

PENNYMAC FINANCIAL SERVICES, INC.

Form 10-Q

August 14, 2014

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

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**Form 10-Q**

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(Mark One)

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

For the quarterly period ended June 30, 2014

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-35916

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## PennyMac Financial Services, Inc.

(Exact name of registrant as specified in its charter)

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**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)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

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

<b>Class</b>	<b>Outstanding at August 12, 2014</b>
<b>Class A Common Stock, \$0.0001 par value</b>	<b>21,513,727</b>
<b>Class B Common Stock, \$0.0001 par value</b>	<b>57</b>

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PENNYMAC FINANCIAL SERVICES, INC.

FORM 10-Q

June 30, 2014

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****PENNYMAC FINANCIAL SERVICES, INC.****CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
	<b>(in thousands, except share data)</b>	
<b>ASSETS</b>		
Cash	\$ 70,810	\$ 30,639
Short-term investments at fair value	46,391	142,582
Mortgage loans held for sale at fair value (includes \$997,506 and \$512,350 pledged to secure mortgage loans sold under agreements to repurchase)	1,000,415	531,004
Servicing advances (includes \$5,564 pledged to secure note payable at December 31, 2013)	179,169	154,328
Derivative assets	34,302	21,540
Carried Interest due from Investment Funds	65,133	61,142
Investment in PennyMac Mortgage Investment Trust at fair value	1,646	1,722
Mortgage servicing rights (includes \$308,599 and \$224,913 mortgage servicing rights at fair value; \$303,831 and \$258,241 pledged to secure note payable; and \$190,244 and \$138,723 pledged to secure excess servicing spread financing)	621,681	483,664
Receivable from Investment Funds	4,654	2,915
Receivable from PennyMac Mortgage Investment Trust	19,636	18,636
Furniture, fixtures, equipment and building improvements, net	11,452	9,837
Capitalized software, net	654	764
Deferred tax asset	55,754	63,117
Loans eligible for repurchase	31,496	46,663
Other	39,001	15,922
Total assets	\$ 2,182,194	\$ 1,584,475
<b>LIABILITIES</b>		
Mortgage loans sold under agreements to repurchase	\$ 825,267	\$ 471,592
Note payable	115,314	52,154
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	190,244	138,723
Derivative liabilities	6,711	2,462
Mortgage servicing liabilities	5,821	
Accounts payable and accrued expenses	70,353	46,387
Payable to Investment Funds	34,929	36,937
Payable to PennyMac Mortgage Investment Trust	95,483	81,174
Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement	74,705	71,056
Liability for loans eligible for repurchase	31,496	46,663
Liability for losses under representations and warranties	10,178	8,123
Total liabilities	1,460,501	955,271
Commitments and contingencies		

**STOCKHOLDERS EQUITY**

Class A common stock authorized 200,000,000 shares of \$0.0001 par value; issued and outstanding, 21,328,115 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		158,977		153,000
Retained earnings		31,990		14,400
Total stockholders equity attributable to PennyMac Financial Services, Inc. common stockholders		190,969		167,402
Noncontrolling interest in Private National Mortgage Acceptance Company, LLC		530,724		461,802
Total stockholders equity		721,693		629,204
Total liabilities and stockholders equity	\$	2,182,194	\$	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 June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands, except per share data)			
<b>Revenue</b>				
Net gains on mortgage loans held for sale at fair value	\$ 39,704	\$ 42,654	\$ 74,242	\$ 82,611
Loan origination fees	10,345	6,312	17,225	11,980
Fulfillment fees from PennyMac Mortgage Investment Trust	12,433	22,054	21,335	50,298
Net loan servicing fees:				
Loan servicing fees				
From non-affiliates	43,314	11,744	79,414	20,801
From PennyMac Mortgage Investment Trust	14,180	8,787	28,771	16,513
From Investment Funds	4,161	2,066	5,638	4,074
Ancillary and other fees	4,838	2,662	9,989	4,923
	66,493	25,259	123,812	46,311
Amortization, impairment and change in estimated fair value of mortgage servicing rights	(9,524)	(3,190)	(23,079)	(8,200)
Net loan servicing fees	56,969	22,069	100,733	38,111
Management fees:				
From PennyMac Mortgage Investment Trust	8,912	8,455	16,986	14,947
From Investment Funds	2,086	1,974	4,121	3,888
	10,998	10,429	21,107	18,835
Carried Interest from Investment Funds	1,834	2,862	3,991	7,599
Net interest (expense) income:				
Interest income	6,252	4,474	10,362	6,217
Interest expense	8,732	4,200	15,118	7,530
	(2,480)	274	(4,756)	(1,313)
Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust	(103)	(320)	12	(233)
Other	735	243	2,038	1,057
Total net revenue	130,435	106,577	235,927	208,945
<b>Expenses</b>				
Compensation	46,971	42,339	89,857	78,020
Loan origination	1,998	2,516	3,415	5,023
Servicing	11,694	1,609	14,784	3,141
Technology	3,741	2,030	6,564	3,616
Professional services	2,661	2,783	4,860	5,070
Other	5,323	5,071	9,339	8,553
Total expenses	72,388	56,348	128,819	103,423
Income before provision for income taxes	58,047	50,229	107,108	105,522
Provision for income taxes	6,630	2,038	12,153	2,038
Net income	51,417	48,191	94,955	103,484
Less: Net income attributable to noncontrolling interest	41,799	45,398	77,365	100,691
Net income attributable to PennyMac Financial Services, Inc. common stockholders	\$ 9,618	\$ 2,793	\$ 17,590	\$ 2,793

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**Earnings per share**

Basic	\$	0.45	\$	0.22	\$	0.84	\$	0.22
Diluted	\$	0.45	\$	0.22	\$	0.83	\$	0.22

**Weighted-average common shares  
outstanding**

Basic		21,142		12,778		21,005		12,778
Diluted		75,915		77,163		75,895		77,163

*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)

	Members equity	PennyMac Financial Services, Inc. Stockholders				Noncontrolling interest in		Total equity
		Number of Shares Class A	Class B	Common stock Class A	Class B	Retained Private National Mortgage earnings Acceptance Company, LLC		
<b>Balance at December 31, 2012</b>	\$ 261,750			\$	\$	\$	\$	\$ 261,750
Capital:								
Distributions	(19,623)							(19,623)
Unit-based compensation expense	238							238
Partner capital issuance costs	(3,745)							(3,745)
Net income	76,834							76,834
Exchange of existing partner units to Class A units of Private National Mortgage Acceptance Company, LLC	(315,454)						315,454	
<b>Balance post-reorganization</b>							315,454	315,454
Issuance of common shares in initial public offering, net of issuance costs		12,778		1		229,999		230,000
Underwriting and offering costs						(13,225)		(13,225)
Initial recognition of noncontrolling interest						(127,160)	127,160	
Stock and unit-based compensation						545	115	660
Distributions							(3,395)	(3,395)
Net income							2,793	26,650
<b>Balance at June 30, 2013</b>		12,778		1		90,159	2,793	556,144
<b>Balance at December 31, 2013</b>	\$	20,813		\$ 2	\$	153,000	\$ 14,400	\$ 461,802
Stock and unit-based compensation		32				1,596		3,886
Issuance of common stock in settlement of directors fees		4				74		74
Distributions							(7,731)	(7,731)
Net income							17,590	94,955
Exchange of Class A units of Private National Mortgage Acceptance Company, LLC to Class A stock of PennyMac Financial Services, Inc.		479				4,598		(4,598)
Tax effect of exchange of Class A units of Private National Mortgage Acceptance Company, LLC to Class A stock of PennyMac Financial Services, Inc.						(291)		(291)

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Balance at June 30, 2014 \$ 21,328 \$ 2 \$ 158,977 \$ 31,990 \$ 530,724 \$ 721,693

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

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## PENNYMAC FINANCIAL SERVICES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six months ended June 30,	
	2014	2013
	(in thousands)	
<b>Cash flow from operating activities</b>		
Net income	\$ 94,955	\$ 103,484
Adjustments to reconcile net income to net cash used in operating activities:		
Net gains on mortgage loans held for sale at fair value	(74,242)	(82,611)
Accrual of servicing rebate to Investment Funds	563	173
Amortization, impairment and change in fair value of mortgage servicing rights	23,079	8,200
Carried Interest from Investment Funds	(3,991)	(7,599)
Accrual of interest on excess servicing spread financing	6,001	
Amortization of debt issuance costs and commitment fees relating to financing facilities	2,646	2,346
Change in fair value of investment in common shares of PennyMac Mortgage Investment Trust	76	318
Stock and unit-based compensation expense	5,482	898
Depreciation and amortization	612	317
Purchase of mortgage loans held for sale from PennyMac Mortgage Investment Trust	(7,085,859)	(8,282,163)
Purchase of mortgage loans from Ginnie Mae securities for modification and subsequent sale	(679,882)	
Originations of mortgage loans held for sale, net	(728,040)	(612,966)
Sale and principal payments of mortgage loans held for sale	8,022,045	8,695,704
Repurchase of loans subject to representations and warranties	(1,784)	
Repurchase of real estate acquired in settlement of loans subject to representations and warranties		(309)
Increase in servicing advances	(30,254)	(1,638)
(Increase) decrease in receivable from Investment Funds	(2,302)	512
Decrease in receivable from PennyMac Mortgage Investment Trust	343	999
Increase in other assets	(27,005)	(5,310)
Decrease in deferred tax asset	10,721	
Increase in accounts payable and accrued expenses	24,040	15,987
Increase in income taxes payable		2,031
Decrease in payable to Investment Funds	(2,008)	(467)
Increase in payable to PennyMac Mortgage Investment Trust	13,360	5,450
Net cash used in operating activities	(431,444)	(156,644)
<b>Cash flow from investing activities</b>		
Decrease (increase) in short-term investments	96,191	(102,984)
Purchase of mortgage servicing rights	(97,644)	(4,009)
Sale of mortgage servicing rights	10,881	
Settlements of derivative financial instruments used for hedging	7,023	
Purchase of furniture, fixtures, equipment and building improvements	(3,054)	(3,735)
Acquisition of capitalized software	(52)	(342)
(Increase) decrease in margin deposits and restricted cash	(7,733)	2,759
Net cash provided by (used in) investing activities	5,612	(108,311)
<b>Cash flow from financing activities</b>		
Sale of loans under agreements to repurchase	7,453,139	8,127,574
Repurchase of loans sold under agreements to repurchase	(7,099,464)	(8,020,681)
Increase (decrease) in note payable	63,160	(5,804)
Issuance of excess servicing spread financing	73,393	

