CENDANT CORP
Form 8-K
October 27, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of report (Date of earliest event reported) October 27, 2005

Cendant Corporation

(Exact name of Registrant as specified in Charter)

Delaware (State or Other Jurisdiction of Incorporation)	1-10308 (Commission File No.)	06-0918165 (I.R.S. Employer Identification Number)
9 West 57th Street New York, NY (Address of principal executive office)		10019 (Zip Code)

Registrant s telephone number, including area code (212) 413-1800

(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

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Item 7.01. Regulation FD Disclosure.

Attached hereto as Exhibit 99 and incorporated herein by reference is an investor presentation given on October 27, 2005.

Item 9.01 Financial Statements and Exhibits.

(d) Exhibits.

Exhibit No.	Description
99	Investor presentation

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

CENDANT CORPORATION

Date: October 27, 2005

By: /s/ Eric J. Bock
Eric J. Bock
Executive Vice President, Law
and Corporate Secretary

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CENDANT CORPORATION
CURRENT REPORT ON FORM 8-K
Report Dated October 27, 2005

EXHIBIT INDEX

Exhibit No.	Description
Exhibit 99	Investor presentation

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387,883

$

361,478

Unused amount (1)

$

612,117

$

88,522

$

612,117

$

88,522

Weighted-average interest rate

1.82

%

2.38

%

1.82

%

2.38

%

Fair value of loans securing agreements to repurchase

$

522,031

$

408,415

$

522,031

$

408,415

During the period:

Average balance of loans sold under agreements to repurchase	$ 373,386	$ 219,047	$ 354,125	$ 146,425
Weighted-average interest rate (2)	1.89 %	2.23 %	2.02 %	2.18

%

Total interest expense	$ 2,920	$ 1,682	$ 8,251	$ 3,583
Maximum daily amount outstanding	$ 588,494	$ 361,588	$ 623,523	$ 361,588

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

(2) Excludes the effect of amortization of commitment fees totaling $1.1 million and $423,000 for the quarters ended September 30, 2013 and September 30, 2012, respectively, and $2.8 million and $1.1 million for the nine months ended September 30, 2013 and September 30, 2012, respectively.

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

Remaining maturity at September 30, 2013		**Balance (in thousands)**
Within 30 days	$	423
Over 30 to 90 days		387,460
Over 90 days to 180 days		
Over 180 days to 1 year		
	$	387,883
Weighted-average maturity (in months)		2.6

The amount at risk (the fair value of the assets pledged plus the related margin deposit, less the amount advanced by the counterparty and accrued interest) relating to the Company s mortgage loans held for sale sold under agreements to repurchase is summarized by counterparty below as of September 30, 2013:

Counterparty		**Amount at risk (in thousands)**	**Weighted-average maturity of advances under repurchase agreement**	**Facility maturity**
Bank of America, N.A.	$	45,516	December 16, 2013	January 2, 2014
Credit Suisse First Boston Mortgage Capital LLC	$	89,917	December 18, 2013	(1)

(1) The earlier to occur of October 31, 2014 or the rolling maturity date that is 364 days from any particular date of determination.

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

Excess Servicing Spread Financing

In August 2013, the Company acquired MSRs on a pool of agency residential mortgage loans. In connection with such acquisition, the Company, in September 2013, sold to PMT the right to receive the excess cash flow generated from the related mortgage loans after receipt of a fixed base servicing fee per loan. The Company retained all ancillary income associated with servicing the loans and the fixed base servicing fee. The Company continues to be the servicer of the loan pool and provides all servicing and advancing functions. PMT has no prior or continuing involvement with the loans. The Company accounts for the transaction as a financing and the total proceeds received was $2.8 million.

The carrying amount of the financing was $2.9 million at September 30, 2013.

Note Payable

The note payable is summarized below:

	September 30, 2013		December 31, 2012	
	(in thousands)			
Period end:				
Note payable secured by:				
Servicing advances	$	3,823	$	4,905
MSRs		52,952		48,108
	$	56,775	$	53,013
Assets pledged to secure note:				
Servicing advances	$	6,865	$	7,430
MSRs	$	226,588	$	100,957

The note payable matures on the earlier to occur of October 31, 2014 or the rolling maturity date that is 364 days from any particular date of determination. Interest is charged at a rate based on the lender s overnight cost of funds. The note payable is secured by servicing advances and MSRs relating to certain loans in the Company s servicing portfolio, and provides for advance rates ranging from 50% to 85% of the amount of the servicing advances or the carrying value of the MSR pledged, up to a maximum of $17 million in the case of servicing advances and $100 million in the case of MSRs.

The borrowing facilities contain various covenants, including financial covenants governing the Company s net worth, debt-to-equity ratio, profitability and liquidity. Management believes the Company was in compliance with these requirements as of September 30, 2013.

Note 15 Liability for Losses Under Representations and Warranties

The Company s agreements with Fannie Mae and Freddie Mac include representations and warranties related to the loans the Company sells to those Agencies. The representations and warranties require adherence to Agency origination and underwriting guidelines, including but not limited to the validity of the lien securing the loan, property eligibility, borrower credit, income and asset requirements, and compliance with applicable federal, state and local law.

In the event of a breach of its representations and warranties, the Company may be required to either repurchase the mortgage loans with the identified defects or indemnify the investor or insurer. In such cases, the Company bears any subsequent credit loss on the mortgage loans. The Company s credit loss may be reduced by any recourse it has to correspondent lenders that, in turn, had sold such mortgage loans to the Company and breached similar or other representations and warranties. In such event, the Company has the right to seek a recovery of related repurchase losses from the correspondent lender.

The Company records a provision for losses relating to the representations and warranties it makes as part of its loan sale transactions. The method used to estimate the liability for representations and warranties is a function of estimated future defaults, loan repurchase rates, the potential severity of loss in the event of defaults and, for loans purchased from correspondent lenders, the probability of reimbursement by the correspondent lenders. The Company establishes a liability at the time loans are sold and continually updates its liability estimate.

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

	Quarter ended September 30, 2013	2012	Nine months ended September 30, 2013	2012
		(in thousands)		
Balance at beginning of period	$ 6,185	$ 1,387	$ 3,504	$ 449
Provisions for losses on loans sold	1,069	918	3,766	1,856
Incurred losses	(39)		(55)	
Balance at end of period	$ 7,215	$ 2,305	$ 7,215	$ 2,305
Unpaid principal balance of mortgage loans subject to representations and warranties	$ 20,428,213	$ 6,444,618	$ 20,428,213	$ 6,444,618

Following is a summary of the Company s repurchase activity:

	Quarter ended September 30, 2013	2012	Nine months ended September 30, 2013	2012
		(in thousands)		
During the period:				
Unpaid balance of mortgage loans repurchased	$ 1,973	$	$ 6,840	$
Unpaid principal balance of mortgage loans put to correspondent lenders	$ 357	$	$ 1,410	$
At period end:				
Unpaid principal balance of mortgage loans subject to pending claims for repurchase	$ 1,249	$ 3,459	$ 1,249	$ 3,459

The Company s representations and warranties are generally not subject to stated limits of exposure. However, management believes that the current unpaid principal balance of loans sold by the Company to date represents the maximum exposure to repurchases related to representations and warranties.

The level of the liability for representations and warranties is difficult to estimate and requires considerable management judgment. The level of mortgage loan repurchase losses is dependent on economic factors, investor demand strategies, and other external conditions that will change over the lives of the underlying loans. However, management believes the amount and range of reasonably possible losses in relation to the recorded liability is not material to the Company s financial condition or results of operations.

Note 16 Income Taxes

The Company files U.S. federal and state corporate income tax returns for PFSI and partnership return for PennyMac. Before the IPO, the Company did not have a provision for income taxes as PennyMac is a pass-through taxable entity. PFSI s tax returns are subject to examination for 2012 and forward. In March 2013, the IRS concluded its audit of the partnership return of PennyMac and its subsidiaries for the tax year ended December 31, 2010 and proposed no changes to the return as originally filed. No returns are currently under examination. PennyMac s federal partnership returns are subject to examination for 2011 and forward. PennyMac s primary state tax return is generally subject to examination for 2009 and forward.

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The following table details the Company s income tax expense (benefit).

	Quarter ended September 30, 2013		Nine months ended September 30, 2013	
	(in thousands)			
Current expense:				
Federal	$		$	
State				
Total current expense				
Deferred expense:				
Federal		2,823		4,339
State		670		1,192
Total deferred expense		3,493		5,531
Total provision for income taxes	$	3,493	$	5,531

The provision for deferred income taxes for the quarter and nine months ended September 30, 2013 primarily relates to its investment in PennyMac partially offset by a net operating loss carryforward. The portion attributable to its investment in PennyMac primarily relates to MSRs that PennyMac received pursuant to sales of mortgage loans held for sale at fair value and Carried Interest from the Investment Funds.

The following table is a reconciliation of the Company s provision for income taxes at statutory rates to the provision for income taxes at the Company s effective tax rate:

	Quarter ended September 30, 2013	Nine months ended September 30, 2013
Federal income tax statutory rate	35.0%	35.0%
Less: Rate attributable to non-controlling members	(26.3)%	(31.6)%
State income taxes, net of federal benefit	1.2%	0.6%
Other	0.0%	0.0%
Valuation allowance	0.0%	0.0%
Effective tax rate	9.9%	4.0%

The components of the Company s provision for deferred income taxes are as follows:

	Quarter ended September 30, 2013		Nine months ended September 30, 2013	
	(in thousands)			
Investment in PennyMac	$	5,491	$	7,762
Net operating loss carryforward		(1,998)		(2,231)
Other				
Valuation allowance				
Total provision for deferred income taxes	$	3,493	$	5,531

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The components of *Deferred tax asset* are as follows:

		September 30, 2013 (in thousands)
Taxes currently receivable	$	7
Deferred income tax asset, net		54,523
Deferred tax asset	$	54,530

The tax effects of temporary differences that gave rise to deferred income tax assets and liabilities are presented below:

		September 30, 2013 (in thousands)
Deferred income tax assets:		
Investment in PennyMac	$	52,292
Net operating loss carryforward	$	2,231
Other		
Gross deferred tax assets		54,523
Deferred income tax liabilities:		
Other		
Gross deferred tax liabilities		
Net deferred income tax asset	$	54,523

The Company s deferred income tax is recorded in *Deferred tax asset* in the consolidated balance sheets as of September 30, 2013. There was no income tax asset or liability as of December 31, 2012 since PennyMac is a pass-through taxable entity and PFSI had no activity in 2012. Increases in deferred tax assets are primarily due to the increase in the Company s ownership of PennyMac as a result of a member exchanging its PennyMac Class A units for PFSI stock. As existing members exchange their units, the Company records a deferred tax asset related to PennyMac s election pursuant to Section 754 of the Internal Revenue Code. The investment in PennyMac deferred tax asset is reflected net of the investment in PennyMac deferred tax liabilities primarily related to deferred income from MSRs and accrued Carried Interest from the Investment Funds.

The Company s net operating loss carryforward of $2.2 million generally expires in 2033.

At September 30, 2013 and December 31, 2012, the Company had no unrecognized tax benefits and does not anticipate any increase in unrecognized tax benefits. Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is the Company s policy to record such accruals in the Company s income tax accounts. No such accruals existed at September 30, 2013 and December 31, 2012.

Note 17 Stockholders Equity

During the quarter ended September 30, 2013, a PennyMac unitholder exchanged 6,110,000 Class A Units for PFSI Class A common stock. The impact of the exchange reduced the percentage of the *Noncontrolling interest in Private National Mortgage Acceptance Company, LLC* from

83.16% to 75.11%.

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Note 18 Net Gain on Mortgage Loans Held for Sale

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

	Quarter ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Cash (loss) gain:				
Sales proceeds	$ (93,725)	$ 26,676	$ (148,866)	$ 49,695
Hedging activities	88,789	(19,574)	128,670	(40,276)
	(4,936)	7,102	(20,196)	9,419
Non-cash gain:				
Receipt of MSRs in loan sale transactions	60,137	25,620	154,352	51,006
MSR recapture payable to affiliate	(86)		(586)	
Provision for losses relating to representations and warranties provided in loan sales	(1,069)	(918)	(3,766)	(1,856)
Change in fair value relating to loans and hedging derivatives held at period end:				
IRLCs	37,768	20,723	(2,382)	25,528
Mortgage loans	27,510	6,693	7,876	8,636
Hedging derivatives	(93,375)	(19,460)	(26,738)	(24,246)
	$ 25,949	$ 39,760	$ 108,560	$ 68,487

Note 19 Net Interest Income (Expense)

Net interest income (expense) is summarized for the periods presented below:

	Quarter ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Interest income:				
Short-term investments	$ 432	$ 11	$ 635	$ 54
Mortgage loans at fair value	4,661	1,903	10,675	4,437
	5,093	1,914	11,310	4,491
Interest expense:				
Assets sold under agreements to repurchase	2,920	1,682	8,251	3,583
Note payable	681	281	2,326	645
Other	555	79	1,109	(2)
	4,156	2,042	11,686	4,226
Net interest income (expense)	$ 937	$ (128)	$ (376)	$ 265

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Note 20 Stock-Based Compensation

The Company s 2013 Equity Incentive Plan provides for grants of stock options, time-based and performance-based restricted stock units (RSUs), stock appreciation rights, performance units and stock grants. As of September 30, 2013, the Company has 120.2 million units available for future awards. The Company estimates the cost of the stock options, time-based restricted stock units and performance-based restricted stock units awarded with reference to the fair value of PFSI s underlying common stock on the date of the award. The Company amortizes the cost of previously granted stock-based awards to compensation expense over the vesting period using the graded vesting method. Compensation costs are fixed, except for the performance-based restricted stock units, at the grant s estimated fair value on the grant date as all grantees are employees and directors of the Company. Expense relating to awards is included in *Compensation* in the consolidated statements of income.

