

PENNYMAC FINANCIAL SERVICES, INC.

Form 10-Q

November 06, 2015

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

Or

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

For the transition period from to

Commission file number: 001-35916

PennyMac Financial Services, Inc.

(Exact name of registrant as specified in its charter)

Delaware	80-0882793
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6101 Condor Drive, Moorpark, California 93021
(Address of principal executive offices) (Zip Code)

(818) 224-7442

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting

company” in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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

Class	Outstanding at November 4, 2015
Class A Common Stock, \$0.0001 par value	21,886,868
Class B Common Stock, \$0.0001 par value	51

Table of Contents

PENNYMAC FINANCIAL SERVICES, INC.

FORM 10-Q

September 30, 2015

TABLE OF CONTENTS

	Page
<u>Special Note Regarding Forward-Looking Statements</u>	3
<u>PART I. FINANCIAL INFORMATION</u>	5
<u>Item 1. Financial Statements (Unaudited):</u>	5
<u>Consolidated Balance Sheets</u>	5
<u>Consolidated Statements of Income</u>	6
<u>Consolidated Statements of Changes in Stockholders' Equity</u>	7
<u>Consolidated Statements of Cash Flows</u>	8
<u>Notes to Consolidated Financial Statements</u>	9
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	51
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	75
<u>Item 4. Controls and Procedures</u>	75
<u>PART II. OTHER INFORMATION</u>	76
<u>Item 1. Legal Proceedings</u>	76
<u>Item 1A. Risk Factors</u>	76
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	76
<u>Item 3. Defaults Upon Senior Securities</u>	76
<u>Item 4. Mine Safety Disclosures</u>	76
<u>Item 5. Other Information</u>	76
<u>Item 6. Exhibits</u>	77

Table of Contents

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (“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,” “estimate,” “approximately,” “believe,” “predict,” “continue,” “plan” or other similar words or expressions.

Forward looking statements are based on 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 the section entitled “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2014, filed with the SEC on March 13, 2015 and our Quarterly Reports on Form 10-Q filed thereafter.

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 mortgage lending and servicing-related regulations promulgated by the Consumer Financial Protection Bureau (“CFPB”) and its enforcement of these regulations;
- our dependence on U.S. government sponsored entities and changes in 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;
- our dependence on the multi-family and commercial real estate sectors for future originations and investments in commercial mortgage loans and other commercial real estate related loans;
- changes in macroeconomic and U.S. 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;
- purchase opportunities for mortgage servicing rights (“MSRs”) and our success in winning bids;

Table of Contents

- changes in prevailing interest rates;
- increases in loan delinquencies and defaults;
- our reliance on PennyMac Mortgage Investment Trust (“PMT”) as a significant source of financing for, and revenue related to, our mortgage banking business;
- 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, service or assist in the fulfillment of, fail to meet certain criteria or characteristics or under other circumstances;
- our obligation to indemnify PMT and certain 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 certain advised entities;
- the effect of public opinion on our reputation;
- our recent growth;
- our ability to effectively identify, manage, monitor and mitigate financial risks;
- our initiation of new business activities or expansion of existing business activities;
 - our ability to detect misconduct and fraud; and
- our ability to mitigate cybersecurity risks and cyber incidents.

Other factors that could also cause results to differ from our expectations may not be described in this Report or any other document. Each of these factors could by itself, or together with one or more other factors, adversely affect our business, results of operations and/or financial condition.

Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update any forward-looking statement to reflect the impact of circumstances or events that arise after the date the forward-looking statement was made.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30, 2015	December 31, 2014
	(in thousands, except share data)	
ASSETS		
Cash	\$ 47,415	\$ 76,256
Short-term investments at fair value	24,766	21,687
Mortgage loans held for sale at fair value (includes \$1,420,782 and \$976,772 pledged to secure mortgage loans sold under agreements to repurchase; and \$255,134 and \$148,133 pledged to secure mortgage loan participation and sale agreement)	1,696,980	1,147,884
Derivative assets	53,569	38,457
Servicing advances, net (includes \$26,503 and \$18,686 valuation allowance)	252,172	228,630
Carried Interest due from Investment Funds	70,196	67,298
Investment in PennyMac Mortgage Investment Trust at fair value	1,160	1,582
Mortgage servicing rights (includes \$669,667 and \$325,383 at fair value; \$619,840 and \$392,254 pledged to secure note payable; and \$418,573 and \$191,166 subject to excess servicing spread financing)	1,307,392	730,828
Furniture, fixtures, equipment and building improvements, net	14,107	11,339
Capitalized software, net	2,035	567
Note receivable from PennyMac Mortgage Investment Trust—secured	150,000	—
Receivable from PennyMac Mortgage Investment Trust	17,220	23,871
Receivable from Investment Funds	1,542	2,291
Deferred tax asset	25,878	46,038
Loans eligible for repurchase	97,455	72,539
Other	53,435	37,419
Total assets	\$ 3,815,322	\$ 2,506,686
LIABILITIES		
Mortgage loans sold under agreements to repurchase	\$ 1,286,411	\$ 822,252
Mortgage loan participation and sale agreement	247,410	143,568
Note payable	406,990	146,855
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	418,573	191,166
Derivative liabilities	4,632	6,513
Accounts payable and accrued expenses	85,530	62,715
Mortgage servicing liabilities at fair value	10,724	6,306
Payable to Investment Funds	30,211	35,908

