portfolio is summarized as follows:

		Servicing rights owned		September 30, 2014 Contract servicing and subservicing (in thousands)		Total loans serviced
Investor:						
Non affiliated entities	$	60,865,411	$		$	60,865,411
Affiliated entities				38,000,767		38,000,767
Mortgage loans held for sale		1,217,599				1,217,599
	$	62,083,010	$	38,000,767	$	100,083,777
Amount subserviced for the Company	$	643,612	$	279	$	643,891
Delinquent mortgage loans:						
30 days	$	1,224,346	$	265,802	$	1,490,148
60 days		475,806		124,884		600,690
90 days or more		1,257,724		1,033,379		2,291,103
		2,957,876		1,424,065		4,381,941
Loans pending foreclosure		335,121		1,526,415		1,861,536
	$	3,292,997	$	2,950,480	$	6,243,477
Custodial funds managed by the Company (1)	$	1,325,037	$	476,909	$	1,801,946

		Servicing rights owned		December 31, 2013 Contract servicing and subservicing (in thousands)		Total loans serviced
Investor:						
Non affiliated entities	$	44,969,026	$		$	44,969,026
Affiliated entities				31,632,718		31,632,718
Private investors		969,794		89,361		1,059,155
Mortgage loans held for sale		506,540				506,540
	$	46,445,360	$	31,722,079	$	78,167,439
Amount subserviced for the Company	$	156,347	$	582,610	$	738,957
Delinquent mortgage loans:						
30 days	$	1,304,054	$	263,518	$	1,567,572
60 days		346,912		112,275		459,187
90 days or more		605,555		1,416,498		2,022,053
		2,256,521		1,792,291		4,048,812
Loans pending foreclosure		168,776		1,792,128		1,960,904
	$	2,425,297	$	3,584,419	$	6,009,716
Custodial funds managed by the Company (1)	$	568,161	$	246,587	$	814,748

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

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

State	September 30, 2014	December 31, 2013
	(in thousands)	
California	$ 33,373,669	$ 30,320,616
Texas	6,299,566	4,470,123
Virginia	5,831,547	3,769,683
Florida	4,998,805	3,416,274
Washington	3,658,408	2,760,900
All other states	45,921,782	33,429,843
	$ 100,083,777	$ 78,167,439

Certain of the loans serviced by the Company are subserviced on the Company s behalf by other mortgage loan servicers. Loans are subserviced for the Company on a transitional basis for loans where the Company has obtained the rights to service the loans but servicing of the loans has not yet transferred to the Company s servicing system.

Note 6 Netting of Financial Instruments

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

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Following are summaries of derivative assets and related netting amounts.

Offsetting of Derivative Assets

	September 30, 2014			December 31, 2013		
	Gross amount of recognized assets	Gross amount offset in the balance sheet	Net amount of assets in the balance sheet	Gross amount of recognized assets	Gross amount offset in the balance sheet	Net amount of assets in the balance sheet
	(in thousands)					
Derivatives subject to master netting arrangements:						
MBS put options	$ 625	$	$ 625	$ 665	$	$ 665
MBS call options	227		227	91		91
Forward purchase contracts	5,686		5,686	416		416
Forward sale contracts	1,273		1,273	18,762		18,762
Put options on Eurodollar futures	1,713		1,713			
Call options on Eurodollar futures	1,050		1,050			
Netting		(5,865)	(5,865)		(7,358)	(7,358)
	10,574	(5,865)	4,709	19,934	(7,358)	12,576
Derivatives not subject to master netting arrangements - IRLCs	23,691		23,691	8,964		8,964
	$ 34,265	$ (5,865)	$ 28,400	$ 28,898	$ (7,358)	$ 21,540

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Derivative Assets, Financial Assets, and Collateral Held by Counterparty

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

	September 30, 2014				December 31, 2013			
		Gross amount not offset in the consolidated balance sheet				Gross amount not offset in the consolidated balance sheet		
	Net amount of assets in the balance sheet	Financial instruments	Cash collateral received	Net amount	Net amount of assets in the balance sheet	Financial instruments	Cash collateral received	Net amount
	(in thousands)							
Interest rate lock commitments	$ 23,691	$	$	$ 23,691	$ 8,964	$	$	$ 8,964
RJ O Brien	2,313			2,313				
Bank of America, N.A.	721			721	1,680			1,680
Jefferies & Co.	626			626	627			627
Multi-Bank	207			207				
Morgan Stanley Bank, N.A.	169			169	1,704			1,704
Credit Suisse First Boston Mortgage Capital LLC					2,149			2,149
Daiwa Capital Markets Inc.					1,190			1,190
Others	673			673	5,226			5,226
	$ 28,400	$	$	$ 28,400	$ 21,540	$	$	$ 21,540

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Offsetting of Derivative Liabilities and Financial Liabilities

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

	September 30, 2014			December 31, 2013		
	Gross amount of recognized liabilities	Gross amount offset in the consolidated balance sheet	Net amount of liabilities in the consolidated balance sheet	Gross amount of recognized liabilities	Gross amount offset in the consolidated balance sheet	Net amount of liabilities in the consolidated balance sheet
	(in thousands)					
Derivatives subject to a master netting arrangement:						
Forward purchase contracts	$ 645	$	$ 645	$ 6,542	$	$ 6,542
Forward sale contracts	9,655		9,655	504		504
Netting		(6,915)	(6,915)		(6,787)	(6,787)
	10,300	(6,915)	3,385	7,046	(6,787)	259
Derivatives not subject to a master netting arrangement - IRLCs	1,055		1,055	2,203		2,203
Total derivatives	11,355	(6,915)	4,440	9,249	(6,787)	2,462
Mortgage loans sold under agreements to repurchase	929,747		929,747	471,592		471,592
	$ 941,102	$ (6,915)	$ 934,187	$ 480,841	$ (6,787)	$ 474,054