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

	Quarter ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Stock options	$ 593	$	$ 791	$
Performance-based RSUs	464		746	
Time-based RSUs	330		395	
	$ 1,387	$	$ 1,932	$

Stock Options

The Stock Option award agreements provide for the award of Stock Options to purchase the optioned common stock. In general, and except as otherwise provided by the agreement, one-third of the optioned common stock will vest in a lump sum on each of the first, second, and third anniversaries of the grant date, subject to the recipient s continued service through each anniversary. Each Stock Option will have a term of ten years from the date of grant but will expire (1) immediately upon termination of the holder s employment or other association with the Company for cause, (2) one year after the holder s employment or other association is terminated due to death or disability and (3) three months after the holder s employment or other association is terminated for any other reason.

The fair value of each Stock Option award is estimated on the date of grant using a variant of the Black Scholes model based on the assumptions noted in the following table:

	Quarter ended September 30, 2013	Nine months ended September 30, 2013
Expected volatility (1)		45%
Expected dividends		0%
Risk-free rate		0.03% - 2.30%
Annualized grantee forfeiture rate		6.2% - 19.2%

(1) Based on historical volatilities of comparable companies common stock.

The Company uses its historical data to estimate employee departure behavior used in the option-pricing model; groups of employees (executives and non-executives) that have similar historical behavior are considered separately for valuation purposes. The expected term of common stock options granted is derived from the option pricing model and represents the period of time that common stock options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the common stock option is based on the U.S. Treasury yield curve in effect at the time of grant.

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The table below summarizes stock option award activity and compensation expense for the periods presented:

		Quarter ended September 30, 2013		Nine months ended September 30, 2013
Number of Stock Options				
Outstanding at beginning of period		423,407		
Granted				423,407
Exercised				
Expired or canceled		253		253
Outstanding at end of period		423,154		423,154
Weighted-average exercise price:				
Outstanding at beginning of period	$	21.03	$	
Granted				21.03
Exercised				
Expired or canceled		21.03		21.03
Outstanding at end of period	$	21.03	$	21.03
Exercisable at end of period				
Available for future grant				
Weighted-average remaining contractual term (in years):				
Outstanding at end of period		9.7		
Exercisable at end of period				
Aggregate intrinsic value:				
Outstanding at end of period	$		$	
Exercisable at end of period	$		$	

Time-Based RSUs

The RSU grant agreements provide for the award of time-based RSUs, for each RSU, entitling the award recipient to one share of the Company s Class A common stock. One-third of all time-based RSUs vest in a lump sum on each of the first, second, and third anniversaries of the vesting commencement date, subject to the recipient s continued service through each anniversary.

Compensation cost relating to time-based RSUs is based on the fair value of PFSI s common stock and the number of shares expected to vest. For purposes of estimating the cost of the time-based RSUs granted, management assumes turnover rates of 6.2% - 19.2% per year based on the grantees employee classification. Compensation cost relating to time-based RSUs is amortized to expense using the graded vesting method and is included in the *Compensation* expense on the accompanying consolidated statements of income.

Following is a summary of time-based RSU activity for the periods presented:

	Quarter ended September 30, 2013	Nine months ended September 30, 2013
Number of units		
Outstanding at beginning of period	70,826	

Granted		27,407		98,233
Vested				
Expired or canceled		126		126
Outstanding at end of period		98,107		98,107
Weighted-average grant date fair value:				
Outstanding at beginning of period	$	17.51	$	
Granted	$	19.37	$	18.03
Vested	$		$	
Expired or canceled	$	17.51	$	17.51
Outstanding at end of period	$	18.03	$	18.03
Compensation expense recorded during the period (in thousands)	$	330	$	395
Period end:				
Unamortized compensation cost (in thousands)	$	979		

Performance-Based RSUs

The performance-based RSUs provide for the issuance of shares of PFSI Class A common stock based equally on the attainment of earnings per share and total shareholder return goals and are adjusted for grantee performance ratings. The performance period for these grants is from June 13, 2013 through December 31, 2015. The grantees satisfaction of the performance goals will be established by review of a committee of PFSI s board of directors. Shares vested under these grants will be issued to the grantees no later than March 15, 2016.

The performance-based RSUs contain both performance goals (attainment of earnings per share) and market goals (total shareholder return). The Company separately accounts for the performance and market goals when recognizing compensation expense relating to performance-based RSUs.

The fair value of the market goal component of the performance-based RSUs is measured using a variant of the Black-Scholes model. Key inputs are the expected volatility of the Company s Class A common stock, the risk-free interest rate and expected grantee forfeiture rates.

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Following are the inputs for grants made for the periods presented:

Input	Quarter ended September 30, 2013	Nine months ended September 30, 2013
Expected volatility		45%
Expected dividends		0%
Risk-free interest rate		0.3%-2.3%
Annualized grantee forfeiture rate		6.2%-19.2%

The fair value of the performance goal component of the performance-based RSUs is measured based on the fair value of the Company s common shares at the grant date, management s estimate of to what extent the performance goal will be met and the number of shares to be forfeited during the vesting period. The cost of the performance-based RSUs is amortized to *Compensation expense* using the straight line method over the performance period.

Following is a summary of performance-based RSU activity for the periods presented:

		Quarter ended September 30, 2013		Nine months ended September 30, 2013
Number of units				
Outstanding at beginning of period		499,364		
Granted				499,364
Vested				
Expired or canceled		253		253
Outstanding at end of period		499,111		499,111
Weighted-average grant date fair value:				
Outstanding at beginning of period	$	11.58	$	
Granted	$		$	11.58
Vested	$		$	
Expired or canceled	$	11.58	$	11.58
Outstanding at end of period	$	11.58	$	11.58
Compensation expense recorded during the period (in thousands)	$	464	$	746
Period end:				
Unamortized compensation cost (in thousands)	$	3,816		

Note 21 Supplemental Cash Flow Information

	Nine months ended September 30,			
	2013		2012	
	(in thousands)			
Cash paid for interest	$	11,110	$	3,506
Cash paid for income taxes	$	7	$	
Non-cash investing activity:				
Receipt of MSRs created in loan sales activities	$	154,352	$	51,006

Note 22 Regulatory Net Worth and Agency Capital Requirements

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

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

	September 30, 2013		December 31, 2012	
Requirement - company subject to requirement	**Net worth (1)**	**Required**	**Net worth (1)**	**Required**
		(in thousands)		
Fannie Mae - PLS	$ 273,445	$ 54,546	$ 172,843	$ 35,947
Freddie Mac - PLS	$ 273,798	$ 53,751	$ 173,273	$ 27,119
Ginnie Mae:				
Issuer PLS	$ 260,032	$ 45,625	$ 152,782	$ 23,886
Issuer s parent PennyMac	$ 554,841	$ 50,188	$ 227,560	$ 26,275
HUD - PLS	$ 260,032	$ 195,891	$ 152,782	$ 1,000

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

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Noncompliance with the respective agencies capital requirements can result in the respective Agency taking various remedial actions up to and including removing PennyMac s ability to sell loans to and service loans on behalf of the respective Agency. Management believes that PennyMac and PLS had Agency capital in excess of the respective Agencies requirements at September 30, 2013.

Note 23 Commitments and Contingencies

Litigation

The business of the Company involves the collection of numerous accounts, as well as the validity of liens and compliance with various state and federal lending and servicing laws. Accordingly, the Company may be involved in proceedings, claims, and legal actions arising in the ordinary course of business. As of September 30, 2013, the Company was not involved in any legal proceedings, claims, or actions in management s view would be reasonably likely to have a material adverse effect on the Company.

Commitments to Fund and Sell Mortgage Loans

	September 30, 2013 (in thousands)
Commitments to purchase mortgage loans from PMT	$ 1,022,670
Commitments to fund mortgage loans	140,861
	$ 1,163,531
Commitments to sell mortgage loans	$ 3,086,889

Note 24 Segments and Related Information

The Company has two operating segments: mortgage banking and investment management.

The mortgage banking segment represents the Company s operations aimed at originating, purchasing, selling and servicing newly originated mortgage loans and servicing mortgage loans sourced and managed by the investment management segment, including executing the loan resolution strategy identified by the investment management segment relating to distressed mortgage loans.

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

The investment management segment presently focuses on managing investments in distressed mortgage assets, which include mortgage loans that are either in default or are perceived to be at higher risk of default. The investment management segment then seeks to maximize the value of the mortgage loans on behalf of investors through the direction of effective high touch servicing by the mortgage banking segment. High touch servicing is based on significant levels of borrower outreach and contact, and the ability to implement long-term, sustainable loan modification and restructuring programs that address borrowers ability and willingness to pay their mortgage loans. Where this is not possible, the investment management segment seeks to effect property resolution in a timely, orderly and economically efficient manner for the investor.

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Financial highlights by operating segment are as follows:

	Quarter ended September 30, 2013		
	Mortgage banking	Investment management (in thousands)	Total
Revenues:			
Net gains on mortgage loans held for sale at fair value	$ 25,949	$	$ 25,949
Loan origination fees	6,280		6,280
Fulfillment fees from PMT	18,327		18,327
Net servicing income	21,399		21,399
Management fees		10,540	10,540
Carried Interest from Investment Funds		2,812	2,812
Net interest income:			
Interest income	5,089	4	5,093
Interest expense	(4,156)		(4,156)
	933	4	937
Other	(22)	972	950
	72,866	14,328	87,194
Expenses:			
Compensation	33,969	1,861	35,830
Other	16,240	207	16,447
	50,209	2,068	52,277
Income before provision for income taxes	$ 22,657	$ 12,260	$ 34,917
Segment assets at period end	$ 1,208,156	$ 46,228	$ 1,254,384

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	Quarter ended September 30, 2012		
	Mortgage banking	Investment management (in thousands)	Total
Revenues:			
Net gains on mortgage loans held for sale at fair value	$ 39,760	$	$ 39,760
Loan origination fees	2,752		2,752
Fulfillment fees from PMT	17,258		17,258
Net servicing income	6,112		6,112
Management fees		6,114	6,114
Carried Interest from Investment Funds		3,355	3,355
Net interest income (expense):			
Interest income	1,913	1	1,914
Interest expense	(2,042)		(2,042)
	(129)	1	(128)
Other	1	1,008	1,009
	65,754	10,478	76,232
Expenses:			
Compensation	29,089	2,767	31,856
Other	6,375	138	6,513
	35,464	2,905	38,369
Income before provision for income taxes	$ 30,290	$ 7,573	$ 37,863
Segment assets at period end	$ 709,733	$ 17,529	$ 727,262

	Nine months ended September 30, 2013		
	Mortgage banking	Investment management (in thousands)	Total
Revenues:			
Net gains on mortgage loans held for sale at fair value	$ 108,560	$	$ 108,560
Loan origination fees	18,260		18,260
Fulfillment fees from PMT	68,625		68,625
Net servicing income	59,510		59,510
Management fees		29,375	29,375
Carried Interest from Investment Funds		10,411	10,411
Net interest income (expense):			
Interest income	11,296	14	11,310
Interest expense	(11,686)		(11,686)
	(390)	14	(376)
Other	(22)	1,796	1,774
	254,543	41,596	296,139
Expenses:			
Compensation	106,584	7,266	113,850
Other	41,354	496	41,850
	147,938	7,762	155,700
Income before provision for income taxes	$ 106,605	$ 33,834	$ 140,439
Segment assets at period end	$ 1,208,156	$ 46,228	$ 1,254,384

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	Nine months ended September 30, 2012		
	Mortgage banking	Investment management (in thousands)	Total
Revenues:			
Net gains on mortgage loans held for sale at fair value	$ 68,487	$	$ 68,487
Loan origination fees	5,439		5,439
Fulfillment fees from PMT	31,097		31,097
Net servicing income	25,346		25,346
Management fees		15,163	15,163
Carried Interest from Investment Funds		7,255	7,255
Net interest income:			
Interest income	4,488	3	4,491
Interest expense	(4,226)		(4,226)
	262	3	265
Other	1	2,514	2,515
	130,632	24,935	155,567
Expenses:			
Compensation	71,541	6,214	77,755
Other	14,443	466	14,909
	85,984	6,680	92,664
Income before provision for income taxes	$ 44,648	$ 18,255	$ 62,903
Segment assets at period end	$ 709,733	$ 17,529	$ 727,262

Note 25 Subsequent Events

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

- On November 1, 2013, the Company, through PLS, acquired $10.3 billion in UPB of Fannie Mae MSRs from a third party, with a $62 million co-investment by PMT in the excess servicing spread associated with this MSR portfolio.

- On November 11, 2013, the Company, through PLS, entered into a purchase agreement with a third party to purchase $10.8 billion in UPB of Ginnie Mae MSRs. The Company expects to enter into an agreement with PMT providing for approximately $86 million of co-investment in the excess servicing spread associated with this MSR portfolio. The MSR acquisition by PLS and PMT s co-investment in the excess servicing spread are subject to the negotiation and execution of definitive documentation, continuing due diligence and customary closing conditions and approvals. There can be no assurance that the committed amounts will ultimately be acquired or that the transactions will be completed at all.

- On October 1, 2013, the Company filed with the SEC a registration statement on Form S-1, which registers the resale from time to time by certain stockholders of up to 43,973,679 shares of the Company s Class A common stock, of which 37,863,679 shares are issuable upon the exchange of Class A Units, and 6,110,000 shares are currently held by one of the stockholders. The registration statement was declared effective by the SEC on October 28, 2013.

- All agreements to repurchase assets that matured between September 30, 2013 and the date of this Report were extended or renewed.