Edgar Filing: PENNYMAC FINANCIAL SERVICES, INC. - Form 10-Q

Payable to PennyMac Mortgage Investment Trust	147,326	123,315
Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement	72,275	75,024
Liability for loans eligible for repurchase	97,455	72,539
Liability for losses under representations and warranties	18,478	13,259
Total liabilities	2,826,015	1,699,420

Commitments and contingencies

STOCKHOLDERS' EQUITY

Class A common stock—authorized 200,000,000 shares of \$0.0001 par value; issued and outstanding, 21,842,868 and 21,577,686 shares, respectively	2	2
Class B common stock—authorized 1,000 shares of \$0.0001 par value; issued and outstanding, 51 and 54 shares, respectively	—	—
Additional paid-in capital	169,297	162,720
Retained earnings	85,699	51,242
Total stockholders' equity attributable to PennyMac Financial Services, Inc. common stockholders	254,998	213,964
Noncontrolling interest in Private National Mortgage Acceptance Company, LLC	734,309	593,302
Total stockholders' equity	989,307	807,266
Total liabilities and stockholders' equity	\$ 3,815,322	\$ 2,506,686

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

Table of Contents

PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Quarter ended		Nine months ended	
	September 30,		September 30,	
	2015	2014	2015	2014
	(in thousands, except earnings per share)			
Revenues				
Net gains on mortgage loans held for sale at fair value:				
From non-affiliates	\$ 85,744	\$ 50,276	\$ 247,822	\$ 128,942
Recapture payable to PennyMac Mortgage Investment Trust	(3,098)	(2,143)	(5,843)	(6,567)
	82,646	48,133	241,979	122,375
Loan origination fees	29,448	11,823	70,551	29,048
Fulfillment fees from PennyMac Mortgage Investment Trust	17,553	15,497	45,752	36,832
Net loan servicing fees:				
Loan servicing fees				
From non-affiliates	83,424	44,647	200,392	124,061
From PennyMac Mortgage Investment Trust	11,736	12,325	34,542	41,096
From Investment Funds	796	1,116	1,917	6,754
Ancillary and other fees	10,096	6,620	33,131	16,609
	106,052	64,708	269,982	188,520
Amortization, impairment and change in fair value of mortgage servicing rights	(59,065)	(20,339)	(128,073)	(58,271)
Change in fair value of excess servicing spread payable to PennyMac Mortgage Investment Trust	10,271	9,539	10,674	24,392
	(48,794)	(10,800)	(117,399)	(33,879)
Net loan servicing fees	57,258	53,908	152,583	154,641
Management fees:				
From PennyMac Mortgage Investment Trust	5,742	9,623	18,524	26,609
From Investment Funds	714	1,756	3,384	5,877
	6,456	11,379	21,908	32,486
Carried Interest from Investment Funds	1,483	1,902	2,898	5,893
Net interest expense:				
Interest income:				
From non-affiliates	13,764	8,975	35,348	19,337
From PennyMac Mortgage Investment Trust	1,289	—	1,822	—
	15,053	8,975	37,170	19,337
Interest expense:				
To non-affiliates	12,918	8,136	31,526	17,253
To PennyMac Mortgage Investment Trust	8,026	3,577	17,596	9,578
	20,944	11,713	49,122	26,831
Net interest expense	(5,891)	(2,738)	(11,952)	(7,494)
	(158)	8	(295)	20

Edgar Filing: PENNYMAC FINANCIAL SERVICES, INC. - Form 10-Q

Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust				
Other	410	713	2,446	2,751
Total net revenue	189,205	140,625	525,870	376,552
Expenses				
Compensation	74,129	48,375	202,695	138,232
Servicing	16,770	13,914	55,108	28,698
Technology	6,676	4,350	18,104	10,914
Loan origination	4,314	2,537	12,813	5,952
Professional services	3,803	3,290	10,710	8,150
Other	9,590	5,467	24,480	14,806
Total expenses	115,282	77,933	323,910	206,752
Income before provision for income taxes	73,923	62,692	201,960	169,800
Provision for income taxes	8,575	7,232	23,308	19,385
Net income	65,348	55,460	178,652	150,415
Less: Net income attributable to noncontrolling interest	52,668	44,971	144,195	122,336
Net income attributable to PennyMac Financial Services, Inc. common stockholders	\$ 12,680	\$ 10,489	\$ 34,457	\$ 28,079
Earnings per share				
Basic	\$ 0.58	\$ 0.49	\$ 1.59	\$ 1.33
Diluted	\$ 0.58	\$ 0.49	\$ 1.58	\$ 1.32
Weighted average common shares outstanding				
Basic	21,810	21,432	21,702	21,149
Diluted	76,138	75,949	76,098	75,918

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

Table of Contents

PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

PennyMac Financial Services, Inc. Stockholders

	Number of shares		Common stock		Additional paid-in capital	Retained earnings
	Class A (in thousands)	Class B	Class A	Class B		
013	20,813	—	\$ 2	\$ —	\$ 153,000	\$ 14,400
	—	—	—	—	—	28,079
	32	—	—	—	2,086	—
	—	—	—	—	—	—
in	9	—	—	—	147	—
of						
C to						
ees,	672	—	—	—	6,572	—
Class						
	—	—	—	—	(496)	—
014	21,526	—	\$ 2	\$ —	\$ 161,309	\$ 42,479
014	21,578	—	\$ 2	\$ —	\$ 162,720	\$ 51,242
	—	—	—	—	—	34,457
	75	—	—	—	3,746	—
	—	—	—	—	—	—
in	13	—	—	—	223	—
of						
C to						
ees,	177	—	—	—	2,919	—
Class	—	—	—	—	(311)	—

ac

015	21,843	—	\$ 2	\$ —	\$ 169,297	\$ 85,699	\$
-----	--------	---	------	------	------------	-----------	----

