

PENNYMAC FINANCIAL SERVICES, INC.

Form 10-Q

August 14, 2014

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

Washington, DC 20549

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**Form 10-Q**

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(Mark One)

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

For the quarterly period ended June 30, 2014

Or

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

For the transition period from            to

Commission file number: 001-35916

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## PennyMac Financial Services, Inc.

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**80-0882793**  
(IRS Employer  
Identification No.)

**6101 Condor Drive, Moorpark, California**  
(Address of principal executive offices)

**93021**  
(Zip Code)

**(818) 224-7442**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

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

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

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PENNYMAC FINANCIAL SERVICES, INC.

FORM 10-Q

June 30, 2014

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

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

**STOCKHOLDERS EQUITY**

|  |    |           |    |           |
|--|----|-----------|----|-----------|
| Class A common stock authorized 200,000,000 shares of \$0.0001 par value; issued and outstanding, 21,328,115 and 20,812,777 shares, respectively | \$ | 2         | \$ | 2         |
| Class B common stock authorized 1,000 shares of \$0.0001 par value; 58 shares issued and outstanding   |    |           |    |           |
| Additional paid-in capital   |    | 158,977   |    | 153,000   |
| Retained earnings  |    | 31,990    |    | 14,400    |
| Total stockholders equity attributable to PennyMac Financial Services, Inc. common stockholders  |    | 190,969   |    | 167,402   |
| Noncontrolling interest in Private National Mortgage Acceptance Company, LLC   |    | 530,724   |    | 461,802   |
| Total stockholders equity  |    | 721,693   |    | 629,204   |
| Total liabilities and stockholders equity  | \$ | 2,182,194 | \$ | 1,584,475 |

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

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## PENNYMAC FINANCIAL SERVICES, INC.

## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

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

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**Earnings per share**

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

**Weighted-average common shares outstanding**

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

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



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## PENNYMAC FINANCIAL SERVICES, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

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

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

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

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## PENNYMAC FINANCIAL SERVICES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

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

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

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

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**PENNYMAC FINANCIAL SERVICES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 1 Organization and Basis of Presentation**

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

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

- *PNMAC Capital Management, LLC* ( *PCM* ) a Delaware limited liability company registered with the Securities and Exchange Commission ( *SEC* ) as an investment adviser under the Investment Advisers Act of 1940, as amended. PCM enters into investment management agreements with entities that invest in residential mortgage loans and related assets.

Presently, PCM has management agreements with PennyMac Mortgage Investment Trust ( *PMT* ), a publicly held real estate investment trust, and three investment funds: PNMAC Mortgage Opportunity Fund, LLC and PNMAC Mortgage Opportunity Fund, L.P., (the *Master Fund* ), both registered under the Investment Company Act of 1940, as amended; and PNMAC Mortgage Opportunity Fund Investors, LLC (collectively, *Investment Funds* ). Together, the Investment Funds and PMT are referred to as the *Advised Entities*.

- *PennyMac Loan Services, LLC* ( *PLS* ) a Delaware limited liability company that services portfolios of residential mortgage loans on behalf of non-affiliates or the *Advised Entities*, originates new prime credit quality residential mortgage loans, and engages in other mortgage banking activities for its own account and the account of *PMT*.

PLS is approved as a seller/servicer of mortgage loans by the Federal National Mortgage Association ( *Fannie Mae* ) and the Federal Home Loan Mortgage Corporation ( *Freddie Mac* ) and as an issuer of securities guaranteed by the Government National Mortgage Association ( *Ginnie Mae* ). PLS is a licensed Federal Housing Administration Nonsupervised Title II Lender with the U.S. Department of Housing and Urban Development ( *HUD* ) and a lender/servicer with the Veterans Administration ( *VA* ) (each an *Agency* and collectively the *Agencies* ).

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- *PNMAC Opportunity Fund Associates, LLC ( PMOFA )* a Delaware limited liability company and the general partner of the Master Fund. PMOFA is entitled to incentive fees representing allocations of profits ( *Carried Interest* ) from the Master Fund.

### *Initial Public Offering and Recapitalization*

On May 14, 2013, PFSI completed an initial public offering ( *IPO* ) in which it sold approximately 12.8 million shares of its Class A common stock, at a public offering price of \$18.00 per share. PFSI received net proceeds of \$216.8 million, after deducting underwriting discounts and commissions, from sales of its shares in the IPO. PFSI used these net proceeds to purchase approximately 12.8 million Class A units of PennyMac. PFSI operates and controls all of the business and affairs and consolidates the financial results of PennyMac and its subsidiaries.

The purchase of 12.8 million Class A units of PennyMac has been accounted for as a transfer of interests under common control. Accordingly, the accompanying consolidated financial statements reflect a reclassification of members' equity to noncontrolling interests in the Company of \$315.5 million. This amount represents the carrying value in the Company of the existing owners of PennyMac on the date of the IPO.

Before the IPO, PennyMac completed a reorganization by amending its limited liability company agreement to convert all classes of ownership interests held by its existing owners to a single class of common units. The conversion of existing interests was based on the various interests liquidation priorities as specified in PennyMac's prior limited liability company agreement. In connection with that reorganization, PFSI became the sole managing member of PennyMac.

After the completion of the recapitalization and reorganization transactions, PennyMac became a consolidated subsidiary of the Company. Accordingly, PennyMac's consolidated financial statements are the Company's historical financial statements. The historical consolidated financial statements of PennyMac are reflected herein based on the historical ownership interests of the then-existing PennyMac unitholders.

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*Tax Receivable Agreement*

As part of the IPO, PFSI entered into an Exchange Agreement with PennyMac's existing unitholders whereby the existing unitholders may exchange their PennyMac units for PFSI stock. PennyMac has made an election pursuant to Section 754 of the Internal Revenue Code which remains in effect. As a result of this election an exchange under the Exchange Agreement results in a special adjustment for PFSI that may increase PFSI's tax basis of certain assets of PennyMac that otherwise would not have been available. These increases in tax basis may reduce the amount of income tax that PFSI would otherwise be required to pay in the future. These increases in tax basis may also decrease gains (or increase losses) on future dispositions of certain assets to the extent a portion of the increased tax basis is allocated to those assets.

As part of the IPO, PFSI entered into a tax receivable agreement with PennyMac's existing unitholders that will provide for the payment by PFSI to PennyMac exchanged unitholders an amount equal to 85% of the amount of the benefits, if any, that PFSI is deemed to realize as a result of (i) increases in tax basis resulting from the exchanges noted above and (ii) certain other tax benefits related to PFSI entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

The term of the tax receivable agreement will continue until all such tax benefits have been utilized or expired, unless PFSI exercises its right to terminate the tax receivable agreement. In the event of termination of the tax receivable agreement, the Company would be required to make an immediate payment equal to the present value of the anticipated future net tax benefits, which upfront payment may be made years in advance of the actual realization of such future benefits.

*Basis of Presentation*

The accompanying consolidated financial statements have been prepared in compliance with accounting principles generally accepted in the United States ( U.S. GAAP ) as codified in the Financial Accounting Standards Board's *Accounting Standards Codification* for interim financial information and with the SEC's instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these financial statements and notes do not include all of the information required by U.S. GAAP for complete financial statements. The interim consolidated information should be read together with the Company's Annual Report on Form 10-K for the year ended December 31, 2013. Intercompany accounts and transactions have been eliminated.

The accompanying unaudited consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, results of operations, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year ending December 31, 2014.

***Reclassification of previously presented balances***

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

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

Following is a summary of the reclassifications:

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

**Note 2 Concentration of Risk**

A substantial portion of the Company's activities relate to the Advised Entities. Fees charged to these entities (generally comprised of management fees, loan servicing fees net of loan servicing rebates, Carried Interest and fulfillment fees) totaled 33% and 43% of total net revenues for the quarters ended June 30, 2014 and 2013, respectively, and 34% and 47% for the six months ended June 30, 2014 and 2013, respectively.



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

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

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

In the event of termination by PMT, the Company may be entitled to a termination fee in certain circumstances. The termination fee is equal to three times the sum of (a) the average annual base management fee, and (b) the average annual performance incentive fee earned by the Company, in each case during the 24 month period before termination.

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

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

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

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

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

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

*Other Transactions*

In connection with the IPO of PMT's common shares on August 4, 2009, the Company entered into an agreement with PMT pursuant to which PMT agreed to reimburse the Company for the \$2.9 million payment that it made to the underwriters in such offering (the Conditional Reimbursement) if PMT satisfied certain performance measures over a specified period of time. Effective February 1, 2013, the parties amended the terms of the reimbursement agreement to provide for the reimbursement to the Company of the Conditional Reimbursement if PMT is required to pay the Company performance incentive fees under the management agreement at a rate of \$10 in reimbursement for every \$100 of performance incentive fees earned. The reimbursement of the Conditional Reimbursement is subject to a maximum reimbursement in any particular 12 month period of \$1.0 million and the maximum amount that may be reimbursed under the agreement is \$2.9 million. The Company received payments from PMT totaling \$36,000 during the six months ended June 30, 2014.

In the event the termination fee is payable to the Company under the management agreement and the Company has not received the full amount of the reimbursements and payments under the reimbursement agreement, such amount will be paid in full. The term of the reimbursement agreement expires on February 1, 2019.

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

|   | Quarter ended June 30, |           | Six months ended June 30, |           |
|---|------------------------|-----------|---------------------------|-----------|
|   | 2014                   | 2013      | 2014                      | 2013      |
|   | (in thousands)         |           |                           |           |
| Reimbursement of common overhead incurred by PCM and its affiliates | \$ 2,691               | \$ 3,201  | \$ 5,269                  | \$ 5,807  |
| Reimbursement of expenses incurred on PMT's behalf                  | 104                    | 585       | 549                       | 1,834     |
|   | \$ 2,795               | \$ 3,786  | \$ 5,818                  | \$ 7,641  |
| Payments and settlements during the year (1)                        | \$ 22,968              | \$ 32,616 | \$ 41,354                 | \$ 65,290 |

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

Amounts due from PMT are summarized below:

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

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

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

Table of Contents**Investment Funds**

Amounts due from the Investment Funds are summarized below:

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

Amounts due to the Investment Funds totaling \$34.9 million and \$36.9 million represent amounts advanced by the Investment Funds to fund servicing advances made by the Company as of June 30, 2014 and December 31, 2013, respectively.

**Exchanged Private National Mortgage Acceptance Company, LLC Unitholders**

As discussed in Note 1, *Organization and Basis of Presentation*, the Company entered into a tax receivable agreement with PennyMac's existing unitholders on the date of the IPO that will provide for the payment by PFSI to PennyMac's exchanged unitholders an amount equal to 85% of the amount of the benefits, if any, that PFSI is deemed to realize as a result of (i) increases in tax basis resulting from such unitholders' exchanges and (ii) certain other tax benefits related to entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement. Based on the PennyMac unitholder exchanges to date, the Company has recorded a \$74.7 million liability and it has not made a payment under the tax sharing agreement as of June 30, 2014.

**Note 4 Earnings Per Share of Common Stock**

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

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

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

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

**Note 5 Loan Sales and Servicing Activities**

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

The following table summarizes cash flows between the Company and transferees upon sale of mortgage loans in transactions where the Company maintains continuing involvement with the mortgage loans (primarily the obligation to service the loans on behalf of the loans owners or owners agents):

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

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



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

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

|  | Servicing<br>rights owned | December 31, 2013<br>Contract servicing<br>and subservicing<br>(in thousands) | Total<br>loans serviced |
|--|---------------------------|---|-------------------------|
| Agencies                                   | \$ 44,969,026             | \$  | \$ 44,969,026           |
| Affiliated entities                        |                           | 31,632,718  | 31,632,718              |
| Private investors                          | 969,794                   | 89,361  | 1,059,155               |
| Mortgage loans held for sale               | 506,540                   |   | 506,540                 |
|  | \$ 46,445,360             | \$ 31,722,079   | \$ 78,167,439           |
| Amount subserviced for the Company         | \$ 156,347                | \$ 582,610  | \$ 738,957              |
| Delinquent mortgage loans:                 |                           |   |                         |
| 30 days                                    | \$ 1,304,054              | \$ 263,518  | \$ 1,567,572            |
| 60 days                                    | 346,912                   | 112,275   | 459,187                 |
| 90 days or more                            | 605,555                   | 1,416,498   | 2,022,053               |
|  | 2,256,521                 | 1,792,291   | 4,048,812               |
| Loans pending foreclosure                  | 168,776                   | 1,792,128   | 1,960,904               |
|  | \$ 2,425,297              | \$ 3,584,419  | \$ 6,009,716            |
| Custodial funds managed by the Company (1) | \$ 568,161                | \$ 246,587  | \$ 814,748              |

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

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

| State            | June 30,<br>2014 | December 31,<br>2013 |
|------------------|------------------|----------------------|
|                  | (in thousands)   |                      |
| California       | \$ 32,301,976    | \$ 30,320,616        |
| Texas            | 5,598,942        | 4,470,123            |
| Virginia         | 5,141,366        | 3,769,683            |
| Florida          | 4,500,059        | 3,416,274            |
| Washington       | 3,422,660        | 2,760,900            |
| All other states | 42,600,265       | 33,429,843           |
|                  | \$ 93,565,268    | \$ 78,167,439        |

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

**Note 6 Netting of Financial Instruments**

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

Following are summaries of derivative assets and related netting amounts.

