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, 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: 001-34416

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 x	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 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 7, 2014
Common Shares of Beneficial Interest, $0.01 par value	**74,139,570**

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PENNYMAC MORTGAGE INVESTMENT TRUST

FORM 10-Q

June 30, 2014

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 30, 2014	December 31, 2013
	(in thousands, except share data)	
ASSETS		
Cash	$ 37,902	$ 27,411
Short-term investments	104,453	92,398
Mortgage-backed securities at fair value pledged to secure assets sold under agreements to repurchase	218,725	197,401
Mortgage loans acquired for sale at fair value (includes $905,044 and $454,210 pledged to secure assets sold under agreements to repurchase)	909,085	458,137
Mortgage loans at fair value (includes $2,407,512 and $1,963,266 pledged to secure assets sold under agreements to repurchase)	2,697,821	2,600,317
Mortgage loans under forward purchase agreements at fair value pledged to secure borrowings under forward purchase agreements		218,128
Excess servicing spread purchased from PennyMac Financial Services, Inc. at fair value	190,244	138,723
Derivative assets	14,594	7,976
Real estate acquired in settlement of loans (includes $107,684 and $89,404 pledged to secure assets sold under agreements to repurchase)	240,471	138,942
Real estate acquired in settlement of loans under forward purchase agreements pledged to secure forward purchase agreements		9,138
Mortgage servicing rights (includes $46,802 and $26,452 carried at fair value)	315,484	290,572
Servicing advances	63,993	59,573
Due from PennyMac Financial Services, Inc.	4,137	6,009
Other assets	72,836	66,192
Total assets	$ 4,869,745	$ 4,310,917
LIABILITIES		
Assets sold under agreements to repurchase	$ 2,701,755	$ 2,039,605
Borrowings under forward purchase agreements		226,580
Asset-backed secured financing of the variable interest entity at fair value	170,201	165,415
Exchangeable senior notes	250,000	250,000
Derivative liabilities	6,347	1,961
Accounts payable and accrued liabilities	69,552	71,561
Due to PennyMac Financial Services, Inc.	19,636	18,636

Income taxes payable	63,218	59,935
Liability for losses under representations and warranties	11,876	10,110
Total liabilities	3,292,585	2,843,803
Commitments and contingencies		
SHAREHOLDERS EQUITY		
Common shares of beneficial interest authorized, 500,000,000 common shares of $0.01 par value; issued and outstanding, 74,139,070 and 70,458,082 common shares, respectively	741	705
Additional paid-in capital	1,468,791	1,384,468
Retained earnings	107,628	81,941
Total shareholders equity	1,577,160	1,467,114
Total liabilities and shareholders equity	$ 4,869,745	$ 4,310,917

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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

Assets and liabilities of consolidated variable interest entity (VIE) included in total assets and liabilities (the assets of the VIE can only be used to settle liabilities of the VIE):

	June 30, 2014	December 31, 2013
	(in thousands)	
ASSETS		
Mortgage loans at fair value	$ 541,320	$ 523,652
Other assets - interest receivable	1,702	1,584
	$ 543,022	$ 525,236
LIABILITIES		
Asset-backed secured financing at fair value	$ 170,201	$ 165,415
Accounts payable and accrued expenses - interest payable	492	497
	$ 170,693	$ 165,912

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)

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands, except per share data)			
Net investment income				
Net gain on mortgage loans acquired for sale	$ 10,222	$ 44,438	$ 20,193	$ 73,717
Loan origination fees	4,485	4,752	6,841	10,225
Net interest income:				
Interest income	48,518	26,797	87,864	43,672
Interest expense	21,865	14,144	41,640	25,380
	26,653	12,653	46,224	18,292
Net gain on investments	73,134	46,834	115,719	110,814
Net loan servicing fees	8,758	7,892	16,179	13,903
Results of real estate acquired in settlement of loans	(5,348)	(1,929)	(11,974)	(5,182)
Other	2,652	913	3,969	1,600
Net investment income	120,556	115,553	197,151	223,369
Expenses				
Expenses payable to PennyMac Financial Services, Inc.:				
Loan servicing fees	14,180	8,787	28,771	16,513
Loan fulfillment fees	12,433	22,054	21,335	50,298
Management fees	8,912	8,455	16,986	14,947
Professional services	2,690	1,339	4,421	3,723
Compensation	1,883	1,438	4,825	3,527
Other	7,154	5,571	11,221	10,517
Total expenses	47,252	47,644	87,559	99,525
Income before provision for income taxes	73,304	67,909	109,592	123,844
(Benefit from) provision for income taxes	(1,907)	13,412	(3,492)	16,051
Net income	$ 75,211	$ 54,497	$ 113,084	$ 107,793
Earnings per share				
Basic	$ 1.01	$ 0.92	$ 1.54	$ 1.81
Diluted	$ 0.93	$ 0.86	$ 1.44	$ 1.75
Weighted-average shares outstanding				
Basic	74,065	59,035	72,803	58,981
Diluted	82,750	65,104	81,535	62,217

Dividends declared per share	$ 0.59	$ 0.57	$ 1.18	$ 1.14

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)

	Number of shares	Par value	Additional paid-in capital	Retained earnings	Total
			(in thousands)		
Balance at December 31, 2012	58,904	$ 589	$ 1,129,858	$ 70,889	$ 1,201,336
Net income				107,793	107,793
Share-based compensation	173	2	2,468		2,470
Dividends, $1.14 per share				(67,249)	(67,249)
Underwriting and offering costs			(169)		(169)
Balance at June 30, 2013	59,077	$ 591	$ 1,132,157	$ 111,433	$ 1,244,181
Balance at December 31, 2013	70,458	$ 705	$ 1,384,468	$ 81,941	$ 1,467,114
Net income				113,084	113,084
Share-based compensation	234	2	2,956		2,958
Dividends, $1.18 per share				(87,397)	(87,397)
Proceeds from offerings of common shares	3,447	34	82,419		82,453
Underwriting and offering costs			(1,052)		(1,052)
Balance at June 30, 2014	74,139	$ 741	$ 1,468,791	$ 107,628	$ 1,577,160

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)

