PennyMac Mortgage Investment Trust
Form 10-Q
August 03, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

Or

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

For the transition period from to

Commission file number: 001-34416

PennyMac Mortgage Investment Trust

(Exact name of registrant as specified in its charter)

Maryland	**27-0186273**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
6101 Condor Drive, Moorpark, California	**93021**
(Address of principal executive offices)	**(Zip Code)**

(818) 224-7442

(Registrant s telephone number, including area code)

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

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

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	x
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 x

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

Class	Outstanding at August 2, 2012
Common Shares of Beneficial Interest, $0.01 par value	**41,466,369**

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PENNYMAC MORTGAGE INVESTMENT TRUST

FORM 10-Q

June 30, 2012

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	June 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Cash	$ 27,970	$ 14,589
Short-term investments	32,340	30,319
United States Treasury security		50,000
Mortgage-backed securities at fair value	167,446	72,813
Mortgage loans acquired for sale at fair value	460,419	232,016
Mortgage loans at fair value	969,954	696,266
Mortgage loans under forward purchase agreements at fair value	16,881	129,310
Real estate acquired in settlement of loans	89,121	80,570
Real estate acquired in settlement of loans under forward purchase agreements	797	22,979
Mortgage servicing rights:		
at lower of amortized cost or fair value	31,547	5,282
at fair value	1,285	749
Principal and interest collections receivable	21,911	8,664
Principal and interest collections receivable under forward purchase agreements	3,004	5,299
Interest receivable	3,610	2,099
Due from affiliates	8,314	347
Other assets	56,146	34,760
Total assets	$ 1,890,745	$ 1,386,062
LIABILITIES		
Assets sold under agreements to repurchase:		
Securities	$ 157,289	$ 115,493
Mortgage loans acquired for sale at fair value	418,019	212,677
Mortgage loans at fair value	412,495	275,649
Real estate acquired in settlement of loans	19,909	27,494
Note payable secured by mortgage loans at fair value		28,617
Borrowings under forward purchase agreements	16,693	152,427
Accounts payable and accrued liabilities	24,174	9,198
Contingent underwriting fees payable	5,883	5,883
Payable to affiliates	21,591	12,166
Income taxes payable	9,019	441
Total liabilities	1,085,072	840,045
Commitments and contingencies		
SHAREHOLDERS EQUITY		
Common shares of beneficial interest authorized, 500,000,000 common shares of $0.01 par value; issued and outstanding, 41,466,369 and 28,404,554 common shares, respectively	415	284
Additional paid-in capital	767,506	518,272

Retained earnings	37,752	27,461
Total shareholders equity	805,673	546,017
Total liabilities and shareholders equity	$ 1,890,745	$ 1,386,062

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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share data)

	Quarter ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Investment Income				
Net gain (loss) on investments:				
Mortgage-backed securities	$ 706	$ (873)	$ 1,063	$ (1,315)
Mortgage loans	27,286	22,951	38,417	33,283
	27,992	22,078	39,480	31,968
Interest income:				
Short-term investments	47	27	78	58
Mortgage-backed securities	1,011	982	1,585	2,068
Mortgage loans	14,944	6,961	30,764	12,047
	16,002	7,970	32,427	14,173
Net gain on mortgage loans acquired for sale	18,046	40	31,416	123
Results of real estate acquired in settlement of loans	2,571	86	6,288	1,175
Net loan servicing fees	(855)	6	(658)	3
Other	650	43	2,102	64
Net investment income	64,406	30,223	111,055	47,506
Expenses				
Loan fulfillment fees	7,715	61	13,839	73
Interest	6,703	2,970	13,377	5,248
Loan servicing	5,036	3,483	9,972	5,786
Management fees	2,488	1,913	4,292	3,462
Compensation	1,744	1,250	3,045	2,264
Professional services	1,186	1,115	1,628	1,992
Other	1,559	1,429	2,352	2,393
Total expenses	26,431	12,221	48,505	21,218
Income before provision for income taxes	37,975	18,002	62,550	26,288
Provision for income taxes	8,406	1,385	13,923	2,026
Net income	$ 29,569	$ 16,617	$ 48,627	$ 24,262
Earnings per share				
Basic	$ 0.80	$ 0.59	$ 1.46	$ 0.96
Diluted	$ 0.79	$ 0.59	$ 1.46	$ 0.96
Weighted-average shares outstanding				
Basic	36,922	27,778	32,999	24,874

Diluted	37,208	28,096	33,253	25,142
Dividends declared per share	$ 0.55	$ 0.42	$ 1.10	$ 0.42

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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(Unaudited)

(In thousands, except share data)