*Offsetting of Derivative Assets*

|   | June 30, 2014                     |  |   | December 31, 2013                 |  |   |
|---|-----------------------------------|--|---|-----------------------------------|--|---|
|   | Gross amount of recognized assets | Gross amount offset in the balance sheet | Net amount of assets in the balance sheet | Gross amount of recognized assets | Gross amount offset in the balance sheet | Net amount of assets in the balance sheet |
|   | (in thousands)                    |  |   |                                   |  |   |
| Derivatives subject to master netting arrangements: |                                   |  |   |                                   |  |   |
| MBS put options                                     | \$ 188                            | \$                                       | \$ 188                                    | \$ 665                            | \$                                       | \$ 665                                    |

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

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

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

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

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

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

|   | June 30, 2014                          |   |   | December 31, 2013                      |   |   |
|---|--|---|---|--|---|---|
|   | Gross amount of recognized liabilities | Gross amount offset in the consolidated balance sheet | Net amount of liabilities in the consolidated balance sheet | Gross amount of recognized liabilities | Gross amount offset in the consolidated balance sheet | Net amount of liabilities in the consolidated balance sheet |
|   | (in thousands)                         |   |   |  |   |   |
| Derivatives subject to a master netting arrangement:            |  |   |   |  |   |   |
| Forward purchase contracts                                      | \$ 205                                 | \$  | \$ 205  | \$ 6,542                               | \$  | \$ 6,542  |
| Forward sale contracts  | 24,489                                 |   | 24,489  | 504                                    |   | 504   |
| Netting   |  | (19,393)  | (19,393)  |  | (6,787)   | (6,787)   |
|   | 24,694                                 | (19,393)  | 5,301   | 7,046                                  | (6,787)   | 259   |
| Derivatives not subject to a master netting arrangement - IRLCs | 1,410                                  |   | 1,410   | 2,203                                  |   | 2,203   |
| Total derivatives   | 26,104                                 | (19,393)  | 6,711   | 9,249                                  | (6,787)   | 2,462   |
| Mortgage loans sold under agreements to repurchase              | 825,267                                |   | 825,267   | 471,592                                |   | 471,592   |
|   | \$ 851,371                             | \$ (19,393)   | \$ 831,978  | \$ 480,841                             | \$ (6,787)  | \$ 474,054  |

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

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

|                                   | June 30, 2014   |   |                         | December 31, 2013                            |   |                         |            |
|-----------------------------------|---|---|-------------------------|--|---|-------------------------|------------|
|                                   | Net amount of liabilities in the consolidated balance sheet | Gross amount not offset in the consolidated balance sheet | Cash collateral pledged | Net amount in the consolidated balance sheet | Gross amount not offset in the consolidated balance sheet | Cash collateral pledged | Net amount |
|                                   | (in thousands)  |   |                         |  |   |                         |            |
| Interest rate lock commitments    | \$ 1,410  | \$  | \$                      | \$ 1,410                                     | \$ 2,203  | \$                      | \$ 2,203   |
| Bank of America, N.A.             | 206,715   | (206,581)   |                         | 134  | 234,511   | (234,511)               |            |
| Credit Suisse                     |   |   |                         |  |   |                         |            |
| First Boston Mortgage Capital LLC | 507,158   | (505,132)   |                         | 2,026  | 198,888   | (198,888)               |            |
| Morgan Stanley Bank, N.A.         | 113,604   | (113,554)   |                         | 50   | 38,193  | (38,193)                |            |
| Citibank, N.A.                    |   |   |                         |  |   |                         |            |
| Others                            | 3,091   |   |                         | 3,091  | 259   |                         | 259        |
|                                   | \$ 831,978  | \$ (825,267)  | \$                      | \$ 6,711                                     | \$ 474,054  | \$ (471,592)            | \$ 2,462   |

**Note 7 Fair Value**

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

*Fair Value Accounting Elections*

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

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

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

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

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

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

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





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|   | December 31, 2013 |            |            |            |
|---|-------------------|------------|------------|------------|
|   | Level 1           | Level 2    | Level 3    | Total      |
|   | (in thousands)    |            |            |            |
| <b>Assets:</b>  |                   |            |            |            |
| Short-term investments  | \$ 142,582        | \$         | \$         | \$ 142,582 |
| Mortgage loans held for sale at fair value  |                   | 527,071    | 3,933      | 531,004    |
| <b>Derivative assets:</b>   |                   |            |            |            |
| Interest rate lock commitments  |                   |            | 8,964      | 8,964      |
| Forward purchase contracts  |                   | 416        |            | 416        |
| Forward sales contracts   |                   | 18,762     |            | 18,762     |
| MBS put options   |                   | 665        |            | 665        |
| MBS call options  |                   | 91         |            | 91         |
| Total derivative assets before netting  |                   | 19,934     | 8,964      | 28,898     |
| Netting (1)   |                   |            |            | (7,358)    |
| Total derivative assets   |                   | 19,934     | 8,964      | 21,540     |
| Investment in PennyMac Mortgage Investment Trust  | 1,722             |            |            | 1,722      |
| Mortgage servicing rights at fair value   |                   |            | 224,913    | 224,913    |
|   | \$ 144,304        | \$ 547,005 | \$ 237,810 | \$ 921,761 |
| <b>Liabilities:</b>   |                   |            |            |            |
| Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust | \$                | \$         | \$ 138,723 | \$ 138,723 |
| <b>Derivative liabilities:</b>  |                   |            |            |            |
| Interest rate lock commitments  |                   |            | 2,203      | 2,203      |
| Forward purchase contracts  |                   | 6,542      |            | 6,542      |
| Forward sales contracts   |                   | 504        |            | 504        |
| Total derivative liabilities before netting   |                   | 7,046      | 2,203      | 9,249      |
| Netting (1)   |                   |            |            | (6,787)    |
| Total derivative liabilities  |                   | 7,046      | 2,203      | 2,462      |
|   | \$                | \$ 7,046   | \$ 140,926 | \$ 141,185 |

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

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As shown above, certain of the Company's mortgage loans held for sale, MSRs at fair value, IRLCs, and ESS financing at fair value are measured using Level 3 inputs. Following is a roll forward of these items for the quarters and six-month periods ended June 30, 2014 and 2013 where Level 3 significant inputs were used on a recurring basis:

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

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

(2) Mortgage loans held for sale transferred from Level 3 to Level 2 as the result of the mortgage loan becoming salable into active mortgage markets pursuant to a loan modification or borrower reperformance.

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

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Mortgage Investment Trust

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

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

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

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

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

(2) Mortgage loans held for sale transferred from Level 3 to Level 2 as the result of the mortgage loan becoming salable into active mortgage markets pursuant to a loan modification or borrower performance.

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

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

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

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

The Company had no transfers in or out among the levels other than transfers of IRLCs to mortgage loans held for sale at fair value upon purchase or funding of the respective mortgage loans.

Net gains (losses) from changes in estimated fair values included in earnings for financial statement items carried at fair value as a result of management's election of the fair value option are summarized below:

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



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

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

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

|                                      | Fair value   | June 30, 2014<br>Principal amount due upon maturity<br>(in thousands) | Difference |
|--------------------------------------|--------------|---|------------|
| <b>Mortgage loans held for sale:</b> |              |   |            |
| Current through 89 days delinquent   | \$ 784,173   | \$ 735,622  | \$ 48,551  |
| <b>90 days or more delinquent:</b>   |              |   |            |
| Not in foreclosure                   | 168,111      | 171,035   | (2,924)    |
| In foreclosure                       | 48,131       | 48,856  | (725)      |
|                                      | \$ 1,000,415 | \$ 955,513  | \$ 44,902  |

|                                      | Fair value | December 31, 2013<br>Principal amount due upon maturity<br>(in thousands) | Difference |
|--------------------------------------|------------|---|------------|
| <b>Mortgage loans held for sale:</b> |            |   |            |
| Current through 89 days delinquent   | \$ 524,665 | \$ 504,705  | \$ 19,960  |
| <b>90 days or more delinquent:</b>   |            |   |            |
| Not in foreclosure                   | 5,567      | 5,479   | 88         |
| In foreclosure                       | 772        | 660   | 112        |
|                                      | \$ 531,004 | \$ 510,844  | \$ 20,160  |

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

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

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

|  | Level 1 | Level 2 | December 31, 2013 |                | Total      |
|--|---------|---------|-------------------|----------------|------------|
|  |         |         | Level 3           | (in thousands) |            |
| Mortgage servicing rights at lower of amortized cost or fair value | \$      | \$      | \$                | 136,690        | \$ 136,690 |
|  | \$      | \$      | \$                | 136,690        | \$ 136,690 |

The following table summarizes the total gains (losses) on assets measured at fair values on a nonrecurring basis:

|  | Quarter ended June 30, |       | Six months ended June 30, |        |
|--|------------------------|-------|---------------------------|--------|
|  | 2014                   | 2013  | 2014                      | 2013   |
|  |                        |       | (in thousands)            |        |
| Mortgage servicing rights at lower of amortized cost or fair value | \$ (3,786)             | \$ 88 | \$ (4,207)                | \$ 643 |
|  | \$ (3,786)             | \$ 88 | \$ (4,207)                | \$ 643 |

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

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

*Cash* is measured using Level 1 significant inputs. The Company's borrowings carried at amortized cost do not have active markets or observable inputs and the fair value is measured using management's estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation. The Company has classified these financial instruments as Level 3 financial statement items as of June 30, 2014 and December 31, 2013 due to the lack of current market activity and the Company's reliance on unobservable inputs to estimate the fair value.

Management has concluded that the carrying value of the *Carried Interest due from Investment Funds* approximates its fair value as the balance represents the amount distributable to the Company at the balance sheet date assuming liquidation of the Investment Funds. Management has concluded that the fair value of the *Note payable* approximates the agreements' carrying value due to the agreement's short term and variable interest rate. The Company has classified these financial instruments as Level 3 financial statement items due to the lack of current market activity and the Company's reliance on unobservable inputs to estimate these instruments' fair value.

The Company also carries the receivable from and payable to the Advised Entities at cost. Management has concluded that the fair value of such balances approximates the carrying value due to the short terms of such balances.

### ***Valuation Techniques and Assumptions***

Most of the Company's financial assets, including its ESS, are carried at fair value with changes in fair value recognized in current period income. Certain of the Company's financial assets and all of its MSRs and ESS are Level 3 financial statement items which require the use of significant unobservable inputs in the estimation of the items' fair values. Unobservable inputs reflect the Company's own assumptions about the factors that market participants use in pricing an asset or liability, and are based on the best information available under the circumstances.

The Company's Financial Analysis and Valuation group (the FAV group), which is responsible for valuing and monitoring the Company's investment portfolios and maintenance of its valuation policies and procedures, estimates the fair values of Level 3 financial instruments and MSRs.

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

The FAV group is responsible for reporting to the Company's senior management valuation committee on a monthly basis on the changes in the valuation of the portfolio, including major factors affecting the valuation and any changes in model methods and inputs. To assess the reasonableness of its valuations, the FAV group presents an analysis of the effect on the valuation of changes to the significant inputs to the models.

Following is a description of the techniques and inputs used in estimating the fair values of Level 2 and Level 3 fair value financial statement items:

*Mortgage Loans Held for Sale*

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

Certain of the Company's mortgage loans may become non salable into active markets due to identification of a defect by the Company or to the repurchase of a mortgage loan with an identified defect. Because such mortgage loans are generally not salable into active mortgage markets, they are classified as Level 3 financial statement items. The Company may also purchase government guaranteed or insured mortgage loans from Ginnie Mae guaranteed pools in its servicing portfolio. The Company's right to purchase such loans arises as the result of the borrower's failure to make payments for three consecutive months preceding the month of repurchase by the Company and provides an alternative to the Company's obligation to continue advancing principal and interest at the coupon rate of the related Ginnie Mae security. To the extent such loans (early buyout loans) have not become salable into another Ginnie Mae guaranteed security by becoming current either through the borrower's reperformance or through completion of a modification of the loan's terms, the Company measures such loans using Level 3 inputs.

The significant unobservable inputs used in the fair value measurement of the Company's Level 3 mortgage loans held for sale at fair value are discount rates, home price projections, voluntary prepayment speeds and default speeds. Significant changes in any of those inputs in isolation could result in a significant change to the loans' fair value measurement. Increases in home price projections are generally accompanied by an increase in voluntary prepayment speeds.

Following is a quantitative summary of key inputs used in the valuation of mortgage loans held for sale at fair value valued using Level 3 inputs:

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

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

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

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

Changes in fair value attributable to changes in instrument specific credit risk are measured by the change in the respective loan's delinquency status at period end from the later of the beginning of the period or acquisition date. Changes in fair value of mortgage loans held for sale are included in *Net gains on mortgage loans held for sale at fair value* in the consolidated statements of income.

Table of Contents*Derivative Financial Instruments*

The Company categorizes IRLCs as a Level 3 financial statement item. The Company estimates the fair value of an IRLC based on quoted Agency mortgage-backed securities ( MBS ) prices, its estimate of the fair value of the MSR it expects to receive in the sale of the loans and the probability that the mortgage loan will fund or be purchased (the pull-through rate ).

The significant unobservable inputs used in the fair value measurement of the Company's IRLCs are the pull-through rate and the MSR component of the Company's estimate of the value of the mortgage loans it has committed to purchase. Significant changes in the pull-through rate or the MSR component of the IRLCs, in isolation, could result in significant changes in fair value measurement. The financial effects of changes in these assumptions are generally inversely correlated as increasing interest rates have a positive effect on the fair value of the MSR component of IRLC value, but increase the pull-through rate for loans that have decreased in fair value.

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

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

The Company estimates the fair value of commitments to sell loans based on quoted MBS prices. The Company estimates the fair value of the MBS options and futures it purchases based on observed interest rate volatilities in the MBS market. Changes in fair value of IRLCs and related hedging derivatives are included in *Net gains on mortgage loans held for sale at fair value* in the consolidated statements of income.