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

7

Table of Contents

PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine months ended September 30,	
	2015	2014
	(in thousands)	
Cash flow from operating activities		
Net income	\$ 178,652	\$ 150,415
Adjustments to reconcile net income to net cash used in operating activities:		
Net gains on mortgage loans held for sale at fair value	(241,979)	(122,375)
Accrual of servicing rebate to Investment Funds	1,193	681
Amortization, impairment and change in fair value of mortgage servicing rights and excess servicing spread	117,399	33,879
Carried Interest from Investment Funds	(2,898)	(5,893)
Accrual of interest on excess servicing spread financing	17,596	9,578
Amortization of debt issuance costs and commitment fees relating to financing facilities	5,688	4,217
Change in fair value of investment in common shares of PennyMac Mortgage Investment Trust	422	115
Stock and unit-based compensation expense	13,104	7,479
Provision for servicing advance losses	23,538	8,519
Depreciation and amortization	1,585	972
Purchase of mortgage loans held for sale from PennyMac Mortgage Investment Trust	(24,877,077)	(11,947,251)
Originations of mortgage loans held for sale	(3,106,147)	(1,261,747)
Purchase of mortgage loans from Ginnie Mae securities for modification and subsequent sale	(989,009)	(897,381)
Capitalization of interest on mortgage loans held for sale at fair value	(11,703)	—
Sale and principal payments of mortgage loans held for sale	28,346,871	13,362,317
Sale of mortgage loans held for sale to PennyMac Mortgage Investment Trust	13,708	4,955
Repurchase of mortgage loans by PennyMac Mortgage Investment Trust	12,379	—
Repurchase of mortgage loans subject to representations and warranties	(17,112)	(1,757)
Increase in servicing advances	(47,080)	(54,850)
Increase in receivable from Investment Funds	(444)	(468)
Decrease (increase) in receivable from PennyMac Mortgage Investment Trust	8,889	(781)
Decrease in deferred tax asset	21,399	14,670
Decrease in payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement	(4,299)	—

Edgar Filing: PENNYMAC FINANCIAL SERVICES, INC. - Form 10-Q

Increase in other assets	(23,113)	(38,806)
Increase in accounts payable and accrued expenses	22,280	16,359
Decrease in payable to Investment Funds	(5,697)	(1,063)
Increase in payable to PennyMac Mortgage Investment Trust	22,698	23,136
Net cash used in operating activities	(519,157)	(695,080)
Cash flow from investing activities		
(Increase) decrease in short-term investments	(3,079)	106,247
Advance on note receivable from PennyMac Mortgage Investment Trust—secured	(168,546)	—
Repayment of note receivable from PennyMac Mortgage Investment Trust—secured	18,546	—
Purchase of mortgage servicing rights	(379,264)	(113,348)
Sale of mortgage servicing rights	—	10,916
Settlement of derivative financial instruments used for hedging	(3,678)	3,048
Purchase of furniture, fixtures, equipment and building improvements	(5,716)	(4,006)
Acquisition of capitalized software	(1,745)	(56)
Decrease (increase) in margin deposits and restricted cash	5,331	(1,620)
Net cash (used in) provided by investing activities	(538,151)	1,181
Cash flow from financing activities		
Sale of loans under agreements to repurchase	25,947,385	12,500,064
Repurchase of loans sold under agreements to repurchase	(25,482,890)	(12,041,909)
Issuance of mortgage loan participation certificates	13,265,896	180,062
Repayment of mortgage loan participation certificates	(13,162,123)	(37,679)
Borrowing on note payable	289,556	102,794
Repayment of note payable	(29,411)	—
Issuance of excess servicing spread financing	271,452	82,646
Repayment of excess servicing spread financing	(55,800)	(25,280)
Repayment of leases payable	(6)	—
Payment of debt issuance costs	(5,965)	—
Distribution to Private National Mortgage Acceptance Company, LLC partners	(9,627)	(20,187)
Net cash provided by financing activities	1,028,467	740,511
Net (decrease) increase in cash	(28,841)	46,612
Cash at beginning of period	76,256	30,639
Cash at end of period	\$ 47,415	\$ 77,251

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

Table of Contents

PENNYMAC FINANCIAL SERVICES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1—Organization and Basis of Presentation

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

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

- PNMAC Capital Management, LLC (“PCM”)—a Delaware limited liability company registered with the Securities and Exchange Commission (“SEC”) as an investment adviser under the Investment Advisers Act of 1940, as amended. PCM enters into investment management agreements with entities that invest in residential mortgage loans and related assets. Presently, PCM has management agreements with PennyMac Mortgage Investment Trust (“PMT”), a publicly held real estate investment trust, PNMAC Mortgage Opportunity Fund, LLC and PNMAC Mortgage Opportunity Fund, L.P., both registered under the Investment Company Act of 1940, as amended, an affiliate of these funds, and PNMAC Mortgage Opportunity Fund Investors, LLC (collectively, “Investment Funds”). Together, the Investment Funds and PMT are referred to as the “Advised Entities.”
- PennyMac Loan Services, LLC (“PLS”)—a Delaware limited liability company that services portfolios of residential mortgage loans on behalf of non-affiliates or the Advised Entities, originates new prime credit quality residential mortgage loans, and engages in other mortgage banking activities for its own account and the account of PMT. PLS is approved as a seller/servicer of mortgage loans by the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”) and as an issuer of securities guaranteed by the Government National Mortgage Association (“Ginnie Mae”). PLS is a licensed Federal Housing Administration Nonsupervised Title II Lender with the U.S. Department of Housing and Urban Development and a lender/servicer with the Veterans Administration and U.S. Department of Agriculture. We refer to each of Fannie Mae, Freddie Mac and Ginnie Mae as an “Agency” and collectively the “Agencies.”
- PNMAC Opportunity Fund Associates, LLC (“PMOFA”)—a Delaware limited liability company and the general partner of PNMAC Mortgage Opportunity Fund, L.P. PMOFA is entitled to incentive fees representing allocations of profits (“Carried Interest”) from PNMAC Mortgage Opportunity Fund, L.P..