	Number of shares	Par value	Additional paid-in capital	Retained earnings	Total
Balance at December 31, 2010	16,832,343	$ 168	$ 317,175	$ 2,570	$ 319,913
Net income				24,262	24,262
Share-based compensation	5,900		1,664		1,664
Cash dividends declared, $0.42 per share				(11,673)	(11,673)
Proceeds from offerings of common shares	10,953,500	110	197,052		197,162
Underwriting and offering costs			(8,404)		(8,404)
Balance at June 30, 2011	27,791,743	$ 278	$ 507,487	$ 15,159	$ 522,924
Balance at December 31, 2011	28,404,554	$ 284	$ 518,272	$ 27,461	$ 546,017
Net income				48,627	48,627
Share-based compensation	88,399		2,192		2,192
Cash dividends declared, $1.10 per share				(38,336)	(38,336)
Proceeds from offerings of common shares	12,973,416	131	248,266		248,397
Underwriting and offering costs			(1,224)		(1,224)
Balance at June 30, 2012	41,466,369	$ 415	$ 767,506	$ 37,752	$ 805,673

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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six months ended June 30, 2012	2011
Cash flows from operating activities		
Net income	$ 48,627	$ 24,262
Adjustments to reconcile net income to net cash used by operating activities:		
Net (gain) loss on mortgage-backed securities at fair value	(1,063)	1,315
Net gain on mortgage loans at fair value	(38,417)	(33,283)
Accrual of unearned discounts on mortgage-backed securities at fair value and capitalization of interest on mortgage loans at fair value	(13,249)	(1,374)
Net gain on mortgage loans acquired for sale at fair value	(31,417)	(123)
Results of real estate acquired in settlement of loans	(6,288)	(1,175)
Change in fair value and amortization of mortgage servicing rights	3,011	(3)
Amortization of credit facility commitment fees	1,268	681
Accrual of costs related to forward purchase agreements	3,255	
Share-based compensation expense	2,192	1,664
Purchases of mortgage loans acquired for sale at fair value	(5,370,540)	(74,370)
Sales of mortgage loans acquired for sale at fair value	5,138,892	59,488
Increase in principal and interest collections receivable	(13,247)	(6,384)
Decrease in principal and interest collections receivable under forward purchase agreements	2,295	
Increase in interest receivable	(1,511)	(1,361)
Increase in due from affiliates	(7,967)	(5,093)
Increase in other assets	(6,112)	(1,991)
Increase (decrease) in accounts payable and accrued liabilities	4,698	(10,019)
Increase in payable to affiliates	9,425	5,787
Increase in income taxes payable	8,578	662
Net cash used by operating activities	(267,570)	(41,317)
Cash flows from investing activities		
Net increase in short-term investments	(2,021)	(38,633)
Maturity of United States Treasury security	50,000	
Purchases of mortgage-backed securities at fair value	(112,211)	
Repayments of mortgage-backed securities at fair value	21,257	34,165
Sales of mortgage-backed securities at fair value		3,345
Purchases of mortgage loans at fair value	(260,595)	(360,403)
Repayments of mortgage loans at fair value	84,564	55,203
Sales of mortgage loans at fair value		2,518
Repayments of mortgage loans under forward purchase agreements at fair value	14,040	
Purchases of real estate acquired in settlement of loans	(48)	(1,510)
Sales of real estate acquired in settlement of loans	65,386	29,321
Sales of real estate acquired in settlement of loans under forward purchase agreements	9,914	
Purchases of mortgage servicing rights	(29)	
Sales of mortgage servicing rights	104	
Decrease (increase) in margin deposits and restricted cash	(5,721)	4,758
Net cash used by investing activities	(135,360)	(271,236)
Cash flows from financing activities		
Sales of securities under agreements to repurchase	706,966	822,934
Repurchases of securities sold under agreements to repurchase	(665,170)	(853,158)
Sales of loans under agreements to repurchase	5,125,421	218,737

Repurchases of loans sold under agreements to repurchase	(4,809,806)	(103,956)
Sales of real estate acquired in settlement of loans financed under agreement to repurchase	10,753	7,808
Repurchases of real estate acquired in settlement of loans financed under agreements to repurchase	(18,338)	
Repayments of note payable secured by mortgage loans at fair value	(2,044)	
Repayments of borrowings under forward purchase agreements	(140,307)	
Proceeds from issuance of common shares	248,397	197,162
Payment of underwriting and offering costs relating to issuance of common shares	(1,224)	(8,404)
Payment of dividends	(38,337)	(11,673)
Net cash provided by financing activities	416,311	269,450
Net increase in cash	13,381	(43,103)
Cash at beginning of period	14,589	45,447
Cash at end of period	$ 27,970	$ 2,344

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Organization and Basis of Presentation

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

The Company is externally managed by an affiliate, PNMAC Capital Management, LLC (PCM or the Manager), an investment adviser registered with the Securities and Exchange Commission (the SEC) that specializes in and focuses on residential mortgage loans. Under the terms of a management agreement, PCM is paid a management fee with a base component and a performance incentive component. Determination of the amount of management fees is discussed in Note 3 *Transactions with Related Parties*.

The Company s objective is to provide attractive risk-adjusted returns to its investors over the long-term, principally through dividends and secondarily through capital appreciation. The Company intends to achieve this objective largely by investing in distressed mortgage assets and acquiring, pooling, securitizing or selling newly originated prime credit quality residential mortgage loans (correspondent lending).