	Six months ended June 30, 2014	2013
	(in thousands)	
Cash flows from operating activities		
Net income	$ 113,084	$ 107,793
Adjustments to reconcile net income to net cash used by operating activities:		
Net gain on mortgage loans acquired for sale at fair value	(20,193)	(73,717)
Accrual of unearned discounts and amortization of premiums on mortgage-backed securities, mortgage loans at fair value, and asset-backed secured financing	(537)	
Capitalization of interest on mortgage loans at fair value	(30,353)	(11,814)
Accrual of interest on excess servicing spread	(6,001)	
Amortization of credit facility commitment fees and debt issuance costs	4,879	4,036
(Reversal) accrual of costs related to forward purchase agreements	(168)	251
Net gain on investments	(115,719)	(110,814)
Change in fair value, amortization and impairment of mortgage servicing rights	20,518	9,321
Results of real estate acquired in settlement of loans	11,974	5,182
Share-based compensation expense	2,958	2,471
Purchases of mortgage loans acquired for sale at fair value	(12,347,365)	(17,759,140)
Sales of mortgage loans acquired for sale at fair value to nonaffiliates	4,789,444	9,044,480
Sales of mortgage loans acquired for sale to PennyMac Financial Services, Inc.	7,085,859	8,282,163
(Increase) decrease in servicing advances	(15,218)	7,481
Decrease in due from PennyMac Financial Services, Inc.	2,812	1,766
(Increase) decrease in other assets	(25,427)	41,379
Decrease in accounts payable and accrued liabilities	(45,366)	(11,016)
Increase in payable to PennyMac Financial Services, Inc.	1,036	4,509
Increase in income taxes payable	3,283	15,088
Net cash used by operating activities	(570,500)	(440,581)
Cash flows from investing activities		
Net increase in short-term investments	(12,055)	(34,219)
Purchases of mortgage-backed securities at fair value	(19,638)	
Repayments of mortgage-backed securities at fair value	5,419	
Purchases of mortgage loans at fair value	(283,017)	(200,486)
Repayments and sales of mortgage loans at fair value	397,643	135,242
Repayments of mortgage loans under forward purchase agreements at fair value	6,413	
Purchase of excess servicing spread from PennyMac Financial Services, Inc.	(73,393)	
Repayment of excess spread investment	16,494	
Settlements of derivative financial instruments used for hedging	(9,785)	
Purchase of real estate acquired in settlement of loans	(3,049)	
Sales of real estate acquired in settlement of loans	76,903	63,017
	5,365	

Sales of real estate acquired in settlement of loans under forward purchase agreements		
Purchase of mortgage servicing rights		(185)
Decrease (increase) in margin deposits and restricted cash	5,454	(13,426)
Net cash provided (used) by investing activities	112,754	(50,057)

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)

	Six months ended June 30, 2014	2013
	(in thousands)	
Cash flows from financing activities		
Sales of assets under agreement to repurchase	15,938,914	16,841,470
Repurchases of assets sold under agreements to repurchase	(15,276,762)	(16,516,020)
Repurchases of real estate acquired in settlement of loans financed under agreement to repurchase		(15,656)
Repayments of borrowings under forward purchase agreements	(227,866)	
Repayments of asset-backed secured financing at fair value	(3,372)	
Issuance of exchangeable senior notes		250,000
Payment of exchangeable senior notes issuance costs		(7,425)
Proceeds from issuance of common shares	82,453	
Payment of common share underwriting and offering costs	(1,052)	(169)
Payment of contingent underwriting fees payable	(424)	(427)
Payment of dividends	(43,654)	(67,249)
Net cash provided by financing activities	468,237	484,524
Net increase (decrease) in cash	10,491	(6,114)
Cash at beginning of period	27,411	33,756
Cash at end of period	$ 37,902	$ 27,642

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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

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 commenced operations on August 4, 2009, when it completed its initial offerings of common shares of beneficial interest (common shares). The Company is a specialty finance company, which, through its subsidiaries (all of which are wholly-owned), invests primarily in residential mortgage loans and mortgage-related assets.

The Company operates in two segments: correspondent production and investment activities:

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

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

The investment activities segment represents the Company s investments in mortgage-related assets, which include distressed mortgage loans, real estate acquired in settlement of loans (REO), MBS, mortgage servicing rights (MSRs) and excess servicing spread (ESS). The Company seeks to maximize the value of the distressed mortgage loans that it acquires through proprietary loan modification programs, special servicing or 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 Company is externally managed by PCM, 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, the Company pays PCM a management fee with a base component and a performance incentive component.

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 has 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 wholly-owned 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) as codified in the Financial Accounting Standards Board s (FASB) *Accounting Standards Codification* 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 (the Annual Report). Intercompany accounts and transactions have been eliminated.

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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.

Reclassification of previously presented balances

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

Interest expense is included with *Interest income* under a new caption, *Net interest income,* to better reflect the Company s results due to growth in its portfolio of interest-earning assets. This reclassification results in the presentation of *Net interest income* in *Net investment income* and a decrease in *Expenses.*

Loan servicing fees payable to PennyMac Financial Services, Inc. is presented without the inclusion of other servicing expenses payable to nonaffiliates. Previously, *Loan servicing expense* included amounts payable to PFSI and to nonaffiliates. Amounts payable to nonaffiliates have been reclassified to *Other expenses*.

Following is a summary of the reclassifications:

	As reported		As previously reported		Reclassification	
	Quarter ended June 30, 2013	Six months ended June 30, 2013	Quarter ended June 30, 2013	Six months ended June 30, 2013	Quarter ended June 30, 2013	Six months ended June 30, 2013
			(in thousands)			
Net interest income (new caption):						
Interest income	$ 26,797	$ 43,672	$ 26,797	$ 43,672	$	$
Interest expense	14,144	25,380			14,144	25,380
	12,653	18,292	26,797	43,672	(14,144)	(25,380)
Net investment income	$ 115,553	$ 223,369	$ 129,697	$ 248,749	$ (14,144)	$ (25,380)
Expenses:						
Interest expense	$	$	$ 14,144	$ 25,380	$ (14,144)	$ (25,380)
Total expenses	$ 47,644	$ 99,525	$ 61,788	$ 124,905	$ (14,144)	$ (25,380)

These reclassifications did not change previously reported income before provision for (benefit from) income taxes, provision for (benefit from) income taxes, net income, reported consolidated balance sheet amounts, including shareholders equity, or consolidated cash flows.

Note 2 Concentration of Risks

As discussed in Note 1 *Organization and Basis of Presentation* above, PMT s operations and investing activities are centered in mortgage-related assets, a substantial portion of which are distressed at acquisition. 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.

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 and unemployment rates and residential real estate values in the markets where the properties securing the Company s mortgage loans are located;

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PCM s ability to identify and the Servicer s 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 effect cures or resolutions to distressed loans; and

regulatory, judicial and legislative support of the foreclosure process, and the resulting effect on the Company s ability to acquire and liquidate the real estate securing its portfolio of distressed mortgage loans in a timely manner or at all.