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Derivative Liabilities, Financial Liabilities, and Collateral Held by Counterparty

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

	September 30, 2014				December 31, 2013			
		Gross amount not offset in the consolidated balance sheet				Gross amount not offset in the consolidated balance sheet		
	Net amount of liabilities in the consolidated balance sheet	Financial instruments	Cash collateral pledged	Net amount	Net amount of liabilities in the consolidated balance sheet	Financial instruments	Cash collateral pledged	Net amount
	(in thousands)							
Interest rate lock commitments	$ 1,055	$	$	$ 1,055	$ 2,203	$	$	$ 2,203
Credit Suisse First Boston Mortgage Capital LLC	564,182	(562,999)		1,183	198,888	(198,888)		
Bank of America, N.A.	224,169	(224,169)			234,511	(234,511)		
Morgan Stanley Bank, N.A.	142,579	(142,579)			38,193	(38,193)		
Deutsche Bank	308			308				
Daiwa Capital Markets Inc.	237			237				
Bank of NY Mellon	236			236				
Fannie Capital Markets	210			210				
Bank of Oklahoma	210			210				
Others	1,001			1,001	259			259
	$ 934,187	$ (929,747)	$	$ 4,440	$ 474,054	$ (471,592)	$	$ 2,462

Note 7 Fair Value

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

Fair Value Accounting Elections

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

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

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Management s risk management efforts in connection with MSRs relating to mortgage loans with initial interest rates of more than 4.5% are aimed at mainly moderating the effects of changes in interest rates on the assets fair values. At times during the quarter and nine months ended September 30, 2014 and the quarter ended September 30, 2013, derivatives were used to hedge the fair value changes of the MSRs.

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:

	September 30, 2014			
	Level 1	**Level 2**	**Level 3**	**Total**
	(in thousands)			
Assets:				
Short-term investments	$ 36,335	$	$	$ 36,335
Mortgage loans held for sale at fair value		973,935	286,056	1,259,991
Derivative assets:				
Interest rate lock commitments			23,691	23,691
MBS put options		625		625
MBS call options		227		227
Forward purchase contracts		5,686		5,686
Forward sales contracts		1,273		1,273
Put options on Eurodollar futures		1,713		1,713
Call options on Eurodollar futures		1,050		1,050
Total derivative assets before netting		10,574	23,691	34,265
Netting (1)				(5,865)
Total derivative assets		10,574	23,691	28,400
Investment in PennyMac Mortgage Investment Trust	1,607			1,607
Mortgage servicing rights at fair value			319,149	319,149
	$ 37,942	$ 984,509	$ 628,896	$ 1,645,482
Liabilities:				
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	$	$	$ 187,368	$ 187,368
Derivative liabilities:				
Interest rate lock commitments			1,055	1,055
Forward purchase contracts		645		645
Forward sales contracts		9,655		9,655
Total derivative liabilities before netting		10,300	1,055	11,355
Netting (1)				(6,915)
Total derivative liabilities		10,300	1,055	4,440
Mortgage servicing liabilities			4,091	4,091
	$	$ 10,300	$ 192,514	$ 195,899

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

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	December 31, 2013			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	$ 142,582	$	$	$ 142,582
Mortgage loans held for sale at fair value		527,071	3,933	531,004
Derivative assets:				
Interest rate lock commitments			8,964	8,964
Forward purchase contracts		416		416
Forward sales contracts		18,762		18,762
MBS put options		665		665
MBS call options		91		91
Total derivative assets before netting		19,934	8,964	28,898
Netting (1)				(7,358)
Total derivative assets		19,934	8,964	21,540
Investment in PennyMac Mortgage Investment Trust	1,722			1,722
Mortgage servicing rights at fair value			224,913	224,913
	$ 144,304	$ 547,005	$ 237,810	$ 921,761
Liabilities:				
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	$	$	$ 138,723	$ 138,723
Derivative liabilities:				
Interest rate lock commitments			2,203	2,203
Forward purchase contracts		6,542		6,542
Forward sales contracts		504		504
Total derivative liabilities before netting		7,046	2,203	9,249
Netting (1)				(6,787)
Total derivative liabilities		7,046	2,203	2,462
	$	$ 7,046	$ 140,926	$ 141,185

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

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As shown above, certain of the Company s mortgage loans held for sale, IRLCs, MSRs at fair value, and ESS financing at fair value are measured using Level 3 inputs. Following is a roll forward of these items for the quarters and nine-month periods ended September 30, 2014 and 2013 where Level 3 significant inputs were used on a recurring basis:

	Quarter ended September 30, 2014 (in thousands)			
	Mortgage loans held for sale	**Net interest rate lock commitments (1)**	**Mortgage servicing rights**	**Total**
Assets:				
Balance, June 30, 2014	$ 254,656	$ 29,750	$ 308,599	$ 593,005
Purchases	217,498		15,704	233,202
Sales	(74,817)			(74,817)
Repayments	(10,659)			(10,659)
Interest rate lock commitments issued, net		30,727		30,727
Mortgage servicing rights resulting from mortgage loan sales			6,381	6,381
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk				
Other factors	1,797	2,289	(11,535)	(7,449)
	1,797	2,289	(11,535)	(7,449)
Transfers to Level 2 mortgage loans held for sale (2)	(102,419)			(102,419)
Transfers of interest rate lock commitments to mortgage loans held for sale		(40,130)		(40,130)
Balance, September 30, 2014	$ 286,056	$ 22,636	$ 319,149	$ 627,841
Changes in fair value recognized during the period relating to assets still held at September 30, 2014	$ 1,797	$ 22,636	$ (11,535)	