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Repayment of excess servicing spread financing	(16,494)	
Issuance of common stock		230,000
Payment of common stock underwriting and offering costs		(13,225)
Payment by noncontrolling interest of common stock issuance costs		(3,745)
Distributions to Private National Mortgage Acceptance Company, LLC partners	(7,731)	(23,019)
Net cash provided by financing activities	466,003	291,100
Net increase in cash	40,171	26,145
Cash at beginning of year	30,639	12,323
Cash at end of year	\$ 70,810	\$ 38,468

*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 loan production (including correspondent production and consumer-direct lending) and 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* ).

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- *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.

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.

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*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 gains (or increase 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 *Accounting Standards Codification* for interim financial information and with the SEC's instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these financial statements and notes do not include all of the information required by 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, results of operations, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year ending December 31, 2014.

***Reclassification of previously presented balances***

Certain prior period amounts have been reclassified to conform to the current presentation. Specifically:

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- *Interest expense* is included in *Interest income* as a new caption of *Net interest (expense) income* to better reflect results of the Company's portfolio of interest-earning assets. Previously, *Interest expense* was included within *Total expenses*. The reclassification results in the presentation of *Net interest (expense) income*.

Following is a summary of the reclassifications:

	Quarter ended June 30, 2013			Six months ended June 30, 2013		
	As reported	As previously reported	Reclassification (in thousands)	As reported	As previously reported	Reclassification
Net interest (expense) income :						
Interest income	\$ 4,474	\$ 4,474	\$	\$ 6,217	\$ 6,217	\$
Interest expense	4,200		4,200	7,530		7,530
	\$ 274	\$ 4,474	\$ (4,200)	\$ (1,313)	\$ 6,217	\$ (7,530)

**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 net of loan servicing rebates, Carried Interest and fulfillment fees) totaled 33% and 43% of total net revenues for the quarters ended June 30, 2014 and 2013, respectively, and 34% and 47% for the six months ended June 30, 2014 and 2013, respectively.



Table of Contents**Note 3 Transactions with Affiliates***Transactions with PMT*

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

	Quarter ended June 30,		Six months end June 30,	
	2014	2013	2014	2013
	(in thousands)			
Management fees:				
Base	\$ 5,838	\$ 4,575	\$ 11,359	\$ 8,940
Performance incentive	3,074	3,880	5,627	6,007
	\$ 8,912	\$ 8,455	\$ 16,986	\$ 14,947

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.

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

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Loan servicing fees relating to:				
Mortgage loans acquired for sale at fair value:				
Base and supplemental	\$ 29	\$ 90	\$ 46	\$ 169
Activity-based	51	111	77	183
	80	201	123	352
Distressed mortgage loans:				
Base and supplemental	4,975	3,699	9,941	7,572
Activity-based	5,746	2,447	12,132	4,324
	10,721	6,146	22,073	11,896
MSRs:				
Base and supplemental	3,323	2,363	6,471	4,126
Activity-based	56	77	104	139
	3,379	2,440	6,575	4,265
	\$ 14,180	\$ 8,787	\$ 28,771	\$ 16,513

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

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	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Fulfillment fee revenue	\$ 12,433	\$ 22,054	\$ 21,335	\$ 50,298
Unpaid principal balance of loans fulfilled for PennyMac Mortgage Investment Trust	\$ 2,991,764	\$ 4,323,885	\$ 4,911,342	\$ 9,110,711
Sourcing fees paid	\$ 1,125	\$ 1,349	\$ 2,017	\$ 2,359
Fair value of loans purchased from PennyMac Mortgage Investment Trust	\$ 3,955,329	\$ 4,733,767	\$ 7,085,859	\$ 8,282,163

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

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Issuance of excess servicing spread	\$ 52,867	\$	\$ 73,393	\$
Interest expense from excess servicing spread	\$ 3,139	\$	\$ 6,001	\$
Excess servicing spread recapture recognized	\$ 2,525	\$	\$ 4,415	\$
MSR recapture recognized	\$ 1	\$ 367	\$ 9	\$ 499

*Other Transactions*

In connection with the IPO of PMT's common shares on August 4, 2009, the Company entered into an agreement with PMT pursuant to which PMT agreed to reimburse the Company for the \$2.9 million payment that it made to the underwriters in such offering (the Conditional Reimbursement) if PMT satisfied certain performance measures over a specified period of time. Effective February 1, 2013, 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 \$36,000 during the six months ended June 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 June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Reimbursement of common overhead incurred by PCM and its affiliates	\$ 2,691	\$ 3,201	\$ 5,269	\$ 5,807
Reimbursement of expenses incurred on PMT's behalf	104	585	549	1,834
	\$ 2,795	\$ 3,786	\$ 5,818	\$ 7,641
Payments and settlements during the year (1)	\$ 22,968	\$ 32,616	\$ 41,354	\$ 65,290

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

Amounts due from PMT are summarized below:

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
	<b>(in thousands)</b>	
Management fees	\$ 8,912	\$ 8,924
Servicing fees	5,208	5,915
Allocated expenses	3,764	2,009
Underwriting fees	1,752	1,788
	<b>\$ 19,636</b>	<b>\$ 18,636</b>

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

Amounts due to PMT totaling \$91.3 million and \$75.2 million represents deposits made by PMT to fund servicing advances made by the Company on PMT's behalf as of June 30, 2014 and December 31, 2013, respectively.

Table of Contents**Investment Funds**

Amounts due from the Investment Funds are summarized below:

	<b>June 30, 2014</b>		<b>December 31, 2013</b>
	(in thousands)		
<b>Carried Interest due from Investment Funds:</b>			
PNMAC Mortgage Opportunity Fund, LLC	\$ 40,012	\$	37,702
PNMAC Mortgage Opportunity Fund Investors, LLC	25,121		23,440
	\$ 65,133	\$	61,142
<b>Receivable from Investment Funds:</b>			
Management fees	\$ 2,077	\$	2,031
Loan servicing fees	2,658		727
Loan servicing rebate	(111)		136
Expense reimbursements	30		21
	\$ 4,654	\$	2,915

Amounts due to the Investment Funds totaling \$34.9 million and \$36.9 million represent amounts advanced by the Investment Funds to fund servicing advances made by the Company as of June 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 \$74.7 million liability and it has not made a payment under the tax sharing agreement as of June 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.

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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 June 30,		Six months ended			
	2014	2013	June 30, 2014			
(in thousands, except per share data)						
<b>Basic earnings per share of common stock:</b>						
Net income attributable to PennyMac Financial Services, Inc. common stockholders	\$	9,618	\$	2,793	\$	17,590
Weighted-average shares of common stock outstanding		21,142		12,778		21,005
Basic earnings per share of common stock	\$	0.45	\$	0.22	\$	0.84
<b>Diluted earnings per share of common stock:</b>						
Net income	\$	9,618	\$	2,793	\$	17,590
Effect of net income attributable to noncontrolling interest, net of income taxes		24,743		13,813		45,754
Diluted net income attributable to common stockholders	\$	34,361	\$	16,606	\$	63,344
Weighted-average shares of common stock outstanding		21,142		12,778		21,005
<b>Dilutive shares:</b>						
PennyMac Class A units exchangeable to common stock		53,509		64,380		53,609
Non-vested PennyMac Class A units issuable under unit-based stock compensation plan and exchangeable to common stock		1,216				1,247
Shares issuable under stock-based compensation plans		48		5		34
Diluted weighted-average shares of common stock outstanding		75,915		77,163		75,895
Diluted earnings per share of common stock	\$	0.45	\$	0.22	\$	0.83

**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 upon sale of mortgage loans in transactions where the Company maintains continuing involvement with the mortgage loans (primarily the obligation to service the loans on behalf of the loans owners or owners agents):

	Quarter ended June 30,		Six months ended June 30,					
	2014	2013	2014	2013				
(in thousands)								
<b>Cash flows:</b>								
Sales proceeds	\$	4,729,647	\$	4,561,998	\$	8,022,045	\$	8,607,810
Servicing fees received	\$	25,282	\$	12,402	\$	47,466	\$	21,701
Net servicing advance (recoveries) advances	\$	(3,730)	\$	78	\$	(4,338)	\$	(3,658)
<b>Period end information:</b>								

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Unpaid principal balance of loans outstanding at end of period	\$	29,546,095	\$	16,408,013
Delinquencies:				
30-89 days	\$	543,347	\$	204,998
90 days or more or in foreclosure or bankruptcy	\$	120,560	\$	63,049



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The Company's mortgage servicing portfolio is summarized as follows:

	Servicing rights owned	June 30, 2014 Contract servicing and subservicing (in thousands)	Total loans serviced
Agencies	\$ 57,051,424	\$	\$ 57,051,424
Affiliated entities		35,554,830	35,554,830
Mortgage loans held for sale	959,014		959,014
	\$ 58,010,438	\$ 35,554,830	\$ 93,565,268
Amount subserviced for the Company	\$ 5,749,967	\$ 325,127	\$ 6,075,094
Delinquent mortgage loans:			
30 days	\$ 4,629,546	\$ 271,058	\$ 4,900,604
60 days	1,926,177	121,641	2,047,818
90 days or more	750,546	1,178,449	1,928,995
	7,306,269	1,571,148	8,877,417
Loans pending foreclosure	289,936	1,629,700	1,919,636
	\$ 7,596,205	\$ 3,200,848	\$ 10,797,053
Custodial funds managed by the Company (1)	\$ 1,181,638	\$ 353,913	\$ 1,535,551

	Servicing rights owned	December 31, 2013 Contract servicing and subservicing (in thousands)	Total loans serviced
Agencies	\$ 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	June 30, 2014		December 31, 2013	
	(in thousands)			
California	\$	32,301,976	\$	30,320,616
Texas		5,598,942		4,470,123
Virginia		5,141,366		3,769,683
Florida		4,500,059		3,416,274
Washington		3,422,660		2,760,900
All other states		42,600,265		33,429,843
	\$	93,565,268	\$	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 ( MSR's ). The Company has elected to present net derivative asset and liability positions, and cash collateral obtained from (or posted to) its counterparties when subject to a master netting arrangement that is legally enforceable on all counterparties in the event of default. The derivatives that are not subject to a master netting arrangement are IRLCs.