The accompanying consolidated financial statements have been prepared in compliance with accounting principles generally accepted in the United States (“GAAP”) as codified in the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Codification for interim financial information and with the SEC’s instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these financial statements and notes do not include all of the information required by GAAP for complete financial statements. The interim consolidated information should be read together with the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

The accompanying unaudited consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, income, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year ending December 31, 2015. Intercompany accounts and transactions have been eliminated.

Table of Contents

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

Reclassification of previously presented balances

In April of 2015, the FASB issued Accounting Standards Update (“ASU”) No. 2015-03, Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs (“ASU 2015-03”). The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability.

ASU 2015-03 specifies that its adoption be made on a retrospective basis. Accordingly, the Company has reclassified its debt issuance costs from Other assets as previously presented to Mortgage loans sold under agreements to repurchase and Mortgage loan participation and sale agreement to conform its December 31, 2014 balance sheet to the current presentation. The adoption of ASU 2015-03 did not result in changes to the Company’s previously presented consolidated statements of income or consolidated statements of cash flows.

Following is a summary of the balance sheet reclassifications:

	December 31, 2014		Reclassification
	As reported (in thousands)	As previously reported	
Assets:			
Other	\$ 37,419	\$ 37,858	\$ (439)
Total assets	\$ 2,506,686	\$ 2,507,125	\$ (439)
Liabilities:			
Mortgage loans sold under agreements to repurchase	\$ 822,252	\$ 822,621	\$ (369)
Mortgage loan participation and sale agreement	\$ 143,568	\$ 143,638	\$ (70)
Total liabilities	\$ 1,699,420	\$ 1,699,859	\$ (439)
Total liabilities and stockholders' equity	\$ 2,506,686	\$ 2,507,125	\$ (439)

Note 2—Concentration of Risk

A substantial portion of the Company's activities relate to the Advised Entities. Fees charged to these entities (generally comprised of fulfillment fees, loan servicing fees, management fees and Carried Interest) totaled 20% and 33% of total net revenue for the quarters ended September 30, 2015 and 2014, respectively, and 18% and 35% for the nine months ended September 30, 2015 and 2014, respectively.

Table of Contents

Note 3—Transactions with Affiliates

Transactions with PMT

Correspondent Production Activities

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

	Quarter ended September 30,		Nine months ended	
	2015	2014	September 30,	2014
	(in thousands)			
Fulfillment fee revenue	\$ 17,553	\$ 15,497	\$ 45,752	\$ 36,832
Unpaid principal balance of loans fulfilled for PennyMac Mortgage Investment Trust	\$ 4,073,201	\$ 3,677,613	\$ 10,542,411	\$ 8,588,955
Sourcing fees paid	\$ 3,236	\$ 1,384	\$ 7,084	\$ 3,401
Unpaid principal balance of loans purchased from PennyMac Mortgage Investment Trust	\$ 10,783,882	\$ 4,609,947	\$ 23,602,020	\$ 11,332,898
Proceeds from sale of mortgage loans held for sale to PennyMac Mortgage Investment Trust	\$ 1,047	\$ 2,970	\$ 11,875	\$ 4,955
Tax service fee receivable from PennyMac Mortgage Investment Trust	\$ 1,291	\$ 703	\$ 3,293	\$ 1,753
Mortgage servicing rights recapture recognized	\$ 670	\$ —	\$ 670	\$ 9

Mortgage Loan Servicing Activities

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

Quarter ended		Nine months ended	
September 30,	2014	September 30,	2014
2015	2014	2015	2014

(in thousands)

Loan servicing fees relating to PennyMac Mortgage Investment Trust:				
Mortgage loans acquired for sale at fair value:				
Base and supplemental	\$ 130	\$ 28	\$ 198	\$ 74
Activity-based	153	35	243	112
	283	63	441	186
Mortgage loans at fair value:				
Base and supplemental	3,896	4,662	12,053	14,549
Activity-based	2,961	4,076	8,948	16,208
	6,857	8,738	21,001	30,757
Mortgage loans held in a variable interest entity by PennyMac Mortgage Investment Trust:				
Base and supplemental	34	17	92	71
Activity-based	—	—	—	—
	34	17	92	71
Mortgage servicing rights:				
Base and supplemental	4,473	3,459	12,783	9,930
Activity-based	89	48	225	152
	4,562	3,507	13,008	10,082
	\$ 11,736	\$ 12,325	\$ 34,542	\$ 41,096

Table of Contents

Management Activities

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

	Quarter ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
	(in thousands)			
Management fees:				
Base	\$ 5,742	\$ 6,033	\$ 17,181	\$ 17,392
Performance incentive	—	3,590	1,343	9,217
	\$ 5,742	\$ 9,623	\$ 18,524	\$ 26,609