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

Cautionary Statement Regarding Forward-Looking Statements

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

Statements contained in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties and other factors, which may cause actual results to be materially different from those expressed or implied in such statements. You can identify these forward-looking statements by words such as may, will, should, expect, anticipate, believe, estimate, intend, plan and other similar expressions. You should forward-looking statements in light of a number of factors, including those described in Factors that May Affect Our Future Results and the risks discussed under the heading Risk Factors in the Company s final prospectus included as part of its Registration Statement on Form S-1, as amended (SEC File No. 333-186495) (the Registration Statement), and in Part II, Item 1A., Risk Factors, of this Quarterly Report on Form 10-Q, as well as its consolidated financial statements, related notes, and the other financial information appearing elsewhere in this Quarterly Report on Form 10-Q and its other filings with the United States Securities and Exchange Commission (SEC). The forward-looking statements contained in this Quarterly Report on Form 10-Q are made as of the date hereof and the Company assumes no obligation to update or supplement any forward-looking statements.

Overview

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

Initial Public Offering and Recapitalization

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

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

Common Stock to be different than the number of Class A Units that PFSI owns.

Before 2013, PennyMac made an election pursuant to Section 754 of the Internal Revenue Code which remains in effect. An exchange results in a special adjustment for PFSI that may increase PFSI s tax basis in the assets of PennyMac that otherwise would not have been available. These increases in tax basis may reduce the amount of tax that PFSI would otherwise be required to pay in the future and result in increases in investment in PennyMac deferred tax assets net of investment in PennyMac deferred tax liabilities.

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

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Our Company

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

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

We conduct our business in two segments: mortgage banking and investment management. Our principal mortgage banking subsidiary, PennyMac Loan Services, LLC, (PLS), is a non-bank producer and servicer of mortgage loans in the United States. Our principal investment management subsidiary, PNMAC Capital Management, LLC, (PCM), is an SEC registered investment adviser. PCM manages PennyMac Mortgage Investment Trust (PMT), a mortgage real estate investment trust, listed on the New York Stock Exchange. PCM also manages PNMAC Mortgage Opportunity Fund, LLC and PNMAC Mortgage Opportunity Fund, LP, both registered under the Investment Company Act of 1940, as amended, and PNMAC Mortgage Opportunity Fund Investors, LLC. We refer to these funds collectively as our Investment Funds and, together with PMT, as our Advised Entities.

Mortgage Banking

Our mortgage banking segment is comprised of three primary businesses: correspondent lending, retail lending, and loan servicing.

- ***Correspondent Lending***. Our correspondent lending business manages, on behalf of PMT and for our own account, the acquisition of newly originated, prime credit quality, first-lien residential mortgage loans that have been underwritten to investor guidelines. PMT acquires, from approved correspondent sellers, newly originated loans, primarily conventional residential mortgage loans guaranteed by the Agencies. For conventional loans, we perform fulfillment activities for PMT and earn a fulfillment fee for each loan purchased by PMT. In the case of government-insured loans, we purchase them from PMT at PMT s cost plus a sourcing fee and fulfill them for our own account.

- ***Retail Lending***. Our retail lending business originates new prime credit quality, first-lien residential conventional and government-insured mortgage loans on a national basis to allow customers to purchase or refinance their homes. We conduct this business through a consumer direct model, which relies on the Internet and call center-based staff to acquire and interact with customers across the country. We do not have a brick and mortar branch network and have been developing our consumer direct operations with call centers strategically positioned across the United States.

- ***Loan Servicing***. Our loan servicing business performs loan administration, collection and default activities, including the collection and remittance of loan payments; response to customer inquiries; accounting for principal and interest; holding custodial (impound) funds for the payment of property taxes and insurance premiums; counseling delinquent mortgagors; and supervising foreclosures and property dispositions. We service a diverse portfolio of loans both as the owner of MSRs and on behalf of other MSR or mortgage owners. We provide prime servicing for conventional and government-insured loans, as well as special servicing for distressed loans that have been acquired as investments by our Advised Entities, and loans in private-label MBS securities, which are securities issued by institutions that are not affiliated with any Agency.

During the quarter and nine months ended September 30, 2013, we managed PMT s acquisition of approximately $8.0 billion and $25.2 billion, respectively, in unpaid principal balance of newly originated, prime credit quality, first-lien residential mortgage loans. We purchased, for our own account, approximately $4.0 billion and $12.0 billion in unpaid principal balance of government-insured loans from PMT during the quarter and nine month period ended September 30, 2013. We also originated $282.5 million and $892.3 million in unpaid principal balance of residential mortgage loans through our retail channel during the quarter and nine month period ended September 30, 2013. During the quarter and nine months ended September 30, 2013, we increased our portfolio of loans that we serviced or subserviced from approximately $28.2 billion at December 31, 2012 to approximately $52.9 billion at September 30, 2013.

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During the quarter and nine months ended September 30, 2012, we managed PMT s acquisition of approximately $6.3 billion and $11.5 billion, respectively, in unpaid principal balance of newly originated, prime credit quality, first-lien residential mortgage loans. We purchased for our account approximately $2.6 billion and $5.0 billion, respectively, in unpaid principal balance of government-insured loans from PMT. We also originated $147.5 million and $302.6 million, respectively, in unpaid principal balance of residential mortgage loans through our retail channel during the quarter and nine months ended September 30, 2012, and increased our portfolio of loans that we serviced or subserviced from approximately $7.7 billion at December 31, 2011 to approximately $18.6 billion at September 30, 2012.

Investment Management

We are an investment manager through our indirect wholly-owned subsidiary, PCM. PCM currently manages PMT and the Investment Funds, which had combined net assets of approximately $2.1 billion as of September 30, 2013. For these activities, we earn management fees as a percentage of net assets and incentive compensation based on investment performance.

Observations on Current Market Opportunities

Our business is affected by macroeconomic conditions in the United States, including economic growth, unemployment rates, the residential housing market and interest rate levels and expectations. The U.S. economy continues its pattern of modest growth as reflected in recent economic data. During the third quarter of 2013, real U.S. gross domestic product expanded at an annual rate of 2.8% compared to revised 2.5% and 2.8% annual rates for the second quarter of 2013 and third quarter of 2012, respectively. Modest economic growth continued to affect unemployment rates during the second quarter of 2013. The national unemployment rate was 7.2% at September 30, 2013 and compares to a revised seasonally adjusted rate of 7.8% at September 30, 2012 and 7.6% at June 30, 2013. Delinquency rates on residential real estate loans remain elevated compared to historical rates. As reported by the Federal Reserve, during the second quarter of 2013, the delinquency rate on residential real estate loans held by commercial banks was 9.4%, a reduction from 10.6% during the second quarter of 2012.

Residential real estate activity appears to be improving. The seasonally adjusted annual rate of existing home sales for September 2013 was 10.7% higher than for September 2012 and the national median existing home price for all housing types was $199,200, an 11.7% increase from September 2012. On a national level, foreclosure filings during the third quarter of 2013 decreased by 27% as compared to the third quarter of 2012. Foreclosure activity across the country is expected to remain above historical average levels through the remainder of 2013 and beyond.

Thirty-year fixed rate mortgage interest rates ranged from a high of 4.49% to a low of 4.37% during the third quarter of 2013 (Source: the Federal Home Loan Mortgage Corporation s Weekly Primary Mortgage Market Survey). During the first nine months of 2013, mortgage interest rates have ranged from a high of 4.58% to a low of 3.34%. During the third quarter of 2012, interest rates for the thirty-year fixed rate mortgage ranged from a high of 3.66% to a low of 3.40%.

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

Mortgage lenders originated an estimated $460 billion of home loans during the third quarter of 2013, down 18.6 percent from the second quarter of the year. That brought year-to-date volume for the origination market to slightly less than $1.6 trillion, up 3.9 percent from the pace set during the first nine months of 2012 (Source: Inside Mortgage Finance). However, mortgage originations are forecast to decline, with current industry estimates for the fourth quarter of 2013 totaling $280 billion (Source: average of Fannie Mae, Freddie Mac and Mortgage Bankers Association forecasts).

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In our capacity as an investment manager, we continue to see substantial volumes of distressed residential mortgage loan sales (sales of loan pools that consist of either nonperforming loans, troubled but performing loans or a combination thereof) offered for sale by a limited number of sellers. During the third quarter of 2013, we reviewed 25 mortgage loan pools with unpaid principal balances totaling approximately $7.3 billion. This compares to our review of 23 mortgage loan pools with unpaid principal balances totaling approximately $3.8 billion during the third quarter of 2012. We managed the acquisition, on behalf of PMT, of distressed mortgage loans with fair values totaling $822 million during the third quarter of 2013 compared to $151 million during the third quarter of 2012.

In recent periods, we have seen increased competition from new and existing market participants in both our correspondent lending and retail lending businesses, as well as reductions in the overall level of refinancing activity. We believe that this change in supply and demand within the marketplace has been driving lower production margins in recent periods, which is reflected in our results of operations in our gains on mortgage loans held for sale. Although margins on gains from mortgage loans held for sale benefitted from wider secondary spreads (the difference between interest rates charged to borrowers and yields on mortgage-backed securities in the secondary market) in 2012, margins narrowed in subsequent quarters and we expect them to continue to normalize toward their long-term averages in 2013 and 2014.

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Results of Operations

Our results of operations are summarized below for the periods presented:

	Quarter ended September 30, 2013	Quarter ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
	(in thousands)			
Revenue				
Net gains on mortgage loans held for sale at fair value	$ 25,949	$ 39,760	$ 108,560	$ 68,487
Loan origination fees	6,280	2,752	18,260	5,439
Fulfillment fees from PennyMac Mortgage Investment Trust	18,327	17,258	68,625	31,097
Net servicing income	21,399	6,112	59,510	25,346
Management fees	10,540	6,114	29,375	15,163
Carried Interest from Investment Funds	2,812	3,355	10,411	7,254
Net interest income	937	(128)	(376)	265
Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust	165	314	(68)	630
Other	785	695	1,842	1,886
Total revenue	87,194	76,232	296,139	155,567
Total expenses	52,277	38,369	155,700	92,664
Provision for income taxes	3,493		5,531	
Net income	$ 31,424	$ 37,863	$ 134,908	$ 62,903
Pre-tax income by segment:				
Mortgage Banking	$ 22,657	$ 30,290	$ 106,605	$ 44,648
Investment Management	12,260	7,573	33,834	18,255
	$ 34,917	$ 37,863	$ 140,439	$ 62,903
During the period:				
Mortgage loans purchased and originated for sale:				
Government-insured or guaranteed loans acquired from PMT at fair value	$ 4,147,535	$ 2,650,097	$ 12,429,698	$ 5,111,185
Retail production at fair value	282,440	149,006	895,405	304,402
	$ 4,429,975	$ 2,799,103	$ 13,325,103	$ 5,415,587
Unpaid principal balance of mortgage loans fulfilled for PMT	$ 3,681,771	$ 2,488,443	$ 12,792,482	$ 4,828,117
At period end:				
Unpaid principal balance of mortgage loan servicing portfolio				
Mortgage loans held for sale	$ 490,088	$ 376,717	$ 490,088	$ 376,717
MSRs owned	22,776,613	8,286,075	22,776,613	8,286,075
Subserviced	29,605,633	10,313,879	29,605,633	10,313,879
	$ 52,872,334	$ 18,976,671	$ 52,872,334	$ 18,976,671
Net assets of Advised Entities				
PennyMac Mortgage Investment Trust	$ 1,494,765	$ 1,184,203	$ 1,494,765	$ 1,184,203
Investment Funds	556,013	575,850	556,013	575,850
	$ 2,050,778	$ 1,760,053	$ 2,050,778	$ 1,760,053

Comparison of the quarters and nine months ended September 30, 2013 and 2012

Net income decreased by approximately $6.4 million or 17% and increased $72.0 million or 114% for the quarter and nine months ended September 30, 2013, respectively, when compared to the same periods in 2012.

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The decrease in net income from the quarter ended September 30, 2012 to the quarter ended September 30, 2013 is due to the contraction in the mortgage origination market and the resulting increased price competition, which had a negative effect on our margins during the quarter ended September 30, 2013. While our mortgage loan origination volume increased $1.6 billion or 58%, increased price competition in the mortgage market during the quarter ended September 30, 2013 caused a reduction in our net gain on mortgage loans held for sale at fair value of $13.8 million or 35%.

The increase in net income for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012, primarily reflects growth in the Company s mortgage banking operations. Loan purchase and origination volume increased by approximately $7.9 billion or 146% in the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012 and the Company s loan servicing portfolio was approximately $52.9 billion at September 30, 2013, an increase of $33.9 billion or 179% from September 30, 2012. This growth was supplemented by growth in the Company s investment management segment due to an increase of $14.2 million or 94% in management fees for the nine months ended September 30, 2013, compared to the nine months ended September 30, 2012. These revenue increases were partly offset by increases in expenses of approximately $63.0 million or 68%, during the nine month periods ended September 30, 2013 as compared to the comparable periods in 2012. We incurred these increases in expenses to accommodate the Company s growth.

Net gains on mortgage loans held for sale at fair value

During the quarter and nine months ended September 30, 2013, we recognized net gains on mortgage loans held for sale at fair value totaling $25.9 million and $108.6 million, respectively. This compares to net gains on mortgage loans held for sale at fair value totaling $39.8 million and $68.5 million, respectively, during the quarter and nine months ended September 30, 2012.

The decrease in net gains on mortgage loans held for sale at fair value from the quarter ended September 30, 2012 to the quarter ended September 30, 2013 is due to the effect of increasing price competition in the mortgage market, which had a negative effect on our margins during the quarter ended September 30, 2013. The net gain for the quarters ended September 30, 2013 and 2012 included $60.1 million and $25.6 million, respectively, in fair value of MSRs received as part of proceeds on sales.

The increase in net gains on mortgage loans held for sale at fair value for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012, was due to growth in the volume of mortgage loans that we purchased and originated and subsequently sold during 2013 as compared to 2012. The net gains for the nine months ended September 30, 2013 included $154.4 million in fair value of MSRs received as part of proceeds on sales. The net gains for the nine months ended September 30, 2012 included $51.0 million in fair value of MSRs received as part of proceeds on sales.