Following are summaries of derivative assets and related netting amounts.

*Offsetting of Derivative Assets*

	June 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	\$ 188	\$	\$ 188	\$ 665	\$	\$ 665

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MBS call options	438		438	91		91
Forward purchase contracts	13,601		13,601	416		416
Forward sale contracts	636		636	18,762		18,762
Put options on Eurodollar futures	256		256			
Call options on Eurodollar futures	254		254			
Netting		(12,230)	(12,230)		(7,358)	(7,358)
	15,373	(12,230)	3,143	19,934	(7,358)	12,576
Derivatives not subject to master netting arrangements - IRLCs	31,159		31,159	8,964		8,964
	\$ 46,532	\$ (12,230)	\$ 34,302	\$ 28,898	\$ (7,358)	\$ 21,540

Table of Contents*Derivative Assets, Financial Assets, and Collateral Held by Counterparty*

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

	June 30, 2014			December 31, 2013			
	Net amount of assets in the balance sheet	Gross amount not offset in the consolidated balance sheet	Cash collateral received	Net amount of assets in the balance sheet	Gross amount not offset in the consolidated balance sheet	Cash collateral received	Net amount
		Financial instruments		Net amount (in thousands)	Financial instruments		
Interest rate lock commitments	\$ 31,159	\$	\$	\$ 31,159	\$ 8,964	\$	\$ 8,964
Jefferies & Co.	520			520	627		627
RJ O Brien	510			510			
RBS Securities	497			497			
Royal Bank of Canada	335			335			
Citibank, N.A.	318			318	28		28
Deutsche Bank	301			301	50		50
Nomura	293			293	839		839
Daiwa Capital Markets	55			55	1,190		1,190
Others	314			314	9,842		9,842
	\$ 34,302	\$	\$	\$ 34,302	\$ 21,540	\$	\$ 21,540

Table of Contents*Offsetting of Derivative Liabilities and Financial Liabilities*

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

	June 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	\$ 205	\$	\$ 205	\$ 6,542	\$	\$ 6,542
Forward sale contracts	24,489		24,489	504		504
Netting		(19,393)	(19,393)		(6,787)	(6,787)
	24,694	(19,393)	5,301	7,046	(6,787)	259
Derivatives not subject to a master netting arrangement - IRLCs	1,410		1,410	2,203		2,203
Total derivatives	26,104	(19,393)	6,711	9,249	(6,787)	2,462
Mortgage loans sold under agreements to repurchase	825,267		825,267	471,592		471,592
	\$ 851,371	\$ (19,393)	\$ 831,978	\$ 480,841	\$ (6,787)	\$ 474,054

Table of Contents*Derivative Liabilities, Financial Liabilities, and Collateral Held by Counterparty*

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

	June 30, 2014			December 31, 2013			
	Net amount of liabilities in the consolidated balance sheet	Gross amount not offset in the consolidated balance sheet	Cash collateral pledged	Net amount in the consolidated balance sheet	Gross amount not offset in the consolidated balance sheet	Cash collateral pledged	Net amount
	(in thousands)						
Interest rate lock commitments	\$ 1,410	\$	\$	\$ 1,410	\$ 2,203	\$	\$ 2,203
Bank of America, N.A.	206,715	(206,581)		134	234,511	(234,511)	
Credit Suisse							
First Boston Mortgage Capital LLC	507,158	(505,132)		2,026	198,888	(198,888)	
Morgan Stanley Bank, N.A.	113,604	(113,554)		50	38,193	(38,193)	
Citibank, N.A.							
Others	3,091			3,091	259		259
	\$ 831,978	\$ (825,267)	\$	\$ 6,711	\$ 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 estimated fair values. The application of fair value estimates may be on a recurring or nonrecurring basis depending on the accounting principles applicable to the specific asset or liability and whether management has elected to carry the item at its estimated fair value as discussed in the following paragraphs.

*Fair Value Accounting Elections*

Management identified all of its non-cash financial assets and its originated MSR's relating to loans with initial interest rates of more than 4.5% and MSR's 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.

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

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

Table of Contents**Financial Statement Items Measured at Fair Value on a Recurring Basis**

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

	June 30, 2014			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
<b>Assets:</b>				
Short-term investments	\$ 46,391	\$	\$	\$ 46,391
Mortgage loans held for sale at fair value		745,759	254,656	1,000,415
<b>Derivative assets:</b>				
Interest rate lock commitments			31,159	31,159
MBS put options		188		188
MBS call options		438		438
Forward purchase contracts		13,601		13,601
Forward sales contracts		636		636
Put options on Eurodollar futures		256		256
Call options on Eurodollar futures		254		254
Total derivative assets before netting		15,373	31,159	46,532
Netting (1)				(12,230)
Total derivative assets		15,373	31,159	34,302
Investment in PennyMac Mortgage Investment Trust	1,646			1,646
Mortgage servicing rights at fair value			308,599	308,599
	\$ 48,037	\$ 761,132	\$ 594,414	\$ 1,391,353
<b>Liabilities:</b>				
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	\$	\$	\$ 190,244	\$ 190,244
<b>Derivative liabilities:</b>				
Interest rate lock commitments			1,410	1,410
Forward purchase contracts		205		205
Forward sales contracts		24,489		24,489
Total derivative liabilities before netting		24,694	1,410	26,104
Netting (1)				(19,393)
Total derivative liabilities		24,694	1,410	6,711
Mortgage servicing liabilities			5,821	5,821
	\$	\$ 24,694	\$ 197,475	\$ 202,776

(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)			
<b>Assets:</b>				
Short-term investments	\$ 142,582	\$	\$	\$ 142,582
Mortgage loans held for sale at fair value		527,071	3,933	531,004
<b>Derivative assets:</b>				
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
<b>Liabilities:</b>				
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	\$	\$	\$ 138,723	\$ 138,723
<b>Derivative liabilities:</b>				
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, MSRs at fair value, IRLCs, and ESS financing at fair value are measured using Level 3 inputs. Following is a roll forward of these items for the quarters and six-month periods ended June 30, 2014 and 2013 where Level 3 significant inputs were used on a recurring basis:

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

(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 the result of the mortgage loan becoming salable into active mortgage markets pursuant to a loan modification or borrower reperformance.

	Excess servicing spread financing	Quarter ended June 30, 2014	
		Mortgage servicing liabilities	Total
(in thousands)			
<b>Liabilities:</b>			
Balance, March 31, 2014	\$ 151,019	\$	\$ 151,019
Issuances	52,867		52,867
Excess servicing spread issued pursuant to a recapture agreement with PennyMac	2,362		2,362

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Mortgage Investment Trust

Accrual of interest on excess servicing spread financing		3,139			3,139
Repayments		(9,081)			(9,081)
Changes in fair value included in income		(10,062)	5,821		(4,241)
Balance, June 30, 2014	\$	190,244	\$	5,821	\$ 196,065
Changes in fair value recognized during the period relating to liabilities still held at June 30, 2014	\$	(10,062)	\$	5,821	

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	Quarter ended June 30, 2013				Total
	Mortgage loans held for sale	Net interest rate lock commitments (1)	Mortgage servicing rights		
	(in thousands)				
Assets:					
Balance, March 31, 2013	\$ 4,487	\$ 25,437	\$ 18,622	\$	48,546
Repurchases of mortgage loans subject to representations and warranties	923				923
Repayments	(608)				(608)
Interest rate lock commitments issued, net		23,530			23,530
Purchases			4,008		4,008
Mortgage servicing rights received as proceeds from mortgage loan sales			17		17
Sales			(550)		(550)
Changes in fair value included in income arising from:					
Changes in instrument-specific credit risk					
Other factors	(277)	(20,983)	973		(20,287)
	(277)	(20,983)	973		(20,287)
Transfers of interest rate lock commitments to mortgage loans held for sale					
		(44,194)			(44,194)
Balance, June 30, 2013	\$ 4,525	\$ (16,210)	\$ 23,070	\$	11,385
Changes in fair value recognized during the period relating to assets still held at June 30, 2013					
	\$ (329)	\$ (16,210)	\$ 973		

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

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

(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 the result of the mortgage loan becoming salable into active mortgage markets pursuant to a loan modification or borrower performance.