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

A substantial portion of the distressed mortgage loans and REO purchased by the Company has been acquired from or through one or more subsidiaries of Citigroup Inc. The following tables present purchases for the Company s investment portfolio of mortgage loans and REO (including purchases under forward purchase agreements), and the portion thereof representing assets purchased from or through one or more subsidiaries of Citigroup Inc.:

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Investment portfolio purchases:				
Mortgage loans	$ 27,203	$ 243,109	$ 284,403	$ 443,582
REO	30	89	3,117	89
	$ 27,233	$ 243,198	$ 287,520	$ 443,671
Investment portfolio purchases above through one or more subsidiaries of Citigroup Inc.:				
Mortgage loans	$ 26,737	$ 242,886	$ 26,737	$ 443,183
REO	30	89	68	89
	$ 26,767	$ 242,975	$ 26,805	$ 443,272

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Following is a summary of the Company s holdings of assets purchased through one or more subsidiaries of Citigroup Inc.:

	June 30, 2014	December 31, 2013
	(in thousands)	
Mortgage loans at fair value	$ 1,067,099	$ 1,138,131
Mortgage loans under forward purchase agreements at fair value		218,128
REO	111,946	84,726
REO under forward purchase agreements		8,705
	$ 1,179,045	$ 1,449,690
Total mortgage loans and REO held at period end	$ 2,938,292	$ 2,966,525

During the year ended December 31, 2013, the Company entered into forward purchase agreements with Citigroup Global Markets Realty Corp. (CGM), a subsidiary of Citigroup Inc., to purchase certain nonperforming mortgage loans and REO (collectively, the CGM Assets). The CGM Assets were acquired by CGM from unaffiliated money center banks and were held in a trust subsidiary by CGM pending settlement by the Company. The commitment under the forward purchase agreement was settled in full during the quarter ended June 30, 2014.

The Company recognized these assets and related obligations as of the dates of the agreements and recognizes all subsequent income and changes in value relating to such assets. As a result of recognizing these assets, the Company s consolidated statements of income and cash flows include the following amounts related to the forward purchase agreements:

	Quarter ended June 30, 2014	Quarter ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
	(in thousands)			
Statements of income:				
Interest income	$ 1,430	$ 260	$ 3,584	$ 260
Interest expense	$ 783	$ 251	$ 2,364	$ 251
Net gain on investments	$ 1,743	$ (690)	$ 803	$ (690)
Net loan servicing fees	$ 201	$	$ 517	$
Results of REO	$ (72)	$	$ (473)	$
Statements of cash flows:				
Repayments of mortgage loans	$ 1,084	$	$ 3,463	$
Sales of REO	$ 3,743	$	$ 5,365	$
Repayments of borrowings under forward purchase agreements	$ (214,742)	$	$ (227,866)	$

The Company has no other variable interests in the trust entity or other exposure to the creditors of the trust entity that could expose the Company to loss.

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Note 3 Transactions with Related Parties

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

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Management fee:				
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 of the management agreement between the Company and PFSI, PFSI 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 PFSI, in each case during the 24-month period before termination.

Following is a summary of mortgage loan servicing fees payable to PFSI:

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Mortgage loans acquired for sale at fair value:				
Base	$ 29	$ 90	$ 46	$ 169
Activity-based	51	111	77	183
	80	201	123	352
Distressed mortgage loans:				
Base	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	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 production activity between the Company and PFSI:

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Fulfillment fee expense payable to PFSI	$ 12,433	$ 22,054	$ 21,335	$ 50,298
Unpaid principal balance of loans fulfilled by PFSI	$ 2,991,764	$ 4,323,885	$ 4,911,342	$ 9,110,711
Sourcing fees received from PFSI	$ 1,125	$ 1,349	$ 2,017	$ 2,359
Fair value of loans sold to PFSI	$ 3,955,329	$ 4,733,767	$ 7,085,859	$ 8,282,163
At period end:				
Mortgage loans included in mortgage loans acquired for sale pending sale to PFSI	$ 304,707	$ 290,567		

Following is a summary of investment activity between the Company and PFSI:

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Purchases of excess servicing spread	$ 52,867	$	$ 73,393	$
Interest income from excess servicing spread	$ 3,138	$	$ 6,001	$
Excess servicing spread recapture recognized	$ 2,525	$	$ 4,415	$
MSR recapture recognized	$ 1	$ 367	$ 9	$ 499

Other Transactions

In connection with the initial public offering of PMT s common shares (IPO) on August 4, 2009, the Company entered into an agreement with PFSI pursuant to which the Company agreed to reimburse PFSI for the $2.9 million payment that it made to the IPO underwriters if the Company satisfied certain performance measures over a specified period (the Conditional Reimbursement). Effective February 1, 2013, the Company amended the terms of the reimbursement agreement to provide for the reimbursement of PFSI of the Conditional Reimbursement if the Company is required to pay PFSI 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. During the six months ended June 30, 2014, the Company paid $36,000 to PFSI.

The reimbursement agreement also provides for the payment to the underwriters in such offering of the payment that the Company agreed to make to them at the time of the offering if the Company satisfied certain performance measures over a specified period. As PFSI earns performance incentive fees under the management agreement, such underwriters will be paid at a rate of $20 of payments for every $100 of performance incentive fees earned by PFSI. The payment to the underwriters is subject to a maximum reimbursement in any particular 12-month period of $2.0 million and the maximum amount that may be paid under the agreement is $5.9 million. During the quarter and six months ended June 30, 2014, the Company paid $315,000 and $387,000 to the underwriters, respectively.

In the event the termination fee is payable to PFSI under the management agreement and PFSI and the underwriters have 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.

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The Company reimburses PFSI and its affiliates for other expenses, including common overhead expenses and other expenses incurred on its behalf by PFSI, in accordance with the terms of its management agreement as summarized below:

	Quarter ended June 30, 2014	Quarter ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
	(in thousands)			
Reimbursement of:				
Common overhead incurred by PFSI	$ 2,691	$ 3,201	$ 5,269	$ 5,807
Expenses incurred on the Company s behalf	104	585	549	1,834
	$ 2,795	$ 3,786	$ 5,818	$ 7,641
Payments and settlements during the period (1)	$ 14,894	$ 32,616	$ 33,280	$ 65,290

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

Amounts due to PFSI are summarized below:

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

Amounts due from affiliates totaled $4.1 million and $6.0 million at June 30, 2014 and December 31, 2013, respectively. At June 30, 2014, the balance represents payments receivable relating to cash flows from the Company s investment in ESS and amounts receivable relating to unsettled MSR and ESS recaptures. At June 30, 2013, amounts due from affiliates represent amounts receivable pursuant to loan sales to PFSI and reimbursable expenses paid on the affiliates behalf by the Company.

PFSI held 75,000 of the Company s common shares at both June 30, 2014 and December 31, 2013.

Note 4 Earnings Per Share

Basic earnings per share is determined using the two-class method. Under the two-class method, all earnings (distributed and undistributed) are allocated to common shares and participating securities, based on their respective rights to receive dividends. Basic earnings per share is determined using net income reduced by income attributable to the participating securities and divided by the weighted-average common shares outstanding during the period. The Company grants restricted share units which entitle the recipients to receive dividend equivalents during the vesting period on a basis equivalent to the dividends paid to holders of common shares. Unvested share-based compensation awards containing non-forfeitable rights to receive dividends or dividend equivalents (collectively, dividends) are classified as participating securities and are included in the basic earnings per share calculation using the two-class method.