Investing and Financing Activities

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

	Quarter ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
	(in thousands)			
Financing activities:				
Excess servicing spread financing:				
Issuance	\$ 84,165	\$ 9,253	\$ 271,452	\$ 82,646
Repayment	\$ 24,717	\$ 8,786	\$ 55,800	\$ 25,280
Change in fair value (gain) loss	\$ 10,271	\$ 9,539	\$ 10,674	\$ 24,392
Interest expense	\$ 8,026	\$ 3,577	\$ 17,596	\$ 9,578
Recapture recognized	\$ 2,428	\$ 2,143	\$ 5,173	\$ 6,558
Investing activities:				
Note receivable from PennyMac Mortgage Investment Trust—secured:				
Advances	\$ 97,474	\$ —	\$ 168,546	\$ —
Repayment	\$ —	\$ —	\$ 18,546	\$ —
Interest income	\$ 1,289	\$ —	\$ 1,822	\$ —

The Company is a party to a Third Amended and Restated Loan and Security Agreement, dated as of March 27, 2015, pursuant to which it finances certain of its mortgage servicing rights (“MSRs”) and servicing advance receivables with Credit Suisse First Boston Mortgage Capital LLC (“CSFB”) (the “Loan and Security Agreement”). On April 30, 2015, the Company amended and restated the Loan and Security Agreement to increase the maximum loan amount thereunder to \$407 million, a \$150 million increase for the purpose of facilitating the financing of the related excess servicing spread (“ESS”) by PMT.

In connection with the Loan and Security Agreement, the Company and PMT entered into an underlying loan and security agreement, dated as of April 30, 2015, pursuant to which PMT may borrow up to \$150 million from the Company for the purpose of financing ESS. The principal amount of the borrowings under the Loan and Security Agreement is based upon a percentage of the fair value of the ESS pledged by PMT, subject to the \$150 million sublimit described above. Pursuant to the underlying loan and security agreement, PMT granted to the Company a security interest in all of its right, title and interest in, to and under the ESS pledged to secure loans. The portion of the loan amount outstanding under the Loan and Security Agreement and relating to advances outstanding with PMT under the underlying loan and security agreement is guaranteed in full by PMT.

The Company and PMT have agreed that PMT is required to repay the Company the principal amount of such borrowings plus accrued interest to the date of such repayment, and the Company is required to repay CSFB the corresponding amount under the Loan and Security Agreement. Interest accrues under the underlying loan and security agreement at a rate based on CSFB’s cost of funds. PMT was also required to pay the Company a fee for the structuring of the Loan and Security Agreement in an amount equal to the portion of the corresponding fee paid by the Company to CSFB under the Loan and Security Agreement and allocable to the \$150.0 million relating to the ESS financing.

As of September 30, 2015, \$150.0 million of principal was outstanding and included in Note receivable from PennyMac Mortgage Investment Trust secured on the accompanying consolidated balance sheets.

Table of Contents

Other Transactions

In connection with PMT's initial public offering of common shares on August 4, 2009 ("IPO"), PMT conditionally agreed to reimburse the Company up to \$2.9 million for underwriting fees paid to the IPO underwriters by the Company on PMT's behalf. The Company received reimbursement payments from PMT totaling \$7,000 and \$237,000 for the quarter and nine months ended September 30, 2015, respectively, and \$256,000 and \$292,000 during the quarter and nine months ended September 30, 2014, respectively.

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

	Quarter ended September 30,		Nine months ended	
	2015	2014	September 30,	2014
	(in thousands)			
Reimbursement of:				
Common overhead incurred by the Company (1)	\$ 2,694	\$ 2,912	\$ 8,125	\$ 8,181
Expenses incurred on PMT's behalf	(85)	122	377	671
	\$ 2,609	\$ 3,034	\$ 8,502	\$ 8,852
Payments and settlements during the period (2)	\$ 17,709	\$ 31,621	\$ 64,575	\$ 72,975

- (1) During the quarter and nine month periods ended September 30, 2015, in accordance with the terms of its management agreement with PMT, the Company provided PMT with discretionary waivers of \$900,000 and \$1.6 million, respectively, of overhead expenses otherwise allocable to PMT.
- (2) Payments and settlements include payments for correspondent production activities, loan servicing activities, management activities, investment activities and financing activities itemized in the preceding tables and netting settlements made pursuant to master netting agreements between the Company and PMT.

Amounts due from PMT are summarized below:

	September 30,	December 31,
	2015	2014
	(in thousands)	
Management fees	\$ 5,742	\$ 8,426
Allocated expenses	5,237	6,581
Fulfillment fees	3,031	506

Edgar Filing: PENNYMAC FINANCIAL SERVICES, INC. - Form 10-Q

Servicing fees	2,310	3,385
Conditional Reimbursement	900	1,137
Unsettled excess servicing spread issuance	—	3,836
	\$ 17,220	\$ 23,871

The Company holds an investment in PMT in the form of 75,000 common shares of beneficial interest as of September 30, 2015 and December 31, 2014. The common shares of beneficial interest had fair values of \$1.2 million and \$1.6 million as of September 30, 2015 and December 31, 2014, respectively.

Of the \$147.3 million payable to PMT as of September 30, 2015, \$138.3 million represents deposits made by PMT to fund servicing advances made by the Company, \$8.2 million represents other expenses and unsettled ESS financing activity, and \$800,000 represents MSR recapture payable to PMT.

Of the \$123.3 million payable to PMT as of December 31, 2014, \$116.7 million represents deposits made by PMT to fund servicing advances made by the Company, \$6.2 million represents other expenses and unsettled ESS financing activity, and \$460,000 represents MSR recapture payable to PMT.