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We recognized gains on mortgage loans held for sale as summarized below:

	Quarter ended September 30, 2013	Quarter ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
	(in thousands)			
Cash (loss) gain:				
Sales proceeds	$ (93,725)	$ 26,676	$ (148,866)	$ 49,695
Hedging activities	88,789	(19,574)	128,670	(40,276)
	(4,936)	7,102	(20,196)	9,419
Non-cash gain:				
Receipt of MSRs in loan sale transactions	60,137	25,620	154,352	51,006
MSR recapture payable to affiliate	(86)		(586)	
Provision for losses relating to representations and warranties provided in loan sales	(1,069)	(918)	(3,766)	(1,856)
Change in fair value relating to mortgage loans and hedging derivatives held for sale at period end:				
IRLCs	37,768	20,723	(2,382)	25,528
Mortgage loans	27,510	6,693	7,876	8,636
Hedging derivatives	(93,375)	(19,460)	(26,738)	(24,246)
	$ 25,949	$ 39,760	$ 108,560	$ 68,487
During the period:				
Unpaid principal balance of loans sold	$ 4,442,944	$ 2,490,174	$ 12,679,436	$ 4,834,492
Interest rate lock commitments issued, net of cancellations	$ 3,699,970	$ 2,274,847	$ 12,280,205	$ 3,539,763
At period end:				
Fair value of mortgage loans held for sale	$ 530,248	$ 410,071	$ 530,248	$ 410,071
Commitments to fund and purchase mortgage loans	$ 1,163,531	$ 1,470,590	$ 1,163,531	$ 1,470,590
Increase (decrease) in gains on mortgage loans held for sale at fair value due to:				
Change in IRLCs fair value	$ 17,045	$ 19,324	$ 27,910	$ 24,428
Volume of loans sold	7,532	17,981	68,494	41,143
Gain margin	(38,388)	112	(512)	(979)
Total change	$ (13,811)	$ 37,417	$ 95,892	$ 64,592

We recognize a substantial portion of our gain on mortgage loans held for sale at fair value before we fund or purchase the loan. In the course of our correspondent and retail lending activities, we make contractual commitments to PMT and to mortgage loan applicants to purchase or fund mortgage loans at specified terms. We call these commitments interest rate lock commitments (IRLCs). We recognize the value of IRLCs at the time we make a commitment to PMT or the borrower.

We estimate the fair value of an IRLC based on quoted Agency MBS prices, our estimate of the fair value of the MSRs we expect to receive in the sale of the loans and the probability that the mortgage loan will fund or be purchased as a percentage of the commitment we have made (the pull-through rate). We update our estimates of the value of the IRLCs as the mortgage loans move through the purchase or loan process for changes in our estimate of the probability the loan will fund and for changes in interest rates.

An active, observable market for IRLCs does not exist. Therefore, we estimate the fair value of IRLCs using methods and assumptions we believe that market participants use in pricing IRLCs. The significant unobservable inputs used in the fair value measurement of the Company s IRLCs are the pull-through rate and the MSR component of the Company s estimate of the value of the mortgage loans we have 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 rising interest rates increase the pull-through rate for loans that have decreased in fair value in comparison to the agreed-upon purchase price.

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Following is a quantitative summary of key unobservable inputs we used in the valuation of IRLCs as of the dates presented:

	September 30, 2013	December 31, 2012
	Range (Weighted average)	
Key Inputs		
Pull-through rate	56.6% - 98.0%	61.6% 98.1%
	(78.3%)	(79.1%)
MSR value expressed as:		
Servicing fee multiple	2.1 - 5.0	3.2 4.2
	(4.0)	(4.0)
Percentage of unpaid principal balance	0.4% - 2.6%	0.6% 2.2%
	(1.1%)	(0.9%)

MSRs represent the value of a contract that obligates us to service mortgage loans on behalf of the purchaser of the loan in exchange for servicing fees and the right to collect certain ancillary income from the borrower. We recognize MSRs at our estimate of the fair value of the contract to service the loans. As discussed in *Net loan servicing income*, below, how much of the MSR we realize in cash depends on how our initial estimates of the future cash flows accruing to the MSRs are realized.

As economic fundamentals influence the loans we sell with servicing rights retained, our estimate of the fair value of MSRs will also change. As a result, we will record changes in fair value as a component of *Net loan servicing income* for the MSRs we carry at fair value and we may recognize changes in fair value relating to our MSRs carried at the lower of amortized cost or fair value depending on the relationship of the asset s fair value to its carrying value at the measurement date.

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

	Quarter ended September 30,			
	2013		2012	
	Range (Weighted average)			
	Amortized cost	Fair value	Amortized cost	Fair value
Unpaid principal balance of underlying loans	$4,120,962	$315,869	$2,485,982	$4,217
Weighted-average servicing fee rate (in basis points)	30	31	27	27
Pricing spread (1)	5.4% - 15.9%	7.4% - 13.1%	7.5% - 9.9%	7.5% - 9.9%
	(8.2%)	(9.9%)	(9.8%)	(7.8%)
Annual total prepayment speed (2)	8.5% - 14.7%	8.8% - 17.2%	8.4% - 9.5%	8.4% - 9.5%
	(8.8%)	(9.2%)	(8.4%)	(9.2%)
Life (in years)	2.9 6.9	3.6 7.0	6.4 6.7	6.4 6.7
	(6.7)	(6.9)	(6.7)	(6.4)
Cost of servicing	$68 $120	$68 $120	$68 $100	$68 $100
	$(104)	$(101)	$(99)	$(71)

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	Nine months ended September 30,			
	2013		2012	
	Range (Weighted average)			
	Amortized cost	**Fair value**	**Amortized cost**	**Fair value**
Unpaid principal balance of underlying loans	$12,350,104	$318,066	$4,811,328	$17,504
Weighted-average servicing fee rate (in basis points)	29	31	27	28
Pricing spread (1)	5.4% - 15.9%	7.4% - 13.1%	7.5% - 9.9%	7.5% - 9.9%
	(8.2%)	(9.9%)	(9.8%)	(8.4%)
Annual total prepayment speed (2)	8.5% - 18.5%	8.8% - 17.2%	7.8% - 9.5%	7.8% - 9.5%
	(8.8%)	(9.2%)	(8.3%)	(8.6%)
Life (in years)	2.9 6.9	3.6 7.0	5.9 6.9	5.9 6.9
	(6.7)	(6.9)	(6.7)	(6.4)
Cost of servicing	$68 $120	$68 $120	$68 $100	$68 $100
	$(102)	$(101)	$(99)	$(77)

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

(2) Annual total prepayment speed is measured using CPR.

We also provide for our estimate of the future losses that we may be required to incur as a result of our breach of representations and warranties provided to the purchasers of the loans we sold. Our agreements with the Agencies include representations and warranties related to the loans we sell to the Agencies. The representations and warranties require adherence to Agency origination and underwriting guidelines, including but not limited to the validity of the lien securing the loan, property eligibility, borrower credit, income and asset requirements, and compliance with applicable federal, state and local law.

In the event of a breach of our representations and warranties, we may be required to either repurchase the mortgage loans with the identified defects or indemnify the investor or insurer. In such cases, we bear any subsequent credit loss on the mortgage loans. Our credit loss may be reduced by any recourse we have to correspondent lenders that sold such mortgage loans and breached similar or other representations and warranties. In such event, we have the right to seek a recovery of related repurchase losses from that correspondent lender.

We evaluate the adequacy of the balance of our recorded liability for losses under representations and warranties based on our loss experience and our assessment of future losses to be incurred relating to loans we have previously sold and which remain outstanding at the balance sheet date. The method used to estimate the liability for representations and warranties is a function of the representations and warranties given and considers a combination of factors, including, but not limited to, estimated future defaults and loan repurchase rates and the potential severity of loss in the event of defaults and the probability of reimbursement by the correspondent loan seller. We establish a liability at the time loans are sold and periodically update our liability estimate.

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Following is a summary of our *Liability for losses under representations and warranties* in the consolidated balance sheets:

	Quarter ended September 30, 2013	2012	Nine months ended September 30, 2013	2012
		(in thousands)		
Balance at beginning of period	$ 6,185	$ 1,387	$ 3,504	$ 449
Provisions for losses on loans sold	1,069	918	3,766	1,856
Incurred losses	(39)		(55)	
Balance at end of period	$ 7,215	$ 2,305	$ 7,215	$ 2,305
Unpaid principal balance of mortgage loans subject to representations and warranties	$ 20,428,213	$ 6,444,618	$ 20,428,213	$ 6,444,618

Following is a summary of the repurchase activity and unpaid balance of mortgage loans subject to representations and warranties:

	Quarter ended September 30, 2013	2012	Nine months ended September 30, 2013	2012
		(in thousands)		
During the period:				
Unpaid balance of mortgage loans repurchased	$ 1,973	$	$ 6,840	$
Unpaid principal balance of mortgage loans put to correspondent lenders	$ 357	$	$ 1,410	$
At period end:				
Unpaid principal balance of mortgage loans subject to pending claims for repurchase	$ 1,249	$ 3,459	$ 1,249	$ 3,459

During the quarter and nine months ended September 30, 2013, we repurchased mortgage loans with unpaid balances totaling $2.0 million and $6.8 million, respectively, and charged $39,000 and $55,000, respectively, in incurred losses relating to these repurchases against our liability for representations and warranties. As the outstanding balance of loans we purchase and sell subject to representations and warranties increases and the loans sold season, we expect the level of repurchase activity to increase. As economic fundamentals change and as investor and Agency evaluation of their loss mitigation strategies, including claims under representations and warranties, change, the level of repurchase activity and ensuing losses will change, which may be material to us.

The level of the liability for losses under representations and warranties is difficult to estimate and requires considerable management judgment. The level of mortgage loan repurchase losses is dependent on economic factors, investor demand strategies, and other external conditions that may change over the lives of the underlying loans. Our representations and warranties are generally not subject to stated limits of exposure. However, we believe that the current unpaid principal balance of loans sold by us to date represents the maximum exposure to repurchases related to representations and warranties. We believe the amount and range of reasonably possible losses in relation to the recorded liability is not material to our financial condition or results of operations.

Our hedging activities relating to correspondent and retail lending primarily involve forward sales of our inventory and IRLCs as well as purchases of options to sell and options to purchase MBS.

Other loan production-related revenues

Loan origination fees increased $3.5 million and $12.8 million, respectively, in the quarter and nine months ended September 30, 2013 compared to the same periods in 2012. The increase was due to growth in the volume of loans produced.

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Loan fulfillment fees from PMT represent fees we collect for services we perform on behalf of PMT in connection with its acquisition, packaging and sale of mortgage loans. The loan fulfillment fees are calculated as a percentage of the unpaid principal balance of the mortgage loans we fulfill for PMT. Summarized below are our fulfillment fees for the periods presented:

	Quarter ended September 30,				Nine months ended September 30,			
	2013		2012		2013		2012	
				(in thousands)				
Fulfillment fee revenue	$	18,327	$	17,258	$	68,625	$	31,097
Unpaid principal balance of loans fulfilled	$	3,681,771	$	2,488,443	$	12,792,482	$	4,828,117

The increase of $1.1 million and $37.5 million, respectively, in fulfillment fees during the quarter and nine months ended September 30, 2013 compared to the same periods in 2012 is due to the continuing growth in the volume of Agency-eligible and jumbo mortgage loans PMT purchased in its correspondent lending activities.

Net servicing income

Our net servicing income is summarized before for the periods presented

	Quarter ended September 30,				Nine months ended September 30,			
	2013		2012		2013		2012	
			(in thousands, except share data)					
Net servicing income:								
Loan servicing fees								
From non-affiliates	$	14,596	$	2,154	$	35,397	$	8,776
From PennyMac Mortgage Investment Trust		10,738		4,600		27,251		13,163
From Investment Funds		1,813		2,484		6,060		9,130
Mortgage servicing rebate from (to) Investment Funds		(362)		135		(535)		(360)
Ancillary and other fees		2,777		1,153		7,700		3,661
		29,562		10,526		75,873		34,370
Amortization, impairment and change in estimated fair value of mortgage servicing rights		(8,163)		(4,414)		(16,363)		(9,024)
Net servicing income	$	21,399	$	6,112	$	59,510	$	25,346

Following is a summary of our loan servicing portfolio as of the dates presented:

	September 30, 2013	December 31, 2012
	(in thousands)	
Loans serviced at period end:		

Prime servicing:		
Subserviced for our Advised Entities	$ 24,540,141	$ 12,920,209
Owned MSRs Originated	20,024,781	8,992,602
Owned MSRs Acquisitions	1,700,612	990,461
Mortgage loans held for sale	490,088	417,742
Total prime servicing	46,755,622	23,321,014
Special servicing:		
Subserviced for our Advised Entities	5,015,113	3,559,893
Subserviced for non-affiliates	50,379	
Owned MSRs Acquisitions	1,051,220	1,271,642
Total special servicing	6,116,712	4,831,535
Total loans serviced	$ 52,872,334	$ 28,152,549

Total loan servicing fees increased $19.0 million and $41.5 million, respectively, in the quarter and nine months ended September 30, 2013 compared to the same periods in 2012. The increase in the quarter and nine months ended September 30, 2013 was due to an increase of $12.4 million and $26.6 million, respectively, in loan servicing fees from non-affiliates due to growth in our portfolio of loans serviced as a result of our ongoing sales of mortgage loans with servicing rights retained; an increase of $6.1 million and $14.1 million, respectively, in loan servicing fees from PMT due to growth in the volume of loans we service and subservice for PMT; and an increase of $1.6 million and $4.0 million, respectively, in ancillary fees due to growth in the portfolios of mortgage loans serviced, partially offset by a decrease in loan servicing fees net of mortgage servicing rebate from the Investment Funds of $398,000 and $3.2 million, respectively. This decrease was due to the decrease in the principal balance in the Investment Funds mortgage loan portfolios as these portfolios liquidate following the end of the related commitment periods on December 31, 2011.