The Company operates two segments: investment activities and correspondent lending. The investment activities segment focuses on mortgage assets that are acquired and held for investment purposes and the correspondent lending segment focuses on the purchase for resale of newly originated mortgage loans.

The investment activities segment represents the Company s investments in distressed mortgage loans, real estate acquired in settlement of loans (REO), mortgage-backed securities (MBS) and mortgage servicing rights (MSRs). Management seeks to maximize the value of the distressed mortgage loans acquired by the Company through proprietary loan modification programs, special servicing and other initiatives focused on keeping borrowers in their homes. Where this is not possible, such as in the case of many nonperforming mortgage loans, the Company seeks to effect property resolution in a timely, orderly and economically efficient manner, including through the use of resolution alternatives to foreclosure.

The correspondent lending segment represents the Company s operations aimed at serving as an intermediary between mortgage lenders and the capital markets by purchasing, pooling and reselling newly originated prime credit quality mortgage loans either directly or in the form of MBS, using the services of the Manager.

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

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

The accompanying consolidated financial statements have been prepared in compliance with accounting principles generally accepted in the United States (U.S. GAAP) 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, 2011 (the Annual Report).

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

In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the periods ended June 30, 2012 are not necessarily indicative of the results for the year ending December 31, 2012.

Note 2 Concentration of Risks

As discussed in Note 1 *Organization and Basis of Presentation* above, PMT s investing activities are centered in real estate-related assets, a substantial portion of which are distressed at acquisition. Because of the Company s investment strategy, many of the mortgage loans in its targeted asset class are purchased at discounts reflecting their distressed state or perceived higher risk of default, as well as a greater likelihood of collateral documentation deficiencies. Before the Company buys loans or other assets, PCM validates key information provided by the sellers that is necessary to determine the value of the acquired asset. A substantial portion of the distressed mortgage loans purchased by the Company has been acquired from or through one or more subsidiaries of Citigroup, Inc.

Through its management agreement with PCM and its loan servicing agreement with an affiliated company, PennyMac Loan Services, LLC (PLS), PMT works with borrowers to perform loss mitigation activities. Such activities include the use of loan modification programs (such as the U.S. Department of the Treasury and Housing and Urban Development s Home Affordable Modification Program (HAMP)) and workout options that PCM believes have the highest probability of successful resolution for both borrowers and PMT. Loan modification or resolution may include PMT accepting a reduction of the principal balances of certain mortgage loans in its investment portfolio. When loan modifications and other efforts are unable to cure distressed loans, the Company s objective is to effect timely acquisition and liquidation of the property securing the mortgage loan.

Because of the Company s investment focus, PMT is exposed, to a greater extent than traditional mortgage investors, to the risks that borrowers may be in economic distress and/or may have become unemployed, bankrupt or otherwise unable or unwilling to make payments when due, and to the effects of fluctuations in the residential real estate market on the performance of its investments. Factors influencing these risks include, but are not limited to:

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

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

On July 12, 2011 and December 20, 2011, the Company entered into forward purchase agreements with Citigroup Global Markets Realty Corp. (CGM), a subsidiary of Citigroup Inc., to purchase certain nonperforming residential mortgage loans and residential real property acquired in settlement of loans (collectively, the CGM Assets). The CGM Assets were acquired by CGM from unaffiliated money center banks. The commitment under the forward purchase commitment dated July 12, 2011 was settled during the quarter ended June 30, 2012. The initial purchase price under the forward commitment dated December 20, 2011 was $22.1 million. The remaining purchase price as of June 30, 2012 is $16.1 million. Remaining subsequent adjustments may increase the purchase price to $16.3 million based on the date the purchase is settled.

The Company also pays CGM a cost of carry on the CGM Assets pending purchase through the date such CGM Assets are ultimately acquired. The Company recognized the assets subject to the transactions and the related liabilities. The CGM Assets are serviced by PLS.

The CGM Assets are included on the Company s consolidated balance sheet as *Mortgage loans under forward purchase agreements at fair value* and *Real estate acquired in settlement of loans under forward purchase agreements* and the related liabilities are included as *Borrowings under forward purchase agreements*. The CGM Assets are being held by CGM within a separate trust entity deemed a variable interest entity. The Company s interest in the CGM Assets is deemed to be contractually segregated from all other interests in the trust. When assets are contractually segregated, they are often referred to as a silo. The silo consists of the CGM Assets and its related liability. The Company directs all of the activities that drive the economic results of the CGM Assets. All of the changes in the fair value and cash flows of the CGM Assets are attributable solely to the Company, and such cash flows can only be used to settle the related liability.