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

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

	Quarter ended September 30, 2014 (in thousands)		
	Excess servicing spread financing	**Mortgage servicing liabilities**	**Total**
Liabilities:			
Balance, June 30, 2014	$ 190,244	$ 5,821	$ 196,065
Proceeds received from excess servicing spread financing	9,253		9,253
ESS issued pursuant to a recapture agreement with PennyMac Mortgage Investment Trust	2,619		2,619
Accrual of interest	3,577		3,577
Repayments	(8,786)		(8,786)
Changes in fair value included in income	(9,539)	(1,730)	(11,269)
Balance, September 30, 2014	$ 187,368	$ 4,091	$ 191,459

Changes in fair value recognized during the period relating to liabilities still held at September 30, 2014	$	(9,539)	$	(1,730)

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

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

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

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	Nine months ended September 30, 2014			
	Mortgage loans held for sale	Net interest rate lock commitments (1)	Mortgage servicing rights	Total
		(in thousands)		
Assets:				
Balance, December 31, 2013	$ 3,933	$ 6,761	$ 224,913	$ 235,607
Purchases	897,381		113,348	1,010,729
Sales	(435,437)		(10,916)	(446,353)
Repayments	(16,778)			(16,778)
Interest rate lock commitments issued, net		113,559		113,559
Mortgage servicing rights resulting from mortgage loan sales			20,647	20,647
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk				
Other factors	(84)	21,768	(28,843)	(7,159)
	(84)	21,768	(28,843)	(7,159)
Transfers to Level 2 mortgage loans held for sale (2)	(162,959)			(162,959)
Transfers of interest rate lock commitments to mortgage loans held for sale		(119,452)		(119,452)
Balance, September 30, 2014	$ 286,056	$ 22,636	$ 319,149	$ 627,841
Changes in fair value recognized during the period relating to assets still held at September 30, 2014	$ (84)	$ 22,636	$ (28,878)	

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

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

	Nine months ended September 30, 2014		
	Excess servicing spread financing	Mortgage servicing liabilities	Total
		(in thousands)	
Liabilities:			
Balance, December 31, 2013	$ 138,723	$	$ 138,723
Proceeds received from excess servicing spread financing	82,646		82,646
Pursuant to a recapture agreement with PennyMac Mortgage Investment Trust	6,093		6,093
Accrual of interest on excess servicing spread financing	9,578		9,578
Repayments	(25,280)		(25,280)
Changes in fair value included in income	(24,392)	4,091	(20,301)
Balance, September 30, 2014	$ 187,368	$ 4,091	$ 191,459
Changes in fair value recognized during the period relating to liabilities still held at September 30, 2014	$ (24,393)	$ 4,091	

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

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

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

The Company had no transfers in or out among the levels other than transfers of IRLCs to mortgage loans held for sale at fair value upon purchase or funding of the respective mortgage loans.

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

	Quarter ended September 30, 2014 Net gains on mortgage loans held for sale at fair value	2014 Net servicing fees	2014 Total	2013 Net gains on mortgage loans held for sale at fair value	2013 Net servicing fees	2013 Total
			(in thousands)			
Assets:						
Mortgage loans held for sale at fair value	$ 63,076	$	$ 63,076	$ (6,060)	$	$ (6,060)
Mortgage servicing rights at fair value		(11,535)	(11,535)		(1,575)	(1,575)
	$ 63,076	$ (11,535)	$ 51,541	$ (6,060)	$ (1,575)	$ (7,635)
Liabilities:						
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	$	$ 9,539	$ 9,539	$	$ (29)	$ (29)
Mortgage servicing liabilities		1,730	1,730			
	$	$ 11,269	$ 11,269	$	$ (29)	$ (29)

	Nine months ended September 30, 2014 Net gains on mortgage loans held for sale at fair value	2014 Net servicing fees	2014 Total	2013 Net gains on mortgage loans held for sale at fair value	2013 Net servicing fees	2013 Total
			(in thousands)			
Assets:						
Mortgage loans held for sale at fair value	$ 180,971	$	$ 180,971	$ 12,428	$	$ 12,428
Mortgage servicing rights at fair value		(34,255)	(34,255)		(1,781)	(1,781)
	$ 180,971	$ (34,255)	$ 146,716	$ 12,428	$ (1,781)	$ 10,647
Liabilities:						
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	$	$ 24,392	$ 24,392	$	$ (29)	$ (29)
Mortgage servicing liabilities		(4,091)	(4,091)			
	$	$ 20,301	$ 20,301	$	$ (29)	$ (29)

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

	September 30, 2014		
	Fair value	Principal amount due upon maturity	Difference
		(in thousands)	
Mortgage loans held for sale:			
Current through 89 days delinquent	$ 987,985	$ 935,173	$ 52,812
90 days or more delinquent:			
Not in foreclosure	188,908	190,910	(2,002)
In foreclosure	83,098	83,313	(215)
	$ 1,259,991	$ 1,209,396	$ 50,595

	December 31, 2013		
	Fair value	Principal amount due upon maturity	Difference
		(in thousands)	
Mortgage loans held for sale:			
Current through 89 days delinquent	$ 524,665	$ 504,705	$ 19,960
90 days or more delinquent:			
Not in foreclosure	5,567	5,479	88
In foreclosure	772	660	112
	$ 531,004	$ 510,844	$ 20,160