Amortization, impairment and change in estimated fair value of mortgage servicing rights are summarized below for the periods presented:

[redacted]				
MSRs carried at lower of amortized cost or fair value:				
[redacted]				
Recognition of impairment	1,192	1,000	549	1,784
[redacted]				
	6,559	2,175	14,553	3,794
[redacted]				
Change in fair value	1,575	2,239	1,781	5,230
[redacted]				
	1,604	2,239	1,810	5,230
[redacted]				

Amortization, impairment and change in estimated fair value of mortgage servicing rights increased $3.8 million from $4.4 million to $8.2 million from the quarter ended September 30, 2012 to the quarter ended September 30, 2013 and increased $7.4 million from $9.0 million to $16.4 million from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. The increase in amortization, impairment and change in estimated fair value during the quarter and nine months ended September 30, 2013 as compared to the quarter and nine months ended September 30, 2012 was due primarily to growth in our investment in MSRs between 2012 and 2013, which caused an increase in amortization of the asset.

Amortization, impairment and changes in fair value of MSRs have a significant effect on net servicing income, driven primarily by our monthly re-estimation of the fair value of MSRs. As our investment in MSRs grows, we expect that the effect of amortization, impairment and changes in fair value will have an increasing influence on our net income. The fair value of MSRs is difficult to determine because MSRs are not actively traded in standalone markets. Considerable judgment is required to estimate the fair values of these assets and the exercise of such judgment can significantly affect our income.

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Our MSR valuation process combines the use of a discounted cash flow model and analysis of current market data to arrive at an estimate of fair value at each balance sheet date. The cash flow and prepayment assumptions used in our discounted cash flow model are based on market factors and include the historical performance of our MSRs, which we believe are consistent with assumptions and data used by market participants valuing similar MSRs.

The key assumptions used in the valuation of MSRs include mortgage prepayment and default rates of the underlying loans, the applicable discount rate, and cost to service loans. These variables can, and generally do, change from period to period as market conditions change. Therefore our estimate of the fair value of MSRs changes from period to period. Our valuation committee reviews and approves the fair value estimates of our MSRs.

We account for MSRs at either our estimate of the asset s estimated fair value with changes in fair value recorded in current period income or using the amortization method with the MSRs carried at the lower of amortized cost or estimated fair value based on whether we believe the underlying mortgages are sensitive to prepayments resulting from changing market interest rates. We have identified an initial mortgage interest rate of 4.5% for MSRs originated through our lending activities as the threshold for whether such mortgage loans are sensitive to changes in interest rates:

- Our risk management efforts in connection with MSRs relating to mortgage loans originated through our lending activities 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 MSRs relating to mortgage loans with initial interest rates of less than or equal to 4.5% that were acquired as a result of our lending activities, we have concluded that such assets present different risks than MSRs relating to mortgage loans with initial interest rates of more than 4.5% and therefore require a different risk management approach. Our 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. We have identified these assets for accounting using the amortization method.

Our MSRs are summarized by the basis on which we account for the assets below as of the dates presented:

Basis of Accounting		**September 30, 2013**		**December 31, 2012**
		(in thousands)		
Fair value	$	26,768	$	19,798
Lower of amortized cost or fair value:				
Amortized cost	$	229,617	$	92,155
Valuation allowance		(3,527)		(2,978)
Carrying value	$	226,090	$	89,177
Fair value	$	239,326	$	91,028
Total MSR:				
Carrying value	$	252,858	$	108,975
Fair value	$	266,094	$	110,826
	$	22,776,613	$	11,254,705

Unpaid balance of mortgage loans underlying MSRs		
Average servicing fee rate (in basis points)		
Amortized cost	28	28
Fair value	27	26
Fair value special servicing	50	50

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Key assumptions used in determining the fair value of MSRs as of the dates presented are as follows:

Purchased MSRs backed by distressed mortgage loans

	September 30, 2013		December 31, 2012	
	Range (Weighted average)			
	Fair value	Amortized cost	Fair value	Amortized cost
	(Unpaid principal balance of underlying loans and effect on value amounts in thousands)			
Carrying value	$10,125		$12,370	
Unpaid principal balance of underlying loans	$1,051,220		$1,271,478	
Weighted-average note rate	5.88%		6.01%	
Weighted-average servicing fee rate (in basis points)	50		50	
Discount rate	15.3% 15.3% (15.3%)		15.3% 15.3% (15.3%)	
Average life (in years)	4.8		5.0	
Prepayment speed (1)	11.7% 11.7% (11.7%)		10.7% 10.7% (10.7%)	
Per-loan cost of servicing	$250 $250 $(250)		$270 $270 $(270)	

(1) Prepayment speed is measured using CPR.

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All other MSRs

	September 30, 2013		December 31, 2012	
	Range (Weighted average)			
	Fair value	Amortized cost	Fair value	Amortized cost
	(Unpaid principal balance of underlying loans and effect on value amounts in thousands)			
Carrying value	$16,643	$226,090	$7,428	$89,177
Unpaid principal balance of underlying loans	$1,700,612	$20,024,781	$1,166,765	$8,730,686
Weighted-average note rate	4.68%	3.57%	5.22%	3.65%
Weighted-average servicing fee rate (in basis points)	27	28	26	28
Pricing spread (1)	6.4% 17.5%	5.4% 15.9%	7.5% 19.5%	7.5% 16.5%
	(8.9%)	(7.6%)	(10.6%)	(9.8%)
Average life (in years)	0.2 14.4	2.6 6.9	0.2 14.4	2.5 6.9
	(6.6)	(6.7)	(5.0)	(6.6)
Prepayment speed (2)	8.7% 72.8%	8.5% 16.0%	9.0% 84.2%	8.7% 28.3%
	(10.6%)	(9.0%)	(19.2%)	(9.2%)
Per-loan cost of servicing	$68 $120	$68 $120	$68 $140	$68 $140
	$(77)	$(102)	$(76)	$(99)

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

(2) Prepayment speed is measured using CPR.

Significant changes to any of the key assumptions shown above in isolation could result in a significant change in the MSR fair value measurement. Changes in these key assumptions are not necessarily directly related. The sensitivity analyses, under *Quantitative and Qualitative Disclosures about Market Risk* in this document, are limited in that they were performed as of a particular point in time, only contemplate the movements in the indicated variables, do not incorporate changes in the variables in relation to other variables, are subject to the accuracy of various models and inputs used, and do not take into account other factors that would affect our overall financial performance in such scenarios, including operational adjustments made by the Manager to account for changing circumstances. For these reasons, the sensitivity tables in the following pages should not be viewed as earnings forecasts.

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Management fees and Carried Interest

Management fees and Carried Interest are summarized below for the periods presented:

	Quarter ended September 30, 2013	Quarter ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
	(in thousands)			
Management Fees:				
PennyMac Mortgage Investment Trust:				
Base management fee	$ 5,104	$ 3,672	$ 14,043	$ 7,964
Performance incentive fee	3,435		9,443	
	8,539	3,672	23,486	7,964
Investment Funds	2,001	2,442	5,889	7,199
	$ 10,540	$ 6,114	$ 29,375	$ 15,163
Carried Interest	$ 2,812	$ 3,355	$ 10,411	$ 7,254
Total management fees and carried interest	$ 13,352	$ 9,469	$ 39,786	$ 22,417
Net assets of Advised Entities:				
PennyMac Mortgage Investment Trust	$ 1,494,765	$ 1,184,203	$ 1,494,765	$ 1,184,203
Investment Funds	556,013	575,850	556,013	575,850
	$ 2,050,778	$ 1,760,053	$ 2,050,778	$ 1,760,053

Management fees from PMT increased $4.9 million and $15.5 million, respectively, in the quarter and nine months ended September 30, 2013 compared to the same periods in 2012. The increase was due primarily to:

- Base management fees increased due to an increase in PMT s shareholders equity upon which its management fee is based by $310.6 million or 26% from September 30, 2012 through September 30, 2013.

- We recognized incentive fees of $3.4 million and $9.4 million for the quarter and nine months ended September 30, 2013, respectively. These fees were not recognized during 2012. We recognized performance incentive fees during 2013 as a result of the amendment to our management agreement with PMT effective February 1, 2013, which changed the basis on which profitability is measured for incentive fee purposes. Under the amended agreement, profitability is primarily based on net income determined in compliance with U.S. GAAP. Previously, the agreement based profitability on U.S. GAAP net income generally excluding non-cash gains and losses.

Partially offsetting the increases in management fees from PMT, management fees from the Investment Funds decreased $441,000 and $1.3 million, respectively, in the quarter and nine months ended September 30, 2013 compared to the same periods in 2012. The decrease was due to decreases in the Investment Funds net asset values as a result of continued distributions to the Funds investors following the end of the Investment Funds commitment periods at December 31, 2011, which reduced the investment base on which the management fees are computed.

Carried Interest from Investment Funds decreased $543,000 from $3.4 million for the quarter ended September 30, 2012 to $2.8 million for the quarter ended September 30, 2013. The decrease was due to decreases in the Investment Funds net asset values as a result of continued distributions to the Funds investors following the end of the Investment Funds commitment periods at December 31, 2011, which reduced the investment base on which the Carried Interest returns is computed. Carried Interest from Investment Funds increased $3.2 million from $7.3 million for the nine months ended September 30, 2012 to $10.4 million for the nine months ended September 30, 2013. The increase was primarily due to valuation gains in the Investment Funds loan portfolios as a result of increases in demand for distressed mortgage loans, improvements in the value of the loans as they proceed through the resolution process and continuing increases in collateral valuations for the properties underlying the Funds loans.

Other revenues

Net interest income increased $1.1 million from ($128,000) for the quarter ended September 30, 2012, to $937,000 for the quarter ended September 30, 2013 due to the increase in our average inventory of mortgage loans held for sale as a result of the growth in our loan production activities, and primarily relates to the interest that we earned on mortgage loans net of interest paid on our financing facilities during the period for which we held the loans pending sale. Net interest income decreased $641,000 from $265,000 for the nine months ended September 30, 2012 to ($376,000) for the nine months ended September 30, 2013 due to interest expense financing our non-interest earning assets exceeding net interest income on our interest earning assets.

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The results of our holdings of common shares of PMT, which is included in *Changes in fair value of investment in, and dividends received from PMT* are summarized below:

	Quarter ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Dividends	$ 43	$ 41	$ 128	$ 124
Change in fair value	122	273	(196)	506
	$ 165	$ 314	$ (68)	$ 630
Fair value of PMT shares at period end	$ 1,701	$ 1,753	$ 1,701	$ 1,753

Change in fair value of investment in and dividends received from PMT decreased $149,000 and $698,000, respectively, in the quarter and nine months ended September 30, 2013 compared to the same periods in 2012. The decreases were primarily due to decreases in the fair value of our investment in common shares of PMT as of September 30, 2013 as compared to the appreciation in value of our investment in common shares of PMT during 2012. During the periods ended September 30, 2013 and 2012, we held 75,000 common shares of PMT.

Expenses

Our compensation expense is summarized below for the periods presented:

	Quarter ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Salaries and wages	$ 26,722	$ 16,320	$ 74,970	$ 41,269
Incentive compensation	2,945	7,645	22,649	14,690
Taxes and benefits	3,825	2,298	11,937	5,964
Stock and unit-based compensation	2,338	5,593	4,294	15,833
	$ 35,830	$ 31,856	$ 113,850	$ 77,756
Average headcount	1,402	800	1,324	649
Period-end headcount	1,329	850	1,329	850

Compensation expense increased $4.0 million from $31.9 million for the quarter ended September 30, 2012 to $35.8 million for the quarter ended September 30, 2013 and increased $36.1 million from $77.8 million for the nine months ended September 30, 2012 to $113.9 million for the nine months ended September 30, 2013. The increase in compensation expense was due to the development of and growth in our mortgage banking segment as well as growth in the level of assets managed and serviced for PMT, partially offset by decreases in unit-based compensation relating to PennyMac Class A units awards. The increase in compensation expense in the quarter ended September 30, 2013 was further offset by reduced accruals for cash-based incentive compensation. We expect stock-based compensation to increase in future quarters as a result of equity-based grants made on June 13, 2013. However, based on current outstanding equity award grants we do not expect to incur stock-based compensation expense at the level recorded during 2012.

Professional services expense increased $1.5 million and $4.4 million, respectively, in the quarter and nine months ended September 30, 2013 compared to the same periods in 2012. The increase was due to growth in the size of our operations.

Loan origination expense increased $1.0 million from $1.8 million for the quarter ended September 30, 2012 to $2.8 million for the quarter ended September 30, 2013 and increased $6.0 million from $1.8 million for the nine months ended September 30, 2012 to $7.8 million for the nine months ended September 30, 2013. The increase was due to growth in our loan origination volume and to changes in our fee structure which resulted in many of our fees being charged to correspondent lenders on an other-than pass-through basis. As a result of this change in structure, we recognized both the fee income and expense during 2013 as compared to passing through these items on a net basis during 2012.

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Technology expense increased $1.5 million and $3.0 million, respectively, in the quarter and nine months ended September 30, 2013 compared to the same periods in 2012. The increase was due to growth in the size of our operations.

Servicing expense increased $932,000 and $2.6 million, respectively, in the quarter and nine months ended September 30, 2013 compared to the same periods in 2012. The increase was due to growth in our mortgage servicing portfolio.

Occupancy expense increased $402,000 and $805,000, respectively, in the quarter and nine months ended September 30, 2013 compared to the same periods in 2012. The increase was primarily due to growth in the size of our operations.

Other expense increased $4.5 million and $10.1 million, respectively, in the quarter and nine months ended September 30, 2013 compared to the same periods in 2012. The increase was due to growth in the size of our operations.