Table of Contents

Transactions with Investment Funds

Amounts due from the Investment Funds are summarized below:

	September 30, 2015	December 31, 2014
	(in thousands)	
Carried Interest due from Investment Funds:		
PNMAC Mortgage Opportunity Fund, LLC	\$ 42,283	\$ 40,771
PNMAC Mortgage Opportunity Fund Investors, LLC	27,913	26,527
	\$ 70,196	\$ 67,298
Receivable from Investment Funds:		
Management fees	\$ 722	\$ 1,596
Loan servicing fees	315	476
Expense reimbursements	284	30
Loan servicing rebate	221	189
	\$ 1,542	\$ 2,291

Amounts due to the Investment Funds totaling \$30.2 million and \$35.9 million represent amounts advanced by the Investment Funds to fund servicing advances made by the Company as of September 30, 2015 and December 31, 2014, respectively.

Exchanged Private National Mortgage Acceptance Company, LLC Unitholders

The Company entered into a tax receivable agreement with PennyMac's existing unitholders on the date of the IPO that will provide for the payment by PFSI to PennyMac's exchanged unitholders an amount equal to 85% of the amount of the benefits, if any, that PFSI is deemed to realize as a result of (i) increases in tax basis of PennyMac's assets resulting from such unitholders' exchanges and (ii) certain other tax benefits related to entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement. Based on the PennyMac unitholder exchanges to date, the Company has recorded a \$72.3 million Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement as of September 30, 2015. The Company made payments under the tax receivable agreement totaling \$0 and \$4.3 million during the quarter and nine months ended September 30, 2015.

Note 4—Earnings Per Share of Common Stock

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

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

Table of Contents

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

	Quarter ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
(in thousands, except per share data)				
Basic earnings per share of common stock:				
Net income attributable to PennyMac Financial Services, Inc. common stockholders	\$ 12,680	\$ 10,489	\$ 34,457	\$ 28,079
Weighted average shares of common stock outstanding	21,810	21,432	21,702	21,149
Basic earnings per share of common stock	\$ 0.58	\$ 0.49	\$ 1.59	\$ 1.33
Diluted earnings per share of common stock:				
Net income	\$ 12,680	\$ 10,489	\$ 34,457	\$ 28,079
Effect of net income attributable to noncontrolling interest, net of income taxes	31,418	26,620	86,012	72,374
Diluted net income attributable to common stockholders	\$ 44,098	\$ 37,109	\$ 120,469	\$ 100,453
Weighted average shares of common stock outstanding	21,810	21,432	21,702	21,149
Dilutive shares:				
PennyMac Class A units exchangeable to common stock	54,042	53,492	53,744	53,569
Non-vested PennyMac Class A units issuable under unit-based stock compensation plan and exchangeable to common stock	163	975	528	1,155
Shares issuable under stock-based compensation plans	123	50	124	45
Diluted weighted average shares of common stock outstanding	76,138	75,949	76,098	75,918
Diluted earnings per share of common stock	\$ 0.58	\$ 0.49	\$ 1.58	\$ 1.32

Note 5—Loan Sales and Servicing Activities

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

The following table summarizes cash flows between the Company and transferees as a result of the sale of mortgage loans in transactions where the Company maintains continuing involvement with the mortgage loans in the form of loan servicing arrangements and a liability for representations and warranties it makes to purchasers and insurers of the mortgage loans, as well as unpaid principal balance information at period end.

	Quarter ended September 30,		Nine months ended	
	2015	2014	September 30, 2015	2014
	(in thousands)			
Cash flows:				
Sales proceeds	\$ 12,738,035	\$ 5,345,227	\$ 28,357,226	\$ 13,367,272
Servicing fees received (1)	\$ 33,745	\$ 30,609	\$ 103,057	\$ 78,075
Net servicing advances (recoveries)	\$ (9,778)	\$ 6,520	\$ (18,733)	\$ 2,182
Period end information:				
Unpaid principal balance of mortgage loans outstanding at end of period	\$ 55,216,410	\$ 33,297,161		
Delinquencies:				
30-89 days	\$ 1,303,412	\$ 662,863		
90 days or more or in foreclosure or bankruptcy	\$ 1,249,692	\$ 168,503		

(1) Net of guarantee fees paid to the Agencies.

Table of Contents

The unpaid principal balance (“UPB”) of the Company’s mortgage servicing portfolio is summarized as follows:

	September 30, 2015		
	Servicing rights owned (in thousands)	Contract servicing and subservicing	Total loans serviced
Investor:			
Non-affiliated entities	\$ 107,933,619	\$ —	\$ 107,933,619
Affiliated entities	—	45,294,101	45,294,101
Mortgage loans held for sale	1,602,692	—	1,602,692
	\$ 109,536,311	\$ 45,294,101	\$ 154,830,412
Amount subserviced for the Company (1)	\$ 1,798	\$ —	\$ 1,798
Delinquent mortgage loans:			
30 days	\$ 2,558,944	\$ 340,589	\$ 2,899,533
60 days	800,846	137,172	938,018
90 days or more			
Not in foreclosure	1,124,614	872,914	1,997,528
In foreclosure	508,771	1,291,618	1,800,389
Foreclosed	19,755	577,581	597,336
	\$ 5,012,930	\$ 3,219,874	\$ 8,232,804
Custodial funds managed by the Company (2)	\$ 2,895,891	\$ 556,565	\$ 3,452,456

- (1) Certain of the mortgage loans serviced by the Company are subserviced on the Company’s behalf by other mortgage loan servicers. Mortgage loans are subserviced for the Company on a transitional basis for loans where the Company has obtained the rights to service the loans but servicing of the loans has not yet been transferred to the Company’s servicing system.
- (2) Borrower and investor custodial cash accounts relate to mortgage loans serviced under the servicing agreements and are not recorded on the Company’s consolidated balance sheets. The Company earns interest on custodial funds it manages on behalf of the mortgage loans’ investors, which is recorded as part of the interest income in the Company’s consolidated statements of income.