	Six months ended June 30, 2014		
	Excess servicing spread financing	Mortgage servicing liabilities	Total
	(in thousands)		
<b>Liabilities:</b>			
Balance, December 31, 2013	\$ 138,723	\$	\$ 138,723
Issuances	73,393		73,393
Excess servicing spread issued pursuant to a recapture agreement with PennyMac Mortgage Investment Trust	3,475		3,475
Accrual of interest on excess servicing spread financing	6,001		6,001
Repayments	(16,494)		(16,494)

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Changes in fair value included in income		(14,854)		5,821		(9,033)
Balance, June 30, 2014	\$	190,244	\$	5,821	\$	196,065
Changes in fair value recognized during the period relating to liabilities still held at June 30, 2014	\$	(14,854)	\$	5,821		

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	Mortgage loans held for sale	Six months ended June 30, 2013		Mortgage servicing rights	Total			
		Net interest rate lock commitments (1)	(in thousands)					
<b>Assets:</b>								
Balance, December 31, 2012	\$	\$	23,951	\$	19,798	\$	43,749	
Repurchases of mortgage loans subject to representations and warranties		5,529					5,529	
Repayments		(622)					(622)	
Interest rate lock commitments issued, net			57,179				57,179	
Purchases				4,008			4,008	
Mortgage servicing rights received as proceeds from mortgage loan sales				20			20	
Sales				(550)			(550)	
<b>Changes in fair value included in income arising from:</b>								
<b>Changes in instrument-specific credit risk</b>								
Other factors		(382)	(21,090)	(206)			(21,678)	
		(382)	(21,090)	(206)			(21,678)	
<b>Transfers of interest rate lock commitments to mortgage loans held for sale</b>								
			(76,250)				(76,250)	
Balance, June 30, 2013	\$	4,525	\$	(16,210)	\$	23,070	\$	11,385
<b>Changes in fair value recognized during the period relating to assets still held at June 30, 2013</b>								
	\$	(443)	\$	(16,210)	\$	(206)		

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

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.

Net gains (losses) from changes in estimated 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:

	Net gains on mortgage loans held for sale at fair value	Quarter ended June 30,		Net gains on mortgage loans held for sale at fair value	Net servicing fees	Total			
		2014 Net servicing fees	Total (in thousands)				2013 Net servicing fees		
<b>Assets:</b>									
Mortgage loans held for sale at fair value	\$	67,993	\$	\$	67,993	\$	(7,791)	\$	(7,791)
Mortgage servicing rights at fair value			(6,615)	(6,615)		973		973	



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	\$	67,993	\$	(6,615)	\$	61,378	\$	(7,791)	\$	973	\$	(6,818)
<b>Liabilities:</b>												
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	\$		\$	10,062	\$	10,062	\$		\$		\$	
Mortgage servicing liabilities				(5,821)		(5,821)						
	\$		\$	4,241	\$	4,241	\$		\$		\$	

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	Six months ended June 30,					
	Net gains on mortgage loans held for sale at fair value	2014 Net servicing fees	Total (in thousands)	Net gains on mortgage loans held for sale at fair value	2013 Net servicing fees	Total
<b>Assets:</b>						
Mortgage loans held for sale at fair value	\$ 117,895	\$	\$ 117,895	\$ 18,489	\$	\$ 18,489
Mortgage servicing rights at fair value		(17,343)	(17,343)		(206)	(206)
	\$ 117,895	\$ (17,343)	\$ 100,552	\$ 18,489	\$ (206)	\$ 18,283
<b>Liabilities:</b>						
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	\$	\$ 14,854	\$ 14,854	\$	\$	\$
Mortgage servicing liabilities		(5,821)	(5,821)			
	\$	\$ 9,033	\$ 9,033	\$	\$	\$

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

	Fair value	June 30, 2014 Principal amount due upon maturity (in thousands)	Difference
<b>Mortgage loans held for sale:</b>			
Current through 89 days delinquent	\$ 784,173	\$ 735,622	\$ 48,551
<b>90 days or more delinquent:</b>			
Not in foreclosure	168,111	171,035	(2,924)
In foreclosure	48,131	48,856	(725)
	\$ 1,000,415	\$ 955,513	\$ 44,902
<b>December 31, 2013</b>			
	Fair value	Principal amount due upon maturity (in thousands)	Difference
<b>Mortgage loans held for sale:</b>			
Current through 89 days delinquent	\$ 524,665	\$ 504,705	\$ 19,960
<b>90 days or more delinquent:</b>			
Not in foreclosure	5,567	5,479	88
In foreclosure	772	660	112
	\$ 531,004	\$ 510,844	\$ 20,160

Table of Contents**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:

	Level 1	Level 2	June 30, 2014		Total
			Level 3	(in thousands)	
Mortgage servicing rights at lower of amortized cost or fair value	\$	\$	\$	194,442	\$ 194,442
	\$	\$	\$	194,442	\$ 194,442

	Level 1	Level 2	December 31, 2013		Total
			Level 3	(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 June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Mortgage servicing rights at lower of amortized cost or fair value	\$ (3,786)	\$ 88	\$ (4,207)	\$ 643
	\$ (3,786)	\$ 88	\$ (4,207)	\$ 643

**Fair Value of Financial Instruments Carried at Amortized Cost**

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

*Cash* is measured using Level 1 significant inputs. The Company's borrowings carried at amortized cost do not have active markets or observable inputs and the fair value is measured using management's 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 June 30, 2014 and December 31, 2013 due to the lack of current market activity and the Company's reliance on unobservable inputs to estimate the fair value.

Management has concluded that the carrying value of the *Carried Interest due from Investment Funds* approximates its fair value as the balance represents the amount distributable to the Company at the balance sheet date assuming liquidation of the Investment Funds. Management has concluded that the 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 lack of current market activity and the Company's reliance on unobservable inputs to estimate these instruments' fair value.

The Company also carries the receivable from and payable 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, including its ESS, 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 significant unobservable inputs in 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.

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.

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

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

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

Certain of the Company's mortgage loans may become non salable into active markets due to identification of a defect by the Company or to the repurchase of a mortgage loan with an identified defect. Because such mortgage loans are generally not salable into active mortgage markets, they are classified as Level 3 financial statement items. The Company may also purchase 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.

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 inputs used in the valuation of mortgage loans held for sale at fair value valued using Level 3 inputs:

	June 30, 2014	December 31, 2013
<b>Key inputs</b>	<b>Range</b>	
	<b>(Weighted average)</b>	

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Discount rate	2.2% - 13.4%	7.8% - 13.4%
	(2.3)%	(8.9)%
Twelve-month projected housing price index change	-0.8% - 12.2%	4.5% - 4.7%
	(4.2)%	(4.6)%
Prepayment speed (1)	2.0% - 18.7%	1.6% - 5.1%
	(15.8)%	(4.4)%
Total prepayment speed (2)	3.6% - 36.3%	2.9% - 5.2%
	(35.5)%	(4.7)%

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

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

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

Table of Contents*Derivative Financial Instruments*

The Company categorizes IRLCs as a Level 3 financial statement item. The Company estimates the fair value of an IRLC based on quoted Agency mortgage-backed securities ( MBS ) prices, its estimate of the fair value of the MSR 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.

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

	June 30, 2014	December 31, 2013
	Range (Weighted average)	
<b>Key inputs</b>		
Pull-through rate	57.0% - 98.0%	62.1% - 98.1%
	(76.1)%	(81.7)%
Mortgage servicing rights value expressed as:		
Servicing fee multiple	1.9 - 4.9	2.0 - 5.0
	(3.8)	(3.7)
Percentage of unpaid principal balance	0.4% - 2.4%	0.4% - 2.4%
	(1.0)%	(0.9)%

The Company estimates the fair value of commitments to sell loans based on quoted MBS prices. The Company estimates the fair value of the MBS options and futures it purchases 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 fair value financial statement items. The Company uses a discounted cash flow approach to estimate the fair value of MSRs. This approach consists of projecting net servicing cash flows discounted at a rate that management believes market participants would use in their determinations of fair value. The key inputs used in the estimation of the fair value of MSRs include prepayment rates of the underlying loans, the applicable discount rate or pricing spread, and the per-loan annual cost to service the respective mortgage loans.

The results of the estimates of fair value of MSRs are reported to the Company's valuation committee as part of their review and approval of monthly valuation results. 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 June 30,			
	2014		2013	
	Fair value	Amortized cost	Fair value	Amortized cost
	Range (Weighted average)			
	(Amount recognized and unpaid principal balance of underlying mortgage loans in thousands)			
Amount recognized	\$7,333	\$42,327	\$17	\$52,461
Unpaid principal balance of underlying mortgage loans	\$600,196	\$3,550,411	\$423,031	\$4,372,786
Weighted-average servicing fee rate (in basis points)	33	30	25	29
Pricing spread (1)	8.3% - 16.2% (11.5)%	6.8% - 15.2% (10.9)%	6.4% - 9.6% (7.2)%	5.4% - 12.4% (8.0)%
Annual total prepayment speed (2)	7.6% - 25.0% (8.8)%	7.6% - 43.6% (8.2)%	8.7% - 15.3% (9.0)%	8.5% - 18.5% (8.8)%
Life (in years)	2.1 7.5 (7.0)	1.5 7.3 (7.1)	3.0 6.9 (6.7)	2.9 6.9 (6.7)
Per-loan annual cost of servicing	\$53 \$100 \$(88)	\$53 \$100 \$(90)	\$68 \$68 \$(68)	\$68 \$120 \$(103)

(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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	Six months ended June 30,			
	2014		2013	
	Fair value	Amortized cost	Fair value	Amortized cost
	Range (Weighted average)			
	(Amount recognized and unpaid principal balance of underlying mortgage loans in thousands)			
Amount recognized	\$14,266	\$72,908	\$20	\$94,194
Unpaid principal balance of underlying mortgage loans	\$1,111,663	\$6,174,010	\$423,355	\$8,229,142
Weighted-average servicing fee rate (in basis points)	33	30	25	28
Pricing spread (1)	8.3% - 16.2% (11.3)%	6.8% - 15.2% (10.7)%	6.4% - 9.6% (7.2)%	5.4% - 12.5% (8.2)%
Annual total prepayment speed (2)	7.6% - 25.0% (8.7)%	7.6% - 45.3% (8.1)%	8.7% - 15.3% (9.0)%	8.5% - 18.5% (8.8)%
Life (in years)	2.1 7.5 (7.1)	1.5 7.5 (7.1)	3.0 6.9 (6.7)	2.9 6.9 (6.7)
Per-loan annual cost of servicing	\$53 \$100 \$(92)	\$53 \$100 \$(94)	\$68 \$68 \$(68)	\$68 \$120 \$(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 MSR's at period end and the effect on the estimated fair value from adverse changes in those assumptions (weighted averages are based upon UPB):

*Purchased MSR's Backed by Distressed Mortgage Loans*

During the quarter ended June 30, 2014, the Company sold a portfolio of purchased MSR's backed by distressed mortgage loans to a non-affiliated entity.