*Mortgage Servicing Rights*

MSRs are categorized as Level 3 fair value financial statement items. The Company uses a discounted cash flow approach to estimate the fair value of MSRs. This approach consists of projecting net servicing cash flows discounted at a rate that management believes market participants would use in their determinations of fair value. The key inputs used in the estimation of the fair value of MSRs include prepayment rates of the underlying loans, the applicable discount rate or pricing spread, and the per-loan annual cost to service the respective mortgage loans.

The results of the estimates of fair value of MSRs are reported to the Company's valuation committee as part of their review and approval of monthly valuation results. Changes in the fair value of MSRs are included in *Net servicing fees Amortization, impairment and change in*

*estimated fair value of mortgage servicing rights* in the consolidated statements of income.



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

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

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

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

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|   | Six months ended June 30,  |                         |                        |                        |
|---|--|-------------------------|------------------------|------------------------|
|   | 2014   |                         | 2013                   |                        |
|   | Fair value   | Amortized cost          | Fair value             | Amortized cost         |
|   | Range<br>(Weighted average)  |                         |                        |                        |
|   | (Amount recognized and unpaid principal balance of underlying mortgage loans in thousands) |                         |                        |                        |
| Amount recognized                                     | \$14,266   | \$72,908                | \$20                   | \$94,194               |
| Unpaid principal balance of underlying mortgage loans | \$1,111,663  | \$6,174,010             | \$423,355              | \$8,229,142            |
| Weighted-average servicing fee rate (in basis points) | 33   | 30                      | 25                     | 28                     |
| Pricing spread (1)                                    | 8.3% - 16.2%<br>(11.3)%  | 6.8% - 15.2%<br>(10.7)% | 6.4% - 9.6%<br>(7.2)%  | 5.4% - 12.5%<br>(8.2)% |
| Annual total prepayment speed (2)                     | 7.6% - 25.0%<br>(8.7)%   | 7.6% - 45.3%<br>(8.1)%  | 8.7% - 15.3%<br>(9.0)% | 8.5% - 18.5%<br>(8.8)% |
| Life (in years)                                       | 2.1 7.5<br>(7.1)   | 1.5 7.5<br>(7.1)        | 3.0 6.9<br>(6.7)       | 2.9 6.9<br>(6.7)       |
| Per-loan annual cost of servicing                     | \$53 \$100<br>\$(92)   | \$53 \$100<br>\$(94)    | \$68 \$68<br>\$(68)    | \$68 \$120<br>\$(102)  |

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

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

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Following is a quantitative summary of key inputs used in the valuation of the Company's MSR's at period end and the effect on the estimated fair value from adverse changes in those assumptions (weighted averages are based upon UPB):

*Purchased MSR's Backed by Distressed Mortgage Loans*

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

|   | June 30, 2014   | Range<br>(Weighted average) | December 31, 2013 |
|---|---|-----------------------------|-------------------|
|   | Fair<br>value   | Amortized<br>cost           | Fair<br>value     |
|   | (Carrying value, unpaid principal balance of underlying mortgage loans and effect on fair value amounts in thousands) |                             |                   |
| Carrying value  |   |                             | \$10,129          |
| Unpaid principal balance of underlying mortgage loans |   |                             | \$969,794         |
| Weighted-average note interest rate                   |   |                             | 5.80%             |
| Weighted-average servicing fee rate (in basis points) |   |                             | 50                |
| Discount rate   |   |                             | 15.3% 15.3%       |
|   |   |                             | (15.3)%           |
| Effect on fair value of:                              |   |                             |                   |
| 5% adverse change                                     |   |                             | \$(251)           |
| 10% adverse change                                    |   |                             | \$(490)           |
| 20% adverse change                                    |   |                             | \$(937)           |
| Life (in years)                                       |   |                             | 5.0 - 5.0         |
|   |   |                             | (5.0)             |
| Prepayment speed (1)                                  |   |                             | 11.4% 11.4%       |
|   |   |                             | (11.4)%           |
| Effect on fair value of:                              |   |                             |                   |
| 5% adverse change                                     |   |                             | \$(231)           |
| 10% adverse change                                    |   |                             | \$(456)           |
| 20% adverse change                                    |   |                             | \$(898)           |
| Per-loan annual cost of servicing                     |   |                             | \$218 \$218       |
|   |   |                             | \$(218)           |
| Effect on fair value of:                              |   |                             |                   |
| 5% adverse change                                     |   |                             | \$(197)           |
| 10% adverse change                                    |   |                             | \$(393)           |
| 20% adverse change                                    |   |                             | \$(787)           |

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



Table of Contents*All Other MSRs*

|   | June 30, 2014   |                | Range<br>(Weighted average) |                | December 31, 2013 |                |
|---|---|----------------|-----------------------------|----------------|-------------------|----------------|
|   | Fair value  | Amortized cost | Fair value                  | Amortized cost | Fair value        | Amortized cost |
|   | (Carrying value, unpaid principal balance of underlying mortgage loans and effect on fair value amounts in thousands) |                |                             |                |                   |                |
| Carrying value  | \$308,599   | \$313,082      |                             |                | \$214,784         | \$258,751      |
| Unpaid principal balance of underlying mortgage loans | \$29,694,503  | \$27,356,921   |                             |                | \$22,469,179      | \$22,499,847   |
| Weighted-average note interest rate                   | 4.29%   | 3.76%          |                             |                | 4.48%             | 3.65%          |
| Weighted-average servicing fee rate (in basis points) | 31  | 29             |                             |                | 32                | 29             |
| Pricing spread (1)                                    | 2.9% 20.3%  | 6.3% 15.4%     |                             |                | 2.9% 18.0%        | 6.3% 14.5%     |
|   | (9.0)%  | (9.9)%         |                             |                | (7.5)%            | (8.7)%         |
| Effect on fair value of:                              |   |                |                             |                |                   |                |
| 5% adverse change                                     | \$(5,347)   | \$(7,150)      |                             |                | \$(3,551)         | \$(5,312)      |
| 10% adverse change                                    | \$(10,506)  | \$(14,009)     |                             |                | \$(6,900)         | \$(10,395)     |
| 20% adverse change                                    | \$(20,302)  | \$(26,920)     |                             |                | \$(13,305)        | \$(20,039)     |
| Average life (in years)                               | 0.1 10.8  | 1.5 7.3        |                             |                | 0.1 14.4          | 1.5 7.3        |
|   | (5.9)   | (6.9)          |                             |                | (6.2)             | (7.0)          |
| Prepayment speed (2)                                  | 7.6% 67.0%  | 7.6% 45.1%     |                             |                | 7.8% 50.8%        | 7.6% 42.5%     |
|   | (10.2)%   | (8.2)%         |                             |                | (9.7)%            | (8.0)%         |
| Effect on fair value of:                              |   |                |                             |                |                   |                |
| 5% adverse change                                     | \$(6,663)   | \$(5,398)      |                             |                | \$(4,622)         | \$(4,615)      |
| 10% adverse change                                    | \$(13,082)  | \$(10,642)     |                             |                | \$(9,073)         | \$(9,097)      |
| 20% adverse change                                    | \$(25,243)  | \$(20,696)     |                             |                | \$(17,500)        | \$(17,684)     |
| Per-loan annual cost of servicing                     | \$61 \$115  | \$61 \$93      |                             |                | \$68 \$115        | \$68 \$100     |
|   | \$(86)  | \$(92)         |                             |                | \$(87)            | \$(99)         |
| Effect on fair value of:                              |   |                |                             |                |                   |                |
| 5% adverse change                                     | \$(3,341)   | \$(2,859)      |                             |                | \$(2,817)         | \$(2,609)      |
| 10% adverse change                                    | \$(6,682)   | \$(5,719)      |                             |                | \$(5,633)         | \$(5,217)      |
| 20% adverse change                                    | \$(13,365)  | \$(11,437)     |                             |                | \$(11,266)        | \$(10,434)     |

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

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

The preceding sensitivity analyses are limited in that they were performed at a particular point in time; only contemplate the movements in the indicated variables; do not incorporate changes to other variables; are subject to the accuracy of various models and assumptions used; and do

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not incorporate other factors that would affect the Company's overall financial performance in such scenarios, including operational adjustments made by management to account for changing circumstances. For these reasons, the preceding estimates should not be viewed as earnings forecasts.

Table of Contents*Excess Servicing Spread Financing at Fair Value*

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

ESS is generally subject to fair value losses when mortgage interest rates increase. Increasing mortgage interest rates normally slow mortgage refinancing activity. Decreased refinancing activity increases the life of the loans underlying the ESS, thereby increasing ESS financing's fair value and the liability owed to PMT. Increases in the fair value of ESS financing increase *Amortization, impairment and change in estimated fair value of mortgage servicing rights*.

Interest expense for ESS financing is accrued using the interest method based upon the expected cash flows from the ESS through the expected life of the underlying mortgage loans. Other changes in fair value are recorded in *Amortization, impairment and change in estimated fair value of mortgage servicing rights*.

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

|   | June 30,<br>2014            | December 31,<br>2013 |
|---|-----------------------------|----------------------|
| Key inputs  | Range<br>(Weighted average) |                      |
| Unpaid principal balance of underlying loans (in thousands) | \$27,445,826                | \$20,512,659         |
| Average servicing fee rate (in basis points)                | 31                          | 32                   |
| Average excess servicing spread (in basis points)           | 16                          | 16                   |
| Pricing spread (1)  | 1.7% - 14.6%                | 2.8% - 14.4%         |
|   | (5.1)%                      | (5.4)%               |
| Average life (in years)                                     | 0.5 - 7.3                   | 0.9 - 8.0            |
|   | (5.9)                       | (6.1)                |
| Annualized prepayment speed (2)                             | 7.6% - 67.0%                | 7.7% - 48.6%         |
|   | (10.3)%                     | (9.7)%               |

(1) Pricing spread represents a margin that is applied to a reference interest rate's forward rate curve to develop periodic discount rates. The Company applies a pricing spread to the United States LIBOR curve for purposes of discounting cash flows relating to ESS.

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

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

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

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



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The Company is exposed to fair value risk relative to its mortgage loans held for sale as well as to its IRLCs and MSRs. The Company bears fair value risk from the time an IRLC is made to PMT or a loan applicant to the time the mortgage loan is sold. The Company is exposed to loss in fair value of its IRLCs and mortgage loans held for sale when mortgage rates increase. The Company is exposed to loss in fair value of its MSRs when interest rates decrease.

The Company engages in interest rate risk management activities in an effort to reduce the variability of earnings caused by changes in market interest rates. To manage this fair value risk resulting from interest rate risk, the Company uses derivative financial instruments acquired with the intention of reducing the risk that changes in market interest rates will result in unfavorable changes in the value of the Company's IRLCs, inventory of mortgage loans held for sale and MSRs.

The Company does not use derivative financial instruments for purposes other than in support of its risk management activities other than IRLCs, which are generated in the normal course of business when the Company commits to purchase or originate mortgage loans held for sale. The Company records all derivative financial instruments at fair value and records changes in fair value in current period income.

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

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

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

Quarter ended June 30, 2014

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

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

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

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

The Company recorded net losses on derivative financial instruments used to hedge IRLCs and mortgage loans held for sale at fair value totaling \$38.8 million and \$58.8 million for the quarter and six months ended June 30, 2014, respectively. The Company recorded net gains on derivative financial instruments totaling \$94.2 million and \$106.5 million for the quarter and six months ended June 30, 2013, respectively. Derivative gains and losses used to hedge IRLCs and mortgage loans held for sale at fair value are included in *Net gains on mortgage loans held for sale at fair value* in the Company's consolidated statements of income.

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The Company recorded net gains on derivatives used to hedge fair value changes of MSRs totaling \$9.6 million and \$9.2 million for the quarter and six months ended June 30, 2014, respectively. Gains and losses on derivative financial instruments used to hedge fair value changes of MSRs are included in *Amortization, impairment and change in estimated fair value of mortgage servicing rights* in the Company's consolidated statements of income.

**Note 10 Mortgage Servicing Assets and Liabilities*****MSRs Carried at Fair Value:***

The activity in MSRs carried at fair value is as follows:

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

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

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

Table of Contents**MSRs Carried at Lower of Amortized Cost or Fair Value:**

The activity in MSRs carried at the lower of amortized cost or fair value is summarized below:

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

The following table summarizes the Company's estimate of future amortization of its existing MSRs. This projection was developed using the assumptions made by management in its June 30, 2014 valuation of MSRs. The assumptions underlying the following estimate will change as market conditions and portfolio composition and behavior change, causing both actual and projected amortization levels to change over time.

| Twelve-month period ending June 30, | Estimated MSR<br>amortization<br>(in thousands) |
|-------------------------------------|---|
| 2015                                | \$ 29,778                                       |
| 2016                                | 29,470  |
| 2017                                | 28,727  |
| 2018                                | 27,440  |
| 2019                                | 25,502  |
| Thereafter                          | 180,994   |
|                                     | \$ 321,911                                      |

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Servicing fees relating to MSRs are recorded in *Net servicing fees - Loan servicing fees - From non-affiliates* on the consolidated statements of income; late charges and other ancillary fees are recorded in *Net servicing fees - Loan servicing fees - Ancillary and other fees* on the consolidated statements of income and are summarized below:

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

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

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

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

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

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

**Note 11 Carried Interest Due from Investment Funds**

The activity in the Company's Carried Interest due from Investment Funds is summarized as follows:

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

The amount of the Carried Interest received by the Company depends on the Investment Funds' future performance. As a result, the amount of Carried Interest recorded by the Company at period end is subject to adjustment based on future results of the Investment Funds and may be reduced in future years. However, the Company is not required to pay guaranteed returns to the Investment Funds and the amount of any reduction to Carried Interest will be limited to the extent of amounts previously recognized.