	December 31, 2014		
	Servicing rights owned (in thousands)	Contract servicing and subservicing	Total loans serviced
Investor:			
Non-affiliated entities	\$ 65,169,194	\$ —	\$ 65,169,194
Affiliated entities	—	39,709,945	39,709,945
Mortgage loans held for sale	1,100,910	—	1,100,910

Edgar Filing: PENNYMAC FINANCIAL SERVICES, INC. - Form 10-Q

	\$ 66,270,104	\$ 39,709,945	\$ 105,980,049
Amount subserviced for the Company (1)	\$ —	\$ 330,768	\$ 330,768
Delinquent mortgage loans:			
30 days	\$ 1,372,915	\$ 302,091	\$ 1,675,006
60 days	434,428	135,777	570,205
90 days or more			
Not in foreclosure	779,129	1,057,973	1,837,102
In foreclosure	422,330	1,544,762	1,967,092
Foreclosed	32,444	533,067	565,511
	\$ 3,041,246	3,573,670	\$ 6,614,916
Custodial funds managed by the Company (2)	\$ 1,522,295	\$ 388,498	\$ 1,910,793

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

Table of Contents

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

Following is a summary of the geographical distribution of mortgage loans included in the Company's servicing portfolio for the top five and all other states as measured by UPB:

State	September 30, 2015 (in thousands)	December 31, 2014
California	\$ 38,425,517	\$ 33,751,630
Texas	11,542,716	6,954,778
Virginia	9,209,929	6,360,171
Florida	9,154,980	5,573,215
Maryland	5,784,906	*
Washington	*	3,830,587
All other states	80,712,364	49,509,668
	\$ 154,830,412	\$ 105,980,049

* State did not represent a top five state as of the respective date.

Note 6—Netting of Financial Instruments

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

Following are summaries of derivative assets and related netting amounts.

Offsetting of Derivative Assets

	September 30, 2015			December 31, 2014		
	Gross amount of recognized assets (in thousands)	Gross amount offset in the consolidated balance sheet	Net amount of assets in the consolidated balance sheet	Gross amount of recognized assets	Gross amount offset in the consolidated balance sheet	Net amount of assets in the consolidated balance sheet
Derivatives subject to master netting arrangements:						
Forward purchase contracts	\$ 37,265	\$ —	\$ 37,265	\$ 9,060	\$ —	\$ 9,060
Forward sale contracts	862	—	862	320	—	320
MBS put options	604	—	604	476	—	476
Put options on interest rate futures purchase contracts	1,301	—	1,301	862	—	862
Call options on interest rate futures purchase contracts	4,539	—	4,539	2,193	—	2,193
Netting	—	(35,465)	(35,465)	—	(7,807)	(7,807)
	44,571	(35,465)	9,106	12,911	(7,807)	5,104
Derivatives not subject to master netting arrangements - IRLCs	44,463	—	44,463	33,353	—	33,353
	\$ 89,034	\$ (35,465)	\$ 53,569	\$ 46,264	\$ (7,807)	\$ 38,457

Table of Contents

Derivative Assets, Financial Assets, and Collateral Held by Counterparty

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

	September 30, 2015				December 31, 2014			
	Gross amount not offset in the consolidated balance sheet			Net amount of assets in the consolidated balance sheet (in thousands)	Gross amount not offset in the consolidated balance sheet			Net amount of assets in the consolidated balance sheet (in thousands)
	Cash	Financial instruments	Cash collateral received		Cash	Financial instruments	Cash collateral received	
Interest rate lock commitments	\$ 44,463	\$ —	\$ —	\$ 44,463	\$ 33,353	\$ —	\$ —	\$ 33,353
RJ O'Brien	4,637	—	—	4,637	2,005	—	—	2,005
Jefferies & Co.	1,544	—	—	1,544	764	—	—	764
Bank of America, N.A.	1,057	—	—	1,057	—	—	—	—
Nomura	606	—	—	606	322	—	—	322
Wells Fargo Bank, N.A.	356	—	—	356	379	—	—	379
Goldman Sachs	—	—	—	—	600	—	—	600
JP Morgan	—	—	—	—	526	—	—	526
Others	906	—	—	906	508	—	—	508
	\$ 53,569	\$ —	\$ —	\$ 53,569	\$ 38,457	\$ —	\$ —	\$ 38,457