Expenses Allocated to PMT

PMT reimburses us for other expenses, including common overhead expenses incurred on its behalf by us, in accordance with the terms of our management agreement. The expense amounts presented in our income statement are net of these allocations. Expense amounts allocated to PMT during the periods ended September 30, 2013 and 2012 are summarized below:

	Quarter ended September 30,		**Nine months ended September 30,**	
	2013	**2012**	**2013**	**2012**
	(in thousands)			
Technology	$ 891	$ 310	$ 2,814	$ 568
Occupancy	558	414	1,658	897
Depreciation and amortization	349	178	986	365
Other	729	342	2,335	645
Total expenses	$ 2,527	$ 1,244	$ 7,793	$ 2,475

The amount of total expenses that we allocated to PMT increased $1.3 million from $1.2 million in the quarter ended September 30, 2012 to $2.5 million for the quarter ended September 30, 2013 and increased $5.3 million from $2.5 million for the nine months ended September 30, 2012 to $7.8 million for the nine months ended September 30, 2013. The increase was due to growth in our overhead expenses, resulting in a larger portion of our overhead expenses being allocated to PMT.

Provision for Income Taxes

For the quarter and nine months ended September 30, 2013, our effective tax rates were 9.9% and 4.0%, respectively. The difference between our effective tax rate and the statutory rate is primarily due to the allocation of earnings to the noncontrolling interest unitholders. As the noncontrolling unitholders convert their ownership units into our shares, we expect an increase in allocated earnings that will be subject to corporate federal and state statutory tax rates.

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Balance Sheet Analysis

Following is a summary of key balance sheet items as of the dates presented:

	September 30, 2013	December 31, 2012
	(in thousands)	
ASSETS		
Cash and short-term investments	$ 183,885	$ 65,487
Mortgage loans held for sale at fair value	530,248	448,384
Servicing advances	105,344	93,152
Receivable from affiliates	22,571	20,363
Carried Interest due from Investment Funds	58,134	47,723
Mortgage servicing rights	252,858	108,975
Other assets	101,344	48,079
Total assets	$ 1,254,384	$ 832,163
LIABILITIES		
Borrowings	$ 444,658	$ 446,547
Payable to affiliates	94,804	83,574
Other liabilities	124,961	40,292
Total liabilities	664,423	570,413
EQUITY	589,961	261,750
Total liabilities and equity	$ 1,254,384	$ 832,163

Total assets increased $422.2 million from $832.2 million at December 31, 2012 to $1.3 billion at September 30, 2013. The increase was primarily due to an increase of $143.9 million in MSRs and an increase of $81.9 million in mortgage loans held for sale at fair value, both due to growth in our correspondent lending operations. Our cash and short-term investment balances increased by $118.4 million reflecting the proceeds from our IPO partially offset by our use of the IPO proceeds to pay down our repurchase agreement borrowings which reduced the percentage of our assets being financed.

Total liabilities increased by $94.0 million from $570.4 million as of December 31, 2012 to $664.4 million as of September 30, 2013. The increase was primarily attributable to an increase in liabilities relating to a tax receivable agreement with PennyMac s partners of $58.6 million, which resulted from one exchange of PennyMac Class A units to shares of PFSI stock.

Cash Flows

Comparison of Quarters ended September 30, 2013 and 2012

Our cash flows resulted in a net increase in cash of $44.1 million during the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012. The positive cash flows arose primarily due to our initial public offering during the period. Cash used in operating activities totaled $68.2 million during the nine months ended September 30, 2013. The cash used in operating activities were primarily due to growth of our mortgage loans held for sale portfolio as origination and purchases of loans exceeded loan sales.

Net cash used in investing activities was $78.5 million during the nine months ended September 30, 2013. This use of cash reflects an increase in short-term investments due to the liquidity provided by the IPO.

Net cash provided by financing activities was $190.8 million during the nine months ended September 30, 2013. Cash provided by financing activities was primarily due to the IPO which raised $212.3 million net of underwriting and offering costs.

Liquidity and Capital Resources

Our liquidity reflects our ability to meet our current obligations (including our operating expenses and, when applicable, the retirement of, and margin calls relating to, our debt, and margin calls relating to hedges on our commitments to purchase or originate mortgage loans), fund new originations and purchases, and make investments as we identify them. We expect our primary sources of liquidity to be through cash flows from business activities, earnings on our investments and proceeds from borrowings and/or additional equity offerings. We believe that our liquidity is sufficient to meet our current liquidity needs.

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Our current leverage strategy is to finance our assets where we believe such borrowing is prudent and appropriate. Our borrowing activities are in the form of sales of mortgage loans under agreements to repurchase, and a note payable secured by mortgage servicing rights and servicing advances.

Our repurchase agreements represent the sales of mortgage loans together with agreements for us to buy back the mortgage loans at a later date. During the nine months ended September 30, 2013, the average balance outstanding under agreements to repurchase mortgage loans totaled $354.1 million, and the maximum daily amount outstanding under such agreements totaled $623.5 million. During the nine months ended September 30, 2012, the average balance outstanding under agreements to repurchase mortgage loans totaled $146.4 million, and the maximum daily amount outstanding under such agreements totaled $361.6 million.

The difference between the maximum and average daily amounts outstanding was due to increases in the sizes and utilization of our existing facilities, all in support of the growth in our mortgage loan production, investments and correspondent lending activities.

All of our borrowings discussed above have short-term maturities. The transactions relating to mortgage loans under agreements to repurchase mature between January 2, 2014 and the earlier to occur of October 31, 2014 or the rolling maturity date that is 364 days from any particular date of determination and provide for the repurchase from major financial institution counterparties based on the estimated fair value of the mortgage loans sold. Our note payable secured by mortgage servicing rights and loan servicing advances at fair value has a maturity date that is the earlier to occur of October 31, 2014 or the rolling maturity date that is 364 days from any particular date of determination.

PLS s debt financing agreements require it to comply with various financial covenants. The most significant financial covenants currently include the following:

- positive net income during each calendar quarter;
- a minimum in unrestricted cash and cash equivalents of $20 million;
- a minimum tangible net worth of $90 million;
- a maximum ratio of total liabilities to tangible net worth of 10:1; and
- at least one other warehouse or repurchase facility that finances amounts and assets similar to those being financed under our existing debt financing agreements.

Although these financial covenants limit the amount of indebtedness that we may incur and affect our liquidity through minimum cash reserve requirements, we believe that these covenants currently provide us with sufficient flexibility to successfully operate our business and obtain the financing necessary to achieve that purpose.

With respect to servicing that we perform for the Advised Entities, we are also subject to certain covenants under their respective debt agreements. These covenants are similar to those above, with the additional covenant that we must maintain a minimum servicing portfolio of $5 billion in UPB.

Our debt financing agreements also contain margin call provisions that, upon notice from the applicable lender at its option, require us to transfer cash or, in some instances, additional assets in an amount sufficient to eliminate any margin deficit. A margin deficit will generally result from any decline in the market value (as determined by the applicable lender) of the assets subject to the related financing agreement. Upon notice from the applicable lender, we will generally be required to satisfy the margin call on the day of such notice or within one business day thereafter, depending on the timing of the notice.

We continue to explore a variety of additional means of financing our continued growth, including debt financing through bank warehouse lines of credit and additional repurchase agreements. However, there can be no assurance as to how much additional financing capacity such efforts will produce, what form the financing will take or whether such efforts will be successful.

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Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

Off-Balance Sheet Arrangements and Guarantees

As of September 30, 2013, we have not entered into any off-balance sheet arrangements or guarantees.

Contractual Obligations

As of September 30, 2013, we had on-balance sheet contractual obligations of $387.9 million to finance assets under agreements to repurchase with maturities between July 25, 2013 and the earlier to occur of October 31, 2014 or the rolling maturity date that is 364 days from any particular date of determination. We also had a contractual obligation of $56.8 million relating to a note payable secured by mortgage servicing rights and loan servicing advances at fair value and with a maturity date that is the earlier to occur of October 31, 2014 or the rolling maturity date that is 364 days from any particular date of determination. We also lease our primary office facilities under an agreement that expires on February 28, 2017 and we license certain software to support our loan servicing operations.

Payment obligations under these agreements are summarized below:

		Payments due by period			
Contractual Obligations	**Total**	**Less than 1 year**	**1 - 3 years (in thousands)**	**3 - 5 years**	**More than 5 years**
Commitments to purchase mortgage loans from PMT	$ 1,022,670	$ 1,022,670	$	$	$
Commitments to fund mortgage loans	140,861	140,861			
Commitments to sell mortgage loans	3,086,889	3,086,889			
Loans sold under agreements to repurchase	387,883	387,883			
Note payable	56,775	56,775			
Payable to Private National Mortgage Acceptance Company, LLC partner under tax receivable agreement	58,615		11,916	9,959	36,740
Software licenses (1)	7,710	3,855	3,855		
Office leases	13,132	3,584	7,829	1,719	
Total	$ 4,774,535	$ 4,702,517	$ 23,600	$ 11,678	$ 36,740

(1) Software licenses include both volume and activity-based fees that are dependent on the number of loans serviced during each period and include a base fee of approximately $452,000 per year. Estimated payments for software licenses above are based on the number of loans currently serviced by us, which totaled approximately 226,000 at September 30, 2013. Future amounts due may significantly fluctuate based on changes in the number of loans serviced by us. For the quarter ended September 30, 2013, software license fees totaled $2.8 million. All figures contained in this footnote are in actual amounts and not in thousands (in contrast to the table above).

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The amount at risk (the fair value of the assets pledged plus the related margin deposit, less the amount advanced by the counterparty and accrued interest) relating to our assets sold under agreements to repurchase is summarized by counterparty below as of September 30, 2013:

Counterparty	**Amount at risk (in thousands)**	**Weighted-average maturity of advances under repurchase agreement**	**Facility Maturity**
Bank of America, N.A.	$ 45,516	December 16, 2013	January 2, 2014
Credit Suisse First Boston Mortgage Capital LLC	$ 89,917	December 18, 2013	(1)

(1) The earlier to occur of October 31, 2014 or the rolling maturity date that is 364 days from any particular date of determination.

Debt Obligations

As described further above in Liquidity and Capital Resources, we currently finance certain of our assets through borrowings with major financial institution counterparties in the form of sales of mortgage loans under agreements to repurchase, and a note payable secured by mortgage servicing rights and loan servicing advances. The borrower under each of these facilities is PLS, and all obligations thereunder are guaranteed by Private National Mortgage Acceptance Company, LLC.

Under the terms of these agreements, PLS is required to comply with certain financial covenants, as described further above in Liquidity and Capital Resources, and various non-financial covenants customary for transactions of this nature. As of September 30, 2013, we were in compliance in all material respects with these covenants.

The agreements also contain margin call provisions that, upon notice from the applicable lender, require us to transfer cash or, in some instances, additional assets in an amount sufficient to eliminate any margin deficit. Upon notice from the applicable lender, we will generally be required to satisfy the margin call on the day of such notice or within one business day thereafter, depending on the timing of the notice.

In addition, the agreements contain events of default (subject to certain materiality thresholds and grace periods), including payment defaults, breaches of covenants and/or certain representations and warranties, cross-defaults, guarantor defaults, servicer termination events and defaults, material adverse changes, bankruptcy or insolvency proceedings and other events of default customary for these types of transactions. The remedies for such events of default are also customary for these types of transactions and include the acceleration of the principal amount outstanding under the agreements and the liquidation by our lenders of the mortgage loans or other collateral then subject to the agreements.

All of PLS s borrowings discussed above have short-term maturities that expire as follows:

Counterparty (1)	Outstanding Indebtedness (2)	Committed Amount	Maturity Date
	(in thousands)		
Bank of America, N.A.	$ 199,423	$ 300,000	January 2, 2014
Citibank, N.A.	$	$ 150,000	July 24, 2014
Credit Suisse First Boston Mortgage Capital LLC	$ 188,460	$ 300,000	(3)
Credit Suisse First Boston Mortgage Capital LLC	$ 56,775	$ 117,000	(3)

(1) The borrowings with Bank of America, N.A., Citibank, N.A. and Credit Suisse First Boston Mortgage Capital LLC (with a committed amount of $300 million) are in the form of sales of mortgage loans under agreements to repurchase. The borrowing with Credit Suisse First Boston Mortgage Capital LLC (with a committed amount of $117 million) is in the form of a note payable secured by mortgage servicing rights and servicing advances.

(2) Represents outstanding indebtedness reduced by cash collateral as of September 30, 2013.

(3) The earlier to occur of October 31, 2014 or the rolling maturity date that is 364 days from any particular date of determination.

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Quantitative and Qualitative Disclosures about Market Risk

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices, real estate values and other market-based risks. The primary market risks that we are exposed to are interest rate risk, credit risk, prepayment risk, inflation risk and market value risk.

Credit Risk

We are subject to credit risk in connection with our loan sales activities. Our loan sales are generally made with contractual representations and warranties, which, if breached, can require us to repurchase the mortgage loan or reimburse the investor for any losses incurred because of that breach. These breaches are generally evidenced when the borrower defaults on a loan. The amount of our liability for losses due to representations and warranties to the loans investors is not limited. However, we believe that the current unpaid principal balance of loans sold by us to date represents the maximum exposure to repurchases related to representations and warranties. We include a provision for potential losses due to recourse as part of our recognition of loan sales, based initially on our estimate of the fair value of such obligation. We review our loss experience relating to representations and warranties and adjust our liability estimate when necessary. We believe that residual loan credit quality is primarily determined by the borrowers credit profiles and loan characteristics.

In the event of developments affecting the credit performance of loans we have sold subject to representations and warranties, such as a significant increase in unemployment or a significant deterioration in real estate values in markets where properties securing mortgage loans we purchase are located, defaults could increase and result in credit losses arising from claims under our representations and warranties, which could materially and adversely affect our business, financial condition and results of operations.

Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations, and other factors beyond our control. Changes in interest rates affect both the fair value of, and interest income we earn from, our mortgage-related investments. This effect is most pronounced with fixed-rate mortgage assets. In general, rising interest rates negatively affect the fair value of our interest rate lock agreements and inventory of mortgage loans held for sale.

Our operating results will depend, in part, on differences between the income from our investments and our financing costs. Presently our debt financing is based on a floating rate of interest calculated on a fixed spread over the relevant index, as determined by the particular financing arrangement.

We engage in interest rate risk management activities in an effort to reduce the variability of income caused by changes in interest rates. To manage this price risk resulting from interest rate risk, we use derivative financial instruments acquired with the intention of moderating the risk that changes in market interest rates will result in unfavorable changes in the value of our interest rate lock commitments and inventory of mortgage loans held for sale. We do not use derivative financial instruments for purposes other than in support of our risk management activities.

Prepayment Risk

To the extent that the actual prepayment rate on the mortgage loans underlying our MSRs differs from what we projected when we initially recognized the MSRs and when we measured fair value as of the end of each reporting period, the carrying value of our investment in MSRs will be affected. In general, a decline in the principal balances of the loans underlying our MSRs or an increase in prepayment expectations will accelerate the amortization and may result in impairments of our MSRs accounted for using the amortization method and decrease our estimates of the fair value of both the MSRs accounted for using the amortization method and those accounted for using the fair value method, thereby reducing net servicing income.

Inflation Risk

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors will influence our performance more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Furthermore, our consolidated financial statements are prepared in accordance with GAAP and any distributions that PennyMac may make to its members will be determined by us as the managing member of PennyMac based primarily on our taxable income and, in each case, our activities and balance sheet are measured with reference to historical cost and/or fair value without considering inflation.

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Market Value Risk

Our mortgage loans held for sale are reported at their estimated fair values. The fair value of these assets fluctuates primarily due to changes in interest rates.

The following sensitivity analyses are limited in that they were (i) performed at a particular point in time, (ii) only contemplate certain movements in interest rates, (iii) do not incorporate changes in interest rate volatility or changes in the relationship of one interest rate index to another, (iv) are subject to the accuracy of various models and assumptions used, including prepayment forecasts and discount rates, and (v) do not incorporate other factors that would affect our overall financial performance in such scenarios, including operational adjustments made by management to account for changing circumstances. For these reasons, the following estimates should not be viewed as an earnings forecast.

Mortgage Servicing Rights

The following tables summarize the estimated change in fair value of MSRs accounted for using the amortization method as of September 30, 2013, given several shifts in pricing spreads, prepayment speed and annual per-loan cost of servicing:

Pricing spread shift in %	**-20%**	**-10%**	**-5%**	**+5%**	**+10%**	**+20%**
			(dollar amounts in thousands)			
Fair value	$ 260,632	$ 249,562	$ 244,345	$ 234,493	$ 229,837	$ 221,023
Change in fair value:						
$	$ 21,306	$ 10,236	$ 5,020	$ (4,833)	$ (9,488)	$ (18,303)
%	8.90%	4.28%	2.10%	-2.02%	-3.96%	-7.65%

Prepayment speed shift in %	**-20%**	**-10%**	**-5%**	**+5%**	**+10%**	**+20%**
			(dollar amounts in thousands)			
Fair value	$ 259,797	$ 249,207	$ 244,182	$ 234,630	$ 230,088	$ 221,435
Change in fair value:						
$	$ 20,472	$ 9,881	$ 4,856	$ (4,696)	$ (9,238)	$ (17,891)
%	8.55%	4.13%	2.03%	-1.96%	-3.86%	-7.48%

Per-loan servicing cost shift in %	**-20%**	**-10%**	**-5%**	**+5%**	**+10%**	**+20%**
			(dollar amounts in thousands)			
Fair value	$ 248,857	$ 244,091	$ 241,709	$ 236,943	$ 234,560	$ 229,794
Change in fair value:						
$	$ 9,531	$ 4,766	$ 2,383	$ (2,383)	$ (4,766)	$ (9,531)
%	3.98%	1.99%	1.00%	-1.00%	-1.99%	-3.98%

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The following tables summarize the estimated change in fair value of MSRs accounted for using the fair value method as of September 30, 2013, given several shifts in pricing spreads, prepayment speed and annual per-loan cost of servicing:

Pricing spread shift in %	**-20%**	**-10%**	**-5%**	**+5%**	**+10%**	**+20%**
			(dollar amounts in thousands)			
Fair value	$ 17,971	$ 17,283	$ 16,957	$ 16,339	$ 16,046	$ 15,490
Change in fair value:						
$	$ 1,329	$ 640	$ 314	$ (303)	$ (596)	$ (1,153)
%	7.99%	3.85%	1.89%	-1.82%	-3.58%	-6.93%

Prepayment speed shift in %	**-20%**	**-10%**	**-5%**	**+5%**	**+10%**	**+20%**
			(dollar amounts in thousands)			
Fair value	$ 18,303	$ 17,440	$ 17,033	$ 16,266	$ 15,904	$ 15,219
Change in fair value:						
$	$ 1,660	$ 797	$ 391	$ (376)	$ (738)	$ (1,423)
%	9.98%	4.79%	2.35%	-2.26%	-4.44%	-8.55%

Per-loan servicing cost shift in %	**-20%**	**-10%**	**-5%**	**+5%**	**+10%**	**+20%**
			(dollar amounts in thousands)			
Fair value	$ 17,244	$ 16,943	$ 16,793	$ 16,492	$ 16,342	$ 16,042
Change in fair value:						
$	$ 601	$ 300	$ 150	$ (150)	$ (300)	$ (601)
%	3.61%	1.81%	0.90%	-0.90%	-1.81%	-3.61%

The following tables summarize the estimated change in fair value of purchased MSRs backed by distressed mortgage loans accounted for using the fair value method as of September 30, 2013, given several shifts in pricing spreads, prepayment speed and annual per-loan cost of servicing:

Pricing spread shift in %	**-20%**	**-10%**	**-5%**	**+5%**	**+10%**	**+20%**
			(dollar amounts in thousands)			
Fair value	$ 11,266	$ 10,667	$ 10,390	$ 9,873	$ 9,631	$ 9,180
Change in fair value:						
$	$ 1,141	$ 542	$ 265	$ (252)	$ (494)	$ (945)
%	11.27%	5.36%	2.61%	-2.49%	-4.88%	-9.33%

Prepayment speed shift in %	**-20%**	**-10%**	**-5%**	**+5%**	**+10%**	**+20%**
			(dollar amounts in thousands)			
Fair value	$ 11,188	$ 10,640	$ 10,377	$ 9,873	$ 9,633	$ 9,174
Change in fair value:						
$	$ 1,063	$ 515	$ 252	$ (252)	$ (492)	$ (951)
%	10.50%	5.08%	2.49%	-2.48%	-4.86%	-9.40%

Per-loan servicing cost shift in %	**-20%**	**-10%**	**-5%**	**+5%**	**+10%**	**+20%**
			(dollar amounts in thousands)			
Fair value	$ 11,018	$ 10,572	$ 10,348	$ 9,902	$ 9,678	$ 9,232
Change in fair value:						
$	$ 893	$ 447	$ 223	$ (223)	$ (447)	$ (893)

%	8.82%	4.41%	2.21%	-2.21%	-4.41%	-8.82%

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Factors That May Affect Our Future Results

This Report contains certain forward-looking statements that are subject to various risks and uncertainties. Forward-looking statements are generally identifiable by use of forward-looking terminology such as may, will, should, potential, intend, expect, seek, anticipate, approximately, believe, could, project, predict, continue, plan or other similar words or expressions. Forward-looking statements are b certain assumptions, discuss future expectations, describe future plans and strategies, contain financial and operating projections or state other forward-looking information. Examples of forward-looking statements include the following:

- Projections of our revenues, income, earnings per share, capital structure or other financial items;
- Descriptions of our plans or objectives for future operations, products or services;
- Forecasts of our future economic performance, interest rates, profit margins and our share of future markets; and
- Descriptions of assumptions underlying or relating to any of the foregoing expectations regarding the timing of generating any revenues.

Our ability to predict results or the actual effect of future events, actions, plans or strategies is inherently uncertain. Although we believe that the expectations reflected in such forward-looking statements are based on reasonable assumptions, our actual results and performance could differ materially from those set forth in the forward-looking statements. There are a number of factors, many of which are beyond our control that could cause actual results to differ significantly from management s expectations. Some of these factors are discussed below.

You should not place undue reliance on any forward-looking statement and should consider the following uncertainties and risks, as well as the risks and uncertainties discussed elsewhere in this Report and as set forth in Item IA. of Part II hereof and the section entitled Risk Factors in our final prospectus filed pursuant to Rule 424(b)(4) on May 8, 2013 with the SEC in connection with our initial public offering.

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

- The continually changing federal, state and local laws and regulations applicable to the highly regulated industry in which we operate;

- Lawsuits or governmental actions if we do not comply with the laws and regulations applicable to our businesses;

- The creation of the Consumer Financial Protection Bureau, or CFPB, its recently issued and future rules and the enforcement thereof by the CFPB;

- Changes in existing U.S. government-sponsored entities, their current roles or their guarantees or guidelines;

- Changes to government mortgage modification programs;

- The licensing and operational requirements of states and other jurisdictions applicable to our businesses, to which our bank competitors are not subject;

- Foreclosure delays and changes in foreclosure practices;

- Certain banking regulations that may limit our business activities;

- Changes in macroeconomic and U.S. residential real estate market conditions;

- Difficulties inherent in growing loan production volume;

- Difficulties inherent in adjusting the size of our operations to reflect changes in business levels;

- Changes in prevailing interest rates;

- Increases in loan delinquencies and defaults;

- Our reliance on PMT as a significant source of financing for, and revenue related to, our correspondent lending business;

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- Any required additional capital and liquidity to support business growth that may not be available on acceptable terms, if at all;

- Our obligation to indemnify third-party purchasers or repurchase loans if loans that we originate, acquire or assist in the fulfillment of, fail to meet certain criteria or characteristics or under other circumstances;

- Our obligation to indemnify PMT and the Investment Funds if our services fail to meet certain criteria or characteristics or under other circumstances;

- Decreases in the historical returns on the assets that we select and manage for our clients, and our resulting management and incentive fees;

- The extensive amount of regulation applicable to our investment management segment;

- Conflicts of interest in allocating our services and investment opportunities among ourselves and our Advised Entities;

- The potential damage to our reputation and adverse impact to our business resulting from the ongoing negative publicity focused on Countrywide Financial Corporation, given the former association of certain of our officers with that entity; and

- Our recent rapid growth.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

In response to this Item, the information set forth on pages 72 to 74 of this Report is incorporated herein by reference.

Item 4. ***Controls and Procedures***

Disclosure Controls and Procedures

Under the supervision and with the participation of management, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as required by Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act) as of September 30, 2013. Based upon our evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective, as of September 30, 2013, to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. No matter how well a control system is designed and operated, it can provide only reasonable, not absolute, assurance that it will detect or uncover control issues and instances of fraud, if any, within the Company to disclose material information otherwise required to be set forth in our periodic reports.

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PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

From time to time, we may be involved in various legal proceedings, claims and actions arising in the ordinary course of business. As of September 30, 2013, we were not involved in any such legal proceedings, claims or actions that management believes would be reasonably likely to have a material adverse effect on us.

Item 1A. ***Risk Factors***

There are no material changes from the risk factors set forth in our final prospectus dated October 28, 2013 included as part of our Registration Statement on Form S-1, as amended (SEC File No. 333-191522).

Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

Effective July 15, 2013, the Company received a Notice of Election of Exchange from a unitholder related to the exchange of 6,110,000 Class A units for an equivalent number of shares of the Company s Class A Common Stock. In connection with delivering the Notice of Election of Exchange, the unitholder surrendered its Class A units to the Company for cancellation and was issued 6,110,000 unregistered shares of Class A Common Stock that qualified for exemption under Section 4(2) of the Securities Act of 1933, as amended.