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

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

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

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

**Note 13 Borrowings**

As of June 30, 2014, the Company maintained five borrowing facilities: four facilities that provide for sales of mortgage loans under agreements to repurchase; and one note payable secured by MSRs and servicing advances made relating to certain loans in the Company's loan servicing portfolio.

***Mortgage Loans Sold Under Agreement to Repurchase***

The borrowing facilities secured by mortgage loans held for sale are in the form of loan sale and repurchase agreements. Eligible loans are sold at advance rates based on the loan type. Interest is charged at a rate based on the buyer's overnight cost-of funds rate for one agreement and based on LIBOR for the other three agreements. Loans sold under these agreements may be re-pledged by the lenders.

Financial data pertaining to mortgage loans sold under agreements to repurchase are as follows:

|  | Quarter ended June 30, | Six months ended June 30, |
|--|------------------------|---------------------------|
|  | 2014                   | 2013                      |



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(in thousands)

|  |    |         |    |         |                       |
|--|----|---------|----|---------|-----------------------|
| Period end:  |    |         |    |         |                       |
| Balance  | \$ | 825,267 | \$ | 500,427 |                       |
| Unused amount (1)  | \$ | 674,733 | \$ | 299,573 |                       |
| Weighted average interest rate                               |    | 1.85%   |    | 1.93%   |                       |
| Fair value of loans securing agreements to repurchase        |    |         |    |         |                       |
|  | \$ | 997,506 | \$ | 646,944 |                       |
| During the period:   |    |         |    |         |                       |
| Average balance of loans sold under agreements to repurchase |    |         |    |         |                       |
|  | \$ | 527,990 | \$ | 412,849 | \$ 410,196 \$ 344,335 |
| Weighted average interest rate (2)                           |    | 1.83%   |    | 1.98%   | 1.81% 2.09%           |
| Total interest expense                                       | \$ | 3,682   | \$ | 2,956   | \$ 6,011 \$ 5,331     |
| Maximum daily amount outstanding                             | \$ | 873,301 | \$ | 623,523 | \$ 873,301 \$ 623,523 |

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

(2) Excludes the effect of amortization of commitment fees totaling \$1.2 million and \$891,000 for the quarters ended June 30, 2014 and 2013, respectively, and \$2.3 million and \$1.7 million for the six month-periods ended June 30, 2014 and 2013, respectively.

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

| Remaining maturity at June 30, 2014   | Balance<br>(in thousands) |
|---------------------------------------|---------------------------|
| Within 30 days                        | \$ 74,716                 |
| Over 30 to 90 days                    | 746,130                   |
| Over 90 days                          | 4,421                     |
|                                       | \$ 825,267                |
| Weighted average maturity (in months) | 2.2                       |

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

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

The Company is subject to margin calls during the period the agreements are outstanding and therefore may be required to repay a portion of the borrowings before the respective agreements mature if the fair value (as determined by the applicable lender) of the mortgage loans securing those agreements decreases. The Company had \$1.5 million on deposit with its mortgage loan repurchase agreement counterparties at June 30, 2014 and December 31, 2013. Such amounts are included in *Other assets* on the consolidated balance sheets.

**Note Payable**

The note payable is summarized below:

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

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|                    |    |    |       |
|--------------------|----|----|-------|
| Servicing advances | \$ | \$ | 5,564 |
|--------------------|----|----|-------|

The note payable matures on October 31, 2014. Interest is charged at a rate based on the lender's overnight cost of funds. The note payable is secured by servicing advances and MSR's relating to certain loans in the Company's servicing portfolio, and currently provides for advance rates ranging from 50% to 85% of the amount of the servicing advances or the carrying value of the MSR pledged.

The borrowing facilities contain various covenants, including financial covenants governing the Company's net worth, debt to equity ratio, profitability and liquidity. Management believes that the Company was in compliance with these requirements as of June 30, 2014.

Table of Contents*Excess Servicing Spread Financing*

In conjunction with the Company's purchase from non-affiliates of certain MSRs on pools of Agency-backed residential mortgage loans, the Company has entered into sale and assignment agreements which are treated as financings and are carried at fair value with changes in fair value recognized in current period income. Under these agreements, the Company sold to PMT the right to receive ESS cash flows relating to certain MSRs. The Company retained all ancillary income associated with servicing the loans and a fixed base servicing fee. The Company continues to be the servicer of the mortgage loans and provides all servicing functions, including responsibility to make servicing advances.

Following is a summary of ESS:

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

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

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

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

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

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

**Note 15 Stockholders Equity**

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

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

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

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

**Note 17 Net Interest Expense**

Net interest expense is summarized below:

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

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

**Note 18 Stock-based Compensation**

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

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

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

Following is a summary of equity awards:

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

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

**Note 19 Income Taxes**

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

**Note 20 Supplemental Cash Flow Information**



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

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

Table of Contents**Note 21 Regulatory Net Worth and Agency Capital Requirements**

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

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

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

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

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

**Note 22 Commitments and Contingencies*****Litigation***

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

***Commitments to Fund and Sell Mortgage Loans***

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

**Note 23 Segments and Related Information**

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

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

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

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

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

Financial highlights by segment are as follows:

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

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

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

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

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

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



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

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

**Note 24 Recently Issued Accounting Pronouncements**

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

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

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

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

### **Note 25 Subsequent Events**

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

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



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

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

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

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

***Overview***

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

***Initial Public Offering and Recapitalization***

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

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

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

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

### ***Our Company***

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

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

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

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

***Mortgage Banking***

***Production***

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

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

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

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

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

***Servicing***

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

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

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

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

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

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

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

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

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

Mortgage lenders originated an estimated \$295 billion of home loans during the quarter ended June 30, 2014, down 52.9% from the quarter ended June 30, 2013. Mortgage originations are forecast to continue to decline, with current industry estimates for 2014 totaling \$1.1 trillion compared to \$1.9 trillion for 2013 (Source: Average of Fannie Mae, Freddie Mac and Mortgage Bankers Association forecasts).

In recent periods, we have seen increased competition from new and existing market participants in the correspondent production business, 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 correspondent and retail production margins in recent periods, which is reflected in our results of operations in our gains on mortgage loans acquired for sale. During the first several months of 2013, gains on mortgage loans acquired for sale benefited from wider secondary spreads (the difference between interest rates charged to borrowers and yields on mortgage-backed securities in the secondary market); however, secondary spreads narrowed in subsequent months and we expect them to continue to normalize toward their long-term averages in 2014.

We believe there is significant long-term market opportunity in non-Agency jumbo mortgage loans. Pricing for non-Agency AAA rated bonds has steadily improved since the beginning of the year, however liquidity is fairly limited. During the six months ended June 30, 2014, prime jumbo MBS issuance totaled \$2.1 billion in unpaid principal balance ( UPB ) compared to \$7.9 billion during the six months ended June 30, 2013. During the six months ended June 30, 2014, we fulfilled for PMT approximately \$93.4 million in UPB of jumbo loans, compared to \$115.5 million in UPB of jumbo loans fulfilled for PMT during the six months ended June 30, 2013.

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 second quarter of 2014, we reviewed 57 mortgage loan pools with UPB totaling approximately \$18.2 billion. This compares to our review of 36 mortgage loan pools with UPB totaling approximately \$11.1 billion and one pool of real estate acquired in settlement of

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loans totaling approximately \$108 million during the second quarter of 2013. During the quarter and six months ended June 30, 2014, we acquired for PMT distressed loans with fair value totaling \$27.2 million and \$287.5 million, respectively, and \$242.7 million and \$443.2 million, respectively, during the same periods in 2013. While we expect to see a continued supply of distressed whole loans, we believe the pricing for recent transactions has been less attractive for buyers. We remain patient and selective for PMT in making new investments in distressed whole loans and we continue to monitor the market to assess best execution opportunities for distressed portfolio investments held by the Advised Entities.

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Our results of operations are summarized below:

|   | Quarter ended June 30, |                     | Six months ended June 30, |                     |
|---|------------------------|---------------------|---------------------------|---------------------|
|   | 2014                   | 2013                | 2014                      | 2013                |
|   | (in thousands)         |                     |                           |                     |
| <b>Revenue</b>  |                        |                     |                           |                     |
| Net gains on mortgage loans held for sale at fair value   | \$ 39,704              | \$ 42,654           | \$ 74,242                 | \$ 82,611           |
| Loan origination fees   | 10,345                 | 6,312               | 17,225                    | 11,980              |
| Fulfillment fees from PennyMac Mortgage Investment Trust  | 12,433                 | 22,054              | 21,335                    | 50,298              |
| Net loan servicing fees   | 56,969                 | 22,069              | 100,733                   | 38,111              |
| Management fees   | 10,998                 | 10,429              | 21,107                    | 18,835              |
| Carried Interest from Investment Funds  | 1,834                  | 2,862               | 3,991                     | 7,599               |
| Net interest expense  | (2,480)                | 274                 | (4,756)                   | (1,313)             |
| Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust  | (103)                  | (320)               | 12                        | (233)               |
| Other   | 735                    | 243                 | 2,038                     | 1,057               |
| <b>Total net revenue</b>  | <b>130,435</b>         | <b>106,577</b>      | <b>235,927</b>            | <b>208,945</b>      |
| Total expenses  | 72,388                 | 56,348              | 128,819                   | 103,423             |
| Provision for income taxes  | 6,630                  | 2,038               | 12,153                    | 2,038               |
| <b>Net income</b>   | <b>\$ 51,417</b>       | <b>\$ 48,191</b>    | <b>\$ 94,955</b>          | <b>\$ 103,484</b>   |
| <b>Income before provision for income taxes by segment:</b>   |                        |                     |                           |                     |
| <b>Mortgage banking:</b>  |                        |                     |                           |                     |
| Production  | \$ 32,761              | \$ 37,843           | \$ 58,715                 | \$ 82,189           |
| Servicing   | 19,959                 | 4,799               | 37,072                    | 6,443               |
| <b>Total mortgage banking</b>   | <b>52,720</b>          | <b>42,642</b>       | <b>95,787</b>             | <b>88,632</b>       |
| Investment management   | 5,327                  | 7,587               | 11,321                    | 16,890              |
|   | \$ 58,047              | \$ 50,229           | \$ 107,108                | \$ 105,522          |
| <b>During the period:</b>   |                        |                     |                           |                     |
| Interest rate lock commitments issued   | \$ 4,749,012           | \$ 4,883,672        | \$ 8,289,907              | \$ 8,580,236        |
| <b>Mortgage loans purchased and originated for sale:</b>  |                        |                     |                           |                     |
| Government-insured or guaranteed loans acquired from PennyMac Mortgage Investment Trust at fair value | \$ 3,955,329           | \$ 4,733,767        | \$ 7,085,859              | \$ 8,282,163        |
| Retail production at fair value, net  | 410,125                | 344,840             | 728,430                   | 612,966             |
|   | \$ 4,365,454           | \$ 5,078,607        | \$ 7,814,289              | \$ 8,895,129        |
| <b>Unpaid principal balance of mortgage loans fulfilled for PennyMac Mortgage Investment Trust</b>    | <b>\$ 2,991,764</b>    | <b>\$ 4,323,885</b> | <b>\$ 4,911,342</b>       | <b>\$ 9,110,711</b> |
| <b>At period end:</b>   |                        |                     |                           |                     |
| <b>Unpaid principal balance of mortgage loan servicing portfolio:</b>                                 |                        |                     |                           |                     |
| Mortgage servicing rights owned   | \$ 57,051,424          | \$ 18,242,514       |                           |                     |
| Subserviced   | 35,554,830             | 25,509,373          |                           |                     |

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|                                    |               |               |
|------------------------------------|---------------|---------------|
| Mortgage loans held for sale       | 959,014       | 653,789       |
|                                    | \$ 93,565,268 | \$ 44,405,676 |
| Net assets of Advised Entities     |               |               |
| PennyMac Mortgage Investment Trust | \$ 1,577,160  | \$ 1,244,181  |
| Investment Funds                   | 565,926       | 561,790       |
|                                    | \$ 2,143,086  | \$ 1,805,971  |



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*Comparison of the quarters and six months ended June 30, 2014 and 2013*

Net income increased by approximately \$3.2 million or 7% for the quarter ended June 30, 2014 and decreased by approximately \$8.5 million or 8% for the six months ended June 30, 2014 when compared to the same periods in 2013. The increase in net income from the quarter ended June 30, 2013 to the quarter ended June 30, 2014 is primarily due to increased loan servicing fee income resulting from the growth in our mortgage loan servicing portfolio. Our servicing portfolio increased from \$44.4 billion at June 30, 2013 to \$93.6 billion at June 30, 2014. The decrease in net income from the six months ended June 30, 2013 to the six months ended June 30, 2014 is primarily due to the effects of the contraction in the mortgage loan origination market, partially offset by growth in our mortgage loan servicing portfolio. Our mortgage loan production decreased by \$1.1 billion or 12% for the six months ended June 30, 2014 when compared to the six months ended June 30, 2013.

*Net gains on mortgage loans held for sale at fair value*

During the quarter and six months ended June 30, 2014, we recognized net gains on mortgage loans held for sale at fair value totaling \$39.7 million and \$74.2 million, respectively. This compares to net gains on mortgage loans held for sale at fair value totaling \$42.7 million and \$82.6 million, respectively, for the quarter and six months ended June 30, 2013. The decrease in net gains on mortgage loans held for sale at fair value was due to the effect of increasing price competition in the mortgage loan origination market, which had a negative effect on our margins, and, to a lesser extent, a reduction in the volume of mortgage loan sales during the period. The net gain for the quarter and six months ended June 30, 2014 included \$49.7 million and \$87.2 million, respectively, in fair value of MSRs received as part of proceeds on sales, net of MSR recapture payable to PMT. The net gain for the quarter and six months ended June 30, 2013 included \$52.5 million and \$94.2 million, respectively, in fair value of MSRs received as part of proceeds on sales, net of MSR recapture payable to PMT.