Financial Statement Items Measured at Fair Value on a Nonrecurring Basis

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

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
		(in thousands)		
Mortgage servicing rights at lower of amortized cost or fair value	$	$	$ 240,403	$ 240,403
	$	$	$ 240,403	$ 240,403

	December 31, 2013			
	Level 1	Level 2	Level 3	Total
		(in thousands)		
Mortgage servicing rights at lower of amortized cost or fair value	$	$	$ 136,690	$ 136,690
	$	$	$ 136,690	$ 136,690

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

	Quarter ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(in thousands)			
Mortgage servicing rights at lower of amortized cost or fair value	$ (925)	$ (1,164)	$ (5,132)	$ (521)
	$ (925)	$ (1,164)	$ (5,132)	$ (521)

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Fair Value of Financial Instruments Carried at Amortized Cost

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

Cash is measured using a Level 1 input. The Company s borrowings carried at amortized cost do not have observable inputs and the fair value is measured using management s estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation. The Company has classified these financial instruments as Level 3 financial statement items as of September 30, 2014 and December 31, 2013 due to the lack of observable inputs to estimate the fair value.

Management has concluded that the carrying value of the *Carried Interest due from Investment Funds* approximates its fair value as the balance represents the amount distributable to the Company at the balance sheet date assuming liquidation of the Investment Funds. Management has concluded that the fair value of the *Note payable* approximates the agreements carrying value due to the agreement s short term and variable interest rate. The Company has classified these financial instruments as Level 3 financial statement items due to the Company s reliance on unobservable inputs to estimate these instruments fair value.

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

Valuation Techniques and Assumptions

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

Due to the difficulty in estimating the fair values of Level 3 financial statement items, management has assigned the estimating of fair value of these assets to specialized staff and subjects the valuation process to significant executive management oversight. The Company s Financial Analysis and Valuation group (the FAV group), which is responsible for valuing and monitoring the Company s investment portfolios and maintenance of its valuation policies and procedures, estimates the fair values of Level 3 financial instruments and MSRs.

The FAV group reports to the Company s senior management valuation committee, which oversees and approves the valuations. The FAV group monitors the models used for valuation of the Company s Level 3 financial statement items, including the models performance versus actual results, and reports those results to the Company s senior management valuation committee. The Company s senior management valuation committee includes PFSI s chief executive, financial, operating, credit and asset/liability management officers.

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

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

Mortgage Loans Held for Sale

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

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

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

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

Key inputs	**September 30, 2014**	**December 31, 2013**
Discount rate		
Range	2.2% - 7.8%	7.8% - 13.4%
Weighted average	2.3%	8.9%
Twelve-month projected housing price index change		
Range	0.2% - 8.2%	4.5% - 4.7%
Weighted average	4.5%	4.6%
Prepayment/resale speed (1)		
Range	7.6% - 14.8%	1.6% - 5.1%
Weighted average	14.7%	4.4%
Total prepayment speed (2)		
Range	7.6% - 36.8%	2.9% - 5.2%
Weighted average	35.2%	4.7%

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

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

Changes in fair value attributable to changes in instrument specific credit risk are measured by the change in the respective loan s delinquency status at period end from the later of the beginning of the period or acquisition date. Changes in fair value of mortgage loans held for sale are included in *Net gains on mortgage loans held for sale at fair value* in the consolidated statements of income.

Derivative Financial Instruments

The Company categorizes IRLCs as a Level 3 financial statement item. The Company estimates the fair value of an IRLC based on quoted Agency mortgage-backed securities (MBS) prices, its estimate of the fair value of the MSRs it expects to receive in the sale of the loans and the probability that the mortgage loan will fund or be purchased (the pull-through rate).

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

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

Key inputs	**September 30, 2014**	**December 31, 2013**
Pull-through rate		
Range	61.2% - 99.0%	62.1% - 98.1%
Weighted average	79.7%	81.7%
Mortgage servicing rights value expressed as:		
Servicing fee multiple		
Range	1.7 - 5.0	2.0 - 5.0
Weighted average	3.8	3.7
Percentage of unpaid principal balance		
Range	0.4% - 2.5%	0.4% - 2.4%
Weighted average	1.2%	0.9%

The remaining derivative financial instruments held or issued by the Company are categorized as Level 2 financial statement items. The Company estimates the fair value of commitments to sell and purchase loans based on quoted MBS prices. The Company estimates the fair value of MBS options based on observed interest rate volatilities in the MBS market. Changes in fair value of IRLCs and related hedging derivatives are included in *Net gains on mortgage loans held for sale at fair value* in the consolidated statements of income.

Mortgage Servicing Rights

MSRs are categorized as Level 3 financial statement items. The Company uses a discounted cash flow approach to estimate the fair value of MSRs. This approach consists of projecting net servicing cash flows discounted at a rate that management believes market participants would use in their determinations of fair value. The key inputs used in the estimation of the fair value of MSRs include prepayment rates of the underlying loans, the applicable discount rate or pricing spread, and the per-loan annual cost to service the respective mortgage loans. Changes in the fair value of MSRs are included in *Net servicing fees Amortization, impairment and change in estimated fair value of mortgage servicing rights* in the consolidated statements of income.