	June 30, 2014	Range (Weighted average)	December 31, 2013
	Fair value	Amortized cost	Fair value
	(Carrying value, unpaid principal balance of underlying mortgage loans and effect on fair value amounts in thousands)		
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
Discount rate			15.3% 15.3%
			(15.3)%
Effect on fair value of:			
5% adverse change			\$(251)
10% adverse change			\$(490)
20% adverse change			\$(937)
Life (in years)			5.0 - 5.0
			(5.0)
Prepayment speed (1)			11.4% 11.4%
			(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			\$218 \$218
			\$(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

	June 30, 2014		Range (Weighted average)		December 31, 2013	
	Fair value	Amortized cost	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)					
Carrying value	\$308,599	\$313,082			\$214,784	\$258,751
Unpaid principal balance of underlying mortgage loans	\$29,694,503	\$27,356,921			\$22,469,179	\$22,499,847
Weighted-average note interest rate	4.29%	3.76%			4.48%	3.65%
Weighted-average servicing fee rate (in basis points)	31	29			32	29
Pricing spread (1)	2.9% 20.3%	6.3% 15.4%			2.9% 18.0%	6.3% 14.5%
	(9.0)%	(9.9)%			(7.5)%	(8.7)%
Effect on fair value of:						
5% adverse change	\$(5,347)	\$(7,150)			\$(3,551)	\$(5,312)
10% adverse change	\$(10,506)	\$(14,009)			\$(6,900)	\$(10,395)
20% adverse change	\$(20,302)	\$(26,920)			\$(13,305)	\$(20,039)
Average life (in years)	0.1 10.8	1.5 7.3			0.1 14.4	1.5 7.3
	(5.9)	(6.9)			(6.2)	(7.0)
Prepayment speed (2)	7.6% 67.0%	7.6% 45.1%			7.8% 50.8%	7.6% 42.5%
	(10.2)%	(8.2)%			(9.7)%	(8.0)%
Effect on fair value of:						
5% adverse change	\$(6,663)	\$(5,398)			\$(4,622)	\$(4,615)
10% adverse change	\$(13,082)	\$(10,642)			\$(9,073)	\$(9,097)
20% adverse change	\$(25,243)	\$(20,696)			\$(17,500)	\$(17,684)
Per-loan annual cost of servicing	\$61 \$115	\$61 \$93			\$68 \$115	\$68 \$100
	\$(86)	\$(92)			\$(87)	\$(99)
Effect on fair value of:						
5% adverse change	\$(3,341)	\$(2,859)			\$(2,817)	\$(2,609)
10% adverse change	\$(6,682)	\$(5,719)			\$(5,633)	\$(5,217)
20% adverse change	\$(13,365)	\$(11,437)			\$(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

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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.

Table of Contents*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, average life, 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 losses 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:

	June 30, 2014	December 31, 2013
Key inputs	Range (Weighted average)	
Unpaid principal balance of underlying loans (in thousands)	\$27,445,826	\$20,512,659
Average servicing fee rate (in basis points)	31	32
Average excess servicing spread (in basis points)	16	16
Pricing spread (1)	1.7% - 14.6%	2.8% - 14.4%
	(5.1)%	(5.4)%
Average life (in years)	0.5 - 7.3	0.9 - 8.0
	(5.9)	(6.1)
Annualized prepayment speed (2)	7.6% - 67.0%	7.7% - 48.6%
	(10.3)%	(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.

**Note 8 Mortgage Loans Held for Sale at Fair Value**

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

	<b>June 30, 2014</b>		<b>December 31, 2013</b>
	(in thousands)		
Government-insured or guaranteed	\$ 711,193	\$	482,066
Conventional conforming	34,566		45,005
Mortgage loans purchased from Ginnie Mae pools serviced by the Company	250,848		
Mortgage loans repurchased pursuant to representations and warranties	3,808		3,933
	\$ 1,000,415	\$	531,004
Fair value of mortgage loans pledged to secure mortgage loans sold under agreements to repurchase	\$ 997,506	\$	512,350



Table of Contents**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 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.

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

Instrument	Notional amount	June 30, 2014 Fair value		Notional amount	December 31, 2013 Fair value	
		Derivative assets	Derivative liabilities		Derivative assets	Derivative liabilities
(in thousands)						
Derivatives not designated as hedging instruments						
Free-standing derivatives:						
Interest rate lock commitments	1,754,845	\$ 31,159	\$ 1,410	971,783	\$ 8,964	\$ 2,203
Forward purchase contracts	2,789,277	13,601	205	1,418,527	416	6,542
Forward sales contracts	4,617,100	636	24,489	2,659,000	18,762	504
MBS put options	225,000	188		185,000	665	
MBS call options	95,000	438		105,000	91	
Put options on Eurodollar futures	377,500	256				
Call options on Eurodollar futures	170,000	254				
Total derivatives before netting		46,532	26,104		28,898	9,249
Netting		(12,230)	(19,393)		(7,358)	(6,787)
		\$ 34,302	\$ 6,711		\$ 21,540	\$ 2,462

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

Quarter ended June 30, 2014

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

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Period/Instrument	Quarter ended June 30, 2013			Balance end of period
	Balance beginning of period	Additions	Dispositions/ expirations	
	(in thousands)			
Forward purchase contracts	1,349,300	11,430,282	(10,707,992)	2,071,590
Forward sales contracts	3,022,710	17,795,302	(16,591,072)	4,226,940
MBS put options	325,000	1,195,000	(1,260,000)	260,000
MBS call options	300,000	950,000	(625,000)	625,000

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

Period/Instrument	Six months ended June 30, 2013			Balance end of period
	Balance beginning of period	Additions	Dispositions/ expirations	
	(in thousands)			
Forward purchase contracts	1,021,981	21,625,832	(20,576,223)	2,071,590
Forward sales contracts	2,621,948	32,472,558	(30,867,566)	4,226,940
MBS put options	500,000	2,160,000	(2,400,000)	260,000
MBS call options		1,800,000	(1,175,000)	625,000

The Company recorded net losses on derivative financial instruments used to hedge IRLCs and mortgage loans held for sale at fair value totaling \$38.8 million and \$58.8 million for the quarter and six months ended June 30, 2014, respectively. The Company recorded net gains on derivative financial instruments totaling \$94.2 million and \$106.5 million for the quarter and six months ended June 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.

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The Company recorded net gains on derivatives used to hedge fair value changes of MSRs totaling \$9.6 million and \$9.2 million for the quarter and six months ended June 30, 2014, respectively. 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.

**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 June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Balance at beginning of period	\$ 246,984	\$ 18,622	\$ 224,913	\$ 19,798
Additions:				
Purchases	71,778	4,008	97,644	4,008
Mortgage servicing rights received as proceeds from mortgage loan sales	7,333	17	14,266	20
	79,111	4,025	111,910	4,028
Sales	(10,881)	(550)	(10,881)	(550)
Change in fair value due to:				
Changes in valuation inputs or assumptions used in valuation model (1)	2,511	1,957	(445)	(1,524)
Other changes in fair value (2)	(9,126)	(984)	(16,898)	1,318
Total change in fair value	(6,615)	973	(17,343)	(206)
Balance at end of period	\$ 308,599	\$ 23,070	\$ 308,599	\$ 23,070

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

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

Table of Contents**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 June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
<b>Amortized cost:</b>				
Balance at beginning of period	\$ 287,187	\$ 130,793	\$ 263,373	\$ 92,155
Mortgage servicing rights resulting from mortgage loan sales	42,327	52,461	72,908	94,194
Amortization	(7,603)	(4,251)	(14,370)	(7,346)
Application of valuation allowance to write down mortgage servicing rights with other-than-temporary impairment				
Balance at end of period	321,911	179,003	321,911	179,003
<b>Valuation allowance:</b>				
Balance at beginning of period	(5,043)	(2,423)	(4,622)	(2,978)
(Additions) reversals	(3,786)	88	(4,207)	643
Application of valuation allowance to write down mortgage servicing rights with other-than-temporary impairment				
Balance at end of period	(8,829)	(2,335)	(8,829)	(2,335)
Mortgage servicing rights, net	\$ 313,082	\$ 176,668	\$ 313,082	\$ 176,668
Fair value of mortgage servicing rights at end of period	\$ 321,383	\$ 194,529	\$ 321,383	\$ 194,529

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 June 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 June 30,	Estimated MSR amortization (in thousands)
2015	\$ 29,778
2016	29,470
2017	28,727
2018	27,440
2019	25,502
Thereafter	180,994
	\$ 321,911

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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 June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Contractual servicing fees	\$ 43,314	\$ 11,744	\$ 79,414	\$ 20,801
Ancillary and other fees				
Late charges	963	396	1,850	809
Other	248	132	424	234
	\$ 44,525	\$ 12,272	\$ 81,688	\$ 21,844

***Mortgage Servicing Liability Carried at Fair Value:***

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

	Quarter ended June 30, 2014 (in thousands)
Amortized cost:	
Balance at beginning of period	\$
Change in fair value due to:	
Changes in valuation inputs or assumptions used in valuation model (1)	5,821
Other changes in fair value (2)	
Total change in fair value	5,821
Balance at end of period	\$ 5,821

(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.