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Our gains on mortgage loans held for sale are summarized below:

|  | Quarter ended June 30, |              | Six months ended June 30, |              |
|--|------------------------|--------------|---------------------------|--------------|
|  | 2014                   | 2013         | 2014                      | 2013         |
|  | (in thousands)         |              |                           |              |
| <b>Cash (loss) gain:</b>   |                        |              |                           |              |
| Sales proceeds   | \$ 10,241              | \$ (43,318)  | \$ 14,722                 | \$ (55,141)  |
| Hedging activities   | (25,549)               | 22,260       | (35,805)                  | 39,881       |
|  | (15,308)               | (21,058)     | (21,083)                  | (15,260)     |
| <b>Non-cash gain:</b>  |                        |              |                           |              |
| Mortgage servicing rights received as proceeds from mortgage loan sales                            | 49,660                 | 52,478       | 87,174                    | 94,214       |
| Mortgage servicing rights recapture payable to PennyMac Mortgage Investment Trust                  | (2,526)                | (367)        | (4,424)                   | (499)        |
| Provision for losses relating to representations and warranties on loans sold                      | (1,204)                | (1,453)      | (2,055)                   | (2,697)      |
| <b>Change in fair value relating to mortgage loans and hedging derivatives held at period end:</b> |                        |              |                           |              |
| Interest rate lock commitments   | 15,453                 | (41,647)     | 22,989                    | (40,150)     |
| Mortgage loans   | 6,830                  | (17,241)     | 14,658                    | (19,634)     |
| Hedging derivatives  | (13,201)               | 71,942       | (23,017)                  | 66,637       |
|  | \$ 39,704              | \$ 42,654    | \$ 74,242                 | \$ 82,611    |
| <b>During the period:</b>  |                        |              |                           |              |
| Unpaid principal balance of mortgage loans sold  | \$ 4,510,460           | \$ 4,377,043 | \$ 7,654,026              | \$ 8,236,132 |
| <b>Interest rate lock commitments issued, net of cancellations:</b>                                |                        |              |                           |              |
| Conventional mortgage loans  | \$ 139,871             | \$ 288,020   | \$ 204,915                | \$ 491,766   |
| Government-insured or guaranteed loans   | 4,609,141              | 4,595,652    | 8,084,992                 | 8,088,470    |
|  | \$ 4,749,012           | \$ 4,883,672 | \$ 8,289,907              | \$ 8,580,236 |
| <b>Period end:</b>   |                        |              |                           |              |
| Mortgage loans held for sale at fair value   | \$ 1,000,415           | \$ 656,341   |                           |              |
| Commitments to fund and purchase mortgage loans  | \$ 1,754,845           | \$ 1,767,314 |                           |              |
| <b>Increase (decrease) in net gains on mortgage loans held for sale at fair value due to:</b>      |                        |              |                           |              |
| Net change in fair value of interest rate lock commitments   | \$ 57,099              | \$ (46,268)  | \$ 63,138                 | \$ (44,955)  |
| Volume of mortgage loans sold  | 2,511                  | 35,344       | (8,100)                   | 83,283       |
| Gain margin  | (62,560)               | 38,788       | (63,407)                  | 15,556       |
| Total change   | \$ (2,950)             | \$ 27,864    | \$ (8,369)                | \$ 53,884    |

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 loan production 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 upon 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 market 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

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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.

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

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

We receive non-cash proceeds on sale of mortgage loans in the form of MSRs. 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 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 fees* 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, excluding MSR purchases:

|   | 2014   |                         | Quarter ended June 30, 2013 |                        |
|---|--|-------------------------|-----------------------------|------------------------|
|   | Fair value   | Amortized cost          | Fair value                  | Amortized cost         |
|   | Range<br>(Weighted average)  |                         |                             |                        |
|   | (Amount recognized and unpaid principal balance of underlying mortgage loans in thousands) |                         |                             |                        |
| Amount recognized                                     | \$7,333  | \$42,327                | \$17                        | \$52,461               |
| Unpaid principal balance of underlying mortgage loans | \$600,196  | \$3,550,411             | \$423,031                   | \$4,372,786            |
| Weighted-average servicing fee rate (in basis points) | 33   | 30                      | 25                          | 29                     |
| Pricing spread (1)                                    | 8.3% - 16.2%<br>(11.5)%  | 6.8% - 15.2%<br>(10.9)% | 6.4% - 9.6%<br>(7.2)%       | 5.4% - 12.4%<br>(8.0)% |
|   | 7.6% - 25.0%   | 7.6% - 43.6%            | 8.7% - 15.3%                | 8.5% - 18.5%           |

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Annual total prepayment speed

|                                   |            |  |            |  |           |
|-----------------------------------|------------|--|------------|--|-----------|
| (2)                               |            |  |            |  |           |
|                                   | (8.8)%     |  | (8.2)%     |  | (9.0)%    |
| Life (in years)                   | 2.1 7.5    |  | 1.5 7.3    |  | 3.0 6.9   |
|                                   | (7.0)      |  | (7.1)      |  | (6.7)     |
| Per-loan annual cost of servicing | \$53 \$100 |  | \$53 \$100 |  | \$68 \$68 |
|                                   | \$(88)     |  | \$(90)     |  | \$(68)    |
|                                   |            |  |            |  | \$(103)   |

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|  | Six months ended June 30,   |                         |                             |                        |
|--|-----------------------------|-------------------------|-----------------------------|------------------------|
|  | 2014                        |                         | 2013                        |                        |
|  | Range<br>(Weighted average) |                         | Range<br>(Weighted average) |                        |
|  | Fair value                  | Amortized cost          | Fair value                  | Amortized cost         |
| (Amount recognized and unpaid principal balance of underlying mortgage loans in thousands) |                             |                         |                             |                        |
| Amount recognized  | \$14,266                    | \$72,908                | \$20                        | \$94,194               |
| Unpaid principal balance of underlying mortgage loans                                      | \$1,111,663                 | \$6,174,010             | \$423,355                   | \$8,229,142            |
| Weighted-average servicing fee rate (in basis points)                                      | 33                          | 30                      | 25                          | 28                     |
| Pricing spread (1)   | 8.3% - 16.2%<br>(11.3)%     | 6.8% - 15.2%<br>(10.7)% | 6.4% - 9.6%<br>(7.2)%       | 5.4% - 12.5%<br>(8.2)% |
| Annual total prepayment speed (2)  | 7.6% - 25.0%<br>(8.7)%      | 7.6% - 45.3%<br>(8.1)%  | 8.7% - 15.3%<br>(9.0)%      | 8.5% - 18.5%<br>(8.8)% |
| Life (in years)  | 2.1 7.5<br>(7.1)            | 1.5 7.5<br>(7.1)        | 3.0 6.9<br>(6.7)            | 2.9 6.9<br>(6.7)       |
| Per-loan annual cost of servicing  | \$53 \$100<br>\$(92)        | \$53 \$100<br>\$(94)    | \$68 \$68<br>\$(68)         | \$68 \$120<br>\$(102)  |

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

(2) Annual total prepayment speed is measured using Life Total Conditional Prepayment Rate (CPR).

We also provide for our estimate of the losses that we may be required to incur in the future 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.

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

Quarter ended June 30,

Six months ended June 30,

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

During the six months ended June 30, 2014, we repurchased mortgage loans with unpaid balances totaling \$1.9 million. We recorded no losses as a result of these repurchases. As the outstanding balance of loans we purchase and sell subject to representations and warranties increases and the loans sold begin to 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,

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change, and as the mortgage market and general economic changes affect our correspondent lenders, the level of repurchase activity and ensuing losses will change, which may be material to us.

We establish a liability at the time loans are sold and periodically update our liability estimate. 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. The level of our liability for representations and warranties is approved by our senior management credit committee on a quarterly basis.

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

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

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, correspondent lender repurchase performance 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 UPB 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 production and consumer-direct 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 \$4.0 million and \$5.2 million, respectively, in the quarter and six months ended June 30, 2014 compared to the same periods in 2013. The increase was due to increases in certain fees we charge in our loan production activities.



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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. Fulfillment fees decreased \$9.6 million and \$29.0 million, respectively, in the quarter and six months ended June 30, 2014 compared to the same periods in 2013. The decreases are due to decreases in the volume of mortgage loans we fulfilled on behalf of PMT and strategic reductions in the fulfillment fee rate charged to PMT. The loan fulfillment fees are calculated as a percentage of the UPB of the mortgage loans we fulfill for PMT. Summarized below are our fulfillment fees:

|   | Quarter ended June 30, |              | Six months ended June 30, |              |
|---|------------------------|--------------|---------------------------|--------------|
|   | 2014                   | 2013         | 2014                      | 2013         |
|   | (in thousands)         |              |                           |              |
| Fulfillment fee revenue                     | \$ 12,433              | \$ 22,054    | \$ 21,335                 | \$ 50,298    |
| Unpaid principal balance of loans fulfilled | \$ 2,991,764           | \$ 4,323,885 | \$ 4,911,342              | \$ 9,110,711 |

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Our net servicing fees are summarized below:

|  | Quarter ended June 30, |                  | Six months ended June 30, |                  |
|--|------------------------|------------------|---------------------------|------------------|
|  | 2014                   | 2013             | 2014                      | 2013             |
|  | (in thousands)         |                  |                           |                  |
| <b>Net servicing fees:</b>   |                        |                  |                           |                  |
| <b>Loan servicing fees</b>   |                        |                  |                           |                  |
| From non-affiliates  | \$ 43,314              | \$ 11,744        | \$ 79,414                 | \$ 20,801        |
| From PennyMac Mortgage Investment Trust  | 14,180                 | 8,787            | 28,771                    | 16,513           |
| From Investment Funds  | 4,161                  | 2,066            | 5,638                     | 4,074            |
| Ancillary and other fees   | 4,838                  | 2,662            | 9,989                     | 4,923            |
|  | 66,493                 | 25,259           | 123,812                   | 46,311           |
| Amortization, impairment and change in estimated fair value of mortgage servicing rights | (9,524)                | (3,190)          | (23,079)                  | (8,200)          |
| <b>Net servicing fees</b>  | <b>\$ 56,969</b>       | <b>\$ 22,069</b> | <b>\$ 100,733</b>         | <b>\$ 38,111</b> |

Following is a summary of our loan servicing portfolio:

|  | June 30, 2014        | December 31, 2013    |
|--|----------------------|----------------------|
|  | (in thousands)       |                      |
| <b>Loans serviced at period end:</b>         |                      |                      |
| <b>Prime servicing:</b>                      |                      |                      |
| Subserviced for Advised Entities             | \$ 31,169,742        | \$ 26,788,479        |
| Owned mortgage servicing rights Originated   | 29,546,095           | 22,499,847           |
| Owned mortgage servicing rights Acquisitions | 27,505,329           | 22,469,179           |
| Mortgage loans held for sale                 | 959,014              | 506,540              |
| <b>Total prime servicing</b>                 | <b>89,180,180</b>    | <b>72,264,045</b>    |
| <b>Special servicing:</b>                    |                      |                      |
| Subserviced for Advised Entities             | 4,385,088            | 4,844,239            |
| Owned mortgage servicing rights Acquisitions |                      | 969,794              |
| Subserviced for non-affiliates               |                      | 89,361               |
| <b>Total special servicing</b>               | <b>4,385,088</b>     | <b>5,903,394</b>     |
| <b>Total loans serviced</b>                  | <b>\$ 93,565,268</b> | <b>\$ 78,167,439</b> |

During the quarter and six months ended June 30, 2014, net loan servicing fees increased \$34.9 million and \$62.6 million, respectively, when compared to the same periods in 2013. The increase in the quarter ended June 30, 2014 was primarily due to an increase of \$31.6 million in loan servicing fees from non-affiliates due to growth in our portfolio of loans serviced as a result of our purchases of MSRs and ongoing sales of mortgage loans with servicing rights retained, partially offset by the sale of a portfolio of MSRs backed by distressed mortgage loans; an increase of \$5.4 million in loan servicing fees from PMT primarily due to activity-based fees relating to the sale of mortgage loans and growth in the volume of loans we service; an increase in loan servicing fees net of mortgage servicing rebate from the Investment Funds of \$2.1 million due to activity-based fees relating to the sale of mortgage loans from the Investment Funds portfolios; and an increase of \$2.2 million in ancillary fees due to growth in the portfolios of mortgage loans serviced.