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

	Quarter ended September 30,			
	2014		2013	
	Fair value	Amortized cost	Fair value	Amortized cost
	(Amount recognized and unpaid princiapl balance of underlying mortgage loans in thousands)			
MSR and pool characteristics:				
Amount recognized	$6,381	$54,819	$4,157	$55,981
Unpaid principal balance of underlying mortgage loans	$515,866	$4,498,619	$315,869	$4,120,962
Weighted-average servicing fee rate (in basis points)	34	31	31	30
Inputs:				
Pricing spread (1)				
Range	8.0% - 15.4%	7.5% - 15.2%	7.4% - 13.1%	5.4% - 15.9%
Weighted average	11.6%	10.9%	9.9%	8.2%
Annual total prepayment speed (2)				
Range	7.6% - 42.3%	7.6% - 47.8%	8.8% - 17.2%	8.5% - 14.7%
Weighted average	9.7%	8.3%	9.2%	8.8%
Life (in years)				
Range	1.6 7.3	1.4 7.3	3.6 7.0	2.9 6.9
Weighted average	6.7	7.1	6.9	6.7
Per-loan annual cost of servicing				
Range	$54 $93	$54 $93	$68 $120	$68 $120
Weighted average	$83	$85	$101	$104

(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 Offering Rate (LIBOR) curve for purposes of discounting cash flows relating to MSRs acquired as proceeds from the sale of mortgage loans.

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

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	Nine months ended September 30,			
	2014		2013	
	Fair value	Amortized cost	Fair value	Amortized cost
	(Amount recognized and unpaid principal balance of underlying mortgage loans in thousands)			
MSR and pool characteristics:				
Amount recognized	$20,647	$127,727	$4,177	$150,175
Unpaid principal balance of underlying mortgage loans	$1,627,529	$10,672,629	$318,066	$12,350,104
Weighted-average servicing fee rate (in basis points)	33	31	31	29
Inputs:				
Pricing spread (1)				
Range	8.0% - 16.2%	6.8% - 15.2%	7.4% - 13.1%	5.4% - 15.9%
Weighted average	11.4%	10.8%	9.9%	8.2%
Annual total prepayment speed (2)				
Range	7.6% - 42.3%	7.6% - 47.8%	8.8% - 17.2%	8.5% - 18.5%
Weighted average	9.0%	8.2%	9.2%	8.8%
Life (in years)				
Range	1.6 7.5	1.4 7.5	3.6 7.0	2.9 6.9
Weighted average	7.0	7.1	6.9	6.7
Per-loan annual cost of servicing				
Range	$53 $100	$53 $100	$68 $120	$68 $120
Weighted average	$89	$90	$101	$102

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

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

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

Purchased MSRs Backed by Distressed Mortgage Loans

During the quarter ended June 30, 2014, the Company sold a portfolio of purchased MSRs backed by distressed mortgage loans to a non-affiliated entity. Following are the key inputs used in determining the fair value of such MSRs as of December 31, 2013:

	December 31, 2013	
	Fair value	**Amortized cost**
	(Carrying value, unpaid principal balance of underlying mortgage loans and effect on fair value amounts in thousands)	
MSR and pool characteristics:		
Carrying value	$10,129	
Unpaid principal balance of underlying mortgage loans	$969,794	
Weighted-average note interest rate	5.80%	
Weighted-average servicing fee rate (in basis points)	50	
Inputs:		
Discount rate		
Range	15.3% 15.3%	
Weighted average	15.3%	
Effect on fair value of:		
5% adverse change	$(251)	
10% adverse change	$(490)	
20% adverse change	$(937)	
Life (in years)		
Range	5.0 - 5.0	
Weighted average	5.0	
Prepayment speed (1)		
Range	11.4% 11.4%	
Weighted average	11.4%	
Effect on fair value of:		
5% adverse change	$(231)	
10% adverse change	$(456)	
20% adverse change	$(898)	
Per-loan annual cost of servicing		
Range	$218 $218	
Weighted average	$218	
Effect on fair value of:		
5% adverse change	$(197)	
10% adverse change	$(393)	
20% adverse change	$(787)	

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

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All Other MSRs

	September 30, 2014		December 31, 2013	
	Fair value	Amortized cost	Fair value	Amortized cost
	(Carrying value, unpaid principal balance of underlying mortgage loans and effect on fair value amounts in thousands)			
MSR and pool characteristics:				
Carrying value	$319,149	$358,264	$214,784	$258,751
Unpaid principal balance of underlying mortgage loans	$30,200,789	$30,664,622	$22,469,179	$22,499,847
Weighted-average note interest rate	4.27%	3.80%	4.48%	3.65%
Weighted-average servicing fee rate (in basis points)	31	29	32	29
Inputs:				
Pricing spread (1)				
Range	2.9% 20.1%	6.3% 15.4%	2.9% 18.0%	6.3% 14.5%
Weighted average	9.0%	10.0%	7.5%	8.7%
Effect on fair value of:				
5% adverse change	$(5,523)	$(8,137)	$(3,551)	$(5,312)
10% adverse change	$(10,850)	$(15,943)	$(6,900)	$(10,395)
20% adverse change	$(20,961)	$(30,637)	$(13,305)	$(20,039)
Average life (in years)				
Range	0.4 8.2	1.5 7.3	0.1 14.4	1.5 7.3
Weighted average	5.9	6.8	6.2	7.0
Prepayment speed (2)				
Range	7.6% 57.6%	7.6% 45.2%	7.8% 50.8%	7.6% 42.5%
Weighted average	10.7%	8.4%	9.7%	8.0%
Effect on fair value of:				
5% adverse change	$(6,911)	$(6,313)	$(4,622)	$(4,615)
10% adverse change	$(13,564)	$(12,441)	$(9,073)	$(9,097)
20% adverse change	$(26,151)	$(24,173)	$(17,500)	$(17,684)
Per-loan annual cost of servicing				
Range	$62 $115	$62 $79	$68 $115	$68 $100
Weighted average	$81	$78	$87	$99
Effect on fair value of:				
5% adverse change	$(3,041)	$(2,706)	$(2,817)	$(2,609)
10% adverse change	$(6,082)	$(5,411)	$(5,633)	$(5,217)
20% adverse change	$(12,165)	$(10,822)	$(11,266)	$(10,434)

(1) Pricing spread represents a margin that is applied to a reference interest rate s forward curve to develop periodic discount rates. The Company applies a pricing spread to the United States Dollar LIBOR curve for purposes of discounting cash flows relating to MSRs acquired as proceeds from the sale of mortgage loans and purchased MSRs not backed by pools of distressed mortgage loans.