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

Diluted earnings per share is determined by dividing net income attributable to diluted shareholders, which adds back to net income the interest expense, net of applicable income taxes, on the Company s exchangeable senior notes (the Notes), by the weighted-average common shares outstanding, assuming all potentially dilutive securities were issued. In periods in which the Company records a loss, potentially dilutive securities are excluded from the diluted loss per share calculation, as their effect on loss per share is anti-dilutive.

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

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands except per share amounts)			
Basic earnings per share:				
Net income	$ 75,211	$ 54,497	$ 113,084	$ 107,793
Effect of participating securities share-based compensation awards	(433)	(444)	(841)	(961)
Net income attributable to common shareholders	$ 74,778	$ 54,053	$ 112,243	$ 106,832
Weighted-average shares outstanding	74,065	59,035	72,803	58,981
Basic earnings per share	$ 1.01	$ 0.92	$ 1.54	$ 1.81
Diluted earnings per share:				
Net income	$ 75,211	$ 54,497	$ 113,084	$ 107,793
Interest on exchangeable senior notes, net of income taxes	2,079	1,382	4,156	1,382
Net income attributable to diluted shareholders	$ 77,290	$ 55,879	$ 117,240	$ 109,175
Weighted-average shares outstanding	74,065	59,035	72,803	58,981
Potentially dilutive securities:				
Shares issuable pursuant exchange of the Notes	8,393	5,709	8,393	2,870
Shares issuable under share-based compensation plan	292	360	338	366
Diluted weighted-average number of shares outstanding	82,750	65,104	81,534	62,217
Diluted earnings per share	$ 0.93	$ 0.86	$ 1.44	$ 1.75

Note 5 Loan Sales

The Company is a variable interest holder in various special purpose entities that relate to its loan transfer and financing activities. The Company has segregated its involvement with variable interest entities (VIEs) between those VIEs which the Company does not consolidate and those VIEs which the Company consolidates.

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Unconsolidated VIEs with Continuing Involvement

The following table summarizes cash flows between the Company and transferees upon sale of loans in transactions where PMT maintains continuing involvement with the mortgage loans as well as unpaid principal balance information at period end:

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
		(in thousands)		
Cash flows:				
Proceeds from sales	$ 2,763,138	$ 3,909,744	$ 4,789,444	9,044,480
Servicing fees received (1)	$ 19,019	$ 11,772	$ 34,907	$ 20,908
Period end information:				
Unpaid principal balance of mortgage loans outstanding	$ 29,268,039	$ 19,850,609		
Unpaid principal balance of delinquent mortgage loans:				
30-89 days delinquent	$ 90,091	$ 44,436		
90 or more days delinquent				
Not in foreclosure	13,325	2,485		
In foreclosure or bankruptcy	11,306	3,163		
	24,631	5,648		
	$ 114,722	$ 50,084		

(1) Net of guarantee fees.

Consolidated VIE

On September 30, 2013, the Company completed a securitization transaction in which a wholly-owned VIE issued $537.0 million in certificates backed by fixed rate prime jumbo mortgage loans of PMT Loan Trust 2013-J1, at a 3.9% weighted yield. The Company retained $366.8 million of those certificates. Management concluded that the Company is the primary beneficiary of the VIE and, as a result, the Company consolidates the VIE. Consolidation of the VIE results in the securitized mortgage loans remaining on the consolidated balance sheets of the Company and the certificates issued by the VIE to nonaffiliates being accounted for as secured financing. The certificates are secured solely by the assets of the VIE and not by any other assets of the Company. The assets of the VIE are the only source of repayment of the certificates.

Note 6 Netting of Financial Instruments

The Company uses derivative financial instruments to manage exposure to interest rate risk created by its MBS, interest rate lock commitments (IRLC), mortgage loans acquired for sale at fair value, mortgage loans at fair value, ESS and MSRs. All derivative financial instruments are recorded on the balance sheet at fair value. The Company has elected to net derivative asset and liability positions, and cash collateral obtained (or posted) by (or to) its counterparties when subject to a legally enforceable master netting arrangement. The derivative financial instruments that are not subject to master netting arrangements are IRLCs.

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Offsetting of Derivative Assets

Following is a summary of net derivative assets. As discussed above, all derivatives with the exception of IRLCs are subject to master netting arrangements.

	June 30, 2014			December 31, 2013		
	Gross amounts of recognized assets	Gross amounts offset in the consolidated balance sheet	Net amounts of assets presented in the consolidated balance sheet	Gross amounts of recognized assets	Gross amounts offset in the consolidated balance sheet	Net amounts of assets presented in the consolidated balance sheet
	(in thousands)					
Derivatives subject to master netting arrangements:						
MBS put options	$ 471	$	$ 471	$ 272	$	$ 272
MBS call options	519		519			
Forward purchase contracts	14,723		14,723	1,229		1,229
Forward sale contracts	314		314	16,385		16,385
Treasury futures	545		545			
Put options on Eurodollar futures	181		181	566		566
Call options on Eurodollar futures	214		214			
Netting		(13,855)	(13,855)		(12,986)	(12,986)
	16,967	(13,855)	3,112	18,452	(12,986)	5,466
Derivatives not subject to master netting arrangements:						
Interest rate lock commitments	11,482		11,482	2,510		2,510
	$ 28,449	$ (13,855)	$ 14,594	$ 20,962	$ (12,986)	$ 7,976

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Derivative 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			
		Gross amounts not offset in the consolidated balance sheet				Gross amounts not offset in the consolidated balance sheet		
	Net amount of assets presented in the consolidated balance sheet	Financial instruments	Cash collateral received	Net amount	Net amount of assets presented in the consolidated balance sheet	Financial instruments	Cash collateral received	Net amount
	(in thousands)							
Interest rate lock commitments	$ 11,482	$	$	$ 11,482	$ 2,510	$	$	$ 2,510
RBS Securities	433			433	133			133
RJ O Brien	940			940	566			566
Nomura	284			284	273			273
JP Morgan	252			252				
Cantor Fitzgerald LP	210			210	613			613
Credit Suisse First Boston Mortgage Capital LLC	138			138	196			196
Bank of America, N.A.					1,024			1,024
Other	855			855	2,661			2,661
Total	$ 14,594	$	$	$ 14,594	$ 7,976	$	$	$ 7,976

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Offsetting of Derivative Liabilities and Financial Liabilities

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

	June 30, 2014			December 31, 2013		
	Gross amounts of recognized liabilities	Gross amounts offset in the consolidated balance sheet	Net amounts of liabilities presented in the consolidated balance sheet	Gross amounts of recognized liabilities	Gross amounts offset in the consolidated balance sheet	Net amounts of liabilities presented in the consolidated balance sheet
	(in thousands)					
Derivatives subject to master netting arrangements:						
Forward purchase contracts	$ 266	$	$ 266	$ 7,420	$	$ 7,420
Forward sales contracts	23,236		23,236	1,295		1,295
Netting		(17,550)	(17,550)		(8,015)	(8,015)
	23,502	(17,550)	5,952	8,715	(8,015)	700
Derivatives not subject to master netting arrangements:						
Interest rate lock commitments	395		395	1,261		1,261
	23,897	(17,550)	6,347	9,976	(8,015)	1,961
Assets sold under agreements to repurchase	2,701,755		2,701,755	2,039,605		2,039,605
	$ 2,725,652	$ (17,550)	$ 2,708,102	$ 2,049,581	$ (8,015)	$ 2,041,566