**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 June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Balance at beginning of period	\$ 63,299	\$ 52,460	\$ 61,142	\$ 47,723
Carried Interest recognized during the period	1,834	2,862	3,991	7,599
Proceeds received during the period				
Balance at end of period	\$ 65,133	\$ 55,322	\$ 65,133	\$ 55,322

The amount of the Carried Interest received by the Company depends on the Investment Funds' future performance. As a result, the amount of Carried Interest recorded by the Company at period end is subject to adjustment based on future results of the Investment Funds and may be reduced in future years. 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.

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

**Note 12 Investment in PennyMac Mortgage Investment Trust at Fair Value**

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

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Dividends	\$ 44	\$ 43	\$ 88	\$ 85
Change in fair value	(147)	(363)	(76)	(318)
	\$ (103)	\$ (320)	\$ 12	\$ (233)
Fair value of PennyMac Mortgage Investment Trust shares at period end	\$ 1,646	\$ 1,579		

**Note 13 Borrowings**

As of June 30, 2014, the Company maintained five borrowing facilities: four facilities that provide for sales of mortgage loans under agreements to repurchase; 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 based on LIBOR for the other three agreements. Loans sold 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 June 30,	Six months ended June 30,
	2014	2013



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(in thousands)

Period end:					
Balance	\$	825,267	\$	500,427	
Unused amount (1)	\$	674,733	\$	299,573	
Weighted average interest rate		1.85%		1.93%	
Fair value of loans securing agreements to repurchase					
	\$	997,506	\$	646,944	
During the period:					
Average balance of loans sold under agreements to repurchase					
	\$	527,990	\$	412,849	\$ 410,196 \$ 344,335
Weighted average interest rate (2)		1.83%		1.98%	1.81% 2.09%
Total interest expense	\$	3,682	\$	2,956	\$ 6,011 \$ 5,331
Maximum daily amount outstanding	\$	873,301	\$	623,523	\$ 873,301 \$ 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 \$1.2 million and \$891,000 for the quarters ended June 30, 2014 and 2013, respectively, and \$2.3 million and \$1.7 million for the six month-periods ended June 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 June 30, 2014	Balance (in thousands)
Within 30 days	\$ 74,716
Over 30 to 90 days	746,130
Over 90 days	4,421
	\$ 825,267
Weighted average maturity (in months)	2.2

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

Counterparty	Amount at risk (in thousands)	Weighted average maturity of advances under repurchase agreement	Facility maturity
Credit Suisse First Boston Mortgage Capital LLC	\$ 117,085	September 3, 2014	October 31, 2014
Bank of America, N.A.	\$ 45,620	September 17, 2014	January 30, 2015
Morgan Stanley	\$ 10,074	August 17, 2014	June 29, 2015
Citibank, N.A.	\$		August 7, 2014

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 June 30, 2014 and December 31, 2013. Such amounts are included in *Other assets* on the consolidated balance sheets.

**Note Payable**

The note payable is summarized below:

	June 30, 2014	December 31, 2013
	(in thousands)	
Period end:		
Note payable secured by:		
Mortgage servicing rights	\$ 115,314	\$ 48,302
Servicing advances		3,852
	\$ 115,314	\$ 52,154
Assets pledged to secure note payable:		
Mortgage servicing rights	\$ 303,831	\$ 258,241

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Servicing advances	\$	\$	5,564
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The note payable matures 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 MSR's 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 June 30, 2014.

Table of Contents*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		Six months ended	
	June 30, 2014			
	(in thousands)			
Balance at beginning of period	\$	151,019	\$	138,723
Purchases		52,867		73,393
Excess servicing spread issued pursuant to a recapture agreement with PennyMac Mortgage Investment Trust		2,362		3,475
Accrual of interest expense		3,139		6,001
Repayments		(9,081)		(16,494)
Change in fair value		(10,062)		(14,854)
Balance at end of period	\$	190,244	\$	190,244

**Note 14 Liability for Losses Under Representations and Warranties**

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

	Quarter ended June 30,		Six months ended June 30,					
	2014	2013	2014	2013				
	(in thousands)							
Balance at beginning of period	\$	8,974	\$	4,748	\$	8,123	\$	3,504
Provision for losses on loans sold		1,204		1,453		2,055		2,697
Incurred losses				(16)				(16)
Balance at end of period	\$	10,178	\$	6,185	\$	10,178	\$	6,185
Unpaid principal balance of mortgage loans subject to representations and warranties at period end	\$	29,882,252	\$	16,408,013				

Following is a summary of the Company's repurchase activity:

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	Quarter ended June 30,		Six months ended June 30,				
	2014	2013	2014	2013			
	(in thousands)						
During the period:							
Unpaid principal balance of mortgage loans repurchased	\$	\$	2,741	\$	1,890	\$	4,867
Unpaid principal balance of repurchased mortgage loans repurchased by correspondent lenders	\$	\$	574	\$	798	\$	1,053
Period end:							
Unpaid principal balance of mortgage loans subject to pending claims for repurchase	\$	5,452	\$	296			

**Note 15 Stockholders Equity**

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

Table of Contents**Note 16 Net Gains on Mortgage Loans Held for Sale**

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

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
<b>Cash gain (loss):</b>				
Sales proceeds	\$ 10,241	\$ (43,318)	\$ 14,722	\$ (55,141)
Hedging activities	(25,549)	22,260	(35,805)	39,881
	(15,308)	(21,058)	(21,083)	(15,260)
<b>Non-cash gain:</b>				
Mortgage servicing rights received as proceeds from mortgage loan sales	49,660	52,478	87,174	94,214
MSR and ESS recapture payable to PennyMac Mortgage Investment Trust	(2,526)	(367)	(4,424)	(499)
Provision for losses relating to representations and warranties on loans sold	(1,204)	(1,453)	(2,055)	(2,697)
<b>Change in fair value relating to loans and hedging derivatives held at period end:</b>				
Interest rate lock commitments	15,453	(41,647)	22,989	(40,150)
Mortgage loans	6,830	(17,241)	14,658	(19,634)
Hedging derivatives	(13,201)	71,942	(23,017)	66,637
	\$ 39,704	\$ 42,654	\$ 74,242	\$ 82,611

**Note 17 Net Interest Expense**

Net interest expense is summarized below:

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
<b>Interest income:</b>				
Short-term investment	\$ 325	\$ 162	\$ 526	\$ 203
Mortgage loans held for sale at fair value	5,927	4,312	9,836	6,014
	6,252	4,474	10,362	6,217
<b>Interest expense:</b>				
Mortgage loans sold under agreements to repurchase	3,682	2,956	6,011	5,331
Note payable	861	910	1,520	1,647
Excess servicing spread financing at fair value	3,139		6,001	
Other	1,050	334	1,586	552

	8,732		4,200		15,118		7,530
\$	(2,480)	\$	274	\$	(4,756)	\$	(1,313)

**Note 18 Stock-based Compensation**

The Company's 2013 Equity Incentive Plan provides for grants of stock options, time based and performance-based restricted stock units (RSUs), stock appreciation rights, performance units and stock grants. As of June 30, 2014, the Company has 16.7 million units available for future awards. The Company estimates the cost of the stock options, time-based restricted stock units and performance-based restricted stock units awarded with reference to the fair value of PFSI's underlying common stock on the date of the award. Compensation costs are fixed, except for the performance-based restricted stock units, at the grant's estimated fair value on the grant date as all grantees are employees of PennyMac and directors of the Company. Expense relating to awards is included in *Compensation* in the consolidated statements of income.

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

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Stock options	\$ 1,375	\$ 198	\$ 2,562	\$ 198
Performance-based restricted stock units	1,112	282	1,874	282
Time-based restricted stock units	437	65	873	65
	\$ 2,924	\$ 545	\$ 5,309	\$ 545

Following is a summary of equity awards:

	Stock options	Quarter ended June 30, 2014 Performance-based RSUs (in thousands)	Time-based RSUs
March 31, 2014	1,169	1,102	198
Granted			38
Vested	(138)		(31)
Expired or canceled	(7)	(2)	(3)
June 30, 2014	1,024	1,100	202

	Stock options	Six months ended June 30, 2014 Performance-based RSUs (in thousands)	Time-based RSUs
December 31, 2013	422	496	100
Granted	753	614	138
Vested	(138)		(31)
Expired or canceled	(13)	(10)	(5)
June 30, 2014	1,024	1,100	202

**Note 19 Income Taxes**

For the quarter and six months ended June 30, 2014, the Company's effective tax rates were 11.4% and 11.3%, respectively. For the quarter and six months ended June 30, 2013, the Company's effective tax rates were 4.1% and 1.9%, respectively. The difference between the Company's effective tax rate and the statutory rate is primarily due to the allocation of earnings to the noncontrolling interest unitholders. As the noncontrolling interest unitholders convert their ownership units into the Company's shares, the portion of the Company's income that will be subject to corporate federal and state statutory tax rates will increase, which will in turn increase its effective income tax rate.