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

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

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Excess Servicing Spread Financing at Fair Value

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

ESS is generally subject to fair value increases when mortgage interest rates increase. Increasing mortgage interest rates normally slow mortgage refinancing activity. Decreased refinancing activity increases the life of the loans underlying the ESS, thereby increasing ESS financing s fair value and the liability owed to PMT. Increases in the fair value of ESS financing increase *Amortization, impairment and change in estimated fair value of mortgage servicing rights*.

Interest expense for ESS financing is accrued using the interest method based upon the expected cash flows from the ESS through the expected life of the underlying mortgage loans. Other changes in fair value are recorded in *Amortization, impairment and change in estimated fair value of mortgage servicing rights*.

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

Key inputs	**September 30, 2014**	**December 31, 2013**
Unpaid principal balance of underlying loans (in thousands)	$27,702,102	$20,512,659
Average servicing fee rate (in basis points)	31	32
Average excess servicing spread (in basis points)	16	16
Pricing spread (1)		
Range	1.7% - 11.8%	2.8% - 14.4%
Weighted average	5.0%	5.4%
Average life (in years)		
Range	0.4 - 7.3	0.9 - 8.0
Weighted average	5.8	6.1
Annualized prepayment speed (2)		
Range	7.6% - 72.4%	7.7% - 48.6%
Weighted average	10.8%	9.7%

(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 LIBOR curve for purposes of discounting cash flows relating to ESS.

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

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Note 8 Mortgage Loans Held for Sale at Fair Value

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

	September 30, 2014	December 31, 2013
	(in thousands)	
Government-insured or guaranteed	$ 895,952	$ 482,066
Conventional conforming	76,119	45,005
Jumbo	1,864	
Mortgage loans purchased from Ginnie Mae pools serviced by the Company	282,572	
Mortgage loans repurchased pursuant to representations and warranties	3,484	3,933
	$ 1,259,991	$ 531,004
Fair value of mortgage loans pledged to secure mortgage loans sold under agreements to repurchase	$ 1,087,425	$ 512,350
Fair value of mortgage loans pledged to secure mortgage loan participation and sale agreement	$ 146,798	$

Note 9 Derivative Financial Instruments

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

The Company engages in interest rate risk management activities in an effort to reduce the variability of earnings caused by changes in market interest rates. To manage this fair value risk resulting from interest rate risk, the Company uses derivative financial instruments acquired with the intention of reducing the risk that changes in market interest rates will result in unfavorable changes in the fair value of the Company s IRLCs, inventory of mortgage loans held for sale and MSRs.

The Company does not use derivative financial instruments for purposes other than in support of its risk management activities other than IRLCs, which are generated in the normal course of business when the Company commits to purchase or originate mortgage loans held for sale. The Company records all derivative financial instruments at fair value and records changes in fair value in current period income.

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

	September 30, 2014			December 31, 2013		
		Fair value			Fair value	
Instrument	Notional amount	Derivative assets	Derivative liabilities	Notional amount	Derivative assets	Derivative liabilities
			(in thousands)			
Derivatives not designated as hedging instruments						
Free-standing derivatives:						
Interest rate lock commitments	1,740,376	$ 23,691	$ 1,055	971,783	$ 8,964	$ 2,203
Forward purchase contracts	2,804,597	5,686	645	1,418,527	416	6,542
Forward sales contracts	4,299,329	1,273	9,655	2,659,000	18,762	504
MBS put options	430,000	625		185,000	665	
MBS call options	50,000	227		105,000	91	
Put options on Eurodollar futures	795,000	1,713				
Call options on Eurodollar futures	450,000	1,050				
Total derivatives before netting		34,265	11,355		28,898	9,249
Netting		(5,865)	(6,915)		(7,358)	(6,787)
		$ 28,400	$ 4,440		$ 21,540	$ 2,462

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

	Quarter ended September 30, 2014			
Period/Instrument	Balance beginning of period	Additions	Dispositions/ expirations	Balance end of period
		(in thousands)		
Forward purchase contracts	2,789,277	12,668,171	(12,652,851)	2,804,597
Forward sales contracts	4,617,100	17,409,056	(17,726,827)	4,299,329
MBS put options	225,000	505,000	(300,000)	430,000
MBS call options	95,000	50,000	(95,000)	50,000
Put options on Eurodollar futures	377,500	1,320,000	(902,500)	795,000
Call options on Eurodollar futures	170,000	675,000	(395,000)	450,000
Treasury future purchase contracts		65,600	(65,600)	
Treasury future sale contracts		78,200	(78,200)	
Call options on futures		35,000	(35,000)	

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

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	Nine months ended September 30, 2014			
Period/Instrument	**Balance beginning of period**	**Additions**	**Dispositions/ expirations**	**Balance end of period**
	(in thousands)			
Forward purchase contracts	1,418,527	30,178,842	(28,792,772)	2,804,597
Forward sales contracts	2,659,000	43,791,245	(42,150,916)	4,299,329
MBS put options	185,000	1,145,000	(900,000)	430,000
MBS call options	105,000	590,000	(645,000)	50,000
Put options on Eurodollar futures		2,022,500	(1,227,500)	795,000
Call options on Eurodollar futures		1,055,000	(605,000)	450,000
Treasury future purchase contracts		143,900	(143,900)	
Treasury future sale contracts		165,600	(165,600)	
Call options on futures		35,000	(35,000)	