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Derivative Liabilities, Financial Liabilities and Collateral Held by Counterparty

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

	June 30, 2014				December 31, 2013			
		Gross amounts not offset in the consolidated balance sheet				Gross amounts not offset in the consolidated balance sheet		
	Net amount of liabilities presented in the consolidated balance sheet	Financial instruments	Cash collateral pledged	Net amount	Net amount of liabilities presented in the consolidated balance sheet	Financial instruments	Cash collateral pledged	Net amount
	(in thousands)							
Interest rate lock commitments	$ 395	$	$	$ 395	$ 1,261	$	$	$ 1,261
Citibank	843,000	(842,377)		623	945,015	(944,856)		159
Credit Suisse First Boston Mortgage Capital LLC	734,416	(734,416)			523,546	(523,546)		
Bank of America, N.A.	610,966	(610,218)		748	408,452	(408,452)		
RBS Securities	229,153	(229,153)						
Morgan Stanley Bank, N.A.	155,189	(154,457)		732	30,226	(30,226)		
Daiwa Capital Markets	131,334	(131,134)		200	132,525	(132,525)		
Fannie Mae Capital Markets	1,021			1,021				
Other	2,628			2,628	541			541
Total	$ 2,708,102	$ (2,701,755)	$	$ 6,347	$ 2,041,566	$ (2,039,605)	$	$ 1,961

Note 7 Fair Value

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

Fair Value Accounting Elections

Management identified all of its non-cash financial assets and MSRs relating to loans with initial interest rates of more than 4.5% to be accounted for at fair value. Management has elected to account for these financial statement items at fair value so such changes in fair value will be reflected in income as they occur and more timely reflect the results of the Company s performance. Management has also identified its asset-backed secured financing of the VIE to be accounted for at fair value to reflect the generally offsetting changes in fair value of these borrowings to changes in fair value of the mortgage loans at fair value collateralizing this financing.

For MSRs relating to mortgage loans with initial interest rates of less than or equal to 4.5%, management 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 fair values. Management has identified these assets to be accounted for using the amortization method.

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The Company s risk management efforts in connection with MSRs relating to mortgage loans with initial interest rates of more than 4.5% are generally aimed at moderating the effects of changes in interest rates on the assets fair values.

For assets sold under agreements to repurchase, borrowings under forward purchase agreements and the Notes, management has determined that historical cost accounting is more appropriate because under this method debt issuance costs are amortized over the term of the debt, thereby matching the debt issuance cost to the periods benefiting from the usage of the debt.

Financial Statement Items Measured at Fair Value on a Recurring Basis

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

	June 30, 2014			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	$ 104,453	$	$	$ 104,453
Mortgage-backed securities at fair value		218,725		218,725
Mortgage loans acquired for sale at fair value		909,085		909,085
Mortgage loans at fair value		541,320	2,156,501	2,697,821
Excess servicing spread purchased from PFSI			190,244	190,244
Derivative assets:				
Interest rate lock commitments			11,482	11,482
MBS put options		471		471
MBS call options		519		519
Forward purchase contracts		14,723		14,723
Forward sales contracts		314		314
Treasury futures		545		545
Put options on Eurodollar futures		181		181
Call options on Eurodollar futures		214		214
Total derivative assets before netting		16,967	11,482	28,449
Netting (1)		(13,855)		(13,855)
Total derivative assets after netting		3,112	11,482	14,594
Mortgage servicing rights at fair value			46,802	46,802
	$ 104,453	$ 1,645,242	$ 2,405,029	$ 4,154,724
Liabilities:				
Asset-backed secured financing of the variable interest entity at fair value	$	$ 170,201	$	$ 170,201
Derivative liabilities:				
Interest rate lock commitments			395	395
Forward purchase contracts		266		266

Forward sales contracts		23,236		23,236
Total derivative liabilities before netting		23,502	395	23,897
Netting (1)		(17,550)		(17,550)
Total derivative liabilities after netting		5,952	395	6,347
Total liabilities	$	$ 176,153	$ 395	$ 176,548

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

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	December 31, 2013			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	$ 92,398	$	$	$ 92,398
Mortgage-backed securities at fair value		197,401		197,401
Mortgage loans acquired for sale at fair value		458,137		458,137
Mortgage loans at fair value		523,652	2,076,665	2,600,317
Mortgage loans under forward purchase agreements at fair value			218,128	218,128
Excess servicing spread purchased from PFSI			138,723	138,723
Derivative assets:				
Interest rate lock commitments			2,510	2,510
MBS put options		272		272
Forward purchase contracts		1,229		1,229
Forward sales contracts		16,385		16,385
Options on Eurodollar futures		566		566
Total derivative assets		18,452	2,510	20,962
Netting (1)		(12,986)		(12,986)
Total derivative assets after netting		5,466	2,510	7,976
Mortgage servicing rights at fair value			26,452	26,452
	$ 92,398	$ 1,184,656	$ 2,462,478	$ 3,739,532
Liabilities:				
Asset-backed secured financing of the variable interest entity at fair value	$	$ 165,415	$	$ 165,415
Derivative liabilities:				
Interest rate lock commitments			1,261	1,261
Forward purchase contracts		7,420		7,420
Forward sales contracts		1,295		1,295
Total derivative liabilities		8,715	1,261	9,976
Netting (1)		(8,015)		(8,015)
Total derivative liabilities		700	1,261	1,961
Total liabilities	$	$ 166,115	$ 1,261	$ 167,376

(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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The following is a summary of changes in items measured using Level 3 inputs on a recurring basis:

	Quarter ended June 30, 2014					
	Mortgage loans at fair value	Mortgage loans under forward purchase agreements	Excess servicing spread	Interest rate lock commitments(1)	Mortgage servicing rights	Total
	(in thousands)					
Assets:						
Balance, March 31, 2014	$ 2,079,020	$ 202,661	$ 151,019	$ 3,271	$ 36,181	$ 2,472,152
Purchases	26,737	466	52,867			80,070
Repayments and sale	(140,807)	(1,084)	(9,080)			(150,971)
Accrual of interest			3,138			3,138
ESS received pursuant to a recapture agreement with PFSI			2,362			2,362
Interest rate lock commitments issued, net				19,158		19,158
Capitalization of interest	17,042	1,057				18,099
Servicing received as proceeds from sales of mortgage loans					15,385	15,385
Changes in fair value included in income arising from:						
Changes in instrument-specific credit risk	19,326	1,236				20,562
Other factors	52,525	507	(10,062)	9,563	(4,764)	47,769
	71,851	1,743	(10,062)	9,563	(4,764)	68,331
Transfers of mortgage loans under forward purchase agreements to mortgage loans	201,443	(201,443)				
Transfers of mortgage loans to REO	(98,785)					(98,785)
Transfers of mortgage loans under forward purchase agreements to REO under forward purchase agreements		(3,400)				(3,400)
Transfers of interest rate lock commitments to mortgage loans acquired for sale at fair value				(20,905)		(20,905)
Balance, June 30, 2014	$ 2,156,501	$	$ 190,244	$ 11,087	$ 46,802	$ 2,404,634
	$ 50,613	$	$ (10,062)	$ 11,088	$ (4,764)	$ 46,875