As a result of consolidating the silo, the Company s consolidated statement of income for the three and six months ended June 30, 2012 includes net gain on mortgage loans of $2.5 million and $9.2 million, interest income on mortgage loans of $348,000 and $0.8 million, interest expense of $0.8 million and $2.3 million and loan servicing fees of $460,000 and $1.0 million in each case attributable to the CGM Assets. The Company received repayments of mortgage loans totaling $5.3 million and $14.0 million and repaid borrowings under the forward purchase agreements totaling $113.2 million during the three and six months ended June 30, 2012. The Company has no other variable interests in the trust entity, or other exposure to the creditors of the trust entity which could expose the Company to loss.

During the six months ended June 30, 2011, the Company purchased $260.6 million of mortgage loans at fair value and real estate acquired in settlement of loans for its investment portfolio. All of the $260.6 million was purchased from or through one or more subsidiaries of Citigroup, Inc.

Beginning in the fourth quarter of 2011, the Company s correspondent lending activities have been experiencing substantial growth. As a result of such growth, the Company s correspondent lending segment contributed approximately 32% of PMT s pre-tax income during the six months ended June 30, 2012 and the inventory of mortgage loans acquired for sale at fair value represented approximately 25% of the Company s investments at June 30, 2012.

Correspondent lending activities introduce different risks from those posed by investments in distressed assets. The Company s correspondent lending activities and the MSRs that are held in the Company s investment segment that the Company receives as proceeds from such correspondent lending sales are more sensitive to the level and volatility of interest rates. For example, a decline in mortgage rates generally increases the demand for home loans as borrowers refinance, but also generally leads to accelerated payoffs in the Company s mortgage servicing portfolio, which have a negative effect on the value of MSRs.

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Management attempts to manage the sensitivity of earnings to the changes in market interest rates through the use of derivative financial instruments to moderate the effects of changes in the level and volatility of interest rates on the fair value of the Company s inventory of mortgage loans acquired for sale at fair value and commitments to purchase mortgage loans for sale. The Company does not presently use derivative financial instruments to moderate the effects on PMT s earnings of changes in the fair value of its investment in MSRs.

The success of the Company s interest rate risk management strategies depends in part on management s ability to predict the earnings sensitivity of its loan servicing and loan production operations in various interest rate environments. There are many market factors that affect the performance of the Company s interest rate risk management activities including interest rate volatility, the shape of the yield curve and the spread between mortgage interest rates and United States Treasury or swap rates. The success of this strategy affects PMT s net income and the effect can be either positive or negative, and can be material to the Company.

The correspondent lending segment s ability to sell loans profitably is affected by many factors, including the relative demands for such loans and MBS evidencing interests in such loans, the cost of credit enhancements and interest rate risk management, investor perceptions of such loans and MBS and the risks posed by such products.

Note 3 Transactions with Related Parties

The Company is managed externally by PCM under the terms of a management agreement that expires on August 4, 2012 and will be automatically renewed for a one-year term on the date thereof and each anniversary date thereafter unless previously terminated. The management agreement provides for an annual review of PCM s performance under the management agreement by the Company s independent trustees. PMT s board of trustees reviews the Company s financial results, policy compliance and strategic direction.

As more fully described in the Company s Annual Report, certain of the underwriting costs incurred in the Company s initial public offering (IPO) were paid on PMT s behalf by PCM and a portion of the underwriting discount was deferred by agreement with the underwriters of the offering. PMT will reimburse PCM the underwriting costs as discussed in Note 25 *Shareholders Equity*.

PMT pays PCM a base management fee and may pay a performance incentive fee, both payable quarterly and in arrears.

Following is a summary of management fee expense and the related liability recorded by the Company for the periods presented:

	Quarter ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
Base management fee	$ 2,488	$ 1,913	$ 4,292	$ 3,462
Performance incentive fee				
Total management fee incurred during the period	2,488	1,913	4,292	3,462
Fee paid during the period	(1,777)	(1,549)	(2,872)	(2,777)
Fee outstanding at beginning of period	1,804	1,549	1,095	1,228
Fee outstanding at period end	$ 2,515	$ 1,913	$ 2,515	$ 1,913

The management fees are more fully described in Note 4 *Transactions with Related Parties* to the Company s Annual Report. Effective May 16, 2012, the Company amended its management agreement with PCM to change the way shareholders equity is measured for purposes of calculating the base component of its management fee. Previously, the measure of shareholders equity excluded unrealized gains, losses or other non-cash items reflected in the Company s financial statements. The management agreement was amended to

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base the management fee on shareholders equity computed using US GAAP. The method of measuring the performance incentive fee was not changed. The purpose of the amendment was to better align the Manager s base management fee with the Company s investment strategy, which, in the pursuit of attractive investment opportunities, has evolved to include nonperforming mortgage loans that generate unrealized gains and correspondent lending activity that produces non-cash income through the retention of mortgage servicing rights created in the sales transactions. The amendment is expected to increase the amount of the base management fee payable by the Company to the Manager.

The Company, through its Operating Partnership, also has a loan servicing agreement with PLS. Servicing fee rates are based on the risk characteristics of the mortgage loans serviced and total servicing compensation is established at levels that management believes are competitive with those charged by other servicers or specialty servicers, as applicable.