**Note 20 Supplemental Cash Flow Information**



**Six months ended June 30,**  
**2014**                      **2013**

Cash paid for interest	\$	14,243	\$	6,594
Cash paid for income taxes	\$	1,432	\$	7
Non-cash investing activity:				
Receipt of mortgage servicing rights created in loan sales activities	\$	87,174	\$	94,214
Non-cash financing activity:				
Transfer of excess servicing spread pursuant to recapture agreement with PennyMac Mortgage Investment Trust	\$	3,475	\$	
Issuance of common stock in settlement of director fees	\$	74	\$	

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**Note 21 Regulatory Net Worth and Agency Capital Requirements**

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

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

Fannie Mae PLS	\$	492,451	\$	87,464	\$ 409,552 \$ 83,148
Freddie Mac PLS	\$	492,671	\$	3,191	\$ 409,860 \$ 3,001
Ginnie Mae:					
Issuer PLS	\$	445,815	\$	99,986	\$ 388,125 \$ 102,619
Issuer's parent PennyMac	\$	673,390	\$	119,983	\$ 598,198 \$ 112,881
HUD PLS	\$	445,815	\$	2,500	\$ 388,125 \$ 2,500

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

Noncompliance with the respective agencies' capital requirements can result in the respective Agency taking various remedial actions up to and including removing PennyMac's ability to sell loans to and service loans on behalf of the respective Agency. PennyMac and PLS had Agency capital in excess of the respective Agencies' requirements at June 30, 2014.

**Note 22 Commitments and Contingencies**

*Litigation*

The business of the Company involves the collection of numerous accounts, as well as the validation of liens and compliance with various state and federal lending and servicing laws. Accordingly, the Company may be involved in proceedings, claims, and legal actions arising in the ordinary course of business. As of June 30, 2014, the Company was not involved in any legal proceedings, claims, or actions in management's view would be reasonably likely to have a material adverse effect on the Company.

*Commitments to Fund and Sell Mortgage Loans*

	<b>June 30, 2014</b> <b>(in thousands)</b>	
Commitments to purchase mortgage loans from PennyMac Mortgage Investment Trust	\$	1,242,982
Commitments to fund mortgage loans		511,863
	\$	1,754,845
Commitments to sell mortgage loans	\$	4,617,100

**Note 23 Segments and Related Information**

Since the date of the Company's IPO, the Company has continued its development of internal management reporting. Such development has resulted in changes in the information that is provided to the Company's chief operating decision maker. Accordingly, during the quarter ended March 31, 2014, management re-evaluated this new information in relation to its definition of its operating segments.

As a result of the new reporting provided to the chief operating decision maker, management has concluded that its mortgage banking operations should be disclosed as two segments: loan production and loan servicing. Accordingly, the following segment disclosure includes three segments: loan production, loan servicing and investment management. Prior period segment disclosures have been restated to conform segment disclosures for the quarter and six months ended June 30, 2013 to those for the quarter and six months ended June 30, 2014.

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

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management segment, including executing the loan resolution strategy identified by the investment management segment relating to distressed mortgage loans.

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

Financial highlights by segment are as follows:

	Quarter ended June 30, 2014				
	Production	Mortgage banking Servicing	Total (in thousands)	Investment management	Total
<b>Revenue</b>					
Net gains on mortgage loans held for sale at fair value	\$ 38,101	\$ 1,603	\$ 39,704	\$	\$ 39,704
Loan origination fees	10,345		10,345		10,345
Fulfillment fees from PennyMac Mortgage Investment Trust	12,433		12,433		12,433
Net servicing fees		56,969	56,969		56,969
Management fees				10,998	10,998
Carried Interest from Investment Funds				1,834	1,834
Net interest income (expense):					
Interest income	5,697	554	6,251	1	6,252
Interest expense	3,072	5,660	8,732		8,732
	2,625	(5,106)	(2,481)	1	(2,480)
Other	383	265	648	(16)	632
<b>Total net revenue</b>	<b>63,887</b>	<b>53,731</b>	<b>117,618</b>	<b>12,817</b>	<b>130,435</b>
Expenses	31,126	33,772	64,898	7,490	72,388
Income before provision for income taxes	\$ 32,761	\$ 19,959	\$ 52,720	\$ 5,327	\$ 58,047
Segment assets at period end (1)	\$ 1,117,090	\$ 895,169	\$ 2,012,259	\$ 111,285	\$ 2,123,544

(1) Amount excludes parent Company assets, which consist primarily of deferred tax assets of \$55.8 million.

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	Quarter ended June 30, 2013				
	Production	Mortgage banking Servicing	Total (in thousands)	Investment management	Total
<b>Revenue</b>					
Net gains on mortgage loans held for sale at fair value	\$ 42,654	\$	\$ 42,654	\$	\$ 42,654
Loan origination fees	6,312		6,312		6,312
Fulfillment fees from PennyMac Mortgage Investment Trust	22,054		22,054		22,054
Net servicing fees		22,069	22,069		22,069
Management fees				10,429	10,429
Carried Interest from Investment Funds				2,862	2,862
<b>Net interest income (expense):</b>					
Interest income	4,469		4,469	5	4,474
Interest expense	2,976	1,224	4,200		4,200
	1,493	(1,224)	269	5	274
Other	83	38	121	(198)	(77)
<b>Total net revenue</b>	<b>72,596</b>	<b>20,883</b>	<b>93,479</b>	<b>13,098</b>	<b>106,577</b>
Expenses	34,753	16,084	50,837	5,511	56,348
Income before provision for income taxes	\$ 37,843	\$ 4,799	\$ 42,642	\$ 7,587	\$ 50,229
Segment assets at period end (1)	\$ 817,633	\$ 344,813	\$ 1,162,446	\$ 117,676	\$ 1,280,122

(1) Amount excludes parent Company assets, which consist primarily of cash of \$714,000.

	Six months ended June 30, 2014				
	Production	Mortgage banking Servicing	Total (in thousands)	Investment management	Total
<b>Revenue</b>					
Net gains on mortgage loans held for sale at fair value	\$ 72,639	\$ 1,603	\$ 74,242	\$	\$ 74,242
Loan origination fees	17,225		17,225		17,225
Fulfillment fees from PennyMac Mortgage Investment Trust	21,335		21,335		21,335
Net servicing fees		100,733	100,733		100,733
Management fees				21,107	21,107
Carried Interest from Investment Funds				3,991	3,991
<b>Net interest income (expense):</b>					
Interest income	9,803	554	10,357	5	10,362
Interest expense	5,401	9,717	15,118		15,118
	4,402	(9,163)	(4,761)	5	(4,756)
Other	1,026	784	1,810	240	2,050
<b>Total net revenue</b>	<b>116,627</b>	<b>93,957</b>	<b>210,584</b>	<b>25,343</b>	<b>235,927</b>
Expenses	57,912	56,885	114,797	14,022	128,819
Income before provision for income taxes	\$ 58,715	\$ 37,072	\$ 95,787	\$ 11,321	\$ 107,108
Segment assets at period end (1)	\$ 1,117,090	\$ 895,169	\$ 2,012,259	\$ 111,285	\$ 2,123,544

(1) Amount excludes parent Company assets, which consist primarily of deferred tax assets of \$55.8 million.



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	Six months ended June 30, 2013				
	Production	Mortgage banking Servicing	Total (in thousands)	Investment management	Total
<b>Revenue</b>					
Net gains on mortgage loans held for sale at fair value	\$ 82,611	\$	\$ 82,611	\$	\$ 82,611
Loan origination fees	11,980		11,980		11,980
Fulfillment fees from PennyMac Mortgage Investment Trust	50,298		50,298		50,298
Net servicing fees		38,111	38,111		38,111
Management fees				18,835	18,835
Carried Interest from Investment Funds				7,599	7,599
Net interest income (expense):					
Interest income	6,207		6,207	10	6,217
Interest expense	5,570	1,960	7,530		7,530
	637	(1,960)	(1,323)	10	(1,313)
Other	408	119	527	297	824
<b>Total net revenue</b>	<b>145,934</b>	<b>36,270</b>	<b>182,204</b>	<b>26,741</b>	<b>208,945</b>
Expenses	63,745	29,827	93,572	9,851	103,423
Income before provision for income taxes	\$ 82,189	\$ 6,443	\$ 88,632	\$ 16,890	\$ 105,522
Segment assets at period end (1)	\$ 817,633	\$ 344,813	\$ 1,162,446	\$ 117,676	\$ 1,280,122

(1) Amount excludes parent Company assets, which consist primarily of cash of \$714,000.

**Note 24 Recently Issued Accounting Pronouncements**

Accounting Standard Update No 2014-04, *Receivables: Troubled Debt Restructuring by Creditors Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure* (ASU 2014-04), clarifies when a creditor should be considered to have received physical possession of residential real estate collateralizing a mortgage loan and the mortgage loan derecognized in the receivable and recognized as real estate property. This update specifies that an in substance repossession occurs when either the creditor has obtained the legal title to the property after a foreclosure or the borrower has transferred all interest in the property to the creditor through a deed in lieu of foreclosure or similar legal agreement so that at that time the asset should be reclassified from a loan receivable to real estate acquired in settlement of loans. This update also provides that a disclosure of the amount between real estate acquired in settlement of loans and the recorded investment in mortgage loans that are in the process of foreclosure must be included in both interim and annual financial reports. This amendment update is effective for periods for fiscal years beginning after December 15, 2014. The adoption of ASU 2014-04 is not expected to have a material effect on the Company's consolidated financial statements.