Changes in fair value recognized during the period relating to assets still held at June 30, 2014

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

	Quarter ended June 30, 2013				
	Mortgage loans at fair value	Mortgage loans under forward purchase agreements	Net interest rate lock commitments(1)	Mortgage servicing rights	Total
			(in thousands)		
Assets:					
Balance, March 31, 2013	$ 1,366,922	$	$ 11,052	$ 1,305	$ 1,379,279
Purchases	13	243,309		186	243,508
Repayments	(73,820)				(73,820)
Interest rate lock commitments issued, net			22,240		22,240
Capitalization of interest	6,584				6,584
Servicing received as proceeds from sales of mortgage loans				77	77
Changes in fair value included in income arising from:					
Changes in instrument-specific credit risk	11,050				11,050
Other factors	36,473	(689)	(20,678)	260	15,366
	47,523	(689)	(20,678)	260	26,416
Transfers of mortgage loans to REO	(37,457)	(89)			(37,546)
Transfers of interest rate lock commitments to mortgage loans acquired for sale			(29,581)		(29,581)
Balance, June 30, 2013	$ 1,309,765	$ 242,531	$ (16,967)	$ 1,828	$ 1,537,157
Changes in fair value recognized during the period relating to assets still held at June 30, 2013	$ 33,292	$ (689)	$ (16,967)	$ 260	$ 15,896

(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 at fair value	Mortgage loans under forward purchase agreements	Excess servicing spread	Interest rate lock commitments(1)	Mortgage servicing rights	Total
	(in thousands)					
Assets:						
Balance, December 31, 2013	$ 2,076,665	$ 218,128	$ 138,723	$ 1,249	$ 26,452	$ 2,461,217
Purchases	283,017	1,386	73,393			357,796
Repayments and sale	(387,430)	(6,413)	(16,494)			(410,337)
Accrual of interest			6,001			6,001
ESS received pursuant to a recapture agreement with PFSI			3,475			3,475
Interest rate lock commitments issued, net				31,754		31,754
Capitalization of interest	28,553	1,801				30,354
Servicing received as proceeds from sales of mortgage loans					27,142	27,142
Changes in fair value included in income arising from:						
Changes in instrument-specific credit risk	42,629	2,269				44,898
Other factors	70,080	(1,466)	(14,854)	11,993	(6,792)	58,961
	112,709	803	(14,854)	11,993	(6,792)	103,859
Transfers of mortgage loans under forward purchase agreements to mortgage loans	205,902	(205,902)				
Transfers of mortgage loans to REO	(162,915)					(162,915)
Transfers of mortgage loans under forward purchase agreements to REO under forward purchase agreements		(9,803)				(9,803)
Transfers of interest rate lock commitments to mortgage loans acquired for sale				(33,909)		(33,909)
Balance, June 30, 2014	$ 2,156,501	$	$ 190,244	$ 11,087	$ 46,802	$ 2,404,634
Changes in fair value recognized during the period relating to assets still held at June 30, 2014	$ 73,951	$	$ (14,854)	$ 11,087	$ (6,792)	$ 63,392

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

	Six months ended June 30, 2013				
	Mortgage loans at fair value	Mortgage loans under forward purchase agreements	Net interest rate lock commitments(1)	Mortgage servicing rights	Total
	(in thousands)				
Assets:					
Balance, December 31, 2012	$ 1,189,971	$	$ 19,479	$ 1,346	$ 1,210,796
Purchases	200,486	243,309		186	443,981
Repayments	(135,242)				(135,242)
Interest rate lock commitments issued, net			57,654		57,654
Capitalization of interest	11,814				11,814
Servicing received as proceeds from sales of mortgage loans				104	104
Changes in fair value included in income arising from:					
Changes in instrument-specific credit risk	19,495				19,495
Other factors	92,008	(689)	(20,678)	192	70,833
	111,503	(689)	(20,678)	192	90,328
Transfers of mortgage loans to REO	(68,767)	(89)			(68,856)
Transfers of interest rate lock commitments to mortgage loans acquired for sale			(73,422)		(73,422)
Balance, June 30, 2013	$ 1,309,765	$ 242,531	$ (16,967)	$ 1,828	$ 1,537,157
Changes in fair value recognized during the period relating to assets still held at June 30, 2013	$ 77,771	$ (689)	$ (16,967)	$ 192	$ 60,307

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

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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, mortgage loans under forward purchase agreements at fair value and mortgage loans at fair value held by VIE):

	June 30, 2014		
	Fair value	Principal amount due upon maturity (in thousands)	Difference
Mortgage loans acquired for sale:			
Current through 89 days delinquent	$ 909,085	$ 866,821	$ 42,264
90 or more days delinquent (1)			
Not in foreclosure			
In foreclosure			
	909,085	866,821	42,264
Mortgage loans and mortgage loans under forward purchase agreements at fair value:			
Current through 89 days delinquent	1,151,747	1,442,755	(291,008)
90 or more days delinquent (1)			
Not in foreclosure	629,021	1,002,407	(373,386)
In foreclosure	917,053	1,437,698	(520,645)
	1,546,074	2,440,105	(894,031)
	2,697,821	3,882,860	(1,185,039)
	$ 3,606,906	$ 4,749,681	$ (1,142,775)

(1) Loans delinquent 90 or more days are placed on nonaccrual status and previously accrued interest is reversed.