Servicing fee rates for nonperforming loans are expected to range between 30 and 100 basis points per year on the unpaid principal balance of the mortgage loans serviced on the Company s behalf. PLS is also entitled to certain customary market-based fees and charges, including boarding and deboarding fees, liquidation and disposition fees, assumption, modification and origination fees and late charges, as well as interest on funds on deposit in custodial accounts. In the event PLS either effects a refinancing of a loan on the Company s behalf and not through a third party lender and the resulting loan is readily saleable, or originates a loan to facilitate the disposition of real estate that the Company has acquired in settlement of a loan, PLS is entitled to receive market-based fees and compensation from the Company.

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

In connection with the mortgage servicing rights acquired in the Company s correspondent lending business, through which the Company acquires mortgage loans originated by correspondent lenders for resale to the government-sponsored agencies such as the Federal National Mortgage Association (Fannie Mae) or securitization through Government National Mortgage Association (Ginnie Mae) (Fannie Mae and Ginnie Mae are each referred to as an Agency and, collectively, as the Agencies) and other investors, PLS is entitled to base subservicing fees, which range from 5 to 20 basis points per year of the unpaid principal balance of such loans, and other customary market-based fees and charges as described above.

Pursuant to the terms of a mortgage banking services agreement, PLS also provides certain mortgage banking services, including fulfillment and disposition-related services, to the Company for a fulfillment fee based on a percentage of the unpaid principal balance of the mortgage loans to be sold to non-affiliates where the Company is approved or licensed to sell to such non-affiliate. The fulfillment fee for such services is currently 50 basis points. During the quarter and six months ended June 30, 2012, the Company recorded fulfillment fees totaling $7.7 million and $13.8 million, respectively. During the quarter and six months ended June 30, 2011, the Company recorded fulfillment fees totaling $61,000 and $73,000, respectively.

The Company collects interest income and a sourcing fee of three basis points for each mortgage loan it purchases from a correspondent and sells to PLS for ultimate disposition to a third party where the Company is not approved or licensed to sell to such third party. During the six months ended June 30, 2012 and 2011, the Company sold loans to PLS with unpaid balances totaling approximately $2.4 billion and $38.3 million and received sourcing fees totaling approximately $701,000 and $12,000, respectively. The Company held mortgage loans pending sale to PLS with unpaid balances totaling approximately $95.9 million and $44.2 million at June 30, 2012 and December 31, 2011, respectively.

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The Company paid servicing and other fees to PLS as described above and as provided in its loan servicing agreement and recorded other expenses, including common overhead expenses incurred on its behalf by PCM and its affiliates, in accordance with the terms of its management agreement. Following is a summary of those expenses for the periods presented:

	Quarter ended June 30, 2012	Quarter ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
	(in thousands)			
Loan servicing fees payable to PLS	$ 5,036	$ 3,313	$ 9,972	$ 5,519
Fulfillment fees payable to PLS	7,715	61	13,839	73
Reimbursement of expenses incurred on PMT s behalf	2,055	911	3,261	1,170
Reimbursement of common overhead incurred by PCM and its affiliates	882	942	1,268	1,529
	$ 15,688	$ 5,227	$ 28,340	$ 8,291
Payments during the period	$ 11,014	$ 4,997	$ 16,859	$ 6,203

Amounts due to affiliates are summarized below as of the dates presented:

	June 30, 2012	December 31, 2011
	(in thousands)	
Contingent offering costs	$ 2,941	$ 2,941
Management fee	2,515	1,096
Other expenses	13,450	8,129
Correspondent lending pass-through items	2,685	
	$ 21,591	$ 12,166

Amounts due from affiliates totaled $8.3 million and $347,000 at June 30, 2012 and December 31, 2011, respectively, and represent amounts receivable pursuant to loan sales to PLS and reimbursable expenses paid on the affiliates behalf by the Company.

PCM s parent company, Private National Mortgage Acceptance Company, LLC, held 75,000 of the Company s common shares of beneficial interest at both June 30, 2012 and December 31, 2011.

Note 4 Earnings Per Share

Basic earnings per share is determined using net income divided by the weighted-average common shares outstanding during the period. Diluted earnings per share is computed by dividing net income attributable to common shareholders by the weighted-average common shares outstanding, assuming all potentially dilutive common shares were issued. In periods in which the Company records a loss, potentially dilutive common shares are excluded from the diluted loss per share calculation, as their effect on loss per share is anti-dilutive.

The Company makes grants of restricted share units which entitle the recipients to receive dividend equivalents during the vesting period on a basis equivalent to the dividends paid to holders of common shares. For purposes of calculating earnings per share, unvested share-based compensation awards containing non-forfeitable rights to dividends or dividend equivalents (collectively, dividends) are classified as participating securities and are included in the basic earnings per share calculation using the two-class method. Under the two-class method, all earnings (distributed and undistributed) are allocated to each class of common shares and participating securities, based on their respective rights to receive dividends.