Offsetting of Derivative Liabilities and Financial Liabilities

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

September 30, 2015

Net

December 31, 2014

Net

Edgar Filing: PENNYMAC FINANCIAL SERVICES, INC. - Form 10-Q

	Gross amount of recognized liabilities (in thousands)	Gross amount offset in the consolidated balance sheet	amount of liabilities in the consolidated balance sheet	Gross amount of recognized liabilities	Gross amount offset in the consolidated balance sheet	amount of liabilities in the consolidated balance sheet
Derivatives subject to a master netting arrangement:						
Forward purchase contracts	\$ 113	\$ —	\$ 113	\$ 141	\$ —	\$ 141
Forward sale contracts	36,619	—	36,619	16,110	—	16,110
Put options on interest rate futures sale contracts	—	—	—	8	—	8
Netting	—	(33,025)	(33,025)	—	(10,698)	(10,698)
	36,732	(33,025)	3,707	16,259	(10,698)	5,561
Derivatives not subject to a master netting arrangement - IRLCs	925	—	925	952	—	952
Total derivatives	37,657	(33,025)	4,632	17,211	(10,698)	6,513
Mortgage loans sold under agreements to repurchase:						
Amount outstanding	1,287,116	—	1,287,116	822,621	—	822,621
Unamortized debt issuance costs	(705)	—	(705)	(369)	—	(369)
	1,286,411	—	1,286,411	822,252	—	822,252
	\$ 1,324,068	\$ (33,025)	\$ 1,291,043	\$ 839,463	\$ (10,698)	\$ 828,765

Table of Contents

Derivative Liabilities, Financial Liabilities, and Collateral Held by Counterparty

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

	September 30, 2015				December 31, 2014			
	Net amount of liabilities in the consolidated balance sheet (in thousands)	Gross amount not offset in the consolidated balance sheet	Cash collateral pledged	Net amount of liabilities in the consolidated balance sheet	Net amount of liabilities in the consolidated balance sheet	Gross amount not offset in the consolidated balance sheet	Cash collateral pledged	Net amount of liabilities in the consolidated balance sheet
Interest rate lock commitments	\$ 925	\$ —	\$ —	\$ 925	\$ 952	\$ —	\$ —	\$ 952
Credit Suisse								
First Boston Mortgage Capital LLC	496,904	(496,855)	—	49	464,737	(463,541)	—	1,196
Bank of America, N.A.	494,691	(494,691)	—	—	236,909	(236,771)	—	138
Morgan Stanley Bank, N.A.	198,790	(198,687)	—	103	122,148	(122,031)	—	117
Citibank, N.A.	97,190	(96,883)	—	307	699	(278)	—	421
Bank of Oklahoma	978	—	—	978	486	—	—	486
Multi-Bank	401	—	—	401	—	—	—	—
JP Morgan	352	—	—	352	—	—	—	—
Bank of New York Mellon	—	—	—	—	1,552	—	—	1,552
Others	1,517	—	—	1,517	1,651	—	—	1,651
	\$ 1,291,748	\$ (1,287,116)	\$ —	\$ 4,632	\$ 829,134	\$ (822,621)	\$ —	\$ 6,513

Note 7—Fair Value

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

Fair Value Accounting Elections

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

The Company's subsequent accounting for MSR's is based on the class of MSR's. Originated MSR's relating to mortgage loans with initial interest rates of less than or equal to 4.5% are accounted for using the amortization method. Originated MSR's relating to mortgage loans with initial interest rates of more than 4.5% and purchased MSR's subject to ESS financing are accounted for at fair value with changes in fair value recorded in current period income.

Table of Contents

Financial Statement Items Measured at Fair Value on a Recurring Basis

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

	September 30, 2015			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	\$ 24,766	\$ —	\$ —	\$ 24,766
Mortgage loans held for sale at fair value	—	1,633,358	63,622	1,696,980
Derivative assets:				
Interest rate lock commitments	—	—	44,463	44,463
Forward purchase contracts	—	37,265	—	37,265
Forward sales contracts	—	862	—	862
MBS put options	—	604	—	604
Put options on interest rate futures purchase contracts	1,301	—	—	1,301
Call options on interest rate futures purchase contracts	4,539	—	—	4,539
Total derivative assets before netting	5,840	38,731	44,463	89,034
Netting (1)	—	—	—	(35,465)
Total derivative assets	5,840	38,731	44,463	53,569
Investment in PennyMac Mortgage Investment Trust	1,160	—	—	1,160
Mortgage servicing rights at fair value	—	—	669,667	669,667
	\$ 31,766	\$ 1,672,089	\$ 777,752	\$ 2,446,142
Liabilities:				
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	\$ —	\$ —	\$ 418,573	\$ 418,573
Derivative liabilities:				
Interest rate lock commitments	—	—	925	925
Forward purchase contracts	—	113	—	113
Forward sales contracts	—	36,619	—	36,619
Total derivative liabilities before netting	—	36,732	925	37,657
Netting (1)	—	—	—	(33,025)
Total derivative liabilities	—	36,732	925	4,632
Mortgage servicing liabilities	—	—	10,724	10,724
	\$ —	\$ 36,732	\$ 430,222	\$ 433,929

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

Table of Contents

	December 31, 2014		Total	Total
	Level 1	Level 2		
	(in thousands)			
Assets:				
Short-term investments	\$ 21,687	\$ —	\$ —	\$ 21,687
Mortgage loans held for sale at fair value	—	937,976	209,908	1,147,884
Derivative assets:				
Interest rate lock commitments	—	—	33,353	33,353
Forward purchase contracts	—	9,060	—	9,060
Forward sales contracts	—	320	—	320
MBS put options	—	476	—	476
Put options on interest rate futures purchase contracts	862	—	—	862
Call options on interest rate futures purchase contracts	2,193	—	—	2,193
Total derivative assets before netting	3,055	9,856	33,353	46,264
Netting (1)	—	—	—	(7,807)
Total derivative assets	3,055	9,856	33,353	38,457
Investment in PennyMac Mortgage Investment Trust	1,582	—	—	1,582
Mortgage servicing rights at fair value	—	—	—	—