Item 3. ***Defaults Upon Senior Securities***

None

Item 4. ***Mine Safety Disclosures***

Not applicable

Item 5. ***Other Information***

None

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Item 6. ***Exhibits***

Exhibit Number	Exhibit Description
3.1	Amended and Restated Certificate of Incorporation of PennyMac Financial Services, Inc. (incorporated by reference to Exhibit 3.1 of the Registrant s Current Report on Form 8-K as filed with the SEC on May 14, 2013).
3.2	Amended and Restated Bylaws of PennyMac Financial Services, Inc. (incorporated by reference to Exhibit 3.1 of the Registrant s Current Report on Form 8-K as filed with the SEC on August 19, 2013).
4.1	Specimen Class A Common Stock Certificate (incorporated by reference to Exhibit 4.1 of the Registrant s Amendment No. 4 to Form S-1 Registration Statement as filed with the SEC on April 29, 2013).
10.1	Fourth Amended and Restated Limited Liability Company Agreement of Private National Mortgage Acceptance Company, LLC, dated as of May 8, 2013 (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K as filed with the SEC on May 14, 2013).
10.2	Exchange Agreement, dated as of May 8, 2013, between PennyMac Financial Services, Inc. and Private National Mortgage Acceptance Company, LLC and the Company Unitholders (incorporated by reference to Exhibit 10.2 of the Registrant s Current Report on Form 8-K as filed with the SEC on May 14, 2013).
10.3	Tax Receivable Agreement, dated as of May 8, 2013, between PennyMac Financial Services, Inc. Private National Mortgage Acceptance Company, LLC and each of the Members (incorporated by reference to Exhibit 10.3 of the Registrant s Current Report on Form 8-K as filed with the SEC on May 14, 2013).
10.4	Registration Rights Agreement, dated as of May 8, 2013, between PennyMac Financial Services, Inc. and the Holders (incorporated by reference to Exhibit 10.4 of the Registrant s Current Report on Form 8-K as filed with the SEC on May 14, 2013).
10.5	Stockholder Agreement, dated as of May 8, 2013, between PennyMac Financial Services, Inc. and BlackRock Mortgage Ventures, LLC (incorporated by reference to Exhibit 10.5 of the Registrant s Current Report on Form 8-K as filed with the SEC on May 14, 2013).
10.6	Stockholder Agreement, dated as of May 8, 2013, between PennyMac Financial Services, Inc. and HC Partners LLC (incorporated by reference to Exhibit 10.6 of the Registrant s Current Report on Form 8-K as filed with the SEC on May 14, 2013).
10.7	PennyMac Financial Services, Inc. 2013 Equity Incentive Plan (incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K as filed with the SEC on May 14, 2013).
10.8	PennyMac Financial Services, Inc. 2013 Equity Incentive Plan Form of Restricted Stock Unit Award Agreement for Non-Employee Directors (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K as filed with the SEC on May 16, 2013).
10.9	PennyMac Financial Services, Inc. 2013 Equity Incentive Plan Form of Restricted Stock Unit Award Agreement for Executive Officers (incorporated by reference to Exhibit 10.2 of the Registrant s Current Report on Form 8-K as filed with the SEC on June 17, 2013).
10.10	PennyMac Financial Services, Inc. 2013 Equity Incentive Plan Form of Restricted Stock Unit Award Agreement for Other Eligible Participants (incorporated by reference to Exhibit 10.3 of the Registrant s Current Report on Form 8-K as filed with the SEC on June 17, 2013).
10.11	PennyMac Financial Services, Inc. 2013 Equity Incentive Plan Form of Stock Option Award Agreement (incorporated by reference to Exhibit 10.1 of the Registrant s Current Report on Form 8-K as filed with the SEC on June 17, 2013).
10.12	Form of PennyMac Financial Services, Inc. Indemnification Agreement (incorporated by reference to Exhibit 10.8 of the Registrant s Amendment No. 2 to Form S-1 Registration Statement as filed with the SEC on April 5, 2013).
10.13	Employment Agreement, dated as of April 20, 2013, by and among Private National Mortgage Acceptance Company, LLC, PennyMac Financial Services, Inc. and Stanford L. Kurland (incorporated by reference to Exhibit 10.34 of the Registrant s Amendment No. 3 to Form S-1 Registration Statement as filed with the SEC on April 22, 2013).
10.14	Employment Agreement, dated as of April 20, 2013, by and among Private National Mortgage Acceptance Company, LLC, PennyMac Financial Services, Inc. and David A. Spector (incorporated by reference to Exhibit 10.35 of the Registrant s Amendment No. 3 to Form S-1 Registration Statement as filed with the SEC on April 22, 2013).
10.15	Mortgage Banking and Warehouse Services Agreement, effective as of February 1, 2013, by and between PennyMac Loan Services, LLC and PennyMac Corp. (incorporated by reference to Exhibit 10.9 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.16	Amendment No. 1 to Mortgage Banking and Warehouse Services Agreement, dated as of March 1, 2013, by and between PennyMac Loan Services LLC and PennyMac Corp. (incorporated by reference to Exhibit 10.31 of the Registrant s

Amendment No. 1 to Form S-1 Registration Statement as filed with the SEC on March 26, 2013).

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Exhibit Number	Exhibit Description
10.17	Amendment No. 2 to Mortgage Banking and Warehouse Services Agreement, dated as of August 14, 2013, by and between PennyMac Loan Services, LLC and PennyMac Corp. (incorporated by reference to Exhibit 1.1 of the Registrant s Current Report on Form 8-K as filed with the SEC on August 19, 2013).
10.18	Amended and Restated Flow Servicing Agreement, dated as of February 1, 2013, by and between PennyMac Loan Services, LLC and PennyMac Operating Partnership, L.P. (incorporated by reference to Exhibit 10.10 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.19	Second Amended and Restated Flow Servicing Agreement, dated as of March 1, 2013, by and between PennyMac Operating Partnership, L.P. and PennyMac Loan Services, LLC (incorporated by reference to Exhibit 10.30 of the Registrant s Amendment No. 1 to Form S-1 Registration Statement as filed with the SEC on March 26, 2013).
10.20	MSR Recapture Agreement, effective as of February 1, 2013, by and between PennyMac Loan Services, LLC and PennyMac Corp. (incorporated by reference to Exhibit 10.11 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.21	Amendment No. 1 to MSR Recapture Agreement, dated as of August 1, 2013, by and between PennyMac Loan Services, LLC and PennyMac Corp. (incorporated by reference to Exhibit 10.21 of the Registrant s Form S-1 Registration Statement as filed with the SEC on October 1, 2013).
10.22	Amended and Restated Management Agreement, dated as of February 1, 2013, by and among PennyMac Mortgage Investment Trust, PennyMac Operating Partnership, L.P. and PNMAC Capital Management, LLC (incorporated by reference to Exhibit 10.12 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.23	Amended and Restated Underwriting Fee Reimbursement Agreement, dated as of February 1, 2013, by and among PennyMac Mortgage Investment Trust, PennyMac Operating Partnership, L.P. and PNMAC Capital Management, LLC (incorporated by reference to Exhibit 10.13 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.24	Master Spread Acquisition and MSR Servicing Agreement, by and between PennyMac Loan Services, LLC and PennyMac Operating Partnership, L.P., dated as of February 1, 2013 (incorporated by reference to Exhibit 10.26 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.25	Amendment No. 1 to Master Spread Acquisition and MSR Servicing Agreement, by and between PennyMac Loan Services, LLC and PennyMac Operating Partnership, L.P., dated as of September 30, 2013 (incorporated by reference to Exhibit 10.25 of the Registrant s Form S-1/A Registration Statement as filed with the SEC on October 22, 2013).
10.26	Confidentiality Agreement, by and between PennyMac Mortgage Investment Trust and PNMAC Capital Management, LLC, dated as of February 6, 2013 (incorporated by reference to Exhibit 10.28 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.27	Amended and Restated Confidentiality Agreement, dated as of March 1, 2013, by and between PennyMac Mortgage Investment Trust and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibit 10.29 of the Registrant s Amendment No. 1 to Form S-1 Registration Statement as filed with the SEC on March 26, 2013).
10.28	Amended and Restated Flow Servicing Agreement, by and between PNMAC Mortgage Co., LLC and PennyMac Loan Services, LLC, dated August 1, 2010 (incorporated by reference to Exhibit 10.14 of the Registrant s Amendment No. 1 to Form S-1 Registration Statement as filed with the SEC on March 26, 2013).
10.29	Second Amended and Restated Flow Servicing Agreement, dated as of August 1, 2008, as amended effective as of January 1, 2012, by and between PNMAC Mortgage Opportunity Fund Investors, LLC and PennyMac Loan Services, LLC (incorporated by reference to Exhibit 10.15 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.30	Amended and Restated Flow Servicing Agreement, dated as of August 1, 2010, by and between PNMAC Mortgage Opportunity Fund, LP and PennyMac Loan Services, LLC (incorporated by reference to Exhibit 10.27 of the Registrant s Amendment No. 1 to Form S-1 Registration Statement as filed with the SEC on March 26, 2013).

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Exhibit Number	Exhibit Description
10.31	Investment Management Agreement, as amended and restated May 26, 2011, by and between PNMAC Mortgage Opportunity Fund, L.P. and PNMAC Capital Management, LLC (incorporated by reference to Exhibit 10.16 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.32	Investment Management Agreement, dated as of August 1, 2008, between PNMAC Mortgage Opportunity Fund Investors, LLC and PNMAC Capital Management, LLC (incorporated by reference to Exhibit 10.17 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.33	Master Repurchase Agreement, dated as of March 17, 2011, by and among Bank of America, N.A., PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibit 10.18 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.34	Amendment No. 1 to Master Repurchase Agreement, dated as of July 21, 2011, by and among Bank of America, N.A., PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibits 10.19 of the Registrant s Amendment No. 3 to Form S-1 Registration Statement as filed with the SEC on April 22, 2013).
10.35	Amendment No. 2 to Master Repurchase Agreement, dated as of March 23, 2012, by and among Bank of America, N.A., PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibits 10.19 of the Registrant s Amendment No. 3 to Form S-1 Registration Statement as filed with the SEC on April 22, 2013).
10.36	Amendment No. 3 to Master Repurchase Agreement, dated as of August 28, 2012, by and among Bank of America, N.A., PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibits 10.19 of the Registrant s Amendment No. 3 to Form S-1 Registration Statement as filed with the SEC on April 22, 2013).
10.37	Amendment No. 4 to Master Repurchase Agreement, dated as of January 3, 2013, by and among Bank of America, N.A., PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibits 10.19 of the Registrant s Amendment No. 3 to Form S-1 Registration Statement as filed with the SEC on April 22, 2013).
10.38	Amendment No. 5 to Master Repurchase Agreement, dated as of March 28, 2013, by and among Bank of America, N.A., PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibits 10.19 of the Registrant s Amendment No. 3 to Form S-1 Registration Statement as filed with the SEC on April 22, 2013).
10.39	Master Repurchase Agreement, dated as of June 26, 2012, by and between PennyMac Loan Services, LLC and Citibank, N.A. (incorporated by reference to Exhibit 10.20 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.40	Amendment Number One to the Master Repurchase Agreement, dated as of December 31, 2012, by and between PennyMac Loan Services, LLC and Citibank, N.A. (incorporated by reference to Exhibit 10.21 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.41	Amendment Number Two to the Master Repurchase Agreement, dated April 17, 2013, by and between PennyMac Loan Services, LLC and Citibank, N.A. (incorporated by reference to Exhibit 10.40 of the Registrant s Form S-1 Registration Statement as filed with the SEC on October 1, 2013).
10.42	Amendment Number Three to the Master Repurchase Agreement, dated June 25, 2013, by and between PennyMac Loan Services, LLC and Citibank, N.A. (incorporated by reference to Exhibit 10.41 of the Registrant s Form S-1 Registration Statement as filed with the SEC on October 1, 2013).
10.43	Amendment Number Four to the Master Repurchase Agreement, dated July 25, by and between PennyMac Loan Services, LLC and Citibank, N.A. (incorporated by reference to Exhibit 10.42 of the Registrant s Form S-1 Registration Statement as filed with the SEC on October 1, 2013).
10.44	Second Amended and Restated Loan and Security Agreement, dated as of March 27, 2012, between Credit Suisse First Boston Mortgage Capital LLC, PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibit 10.22 of the Registrant s Form S-1 Registration Statement as filed with the SEC on February 7, 2013).
10.45	Amendment No. 1 to Second Amended and Restated Loan and Security Agreement, dated as of December 12, 2012, among Credit Suisse First Boston Mortgage Capital LLC, PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibit 10.23 of the Registrant s Amendment No. 3 to Form S-1 Registration Statement as filed with the SEC on April 22, 2013).
10.46	Amendment No. 2 to Second Amended and Restated Loan and Security Agreement, dated as of March 22, 2013, among Credit Suisse First Boston Mortgage Capital LLC, PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibit 10.23 of the Registrant s Amendment No. 3 to Form S-1 Registration

Statement as filed with the SEC on April 22, 2013).

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Exhibit Number	Exhibit Description
10.47	Amended and Restated Master Repurchase Agreement, dated as of May 3, 2013, by and among Credit Suisse First Boston Mortgage Capital LLC, PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibit 10.36 of the Registrant s Amendment No. 5 to Form S-1 Registration Statement as filed with the SEC on May 7, 2013).
10.48	Amendment No. 1 to Amended and Restated Master Repurchase Agreement, dated as of September 5, 2013, by and among Credit Suisse First Boston Mortgage Capital LLC, PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibit 10.47 of the Registrant s Form S-1 Registration Statement as filed with the SEC on October 1, 2013).
10.49	Master Repurchase Agreement, dated as of July 2, 2013, by and between PennyMac Loan Services, LLC and Morgan Stanley Bank, N.A. (incorporated by reference to Exhibit 1.1 of the Registrant s Current Report on Form 8-K as filed with the SEC on July 8, 2013).
10.50	Amendment Number One to the Master Repurchase Agreement, dated as of August 26, 2013, by and between PennyMac Loan Services, LLC and Morgan Stanley Bank, N.A. (incorporated by reference to Exhibit 10.49 of the Registrant s Form S-1 Registration Statement as filed with the SEC on October 1, 2013).
10.51	Guaranty Agreement, dated as of July 2, 2013, by Private National Mortgage Acceptance Company, LLC in favor of Morgan Stanley Bank, N.A. (incorporated by reference to Exhibit 1.2 of the Registrant s Current Report on Form 8-K as filed with the SEC on July 8, 2013).
31.1	Certification of Stanford L. Kurland pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Anne D. McCallion pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Stanford L. Kurland pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Anne D. McCallion pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101**	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of September 30, 2013 and December 31, 2012, (ii) the Consolidated Statements of Income for the quarters ended September 30, 2013 and 2012, (iii) the Consolidated Statements of Changes in Members Equity for the quarters ended September 30, 2013 and 2012, (iv) the Consolidated Statements of Cash Flows for the quarters ended September 30, 2013 and 2012 and (v) the Notes to the Consolidated Financial Statements.

* The certifications attached hereto as Exhibits 32.1 and 32.2 are furnished to the SEC pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, except as shall be expressly set forth by specific reference in such filing.

** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and are not otherwise subject to liability under those sections.

Indicates management contract or compensatory plan or arrangement.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

	PENNYMAC FINANCIAL SERVICES, INC. (Registrant)	
Dated: November 14, 2013	By:	/S/ STANFORD L. KURLAND Stanford L. Kurland *Chairman of the Board and Chief Executive Officer*
Dated: November 14, 2013	By:	/S/ ANNE D. MCCALLION Anne D. McCallion *Chief Financial Officer*