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	December 31, 2013		
	Fair value	Principal amount due upon maturity (in thousands)	Difference
Mortgage loans acquired for sale:			
Current through 89 days delinquent	$ 457,968	$ 447,224	$ 10,744
90 or more days delinquent (1)			
Not in foreclosure	169	162	7
In foreclosure			
	169	162	7
	458,137	447,386	10,751
Mortgage loans and mortgage loans under forward purchase agreements at fair value:			
Current through 89 days delinquent	1,170,918	1,495,961	(325,043)
90 or more days delinquent (1)			
Not in foreclosure	738,043	1,190,403	(452,360)
In foreclosure	909,484	1,493,644	(584,160)
	1,647,527	2,684,047	(1,036,520)
	2,818,445	4,180,008	(1,361,563)
	$ 3,276,582	$ 4,627,394	$ (1,350,812)

(1) Loans delinquent 90 or more days are placed on nonaccrual status and previously accrued interest is reversed.
Following are the changes in fair value included in current period income by consolidated statement of income line item for financial statement items accounted for under the fair value option:

	Quarter ended June 30, 2014				
	Net gain on mortgage loans acquired for sale	Net interest income	Net gain on investments (in thousands)	Net loan servicing fees	Total
Assets:					
Short-term investments	$	$	$	$	$
Mortgage-backed securities at fair value		155	4,081		4,236
Mortgage loans acquired for sale at fair value	31,202				31,202
Mortgage loans at fair value		223	88,029		88,252

Mortgage loans under forward purchase agreements at fair value			1,743		1,743
Excess servicing spread at fair value			(7,537)		(7,537)
Mortgage servicing rights at fair value				(4,764)	(4,764)
	$ 31,202	$ 378	$ 86,316	$ (4,764)	$ 113,132
Liabilities:					
Asset-backed secured financing at fair value	$ (5,175)	$ (80)	$	$	$ (5,255)
	$ (5,175)	$ (80)	$	$	$ (5,255)

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	Quarter ended June 30, 2013				
	Net gain on mortgage loans acquired for sale	Net interest income	Net gain on investments (in thousands)	Net loan servicing fees	Total
Assets:					
Short-term investments	$	$	$	$	$
Mortgage loans acquired for sale at fair value	(56,951)				(56,951)
Mortgage loans at fair value			47,523		47,523
Mortgage loans under forward purchase agreements at fair value			(689)		(689)
Mortgage servicing rights at fair value				260	260
	$ (56,951)	$	$ 46,834	$ 260	$ (9,857)

	Six months ended June 30, 2014				
	Net gain on mortgage loans acquired for sale	Net interest income	Net gain on investments (in thousands)	Net loan servicing fees	Total
Assets:					
Short-term investments	$	$	$	$	$
Mortgage-backed securities at fair value		188	6,734		6,922
Mortgage loans acquired for sale at fair value	49,834				49,834
Mortgage loans at fair value		553	140,194		140,747
Mortgage loans under forward purchase agreements at fair value			803		803
Excess servicing spread at fair value			(10,438)		(10,438)
Mortgage servicing rights at fair value				(6,792)	(6,792)
	$ 49,834	$ 741	$ 137,293	$ (6,792)	$ 181,076
Liabilities:					
Asset-backed secured financing at fair value	$ (7,954)	$ (204)	$	$	$ (8,158)
	$ (7,954)	$ (204)	$	$	$ (8,158)

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	Six months ended June 30, 2013				
	Net loss on mortgage loans acquired for sale	Net interest income	Net gain (loss) on investments (in thousands)	Net loan servicing fees	Total
Assets:					
Short-term investments	$	$	$	$	$
Mortgage loans acquired for sale at fair value	(32,180)				(32,180)
Mortgage loans at fair value			111,503		111,503
Mortgage loans under forward purchase agreements at fair value			(689)		(689)
Mortgage servicing rights at fair value				192	192
	$ (32,180)	$	$ 110,814	$ 192	$ 78,826

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:

	June 30, 2014			
	Level 1	Level 2	Level 3 (in thousands)	Total
Real estate asset acquired in settlement of loans	$	$	$ 102,660	$ 102,660
Mortgage servicing rights at lower of amortized cost or fair value			56,171	56,171
	$	$	$ 158,831	$ 158,831

	December 31, 2013			
	Level 1	Level 2	Level 3 (in thousands)	Total
Real estate asset acquired in settlement of loans	$	$	$ 63,043	$ 63,043
Real estate asset acquired in settlement of loans under forward purchase agreements			7,760	7,760
Mortgage servicing rights at lower of amortized cost or fair value			184,067	184,067
	$	$	$ 254,870	$ 254,870

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The following table summarizes the net losses recognized during the period on assets measured at estimated fair values on a nonrecurring basis:

	Quarter ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
	(in thousands)			
Real estate asset acquired in settlement of loans	$ (7,942)	$ (4,095)	$ (12,525)	$ (6,594)
Mortgage servicing rights at lower of amortized cost or fair value	(2,224)	1,222	(2,851)	3,708
	$ (10,166)	$ (2,873)	$ (15,376)	$ (2,886)

Real Estate Acquired in Settlement of Loans

The Company measures its investment in REO at the respective properties fair values less cost to sell on a nonrecurring basis. The initial carrying value of the REO is measured by cost in the case of purchased REO or by the fair value of the mortgage loan immediately before acquisition in the case of acquisition in settlement of a loan. REO may be subsequently revalued due to the Company receiving greater access to the property, the property being held for an extended period or management receiving indications that the property s value may not be supported by developing market conditions. Any subsequent change in fair value to a level that is less than or equal to the amount at which the property was initially recorded is recognized in *Results of real estate acquired in settlement of loans* in the consolidated statements of income.

Mortgage Servicing Rights at Lower of Amortized Cost or Fair Value

The Company evaluates its MSRs at lower of amortized cost or fair value for impairment with reference to the assets fair value. For purposes of performing its MSR impairment evaluation, the Company stratifies its MSRs at lower of amortized cost or fair value based on the interest rates borne by the mortgage loans underlying the MSRs. Mortgage loans are grouped into pools of mortgage loans with 50 basis point interest rate ranges for fixed-rate mortgage loans with interest rates between 3% and 4.5% and a single pool for mortgage loans with interest rates below 3%. MSRs relating to adjustable rate mortgage loans with initial interest rates of 4.5% or less are evaluated in a single pool. If the fair value of MSRs in any of the interest rate pools is below the amortized cost of the MSRs reduced by the existing valuation allowance for that pool, those MSRs are impaired.

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

Management periodically reviews the various impairment strata to determine whether the fair value of the impaired MSRs in a given stratum is likely to recover. When management deems recovery of the value to be unlikely in the foreseeable future, a write-down of the cost of the MSRs for that stratum to its estimated recoverable value is charged to the valuation allowance.

Fair Value of Financial Instruments Carried at Amortized Cost

The Company s cash balances as well as certain of its borrowings are carried at amortized cost. Management has concluded that the fair values of *Cash*, *Assets sold under agreements to repurchase, and Borrowings under forward purchase agreements* approximate the agreements carrying values due to the immediate realizability of cash at its carrying amount and to the borrowing agreements short terms and variable interest rates.

Cash is measured using Level 1 inputs. The Company s assets sold under agreements to repurchase and borrowings under forward purchase agreements are carried at amortized cost. The Company has classified these financial instruments as Level 3 financial statement items as of June 30, 2014 due to the lack of current market activity and the Company s reliance on unobservable inputs to estimate these instruments fair values.

Exchangeable Senior Notes are carried at amortized cost. The fair value of the Notes at June 30, 2014 and December 31, 2013 was $247.1 million and $238.4 million, respectively. The fair value of the Notes is estimated using a broker indication of value. The Company has classified the Notes as Level 3 financial statement items as of June 30, 2014 due to the lack of current market activity and the use of broker s indication of value to estimate the instrument s fair values.