	Nine months ended September 30, 2013			
Period/Instrument	**Balance beginning of period**	**Additions**	**Dispositions/ expirations**	**Balance end of period**
	(in thousands)			
Forward purchase contracts	1,021,981	35,012,198	(34,453,745)	1,580,434
Forward sales contracts	2,621,948	51,199,986	(50,735,045)	3,086,889
MBS put options	500,000	2,210,000	(2,710,000)	
MBS call options		2,100,000	(2,100,000)	

The Company recorded net losses on derivative financial instruments used to hedge IRLCs and mortgage loans held for sale at fair value totaling $5.2 million and $64.0 million for the quarter and nine months ended September 30, 2014, respectively. The Company recorded net losses on derivative financial instruments totaling $4.6 million and net gains on derivative financial instruments totaling $101.9 million for the quarter and nine months ended September 30, 2013, respectively. Derivative gains and losses used to hedge IRLCs and mortgage loans held for sale at fair value are included in *Net gains on mortgage loans held for sale at fair value* in the Company s consolidated statements of income.

The Company recorded net losses on derivatives used to hedge fair value changes of MSRs totaling $897,000 and net gains on derivatives used to hedge fair value changes of MSRs totaling $8.3 million for the quarter and nine months ended September 30, 2014, respectively. The Company did not record any net gains or losses on derivatives used to hedge fair value changes of MSRs for the quarter ended September 30, 2013. The Company recorded net losses on derivatives used to hedge fair value changes of MSRs totaling $1.3 million for the nine months ended September 30, 2013. Gains and losses on derivative financial instruments used to hedge fair value changes of MSRs are included in *Amortization, impairment and change in estimated fair value of mortgage servicing rights* in the Company s consolidated statements of income.

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Note 10 Mortgage Servicing Assets and Liabilities

MSRs Carried at Fair Value:

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

	Quarter ended September 30, 2014	Quarter ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
	(in thousands)			
Balance at beginning of period	$ 308,599	$ 23,070	$ 224,913	$ 19,798
Additions:				
Purchases	15,704	1,116	113,348	5,124
Mortgage servicing rights resulting from mortgage loan sales	6,381	4,157	20,647	4,177
	22,085	5,273	133,995	9,301
Sales			(10,916)	(550)
Change in fair value due to:				
Changes in valuation inputs or assumptions used in valuation model (1)	(544)	(635)	(989)	1,233
Other changes in fair value (2)	(10,991)	(940)	(27,854)	(3,014)
Total change in fair value	(11,535)	(1,575)	(28,843)	(1,781)
Balance at end of period	$ 319,149	$ 26,768	$ 319,149	$ 26,768

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

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

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MSRs Carried at Lower of Amortized Cost or Fair Value:

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

	Quarter ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(in thousands)			
Amortized cost:				
Balance at beginning of period	$ 321,911	$ 179,003	$ 263,373	$ 92,155
Mortgage servicing rights resulting from mortgage loan sales	54,819	55,981	127,727	150,175
Amortization	(8,712)	(5,367)	(23,082)	(12,713)
Application of valuation allowance to write down mortgage servicing rights with other-than- temporary impairment				
Balance at end of period	368,018	229,617	368,018	229,617
Valuation allowance:				
Balance at beginning of period	(8,829)	(2,335)	(4,622)	(2,978)
Additions	(925)	(1,192)	(5,132)	(549)
Application of valuation allowance to write down mortgage servicing rights with other-than- temporary impairment				
Balance at end of period	(9,754)	(3,527)	(9,754)	(3,527)
Mortgage servicing rights, net	$ 358,264	$ 226,090	$ 358,264	$ 226,090
Fair value of mortgage servicing rights at end of period	$ 368,270	$ 239,326		

The following table summarizes the Company s estimate of future amortization of its existing MSRs. This projection was developed using the assumptions made by management in its September 30, 2014 valuation of MSRs. The assumptions underlying the following estimate will change as market conditions and portfolio composition and behavior change, causing both actual and projected amortization levels to change over time.

Twelve-month period ending September 30,	Estimated MSR amortization (in thousands)
2015	$ 34,263
2016	34,574
2017	33,591
2018	31,574
2019	28,848
Thereafter	205,168
	$ 368,018

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

	Quarter ended September 30, 2014	2013	Nine months ended September 30, 2014	2013
	(in thousands)			
Contractual servicing fees	$ 44,647	$ 14,596	$ 124,061	$ 35,397
Ancillary and other fees				
Late charges	1,171	527	3,021	1,336
Other	361	140	785	374
	$ 46,179	$ 15,263	$ 127,867	$ 37,107

Mortgage Servicing Liability Carried at Fair Value:

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

	Quarter ended	Nine months ended
	September 30, 2014 (in thousands)	
Amortized cost:		
Balance at beginning of period	$ 5,821	$
Additions		
Change in fair value	(1,730)	4,091
Balance at end of period	$ 4,091	$ 4,091

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

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

Note 11 Carried Interest Due from Investment Funds

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

	Quarter ended September 30, 2014	2013	Nine months ended September 30, 2014	2013
	(in thousands)			
Balance at beginning of period	$ 65,133	$ 55,322	$ 61,142	$ 47,723
Carried Interest recognized during the period	1,902	2,812	5,893	10,411

Proceeds received during the period				
Balance at end of period	$ 67,035	$ 58,134	$ 67,035	$ 58,134

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

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

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Note 12 Investment in PennyMac Mortgage Investment Trust at Fair Value

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

	Quarter ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(in thousands)			
Dividends	$ 46	$ 43	$ 135	$ 128
Change in fair value	(38)	122	(115)	(196)
	$ 8	$ 165	$ 20	$ (68)
Fair value of PennyMac Mortgage Investment Trust shares at period end	$ 1,607	$ 1,701		

Note 13 Borrowings

As of September 30, 2014, the Company maintained six borrowing facilities: four facilities that provide funding for sales of mortgage loans under agreements to repurchase; one facility that provides for sales of mortgage loan participation certificates; and one note payable secured by MSRs and servicing advances made relating to certain loans in the Company s loan servicing portfolio.