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

|   | Quarter ended June 30, |            | Six months ended June 30, |            |
|---|------------------------|------------|---------------------------|------------|
|   | 2014                   | 2013       | 2014                      | 2013       |
|   | (in thousands)         |            |                           |            |
| <b>Effect of mortgage servicing rights:</b>   |                        |            |                           |            |
| Amortization and realization of cash flows  | \$ (16,729)            | \$ (5,235) | \$ (31,268)               | \$ (9,420) |
| Change in fair value and (provision for) reversal of impairment of mortgage servicing rights carried at lower of amortized cost or fair value | (12,474)               | 2,045      | (15,851)                  | 2,511      |
| Change in fair value of excess servicing spread financing   | 10,062                 |            | 14,854                    |            |
| Hedging gains (losses)  | 9,617                  |            | 9,186                     | (1,291)    |
| Total amortization, impairment and change in estimated fair value of mortgage servicing rights  | \$ (9,524)             | \$ (3,190) | \$ (23,079)               | \$ (8,200) |
| <b>Ending mortgage servicing rights:</b>  |                        |            |                           |            |
| At lower of amortized cost or fair value  | \$ 313,082             | \$ 176,668 |                           |            |
| At fair value   | 308,599                | 23,070     |                           |            |
|   | \$ 621,681             | \$ 199,738 |                           |            |
| <b>Average MSR balances:</b>  |                        |            |                           |            |
| At lower of amortized cost or fair value  | \$ 297,663             | \$ 152,009 | \$ 284,241                | \$ 130,594 |
| At fair value   | \$ 263,238             | \$ 19,279  | \$ 244,102                | \$ 19,415  |

Amortization, impairment and change in estimated fair value of mortgage servicing rights increased \$6.3 million and \$14.9 million, respectively, for the quarter and six months ended June 30, 2014 compared to the same periods in 2013. The increase in *Amortization, impairment and change in estimated fair value of mortgage servicing rights* was due to growth in our investment in MSR, which caused an increase in amortization of the asset and impairment, and to expectations for higher prepayment speeds as a result of lower interest rates at quarter end; offset with the positive change in fair value of the excess servicing spread financing.

Impairment and changes in fair value of MSR have a significant effect on net servicing fees, driven primarily by our monthly re-estimation of the fair value of MSR. As our investment in MSR grows, we expect that the effect of impairment and changes in fair value will have an increasing influence on our net income. MSR are sensitive to changes in interest rates. Decreasing interest rates encourage increased borrower refinancing activity. Increased borrower refinancing activity shortens the life of our MSR assets, thereby reducing the income we expect to receive from such assets and, by extension, MSR fair value.

The fair value of MSR is difficult to determine because MSR are not actively traded in observable markets. Considerable judgment is required to estimate the fair values of these assets and the exercise of such judgment can significantly affect our income. 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 inputs used in our discounted cash flow model are based on market factors and include the historical performance of our MSR, which we believe are consistent with inputs and data used by market participants valuing similar MSR.

The key inputs used in the valuation of MSR include mortgage prepayment and default rates of the underlying loans, the applicable discount rate, and cost to service loans. These inputs can, and generally do, change from period to period as market conditions change. Therefore our

estimate of the fair value of MSR changes from period to period. Our senior management valuation committee reviews and approves the fair value estimates of our MSR.

We account for MSR 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 MSR carried at the lower of amortized cost or estimated fair value based on how we finance certain of our MSR purchases and 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 MSR 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 purchased MSR and MSR relating to mortgage loans originated through our loan production 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 MSR 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 MSR relating to mortgage loans with initial interest rates of more than 4.5% and therefore require a different risk management approach. Our risk management

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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.

- MSRs purchased for which a financing in the form of ESS cash flows has been recorded are accounted for at fair value. The ESS financing at fair value is accounted for at fair value to align the accounting for the MSR with the related liability.

Our MSRs are summarized by the basis on which we account for the assets below:

| Basis of accounting   | June 30,       | December 31,  |
|---|----------------|---------------|
|   | 2014           | 2013          |
|   | (in thousands) |               |
| Fair value  | \$ 308,599     | \$ 224,913    |
| Lower of amortized cost or fair value:  |                |               |
| Amortized cost  | \$ 321,911     | \$ 263,373    |
| Valuation allowance   | (8,829)        | (4,622)       |
| Carrying value  | \$ 313,082     | \$ 258,751    |
| Fair value  | \$ 321,383     | \$ 269,422    |
| Total mortgage servicing rights:  |                |               |
| Carrying value  | \$ 621,681     | \$ 483,664    |
| Fair value  | \$ 629,982     | \$ 494,335    |
| Unpaid principal balance of mortgage loans underlying mortgage servicing rights | \$ 57,051,424  | \$ 45,938,820 |

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Key assumptions used in determining the fair value of MSR are as follows:

*Purchased MSRs backed by distressed mortgage loans*

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

|  | June 30, 2014  | Range<br>(Weighted average) | December 31, 2013 |                   |
|--|--|-----------------------------|-------------------|-------------------|
|  | Fair<br>value  | Amortized<br>cost           | Fair<br>value     | Amortized<br>cost |
|  | (Carrying value, unpaid principal balance of underlying mortgage loans and effect on<br>fair value amounts in thousands) |                             |                   |                   |
| Carrying value   |  |                             | \$10,129          |                   |
| Unpaid principal balance of<br>underlying mortgage loans |  |                             | \$969,794         |                   |
| Weighted-average note interest rate                      |  |                             | 5.80%             |                   |
| Weighted-average servicing fee<br>rate (in basis points) |  |                             | 50                |                   |
| Discount rate  |  |                             | 15.3%             | 15.3%             |
|  |  |                             | (15.3)%           |                   |
| Average life (in years)                                  |  |                             | 5.0 - 5.0         |                   |
|  |  |                             | (5.0)             |                   |
| Prepayment speed (1)                                     |  |                             | 11.4%             | 11.4%             |
|  |  |                             | (11.4)%           |                   |
| Per-loan cost of servicing                               |  |                             | \$218             | \$218             |
|  |  |                             | \$(218)           |                   |

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

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|   | June 30, 2014   |       |                |       | December 31, 2013 |       |                |       |
|---|---|-------|----------------|-------|-------------------|-------|----------------|-------|
|   | Fair value  |       | Amortized cost |       | Fair value        |       | Amortized cost |       |
|   | (Carrying value, unpaid principal balance of underlying mortgage loans and effect on fair value amounts in thousands) |       |                |       |                   |       |                |       |
| Carrying value  | \$308,599   |       | \$313,082      |       | \$214,784         |       | \$258,751      |       |
| Unpaid principal balance of underlying mortgage loans | \$29,694,503  |       | \$27,356,921   |       | \$22,469,179      |       | \$22,499,847   |       |
| Weighted-average note interest rate                   | 4.29%   |       | 3.76%          |       | 4.48%             |       | 3.65%          |       |
| Weighted-average servicing fee rate (in basis points) | 31  |       | 29             |       | 32                |       | 29             |       |
| Pricing spread (1)                                    | 2.9%  | 20.3% | 6.3%           | 15.4% | 2.9%              | 18.0% | 6.3%           | 14.5% |
|   | (9.0)%  |       | (9.9)%         |       | (7.5)%            |       | (8.7)%         |       |
| Average life (in years)                               | 0.1   | 10.8  | 1.5            | 7.3   | 0.1               | 14.4  | 1.5            | 7.3   |
|   | (5.9)   |       | (6.9)          |       | (6.2)             |       | (7.0)          |       |
| Prepayment speed (2)                                  | 7.6%  | 67.0% | 7.6%           | 45.1% | 7.8%              | 50.8% | 7.6%           | 42.5% |
|   | (10.2)%   |       | (8.2)%         |       | (9.7)%            |       | (8.0)%         |       |
| Per-loan cost of servicing                            | \$61  | \$115 | \$61           | \$93  | \$68              | \$115 | \$68           | \$100 |
|   | \$(86)  |       | \$(92)         |       | \$(87)            |       | \$(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 MSR's acquired as proceeds from the sale of loans and purchased MSR's not backed by pools of distressed mortgage loans.

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

*Management fees and Carried Interest*

Management fees and Carried Interest are summarized below:

|                                     | Quarter ended June 30, |          | Six months ended June 30, |          |
|-------------------------------------|------------------------|----------|---------------------------|----------|
|                                     | 2014                   | 2013     | 2014                      | 2013     |
|                                     | (in thousands)         |          |                           |          |
| Management fees:                    |                        |          |                           |          |
| PennyMac Mortgage Investment Trust: |                        |          |                           |          |
| Base management fee                 | \$ 5,838               | \$ 4,575 | \$ 11,359                 | \$ 8,940 |
| Performance incentive fee           | 3,074                  | 3,880    | 5,627                     | 6,007    |



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|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
|  | 8,912     | 8,455     | 16,986    | 14,947    |
| Investment Funds                           | 2,086     | 1,974     | 4,121     | 3,888     |
|  | \$ 10,998 | \$ 10,429 | \$ 21,107 | \$ 18,835 |
| Carried Interest                           | \$ 1,834  | \$ 2,862  | \$ 3,991  | \$ 7,599  |
| Total management fees and Carried Interest | \$ 12,832 | \$ 13,291 | \$ 25,098 | \$ 26,434 |

Net assets of Advised Entities at period end:

PennyMac Mortgage Investment

|                  |              |              |
|------------------|--------------|--------------|
| Trust            | \$ 1,577,160 | \$ 1,244,181 |
| Investment Funds | 565,926      | 561,790      |
|                  | \$ 2,143,086 | \$ 1,805,971 |

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Management fees from PMT increased \$457,000 and \$2.0 million in the quarter and six months ended June 30, 2014, respectively, compared to the same periods in 2013. The increase was due primarily to:

- Base management fees increased by \$1.3 million or 28% and \$2.4 million or 27% in the quarter and six months ended June 30, 2014, respectively, compared to the same periods in 2013 due to an increase in PMT's shareholders' equity upon which its management fee is based.
- Performance incentive fees decreased \$806,000 and \$380,000 in the quarter and six months ended June 30, 2014, respectively, compared to the same periods in 2013. We began to recognize performance incentive fees 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 for a rolling four-quarter period 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.

Management fees from the Investment Funds increased \$112,000 and \$233,000 in the quarter and six months ended June 30, 2014, respectively, compared to the same periods in 2013. The increase was due to an increase in the Investment Funds' net asset values, which increased the investment base on which the management fees are computed.

Carried Interest from Investment Funds decreased \$1.0 million and \$3.6 million in the quarter and six months ended June 30, 2014, respectively, compared to the same period in 2013. Observed market demand for distressed loans, changes 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 in the quarter and six months ended June 30, 2013 resulted in valuation gains. This was not repeated in the same magnitude in the quarter and six months ended June 30, 2014.

*Other revenues*

Net interest expense increased \$2.8 million and \$3.4 million during the quarter and six months ended June 30, 2014, respectively, compared to the same periods in 2013 due to growth in our investments in non-interest earning assets—primarily MSRs which are financed in part with ESS financing. Income from MSRs is included in *Net loan servicing fees*.

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 June 30,<br>2014 |       | 2013           |       | Six months ended June 30,<br>2014 |      | 2013 |       |
|----------------------|--------------------------------|-------|----------------|-------|-----------------------------------|------|------|-------|
|                      |                                |       | (in thousands) |       |                                   |      |      |       |
| Dividends            | \$                             | 44    | \$             | 43    | \$                                | 88   | \$   | 85    |
| Change in fair value |                                | (147) |                | (363) |                                   | (76) |      | (318) |
|                      | \$                             | (103) | \$             | (320) | \$                                | 12   | \$   | (233) |

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Fair value of PennyMac Mortgage

|                                       |    |       |    |       |
|---------------------------------------|----|-------|----|-------|
| Investment Trust shares at period end | \$ | 1,646 | \$ | 1,579 |
|---------------------------------------|----|-------|----|-------|

Change in fair value of investment in and dividends received from PMT increased \$217,000 and \$245,000, respectively, in the quarter and six months ended June 30, 2014 compared to the same periods in 2013. The increase was primarily due to a smaller decrease in the fair value of our investment in common shares of PMT during the periods ended June 30, 2014 as compared to the periods ended June 30, 2013. During the periods ended June 30, 2014 and 2013, we held 75,000 common shares of PMT.

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Our compensation expense is summarized below:

|                                   | Quarter ended June 30, |           | Six months ended June 30, |           |
|-----------------------------------|------------------------|-----------|---------------------------|-----------|
|                                   | 2014                   | 2013      | 2014                      | 2013      |
|                                   | (in thousands)         |           |                           |           |
| Salaries and wages                | \$ 28,202              | \$ 25,231 | \$ 54,561                 | \$ 48,248 |
| Incentive compensation            | 10,340                 | 11,957    | 18,294                    | 19,704    |
| Taxes and benefits                | 4,689                  | 4,185     | 9,486                     | 8,112     |
| Stock and unit-based compensation | 3,740                  | 966       | 7,516                     | 1,956     |
|                                   | \$ 46,971              | \$ 42,339 | \$ 89,857                 | \$ 78,020 |
| Average headcount                 | 1,506                  | 1,246     | 1,463                     | 1,219     |
| Period end headcount              | 1,589                  | 1,356     |                           |           |

Compensation expense increased \$4.6 million and \$11.8 million, respectively, in the quarter and six months ended June 30, 2014 compared to the same periods in 2013. The increase in compensation expense was due to the development of and growth in our loan servicing segment as well as stock-based compensation reflecting the amortization of equity awards that we granted to our directors and certain officers and employees of PennyMac.

Loan origination expense decreased \$518,000 and \$1.6 million, respectively, in the quarter and six months ended June 30, 2014 compared to the same periods in 2013. The decrease was due to decreased loan production in 2014 compared to 2013.

Technology expense increased \$1.7 million and \$2.9 million, respectively, in the quarter and six months ended June 30, 2014 compared to the same periods in 2013. The increase was due to growth in loan servicing operations and continued investment in loan production infrastructure.

Servicing expense increased \$10.1 million and \$11.6 million, respectively, in the quarter and six months ended June 30, 2014 compared to the same periods in 2013. The increase was due to growth in our mortgage servicing portfolio and approximately \$7 million was due to the initiation of an early buyout ( EBO ) program to purchase defaulted loans out of legacy Ginnie Mae pools. The purchase of \$575 million in UPB of EBOs produced current period expense as accumulated net interest advances are charged to servicing expense when the loans are purchased from the Ginnie Mae pools. The economic benefit of EBO is reduced servicing costs by purchasing and either selling the defaulted loans or otherwise financing them with debt at interest rates below the Ginnie Mae MBS pass-through rates rather than advancing principal and interest on such defaulted loans at the Ginnie Mae MBS pass-through rate until liquidation.