Valuation Techniques and Inputs

Most of the Company s assets and a portion of its liabilities are carried at fair value with changes in fair value recognized in current period income. A substantial portion of those items are Level 3 financial statement items which require the use of significant unobservable inputs in the estimation of the assets and liabilities 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.

PFSI has assigned the responsibility for estimating the fair values of Level 3 financial statement items to its 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.

The FAV group reports to PFSI s valuation committee, which oversees and approves the valuations. The valuation committee includes the chief executive, financial, operating, credit, and asset/liability management officers of PFSI. 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 PFSI s valuation committee. The results developed in the FAV group s monitoring activities are used to calibrate subsequent projections used for valuation.

The FAV group is responsible for reporting to PFSI s valuation committee on a monthly basis on the changes in the valuation of the Level 3 assets and liabilities it values, including major factors affecting the valuation and any changes in model methods and assumptions. To assess the reasonableness of its valuations, the FAV group presents an analysis of the effect on the valuation of each of the changes to the significant inputs to the valuation models.

The following describes the valuation techniques and assumptions used in estimating the fair values of Level 2 and Level 3 financial statement items:

Mortgage-Backed Securities

The Company s MBS securities are presently Agency MBS. Agency MBS are categorized as Level 2 financial statement items. Fair value of Agency MBS is estimated based on quoted market prices for similar securities.

Mortgage Loans

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

Mortgage loans that are saleable into active markets, comprised of the Company s mortgage loans acquired for sale at fair value and the portion of mortgage loans at fair value held in a VIE, are categorized as Level 2 financial statement items. The fair values of mortgage loans acquired for sale at fair value are estimated using their quoted market or contracted price or market price equivalent. For the mortgage loans at fair value held in a VIE, the fair values of all of the individual securities issued by the securitization trust are used to derive a price for the mortgage loans.

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Loans that are not saleable into active markets, comprised of the Company s mortgage loans at fair value held outside the VIE and mortgage loans under forward purchase agreements at fair value, are categorized as Level 3 financial statement items and their fair values are estimated using a discounted cash flow approach. Inputs to the discounted cash flow model include current interest rates, loan amount, payment status, property type or contracted selling price, discount rates and forecasts of future interest rates, home prices, prepayment speeds, default speeds and loss severities.

The valuation process includes the computation by stratum of loan population and a review for reasonableness of various measures such as weighted average life, projected prepayment and default speeds, and projected default and loss percentages. The FAV group computes the effect on the valuation of changes in input variables such as interest rates, home prices, and delinquency status to assess the reasonableness of changes in the loan valuation. The results of the estimates of fair value of Level 3 mortgage loans are reported to PFSI s valuation committee as part of its review and approval of monthly valuation results.

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

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

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Following is a quantitative summary of key inputs used in the valuation of mortgage loans at fair value and mortgage loans under forward purchase agreements at fair value:

	Range (Weighted average)	
Key inputs	**June 30, 2014**	**December 31, 2013**
Mortgage loans at fair value		
Discount rate	7.1% 16.9% (11.8%)	8.7% 16.9% (12.7%)
Twelve-month projected housing price index change	3.5% 9.1% (4.7%)	2.5% 4.3% (3.7%)
Prepayment speed (1)	0.0% 6.6% (2.5%)	0.0% 3.9% (2.0%)
Total prepayment speed (2)	0.8% 27.4% (21.8%)	0.3% 33.9% (24.3%)
Mortgage loans under forward purchase agreements		
Discount rate		9.5% 13.5% (11.9%)
Twelve-month projected housing price index change		3.3% 4.2% (3.8%)
Prepayment speed (1)		1.1% 2.9% (2.2%)
Total prepayment speed (2)		13.4% 27.9% (22.8%)

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

Excess Servicing Spread Purchased from PennyMac Financial Services, Inc.

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

ESS is generally subject to loss in fair value when interest rates decrease. Decreasing mortgage rates normally encourage increased mortgage refinancing activity. Increased refinancing activity reduces the life of the loans underlying the ESS, thereby reducing ESS fair value. Reductions in the fair value of ESS affect income primarily through change in fair value.

Interest income for ESS is accrued using the interest method, based upon the expected interest yield from the ESS through the expected life of the underlying mortgages. Changes to expected interest yield result in a change in interest income which is recorded in *Interest income*. Changes to expected cash flows result in a change to fair value that is recognized in *Net gain (loss) on investments*.

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

	Range (Weighted average)	
Key inputs	**June 30, 2014**	**December 31, 2013**
Unpaid principal balance of underlying mortgage loans (in thousands)	$ 27,445,826	$ 20,512,659
Average servicing fee rate (in basis points)	31	32
Average ESS rate (in basis points)	16	16
Pricing spread (1)	1.7% 14.6%	2.8% - 14.4%
	(5.1%)	(5.4%)
Life (in years)	0.5 - 7.3	0.9 - 8.0
	(5.9)	(6.1)
Annual total 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 Dollar London Interbank Offered Rate (LIBOR) curve for purposes of discounting cash flows relating to ESS.
(2) Prepayment speed is measured using Life Total CPR.

Derivative Financial Instruments

The Company estimates the fair value of IRLCs based on quoted Agency MBS prices, its estimate of the fair value of the MSRs it expects to receive in the sale of the loans and the probability that the mortgage loan will be purchased as a percentage of the commitments it has made (the pull-through rate). The Company categorizes IRLCs as Level 3 financial statement items.

The significant unobservable inputs used in the fair value measurement of the Company s IRLCs are the pull-through rate and the MSR component of the Company s estimate of the fair value of the mortgage loans it has committed to purchase. Significant changes in the pull-through rate and the MSR component of the IRLCs, in isolation, could result in a significant change 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:

	Range (Weighted average)	
Key inputs	**June 30, 2014**	**December 31, 2013**
Pull-through rate	49.0% - 98.0%	64.8% - 98.0%
	(81.6%)	(86.4%)
MSR value expressed as:		
Servicing fee multiple	1.7 - 5.0	1.4 - 5.1

	(3.9)	(4.1)
Percentage of unpaid principal balance	0.4% - 1.3%	0.4% - 1.3%
	(1.0%)	(1.0%)

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The Company estimates the fair value of commitments to sell loans based on quoted MBS prices. The Company estimates the fair value of the interest rate options and futures it purchases and sells based on observed interest rate volatilities in the MBS market.

Real Estate Acquired in Settlement of Loans

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

REO values are reviewed by PCM s staff appraisers when the Company obtains multiple indications of value and there is a significant difference between the values received. PCM s staff appraisers will attempt to resolve the difference between the indications of value. In circumstances where the appraisers are not able to generate adequate data to support a value conclusion, the staff appraisers will order an additional appraisal to determine the value.

Mortgage Servicing Rights

MSRs are categorized as Level 3 financial statement items. The Company uses a discounted cash flow approach to estimate the fai