Mortgage Loans Sold Under Agreement to Repurchase

The borrowing facilities secured by mortgage loans held for sale are in the form of loan sale and repurchase agreements. Eligible loans are sold at advance rates based on the loan type. Interest is charged at a rate based on the buyer s overnight cost of funds rate for one agreement and on LIBOR for the other three agreements. Loans financed under these agreements may be re-pledged by the lenders.

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

	Quarter ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(in thousands)			
Period end:				
Balance	$ 929,747	$ 387,883		
Unused amount (1)	$ 570,253	$ 612,117		
Weighted average interest rate	1.73%	1.82%		
Fair value of mortgage loans securing agreements to repurchase	$ 1,087,425	$ 522,031		
During the period:				

Average balance of mortgage loans sold under agreements to repurchase	$	691,730	$	373,386	$	505,072	$	354,125
Weighted average interest rate (2)		1.83%		1.89%		1.82%		2.02%
Total interest expense	$	4,495	$	2,920	$	10,506	$	8,251
Maximum daily amount outstanding	$	1,010,146	$	588,494	$	1,010,146	$	623,523

(1) The amount the Company is able to borrow under loan repurchase agreements is tied to the fair value of unencumbered mortgage loans eligible to secure those agreements and the Company s ability to fund the agreements margin requirements relating to the mortgage loans sold.

(2) Excludes the effect of amortization of commitment fees totaling $1.3 million and $1.1 million for the quarters ended September 30, 2014 and 2013, respectively, and $3.5 million and $2.8 million for the nine-month periods ended September 30, 2014 and 2013, respectively.

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

Remaining maturity at September 30, 2014		**Balance (in thousands)**
Within 30 days	$	6,479
Over 30 to 90 days		922,683
Over 90 days		585
	$	929,747
Weighted average maturity (in months)		1.8

The amount at risk (the fair value of the assets pledged plus the related margin deposit, less the amount advanced by the counterparty and accrued interest) relating to the Company s mortgage loans held for sale sold under agreements to repurchase is summarized by counterparty below as of September 30, 2014:

Counterparty		**Amount at risk (in thousands)**	**Weighted average maturity of advances under repurchase agreement**	**Facility maturity**
Credit Suisse First Boston Mortgage Capital LLC	$	105,334		October 31, 2014
Bank of America, N.A.	$	41,811	December 21, 2014	January 30, 2015
Morgan Stanley	$	11,080	November 19, 2014	June 29, 2015
Citibank, N.A.	$			September 7, 2015

The Company is subject to margin calls during the period the agreements are outstanding and therefore may be required to repay a portion of the borrowings before the respective agreements mature if the fair value (as determined by the applicable lender) of the mortgage loans securing those agreements decreases. The Company had $1.5 million on deposit with its mortgage loan repurchase agreement counterparties at September 30, 2014 and December 31, 2013. Such amounts are included in *Other assets* on the consolidated balance sheets.

Mortgage Loan Participation and Sale Agreement

The mortgage loan participation and sale agreement is summarized below:

		September 30, 2014		**December 31, 2013**
		(in thousands)		
Mortgage loan participation and sale agreement secured by mortgage loans	$	142,383	$	
Mortgage loans pledged to secure mortgage loan participation and sale agreement	$	146,798	$	

One of the borrowing facilities secured by mortgage loans held for sale is in the form of a mortgage loan participation and sale agreement. Participation certificates, each of which represents an undivided beneficial ownership interest in a pool of mortgage loans that have been pooled with Fannie Mae, Freddie Mac or Ginnie Mae, are sold to the lender pending the securitization and sale of the resulting securities. A commitment to sell the securities resulting from the pending securitization between the Company and a non-affiliate is also assigned to the lender at the time a participation certificate is sold.

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

Note Payable

The note payable is summarized below:

	September 30, 2014	December 31, 2013
	(in thousands)	
Note payable secured by:		
Mortgage servicing rights	$ 154,948	$ 48,302
Servicing advances		3,852
	$ 154,948	$ 52,154
Assets pledged to secure note payable:		
Mortgage servicing rights	$ 350,758	$ 258,241
Servicing advances	$	$ 5,564

The note payable matured on October 31, 2014. Interest is charged at a rate based on the lender s overnight cost of funds. The note payable is secured by servicing advances and MSRs relating to certain loans in the Company s servicing portfolio, and currently provides for advance rates ranging from 50% to 85% of the amount of the servicing advances or the carrying value of the MSR pledged.

The borrowing facilities contain various covenants, including financial covenants governing the Company s net worth, debt to equity ratio, profitability and liquidity. Management believes that the Company was in compliance with these requirements as of September 30, 2014.

Excess Servicing Spread Financing

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

Following is a summary of ESS:

	Quarter ended September 30,				Nine months ended September 30,			
	2014		2013		2014		2013	
				(in thousands)				
Balance at beginning of period	$	190,244	$		$	138,723	$	
Proceeds received from excess servicing spread financing		9,253		2,828				