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

	Quarter ended June 30, 2012	Quarter ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
	(in thousands, except per share amounts)			
Basic earnings per share:				
Net income	$ 29,569	$ 16,617	$ 48,627	$ 24,262
Effect of participating securities share-based compensation instruments	(213)	(224)	(424)	(274)
Net income attributable to common shareholders	$ 29,356	$ 16,393	$ 48,203	$ 23,988
Weighted-average shares outstanding	36,922	27,778	32,999	24,874
Basic earnings per share	$ 0.80	$ 0.59	$ 1.46	$ 0.96
Diluted earnings per share:				
Net income	$ 29,569	$ 16,617	$ 48,627	$ 24,262
Weighted-average shares outstanding	36,922	27,778	32,999	24,874
Dilutive potential common shares shares issuable undershare-based compensation plan	286	318	254	268
Diluted weighted-average number of common shares outstanding	37,208	28,096	33,253	25,142
Diluted earnings per common share	$ 0.79	$ 0.59	$ 1.46	$ 0.96

Note 5 Loan Sales

The Company purchases and sells mortgage loans into the secondary mortgage market without recourse for credit losses. However the Company maintains continuing involvement with the loans in the form of servicing or subservicing arrangements and the potential 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 loans in transactions whereby the Company maintains continuing involvement with the mortgage loan and period-end information relating to such loans:

	Quarter ended June 30, 2012	Six months ended June 30, 2012
	(in thousands)	
Cash flows:		
Proceeds from sales	$ 1,819,393	$ 2,912,297
Service fees received	$ 1,757	$ 2,409
Period-end information:		
Unpaid principal balance of loans outstanding at period-end	$ 2,932,967	
Loans delinquent 30-89 days	$ 3,897	
Loans delinquent 90 or more days or in foreclosure or bankruptcy	$ 175	

Note 6 Fair Value

The Company s 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.

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Fair Value Accounting Elections

Management identified all of its financial assets, including short-term investments, United States Treasury security, MBS, and mortgage loans as well as its securities sold under agreements to repurchase and its MSRs relating to loans with initial interest rates of more than 4.5% that were acquired as a result of its correspondent lending operations to be accounted for at estimated fair value so such changes in fair value will be reflected in income as they occur and more timely reflect the results of the Company s investment performance.

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

For loans sold under agreements to repurchase subject to agreements made beginning in December 2010, REO financed through agreements to repurchase beginning in June 2011 and borrowings under forward purchase agreements beginning in July 2011, management has determined that historical cost accounting is more appropriate because under this method debt issuance costs are spread over the term of the debt, thereby matching the debt issuance expense to the periods benefiting from the usage of the debt.

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Financial Statement Items Measured at Fair Value on a Recurring Basis

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

	June 30, 2012			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	$ 32,340	$	$	$ 32,340
Mortgage-backed securities at fair value		114,285	53,161	167,446
Mortgage loans acquired for sale at fair value		460,419		460,419
Mortgage loans at fair value			969,954	969,954
Mortgage loans under forward purchase agreements at fair value			16,881	16,881
MSRs at fair value			1,285	1,285
Derivative financial instruments		14,682		14,682
	$ 32,340	$ 589,386	$ 1,041,281	$ 1,663,007
Liabilities:				
Securities sold under agreements to repurchase	$	$	$ 157,289	$ 157,289
Derivative financial instruments		9,030		9,030
	$	$ 9,030	$ 157,289	$ 166,319

	December 31, 2011			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	$ 30,319	$	$	$ 30,319
United States Treasury security	50,000			50,000
Mortgage-backed securities at fair value			72,813	72,813
Mortgage loans acquired for sale at fair value		232,016		232,016
Mortgage loans at fair value			696,266	696,266
Mortgage loans under forward purchase agreements at fair value			129,310	129,310
MSRs at fair value			749	749
Derivative financial instruments		1,938		1,938
	$ 80,319	$ 233,954	$ 899,138	$ 1,213,411
Liabilities:				
Securities sold under agreements to repurchase	$	$	$ 115,493	$ 115,493
	$	$	$ 115,493	$ 115,493

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The Company s short-term investments, including United States Treasury securities and cash balances were measured using Level 1 inputs. The Company s non-Agency MBS, mortgage loans at fair value, mortgage loans under forward purchase agreements at fair value, MSRs and securities sold under agreements to repurchase were measured using Level 3 inputs on a recurring basis. The following is a summary of changes in those items for the periods presented:

	Quarter ended June 30, 2012				
	Mortgage-backed securities	Mortgage loans at fair value	Mortgage loans under forward purchase agreements	Mortgage servicing rights	Total
			(in thousands)		
Assets:					
Balance, March 31, 2012	$ 62,425	$ 667,542	$ 105,030	$ 1,188	$ 836,185
Purchases		260,683	784		261,467
Repayments	(9,804)	(49,865)	(5,340)		(65,009)
Sales				(30)	(30)
Addition of unpaid interest, impound advances and fees to unpaid balance of mortgage loans		4,416			4,416
Accrual of unearned discounts	29				29
MSRs received as proceeds from sales of mortgage loans				568	568
Changes in fair value included in income arising from:					
Changes in instrument-specific credit risk		8,227	312		8,539
Other factors	511	16,571	2,177	(441)	18,818
	511	24,798	2,489	(441)	27,357
Transfer of mortgage loans to REO		(21,485)			(21,485)
Transfer of mortgage loans under forward purchase agreements					
Transfer of mortgage loans under forward purchase agreements to REO under forward purchase agreements			(2,217)		(2,217)
Transfer of mortgage loans under forward purchase agreements to mortgage loans		83,865	(83,865)		
Balance, June 30, 2012	$ 53,161	$ 969,954	$ 16,881	$ 1,285	$ 1,041,281
Changes in fair value recognized during the period relating to assets still held at June 30, 2012	$ 511	$ 15,845	$ 1,044	$ (441)	$ 16,959
Accumulated changes in fair value relating to assets still held at June 30, 2012	$ (1,777)	$ 75,797	$ 1,523		

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	Securities sold under agreements to repurchase (in thousands)
Liabilities:	
Balance, March 31, 2012	$ 53,068
Changes in fair value included in income	
Sales	415,052
Repurchases	(310,831)
Balance, June 30, 2012	$ 157,289
Changes in fair value recognized during the period relating to liabilities still outstanding at June 30, 2012	$

	Quarter ended June 30, 2011			
	Mortgage-backed securities	Mortgage loans at fair value (in thousands)	Mortgage servicing rights	Total
Assets:				
Balance, March 31, 2011	$ 102,195	$ 588,036	$ 37	$ 690,268
Purchases		117,275		117,275
Repayments	(16,216)	(39,634)		(55,850)
Accrual of unearned discounts	660			660
Addition of unpaid interest, impound advances and fees to unpaid balance of mortgage loans		271		271
Sales	(3,345)	47		(3,298)
MSRs received as proceeds from sales of mortgage loans			137	137
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk		8,047		8,047
Other factors	(873)	14,829	6	13,962
	(873)	22,876	6	22,009
Transfer of mortgage loans to REO		(31,648)		(31,648)
Balance, June 30, 2011	$ 82,421	$ 657,223	$ 180	$ 739,824
Changes in fair value recognized during the period relating to assets still held at June 30, 2011	$ (873)	$ 19,720	$ 6	$ 18,853
Accumulated changes in fair value relating to assets still held at June 30, 2011	$ (1,033)	$ 39,818		

	Securities sold under agreements to repurchase (in thousands)
Liabilities:	
Balance, March 31, 2011	$ 88,065
Changes in fair value included in income	
Sales	564,982

Repurchases		(582,069)
Balance, June 30, 2011	$	70,978
Changes in fair value recognized during the period relating to liabilities still outstanding at June 30, 2011	$	

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	Six months June 30, 2012				
	Mortgage-backed securities	Mortgage loans at fair value	Mortgage loans under forward purchase agreements (in thousands)	Mortgage servicing rights	Total
Assets:					
Balance, December 31, 2011	$ 72,813	$ 696,266	$ 129,310	$ 749	$ 899,138
Purchases		260,595	1,070	20	261,685
Repayments	(20,890)	(84,564)	(14,040)		(119,494)
Sales				(30)	(30)
Accrual of unearned discounts	363				363
Addition of unpaid interest, impound advances and fees to unpaid balance of mortgage loans		13,016			13,016
Sales					
MSRs received as proceeds from sales of mortgage loans				1,088	1,088
Changes in fair value included in income arising from:					
Changes in instrument-specific credit risk		17,307	705		18,012
Other factors	875	11,828	8,483	(542)	20,644
	875	29,135	9,188	(542)	38,656
Transfer of mortgage loans to REO		(45,686)			(45,686)
Transfer from mortgage loans acquired for sale		18			18
Transfer of mortgage loans under forward purchase agreements to REO under forward purchase agreements			(7,473)		(7,473)
Transfer of mortgage loans under forward purchase agreements to mortgage loans		101,174	(101,174)		
Balance, June 30, 2012	$ 53,161	$ 969,954	$ 16,881	$ 1,285	$ 1,041,281
Changes in fair value recognized during the period relating to assets still held at June 30, 2012	$ 838	$ 17,888	$ 1,635	$ (542)	$ 19,819
Accumulated changes in fair value relating to assets still held at June 30, 2012	$ (1,777)	$ 75,797	$ 1,523		

	Securities sold under agreements to repurchase (in thousands)
Liabilities:	
Balance, December 31, 2011	$ 115,493
Changes in fair value included in income	
Sales	706,966
Repurchases	(665,170)
Balance, June 30, 2012	$ 157,289
Changes in fair value recognized during the period relating to liabilities still outstanding at June 30, 2012	$