*Expenses Allocated to PMT*

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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 with PMT. The expense amounts presented in our income statement are net of these allocations. Expense amounts allocated to PMT during the periods ended June 30, 2014 and 2013 are summarized below:

|                               | Quarter ended June 30, |                 | Six months ended June 30, |                 |
|-------------------------------|------------------------|-----------------|---------------------------|-----------------|
|                               | 2014                   | 2013            | 2014                      | 2013            |
|                               | (in thousands)         |                 |                           |                 |
| Technology                    | \$ 1,005               | \$ 1,151        | \$ 2,057                  | \$ 1,923        |
| Occupancy                     | 570                    | 633             | 1,058                     | 1,100           |
| Depreciation and amortization | 501                    | 351             | 990                       | 637             |
| Other                         | 562                    | 840             | 1,110                     | 1,606           |
| <b>Total expenses</b>         | <b>\$ 2,638</b>        | <b>\$ 2,975</b> | <b>\$ 5,215</b>           | <b>\$ 5,266</b> |

The amount of total expenses that we allocated to PMT remained generally consistent in the quarter and six months ended June 30, 2014 compared to the same periods in 2013.

### *Provision for Income Taxes*

For the quarter and six months ended June 30, 2014, our effective tax rates were 11.4% and 11.3%, respectively. For the quarter and six months ended June 30, 2013, our effective tax rates were 4.1% and 1.9%, 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

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noncontrolling interest 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, which will in turn increase our effective income tax rate.

**Balance Sheet Analysis**

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

|  | June 30,<br>2014 | December 31,<br>2013 |
|--|------------------|----------------------|
|  | (in thousands)   |                      |
| <b>ASSETS</b>                              |                  |                      |
| Cash and short-term investments            | \$ 117,201       | \$ 173,221           |
| Mortgage loans held for sale at fair value | 1,000,415        | 531,004              |
| Servicing advances                         | 179,169          | 154,328              |
| Receivable from affiliates                 | 24,290           | 21,551               |
| Carried Interest due from Investment Funds | 65,133           | 61,142               |
| Mortgage servicing rights                  | 621,681          | 483,664              |
| Other assets                               | 174,305          | 159,565              |
| Total assets                               | \$ 2,182,194     | \$ 1,584,475         |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b> |                  |                      |
| Borrowings                                 | \$ 940,581       | \$ 523,746           |
| Payable to affiliates                      | 320,656          | 256,834              |
| Other liabilities                          | 199,264          | 174,691              |
| Total liabilities                          | 1,460,501        | 955,271              |
| Total stockholders equity                  | 721,693          | 629,204              |
| Total liabilities and stockholders equity  | \$ 2,182,194     | \$ 1,584,475         |

Total assets increased \$597.7 million from \$1.6 billion at December 31, 2013 to \$2.2 billion at June 30, 2014. The increase was primarily due to an increase of \$469.4 million in mortgage loans held for sale at fair value primarily related to the initiation of the EBO program and an increase of \$138.0 million in MSRs, resulting from growth in our mortgage banking operations and purchases of MSRs, partially offset by a decrease in cash and short-term investments of \$56.0 million as we deployed cash and proceeds from sales of ESS to fund balance sheet growth.

Total liabilities increased by \$505.2 million from \$955.3 million as of December 31, 2013 to \$1.5 billion as of June 30, 2014. The increase was primarily attributable to an increase in mortgage loans sold under agreements to repurchase of \$353.7 million and an increase in liabilities relating to the sale of ESS to PMT of \$51.5 million.

**Cash Flows**

*Comparison of six-month periods ended June 30, 2014 and 2013*

Our cash flows resulted in a net increase in cash of \$40.2 million during the six months ended June 30, 2014. Cash used in operating activities totaled \$431.4 million during the six months ended June 30, 2014. The cash used in operating activities was primarily due to growth of our portfolio of mortgage loans held for sale as a result of our loan production and EBO purchases of loans exceeded loan sales.

Net cash provided by investing activities was \$5.6 million during the six months ended June 30, 2014. The net cash provided by investing activities was primarily due to the sale of a portfolio of MSRs backed by distressed mortgage loans.

Net cash provided by financing activities was \$466.0 million during the six months ended June 30, 2014. Cash provided by financing activities was primarily due to sales of loans under agreements to repurchase.

*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

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liquidity to be through cash flows from business activities, earnings on our investments and proceeds from borrowings, proceeds from issuance of ESS financing and/or additional equity offerings. We believe that our liquidity is sufficient to meet our current liquidity needs.

Our current leverage strategy is to finance our assets where we believe such borrowing is prudent, appropriate and available. Our borrowing activities are in the form of sales of mortgage loans under agreements to repurchase, ESS financing and a note payable secured by mortgage servicing rights ( MSRs ) and loan 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 six months ended June 30, 2014, the average balance outstanding under agreements to repurchase mortgage loans totaled \$410.2 million, and the maximum daily amount outstanding under such agreements totaled \$873.3 million. During the six months ended June 30, 2013, the average balance outstanding under agreements to repurchase mortgage loans totaled \$344.3 million, and the maximum daily amount outstanding under such agreements totaled \$623.5 million.

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

All of our borrowings discussed above have short-term maturities. The transactions relating to mortgage loans under agreements to repurchase mature between September 8, 2014 and June 29, 2015 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 MSRs and loan servicing advances at fair value has a maturity date of October 31, 2014.

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 \$200 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 PMT, we are also subject to certain covenants under its debt agreements. These covenants are similar to those above.

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 have purchased portfolios of MSRs and have financed them in part through the sale to PMT of the right to receive ESS. The repayment of the ESS financing is based on amounts received on the underlying mortgage loans.

We continue to explore a variety of additional means of financing our continued growth, including debt financing through bank warehouse lines of credit, additional repurchase agreements and corporate debt. 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.

#### *Off-Balance Sheet Arrangements and Aggregate Contractual Obligations*

#### *Off-Balance Sheet Arrangements and Guarantees*

As of June 30, 2014, we have not entered into any off-balance sheet arrangements or guarantees.

Table of Contents**Contractual Obligations**

As of June 30, 2014, we had on-balance sheet contractual obligations of \$825.3 million to finance assets under agreements to repurchase under facilities with maturities between July 24, 2014 and June 29, 2015. We also had a contractual obligation of \$115.3 million relating to a note payable secured by MSRs and loan servicing advances at fair value and with a maturity date of October 31, 2014. 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:

| Contractual obligations  | Total        | Payments due by period |                |                |                      |
|--|--------------|------------------------|----------------|----------------|----------------------|
|  |              | Less than<br>1 year    | 1 - 3<br>years | 3 - 5<br>years | More than<br>5 years |
|  |              | (in thousands)         |                |                |                      |
| Commitments to purchase mortgage loans from PennyMac Mortgage Investment Trust (1) | \$ 1,242,982 | \$ 1,242,982           | \$             | \$             | \$                   |
| Commitments to fund mortgage loans (1)   | 511,863      | 511,863                |                |                |                      |
| Commitments to sell mortgage loans (1)   | 4,617,100    | 4,617,100              |                |                |                      |
| Loans sold under agreements to repurchase  | 825,267      | 825,267                |                |                |                      |
| Note payable   | 115,314      | 115,314                |                |                |                      |
| Software licenses (2)  | 18,824       | 9,412                  | 9,412          |                |                      |
| Office leases  | 14,520       | 4,554                  | 7,938          | 2,028          |                      |
| Total  | \$ 7,345,870 | \$ 7,326,492           | \$ 17,350      | \$ 2,028       | \$                   |

(1) The contractual obligations relate to our mortgage loan acquisition obligations to affiliates and non-affiliates and our obligation to sell mortgage loans.

(2) 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 \$490,000 per year. Estimated payments for software licenses above are based on the number of loans currently serviced by us, which totaled approximately 451,000 at June 30, 2014. Future amounts due may significantly fluctuate based on changes in the number of loans serviced by us. Software license fees totaled \$3.8 million and \$6.8 million, respectively, for the quarter and six months ended June 30, 2014. All figures contained in this footnote are in actual amounts and not in thousands (in contrast to the table above).

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 June 30, 2014:

| Counterparty | Amount at risk | Weighted-average maturity of advances under repurchase agreement | Facility Maturity |
|--------------|----------------|--|-------------------|
|              | \$ 117,085     | September 3, 2014  | October 31, 2014  |

|  |    |        |                    |                  |
|--|----|--------|--------------------|------------------|
| Credit Suisse First Boston<br>Mortgage Capital LLC |    |        |                    |                  |
| Bank of America, N.A.                              | \$ | 45,620 | September 17, 2014 | January 30, 2015 |
| Morgan Stanley                                     | \$ | 10,074 | August 17, 2014    | June 29, 2015    |
| Citibank, N.A.                                     | \$ |        |                    | August 7, 2014   |

***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 MSRs 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 June 30, 2014, we were in compliance in all material respects with these covenants.

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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<br>Indebtedness (2) | Committed<br>Amount | Maturity Date    |
|--|---------------------------------|---------------------|------------------|
|  | (in thousands)                  |                     |                  |
| Bank of America, N.A.                              | \$ 206,581                      | \$ 225,000          | January 30, 2015 |
| Credit Suisse First Boston Mortgage<br>Capital LLC | \$ 505,132                      | \$ 800,000          | October 31, 2014 |
| Credit Suisse First Boston Mortgage<br>Capital LLC | \$ 115,314                      | \$ 117,000          | October 31, 2014 |
| Morgan Stanley                                     | \$ 113,554                      | \$ 125,000          | June 29, 2015    |
| Citibank, N.A.                                     | \$ 0                            | \$ 50,000           | August 7, 2014   |

(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 \$800 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 certain MSRs and loan servicing advances.

(2) Represents outstanding indebtedness reduced by cash collateral as of June 30, 2014.

***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 credit risk, interest rate risk, prepayment risk, inflation risk and market value risk.

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

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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 MSR's accounted for using the amortization method as of June 30, 2014, 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%        |
|---------------------------|------------|------------|------------|------------|-------------|-------------|
| Fair value                | \$ 353,265 | \$ 336,627 | \$ 328,841 | \$ 314,233 | \$ 307,374  | \$ 294,463  |
| Change in fair value:     |            |            |            |            |             |             |
| \$                        | \$ 31,882  | \$ 15,244  | \$ 7,458   | \$ (7,150) | \$ (14,009) | \$ (26,920) |
| %                         | 9.92%      | 4.74%      | 2.32%      | -2.22%     | -4.36%      | -8.38%      |

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| Prepayment speed shift in % | -20%       | -10%       | -5%        | +5%        | +10%        | +20%        |
|-----------------------------|------------|------------|------------|------------|-------------|-------------|
| Fair value                  | \$ 344,637 | \$ 332,663 | \$ 326,940 | \$ 315,985 | \$ 310,741  | \$ 300,687  |
| Change in fair value:       |            |            |            |            |             |             |
| \$                          | \$ 23,255  | \$ 11,280  | \$ 5,557   | \$ (5,398) | \$ (10,642) | \$ (20,696) |
| %                           | 7.24%      | 3.51%      | 1.73%      | -1.68%     | -3.31%      | -6.44%      |

| Per-loan servicing cost shift in % | -20%                          | -10%       | -5%        | +5%        | +10%       | +20%        |
|------------------------------------|-------------------------------|------------|------------|------------|------------|-------------|
|                                    | (dollar amounts in thousands) |            |            |            |            |             |
| Fair value                         | \$ 332,820                    | \$ 327,101 | \$ 324,242 | \$ 318,523 | \$ 315,664 | \$ 309,945  |
| Change in fair value:              |                               |            |            |            |            |             |
| \$                                 | \$ 11,437                     | \$ 5,719   | \$ 2,859   | \$ (2,859) | \$ (5,719) | \$ (11,437) |
| %                                  | 3.56%                         | 1.78%      | 0.89%      | -0.89%     | -1.78%     | -3.56%      |

The following tables summarize the estimated change in fair value of MSR accounts for using the fair value method as of June 30, 2014, 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                | \$ 332,078                    | \$ 319,897 | \$ 314,144 | \$ 303,253 | \$ 298,093  | \$ 288,298  |
| Change in fair value:     |                               |            |            |            |             |             |
| \$                        | \$ 23,480                     | \$ 11,298  | \$ 5,545   | \$ (5,347) | \$ (10,506) | \$ (20,302) |
| %                         | 7.61%                         | 3.66%      | 1.80%      | -1.73%     | -3.40%      | -6.58%      |

| Prepayment speed shift in % | -20%                          | -10%       | -5%        | +5%        | +10%        | +20%        |
|-----------------------------|-------------------------------|------------|------------|------------|-------------|-------------|
|                             | (dollar amounts in thousands) |            |            |            |             |             |
| Fair value                  | \$ 337,985                    | \$ 322,713 | \$ 315,520 | \$ 301,937 | \$ 295,517  | \$ 283,357  |
| Change in fair value:       |                               |            |            |            |             |             |
| \$                          | \$ 29,385                     | \$ 14,113  | \$ 6,920   | \$ (6,663) | \$ (13,082) | \$ (25,243) |
| %                           | 9.52%                         | 4.57%      | 2.24%      | -2.16%     | -4.24%      | -8.18%      |

| Per-loan servicing cost shift in % | -20%                          | -10%       | -5%        | +5%        | +10%       | +20%        |
|------------------------------------|-------------------------------|------------|------------|------------|------------|-------------|
|                                    | (dollar amounts in thousands) |            |            |            |            |             |
| Fair value                         | \$ 321,964                    | \$ 315,282 | \$ 311,941 | \$ 305,258 | \$ 301,917 | \$ 295,235  |
| Change in fair value:              |                               |            |            |            |            |             |
| \$                                 | \$ 13,365                     | \$ 6,682   | \$ 3,341   | \$ (3,341) | \$ (6,682) | \$ (13,365) |
| %                                  | 4.33%                         | 2.17%      | 1.08%      | -1.08%     | -2.17%     | -4.33%      |