Accounting Standards Update No 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), was created to standardize revenue recognition process between public and private companies as well as across industries in an effort to more closely align GAAP revenue recognition with international standards to provide a more comparable revenue number for the users of the financial statements. The standard outlines that for all contracts, revenue should be recognized when or as the entity satisfies a performance obligation. Revenue is recognized either over a period or at one point in time in accordance with how the control of the service or good is transferred. This amendment update is for all year-end and interim periods beginning after December 15, 2016 and early application is not permitted. The Company is evaluating the effect of adopting ASU 2014-09 to its consolidated financial statements.

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In June of 2014, the FASB issued Accounting Standards Update No. 2014-11, *Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures* (the Update) to the Transfers and Servicing topic of its Accounting Standards Codification. The amendments in the Update require two accounting changes. First, the amendments in the Update change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. Second, for repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement.

The amendments in the Update require disclosures for certain transactions comprising (1) a transfer of a financial asset accounted for as a sale and (2) an agreement with the same transferee entered into in contemplation of the initial transfer that results in the transferor retaining substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. The Update also specifies certain disclosure requirements for those transactions outstanding at the reporting date and for repurchase agreements, securities lending transactions and repurchase-to-maturity transactions, the transferor is required to make certain disclosures by type of transaction. The adoption of the Update is not expected to have a material effect on the Company's consolidated financial statements.

### **Note 25 Subsequent Events**

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

- All agreements to repurchase assets that matured between June 30, 2014 and the date of this Report were extended or renewed.



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

***Cautionary Statement Regarding Forward-Looking Statements***

The following discussion and analysis of financial condition and results of operations should be read with the consolidated financial statements and the related notes of PennyMac Financial Services, Inc. included within this Quarterly Report on Form 10-Q.

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

***Overview***

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

***Initial Public Offering and Recapitalization***

On May 14, 2013, we completed an initial public offering (IPO) in which we sold approximately 12.8 million shares of Class A Common Stock par value \$0.0001 per share (Class A Common Stock) for cash consideration of \$16.875 per share (net of underwriting discounts). With the net proceeds from the IPO, we bought approximately 12.8 million Class A units of Private National Mortgage Acceptance Company, LLC (PennyMac) and became its sole managing member. We operate and control all of the business and affairs and consolidate the financial results of PennyMac.

Before the completion of the IPO, the limited liability company agreement of PennyMac was amended and restated to, among other things, change its capital structure by converting the different classes of interests held by its existing unitholders into Class A units. PennyMac and its existing unitholders also entered into an exchange agreement under which (subject to the terms of the exchange agreement) they have the right to exchange their Class A units for shares of our Class A Common Stock on a one for one basis, subject to customary conversion rate adjustments for stock splits, stock dividends, reclassifications and certain other transactions.

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 pursuant to the exchange agreement results in a special adjustment for PFSI that may increase PFSI's tax basis in certain assets of PennyMac that otherwise would not have been available. These increases in tax basis may reduce the amount of tax that PFSI would otherwise be required to pay in the future and result in increases in investment in PennyMac deferred tax assets net of investment in PennyMac deferred tax liabilities.

As part of the IPO, we entered into a tax receivable agreement with the then existing unitholders of PennyMac that provides for payment to such owners of 85% of the tax benefits, if any, that we are deemed to realize under certain circumstances as a result of (i) increases in tax basis resulting from exchanges of Class A units and (ii) certain other tax benefits related to our tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

### ***Our Company***

We are a specialty financial services firm with a comprehensive mortgage platform and integrated business focused on the production and servicing of U.S. residential mortgage loans (activities which we refer to as mortgage banking) and the management of investments related to the U.S. residential mortgage market. We believe that our operating capabilities, specialized expertise, access to long term investment capital, and our management's experience across all aspects of the mortgage business will allow us to profitably grow these activities and capitalize on other related opportunities as they arise in the future.

PennyMac was founded in 2008 by members of its executive leadership team and two strategic partners, BlackRock Mortgage Ventures, LLC, together with its affiliates, and HC Partners LLC, formerly known as Highfields Capital Investments LLC, together with its affiliates.

We conduct our business in three segments: loan production, loan servicing and investment management. Our principal mortgage banking subsidiary, PennyMac Loan Services, LLC ( "PLS" ), is a non-bank producer and servicer of mortgage loans in the United

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States. Our principal investment management subsidiary, PNMAC Capital Management, LLC ( PCM ), is an SEC registered investment adviser. PCM manages PennyMac Mortgage Investment Trust ( PMT ), a mortgage real estate investment trust, listed on the New York Stock Exchange under the ticker symbol PMT. PCM also manages PNMAC Mortgage Opportunity Fund, LLC and PNMAC Mortgage Opportunity Fund, LP, both registered under the Investment Company Act, an affiliate of these funds, and PNMAC Mortgage Opportunity Fund Investors, LLC. We refer to these funds collectively as our Investment Funds and, together with PMT, as our Advised Entities.

***Mortgage Banking***

***Production***

Our loan production segment is sourced through two channels: correspondent production and consumer-direct lending.

In correspondent production we manage, on behalf of PMT and for our own account, the acquisition of newly originated, prime credit quality, first lien residential mortgage loans that have been underwritten to investor guidelines. PMT acquires, from approved correspondent sellers, newly originated loans, including both conventional and government-insured residential mortgage loans that qualify for inclusion in securitizations that are guaranteed by the Agencies. For conventional loans, we perform fulfillment activities for PMT and earn a fulfillment fee for each loan purchased by PMT. In the case of government insured loans, we purchase them from PMT at PMT's cost plus a sourcing fee and fulfill them for our own account.

Through our consumer-direct lending channel, we originate new prime credit quality, first lien residential conventional and government-insured mortgage loans on a national basis to allow customers to purchase or refinance their homes. The consumer direct model relies on the Internet and call center based staff to acquire and interact with customers across the country. We do not have a brick and mortar branch network and have been developing our consumer direct operations with call centers strategically positioned across the United States.

During the quarter and six months ended June 30, 2014, we managed PMT's acquisition of newly originated, prime credit quality, first lien residential conventional and government-insured mortgage loans with fair values totaling \$7.3 billion and \$12.3 billion, respectively. We purchased for our own account approximately \$4.0 billion and \$7.1 billion, respectively, of government-insured loans at fair value from PMT during the quarter and six months ended June 30, 2014. We also originated \$410.1 million and \$728.4 million, respectively, of residential mortgage loans at fair value through our consumer-direct channel during the quarter and six months ended June 30, 2014.

During the quarter and six months ended June 30, 2013, we managed PMT's acquisition of newly originated, prime credit quality, first lien residential conventional and government-insured mortgage loans with fair values totaling \$8.9 billion and \$17.8 billion, respectively. We purchased for our own account approximately \$4.7 billion and \$8.3 billion, respectively, of government-insured loans at fair value from PMT during the quarter and six months ended June 30, 2013. We also originated \$344.8 million and \$613.0 million, respectively, of residential mortgage loans at fair value through our consumer-direct channel during the quarter and six months ended June 30, 2013.

***Servicing***

Our loan servicing segment performs loan administration, collection and default activities, including the collection and remittance of loan payments; response to customer inquiries; accounting for principal and interest; holding custodial (impound) funds for the payment of property taxes and insurance premiums; counseling delinquent mortgagors; and supervising foreclosures and property dispositions. We service a diverse portfolio of loans both as the owner of MSRs and on behalf of other MSR or mortgage owners. We provide prime servicing for conventional and government insured loans, as well as special servicing for distressed loans that have been acquired as investments by our Advised Entities. As of June 30, 2014, the portfolio of loans that we serviced or subserviced totaled approximately \$93.6 billion in UPB.

#### ***Investment Management***

We are an investment manager through an indirect subsidiary, PCM. PCM currently manages PMT and the Investment Funds. PMT and the Investment Funds had combined net assets of approximately \$2.1 billion as of June 30, 2014. For these activities, we earn management fees as a percentage of net assets and incentive compensation based on investment performance.

#### ***Observations on Current Market Conditions***

Our business is affected by macroeconomic conditions in the United States, including economic growth, unemployment rates, the residential housing market and interest rate levels and expectations. During the second quarter of 2014, real U.S. gross domestic product expanded at an annual rate of 4.0% compared to a revised 2.1% decrease for the first quarter of 2014 and a 2.5% increase for the second quarter of 2013. The national unemployment rate was 6.1% at June 30, 2014 and compares to a revised

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seasonally adjusted rate of 7.5% at June 30, 2013 and 6.7% at March 31, 2014. While delinquency rates on residential real estate loans continue to decrease, they remain elevated compared to historical rates. As reported by the Federal Reserve Bank, during the first quarter of 2014, the delinquency rate on residential real estate loans held by commercial banks was 7.8%, a reduction from 9.7% during the first quarter of 2013.

The seasonally adjusted annual rate of existing home sales for June 2014 was 2.3% lower than for June 2013 and the national median existing home price for all housing types was \$223,300, a 4.3% increase from June 2013. On a national level, foreclosure filings during the second quarter of 2014 decreased by 19% as compared to the second quarter of 2013. Foreclosure activity across the country is on a decreasing trend; however, it is expected to remain above historical average levels through 2014 and beyond.

Thirty-year fixed mortgage interest rates ranged from a low of 4.16% to a high of 4.34% during the second quarter of 2014. During the second quarter of 2013, thirty-year fixed mortgage interest rates ranged from a low of 3.45% to a high of 4.07% (Source: the Federal Home Loan Mortgage Corporation's Weekly Primary Mortgage Market Survey).

Changes in fixed rate residential mortgage loan interest rates generally follow changes in long term U.S. Treasury yields. Toward the end of the second quarter of 2013, an increase in these Treasury yields led to an increase in mortgage loan interest rates. As a result of this increase in mortgage loan interest rates, market volumes for mortgage originations have decreased led by a reduction in refinance activity.