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	Six months ended June 30, 2011			
	Mortgage-backed securities	Mortgage loans at fair value	Mortgage servicing rights	Total
	(in thousands)			
Assets:				
Balance, December 31, 2010	$ 119,872	$ 364,250	$	$ 484,122
Purchases		360,403		360,403
Repayments	(34,165)	(55,203)		(89,368)
Accrual of unearned discounts	1,374			1,374
Addition of unpaid interest, impound advances and fees to unpaid balance of mortgage loans		311		311
Sales	(3,345)	(2,518)		(5,863)
MSRs received as proceeds from sales of mortgage loans			177	177
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk		14,295		14,295
Other factors	(1,315)	21,508	3	20,196
	(1,315)	35,803	3	34,491
Transfer of mortgage loans to REO		(45,823)		(45,823)
Balance, June 30, 2011	$ 82,421	$ 657,223	$ 180	$ 739,824
Changes in fair value recognized during the period relating to assets still held at June 30, 2011	$ (1,315)	$ 27,339	$ 3	$ 26,027
Accumulated changes in fair value relating to assets still held at June 30, 2011	$ (1,033)	$ 39,818		

	Securities sold under agreements to repurchase (in thousands)
Liabilities:	
Balance, December 31, 2010	$ 101,202
Changes in fair value included in income	
Sales	822,934
Repurchases	(853,158)
Balance, June 30, 2011	$ 70,978
Changes in fair value recognized during the period relating to liabilities still outstanding at June 30, 2011	$

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Following are the fair values and related principal amounts due upon maturity of mortgage loans accounted for under the fair value option (including mortgage loans acquired for sale, mortgage loans at fair value and mortgage loans under forward purchase agreements at fair value) as of the dates presented:

	June 30, 2012		
	Fair value	Principal amount due upon maturity (in thousands)	Difference
Mortgage loans acquired for sale:			
Current through 89 days delinquent	$ 460,419	$ 436,383	$ 24,036
90 or more days delinquent (1)			
	460,419	436,383	24,036
Other mortgage loans at fair value (2):			
Current through 89 days delinquent	404,789	640,472	(235,683)
90 or more days delinquent (1)	582,046	1,060,478	(478,432)
	986,835	1,700,950	(714,115)
	$ 1,447,254	$ 2,137,333	$ (690,079)

	December 31, 2011		
	Fair value	Principal amount due upon maturity (in thousands)	Difference
Mortgage loans acquired for sale:			
Current through 89 days delinquent	$ 232,016	$ 222,399	$ 9,617
90 or more days delinquent (1)			
	232,016	222,399	9,617
Other mortgage loans at fair value (2):			
Current through 89 days delinquent	209,599	345,140	(135,541)
90 or more days delinquent (1)	615,977	1,184,687	(568,710)
	825,576	1,529,827	(704,251)
	$ 1,057,592	$ 1,752,226	$ (694,634)

(1) Loans delinquent 90 or more days are placed on nonaccrual status and previously accrued interest is reversed.
(2) Includes mortgage loans at fair value and mortgage loans value under forward purchase agreements at fair value.

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

	Changes in fair value included in current period income Quarter ended June 30, 2012				
	Net gain on investments	Interest income	Net gain on mortgage loans acquired for sale (in thousands)	Net loan servicing fees	Total
Assets:					
Short-term investments	$	$	$	$	$
Mortgage-backed securities at fair value	706	(101)			605
Mortgage loans acquired for sale at fair value			18,046		18,046
Mortgage loans at fair value	24,798				24,798
Mortgage loans under forward purchase agreements at fair value	2,488				2,488
Mortgage servicing rights at fair value				(441)	(441)
	$ 27,992	$ (101)	$ 18,046	$ (441)	$ 45,496
Liabilities:					
Securities sold under agreements to repurchase at fair value	$	$	$	$	$
	$	$	$	$	$

	Changes in fair value included in current period income Quarter ended June 30, 2011				
	Net gain (loss) on investments	Interest income	Net gain on mortgage loans acquired for sale (in thousands)	Net loan servicing fees	Total
Assets:					
Short-term investments	$	$	$	$	$
Mortgage-backed securities at fair value	(873)	660			(213)
Mortgage loans acquired for sale at fair value			40		40
Mortgage loans at fair value	22,951				22,951
Mortgage servicing rights at fair value				6	6
	$ 22,078	$ 660	$ 40	$ 6	$ 22,784
Liabilities:					
Securities sold under agreements to repurchase at fair value	$	$	$	$	$
	$	$	$	$	$

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	Changes in fair value included in current period income Six months ended June 30, 2012				
	Net gain on investments	Interest income	Net gain on mortgage loans acquired for sale (in thousands)	Net loan servicing fees	Total
Assets:					
Short-term investments	$	$	$	$	$
Mortgage-backed securities at fair value	1,063	233			1,296
Mortgage loans acquired for sale at fair value			31,416		31,416
Mortgage loans at fair value	29,229				29,229
Mortgage loans under forward purchase agreements at fair value	9,188				9,188