*Excess Servicing Spread Financing*

The following tables summarize the estimated change in fair value of our ESS financing accounted for using the fair value method as of June 30, 2014, given several shifts in pricing spreads and prepayment speed:

| Pricing spread shift in % | -20% | -10% | -5% | +5% | +10% | +20% |
|---------------------------|------|------|-----|-----|------|------|
|---------------------------|------|------|-----|-----|------|------|

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|                       | (dollar amounts in thousands) |            |            |            |            |            |  |
|-----------------------|-------------------------------|------------|------------|------------|------------|------------|--|
| Fair value            | \$ 199,426                    | \$ 194,727 | \$ 192,459 | \$ 188,079 | \$ 185,963 | \$ 181,870 |  |
| Change in fair value: |                               |            |            |            |            |            |  |
| \$                    | \$ 9,182                      | \$ 4,483   | \$ 2,215   | \$ (2,165) | \$ (4,281) | \$ (8,374) |  |
| %                     | 4.83%                         | 2.36%      | 1.16%      | -1.14%     | -2.25%     | -4.40%     |  |

| Prepayment speed shift in % | -20%                          | -10%       | -5%        | +5%        | +10%       | +20%        |  |
|-----------------------------|-------------------------------|------------|------------|------------|------------|-------------|--|
|                             |                               |            |            |            |            |             |  |
|                             | (dollar amounts in thousands) |            |            |            |            |             |  |
| Fair value                  | \$ 209,090                    | \$ 199,286 | \$ 194,675 | \$ 185,983 | \$ 181,882 | \$ 174,132  |  |
| Change in fair value:       |                               |            |            |            |            |             |  |
| \$                          | \$ 18,847                     | \$ 9,043   | \$ 4,431   | \$ (4,261) | \$ (8,361) | \$ (16,112) |  |
| %                           | 9.91%                         | 4.75%      | 2.33%      | -2.24%     | -4.40%     | -8.47%      |  |

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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 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 as set forth in Item IA. of Part II hereof and the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on March 14, 2014 .

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;



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- 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 ( CFPB ), its recently effective 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;
- Purchase opportunities for mortgage servicing rights and our success in winning bids;
- Changes in prevailing interest rates;
- Increases in loan delinquencies and defaults;

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- Our reliance on 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 the Investment Funds if our services fail to meet certain criteria or characteristics or under other circumstances;

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- 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 65 to 66 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 June 30, 2014. Based upon our evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective, as of June 30, 2014, 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 June 30, 2014, 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 under Item 1A. *Risk Factors* in our Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on March 14, 2014.

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

Effective April 11, 2013, we received a Notice of Election of Exchange under our Exchange Agreement from a unitholder related to the exchange of 100,000 Class A units for an equivalent number of shares of our Class A Common Stock. Effective April 25, 2013, we also received a Notice of Election of Exchange from that same unitholder related to the exchange of 200,000 Class A units for an equivalent number of shares of our Class A Common Stock. In connection with delivering each Notice of Election of Exchange, the unitholder surrendered to us Class A units for cancellation and was issued an equal amount of 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.



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**Item 5. Other Information**

On August 13, 2014, the Company, through its wholly-owned subsidiary, PennyMac Loan Services, LLC ( PLS ), entered into a mortgage loan participation and sale agreement, by and among Bank of America, N.A. ( BANA ), PLS and Private National Mortgage Acceptance Company, LLC ( PennyMac ) (the BANA Participation Agreement ).

Pursuant to the terms of the BANA Participation Agreement, PLS may sell to BANA participation certificates, each of which represents an undivided beneficial ownership interest in a pool of mortgage loans that have been pooled with Fannie Mae, Freddie Mac or Ginnie Mae and are pending securitization. In connection with its sale of any participation certificate, PLS will also assign to BANA a take-out commitment, which evidences PLS 's right to sell to a third party investor the security backed by the mortgage loans underlying the related participation certificate.

The purchase price paid by BANA for each participation certificate is based on the trade price (expressed as a percentage) of the security multiplied by its principal amount, plus an amount of interest expected to accrue on the security to its anticipated delivery date, minus a present value adjustment and any related hedging costs. At the time of its purchase of a participation certificate, BANA retains a holdback amount that is based on a percentage of the purchase price and is not required to be paid to PLS until the settlement of the security and its delivery to BANA.

The BANA Participation Agreement requires PLS to maintain various covenants that are customary for this type of transaction, as well as financial covenants that include the following: (i) an adjusted tangible net worth of at least \$200 million; (ii) a ratio of total liabilities to adjusted tangible net worth not to exceed 10:1; (iii) liquidity of not less than \$20 million; and (iv) quarterly net income of not less than \$1.00.

The BANA Participation Agreement also contains 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, material adverse changes, bankruptcy or insolvency proceedings and other events of default customary for this type of transaction. The remedies for such events of default are also customary for this type of transaction and include the acceleration of all amounts due under the BANA Participation Agreement and indemnity by PLS, as well as the ability of BANA to possess the mortgage loans and retain any holdback amounts.

The Company, through PLS, is required to pay BANA fees for the structuring of the BANA Participation Agreement, as well as certain other administrative costs and expenses. The BANA Participation Agreement is effective until January 30, 2015, and the obligations of PLS are fully guaranteed by PennyMac.

The foregoing description of the BANA Participation Agreement and the related guaranty by PennyMac do not purport to be complete and are qualified in their entirety by reference to the full text of the BANA Participation Agreement and the related guaranty, which have been filed with this Quarterly Report on Form 10-Q as Exhibits 10.72 and 10.73, respectively.





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**Item 6. Exhibits**

| <b>Exhibit Number</b> | <b>Exhibit Description</b>   |
|-----------------------|--|
| 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                 |  |

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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).

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| <b>Exhibit Number</b> | <b>Exhibit Description</b>   |
|-----------------------|--|
| 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).                                       |
| 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                 | Amendment No. 1 to Second Amended and Restated Flow Servicing Agreement, dated as of November 14, 2013, by and between PennyMac Operating Partnership, L.P. and PennyMac Loan Services, LLC (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K as filed with the SEC on November 20, 2013).                               |
| 10.21                 | Amendment No. 2 to Second Amended and Restated Flow Servicing Agreement, dated as of June 1, 2014, by and between PennyMac Operating Partnership, L.P. and PennyMac Loan Services, LLC.  |
| 10.22                 | 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).   |
| 10.23                 | 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).   |
| 10.24                 | 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).                     |
| 10.25                 | 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). |
| 10.26                 | 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).   |
| 10.27                 | 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 23, 2013).                      |
| 10.28                 | Amendment No. 2 to Master Spread Acquisition and MSR Servicing Agreement, dated as of November 14, 2013, by and between PennyMac Loan Services, LLC and PennyMac Operating Partnership, L.P. (incorporated by reference to Exhibit 10.27 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2013).                                   |

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- 10.29 Amendment No. 3 to Master Spread Acquisition and MSR Servicing Agreement, dated as of March 19, 2014, by and between PennyMac Loan Services, LLC and PennyMac Operating Partnership, L.P. (incorporated by reference to Exhibit 10.28 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014).

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| Exhibit Number | Exhibit Description   |
|----------------|---|
| 10.30          | Master Spread Acquisition and MSR Servicing Agreement, by and between PennyMac Loan Services, LLC and PennyMac Holdings, LLC dated as of December 30, 2013 (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K/A as filed with the SEC on March 21, 2014).  |
| 10.31          | Amendment No. 1 to Master Spread Acquisition and MSR Servicing Agreement, dated as of June 1, 2014, by and between PennyMac Loan Services, LLC and PennyMac Holdings, LLC.  |
| 10.32          | 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).  |
| 10.33          | 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).                         |
| 10.34          | 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).  |
| 10.35          | 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). |
| 10.36          | 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).  |
| 10.37          | 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).   |
| 10.38          | 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).   |
| 10.39          | 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).  |
| 10.40          | 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).          |
| 10.41          | 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).         |
| 10.42          | 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).        |
| 10.43          | 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).        |



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| <b>Exhibit Number</b> | <b>Exhibit Description</b>   |
|-----------------------|--|
| 10.44                 | 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).  |
| 10.45                 | Amendment No. 6 to Master Repurchase Agreement, dated as of January 31, 2014, by and among Bank of America, N.A., PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K as filed with the SEC on February 6, 2014).  |
| 10.46                 | Amendment No. 7 to Master Repurchase Agreement, dated as of March 27, 2014, by and among Bank of America, N.A., PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibit 10.44 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014).   |
| 10.47                 | 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).  |
| 10.48                 | 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).  |
| 10.49                 | 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).  |
| 10.50                 | 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).   |
| 10.51                 | Amendment Number Four to the Master Repurchase Agreement, dated July 25, 2013, 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).  |
| 10.52                 | Amendment Number Five to the Master Repurchase Agreement, dated February 5, 2014, by and between PennyMac Loan Services, LLC and Citibank, N.A. (incorporated by reference to Exhibit 10.50 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014).   |
| 10.53                 | Amendment Number Six to the Master Repurchase Agreement, dated February 25, 2014, by and between PennyMac Loan Services, LLC and Citibank, N.A. (incorporated by reference to Exhibit 10.51 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014).   |
| 10.54                 | Amendment Number Seven to the Master Repurchase Agreement, dated July 24, 2014, by and between PennyMac Loan Services, LLC and Citibank, N.A.  |
| 10.55                 | Amendment Number Eight to the Master Repurchase Agreement, dated August 7, 2014, by and between PennyMac Loan Services, LLC and Citibank, N.A.   |
| 10.56                 | Second Amended and Restated Loan Security Agreement, dated as of March 27, 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 10.22 of the Registrant's Form S-1 Registration Statement as filed with the SEC on February 7, 2013).  |
| 10.57                 | Amendment No. 1 to Second Amended and Restated Loan 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). |

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- 10.58 Amendment No. 2 to Second Amended and Restated Loan 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).
- 10.59 Amendment No. 3 to Second Amended and Restated Loan Security Agreement, dated as of December 30, 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 10.2 of the Registrant's Current Report on Form 8-K as filed with the SEC on January 3, 2014).



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| Exhibit<br>Number | Exhibit Description  |
|-------------------|--|
| 10.60             | 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).           |
| 10.61             | 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). |
| 10.62             | Amendment No. 2 to Amended and Restated Master Repurchase Agreement, dated as of January 10, 2014, 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 10.58 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014).        |
| 10.63             | Amendment No. 3 to Amended and Restated Master Repurchase Agreement, dated as of March 13, 2014, 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 10.59 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014).          |
| 10.64             | Amendment No. 4 to Amended and Restated Master Repurchase Agreement, dated as of April 30, 2014, 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 10.1 of the Registrant's Current Report on Form 8-K as filed with the SEC on May 5, 2014).              |
| 10.65             | Amendment No. 5 to Amended and Restated Master Repurchase Agreement, dated as of May 22, 2014, by and among Credit Suisse First Boston Mortgage Capital LLC, PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC   |
| 10.66             | Amendment No. 6 to Amended and Restated Master Repurchase Agreement, dated as of June 3, 2014, by and among Credit Suisse First Boston Mortgage Capital LLC, PennyMac Loan Services, LLC and Private National Mortgage Acceptance Company, LLC   |
| 10.67             | 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).   |
| 10.68             | 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).  |
| 10.69             | Amendment Number Two to the Master Repurchase Agreement, dated as of January 28, 2014, by and between PennyMac Loan Services, LLC and Morgan Stanley Bank, N.A. (incorporated by reference to Exhibit 10.63 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014).   |
| 10.70             | Amendment Number Three to the Master Repurchase Agreement, dated as of June 30, 2014, by and between PennyMac Loan Services, LLC and Morgan Stanley Bank, N.A.   |
| 10.71             | 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).  |
| 10.72             | Mortgage Loan Participation Purchase and Sale Agreement, dated as of August 13, 2014, by and among PennyMac Loan Services, LLC, Private National Mortgage Acceptance Company, LLC and Bank of America, N.A.  |

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- 10.73 Amended and Restated Guaranty, dated as of August 13, 2014, by Private National Mortgage Acceptance Company, LLC in favor of Bank of America, N.A.
- 31.1 Certification of Stanford L. Kurland pursuant to Rule 13a-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), as adopted pursuant to Section 302 of the Sarbanes- Oxley Act of 2002.
- 32.1\*\* Certification of Stanford L. Kurland pursuant to Rule 13a-14(b) and 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 Rule 13a-14(b) and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**Exhibit**

**Number**

**Exhibit Description**

101\*\*\* Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013, (ii) the Consolidated Statements of Income for the quarters ended June 30, 2014 and 2013, (iii) the Consolidated Statements of Changes in Stockholders' Equity for the quarters ended June 30, 2014 and 2013, (iv) the Consolidated Statements of Cash Flows for the quarters ended June 30, 2014 and 2013 and (v) the Notes to the Consolidated Financial Statements.

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\*\* 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 Section 13 or 15(d) 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: August 14, 2014

By:

/S/ STANFORD L. KURLAND  
Stanford L. Kurland  
*Chairman of the Board of Directors and Chief  
Executive Officer*

Dated: August 14, 2014

By:

/S/ ANNE D. MCCALLION  
Anne D. McCallion  
*Chief Financial Officer*