

PennyMac Mortgage Investment Trust
Form 10-Q
August 05, 2011

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[TABLE OF CONTENTS](#)

[Table of Contents](#)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

Or

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

For the transition period from _____ to _____
Commission file number: 001-34416

PennyMac Mortgage Investment Trust

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

27-0186273
(IRS Employer
Identification No.)

27001 Agoura Road, Calabasas, California
(Address of principal executive offices)

91301
(Zip Code)

(818) 224-7442

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a
smaller reporting company)

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

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

| Class | Outstanding at August 3, 2011 |
|---|-------------------------------|
| Common Shares of Beneficial Interest, \$.01 par value | 27,791,743 |

Table of Contents

**PENNYMAC MORTGAGE INVESTMENT TRUST
FORM 10-Q
June 30, 2011**

TABLE OF CONTENTS

| | | Page |
|---|--|-------------|
| <u>PART I. FINANCIAL INFORMATION</u> | | |
| <u>Item 1.</u> | <u>Financial Statements (Unaudited):</u> | <u>1</u> |
| | <u>Consolidated Balance Sheets</u> | <u>1</u> |
| | <u>Consolidated Statements of Income</u> | <u>2</u> |
| | <u>Consolidated Statements of Changes in Shareholders' Equity</u> | <u>3</u> |
| | <u>Consolidated Statements of Cash Flows</u> | <u>4</u> |
| | <u>Notes to Consolidated Financial Statements</u> | <u>5</u> |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>35</u> |
| | <u>Observations on Current Market Opportunities</u> | <u>36</u> |
| | <u>Results of Operations</u> | <u>38</u> |
| | <u>Net Investment Income</u> | <u>38</u> |
| | <u>Expenses</u> | <u>48</u> |
| | <u>Balance Sheet Analysis</u> | <u>49</u> |
| | <u>Asset Acquisitions</u> | <u>50</u> |
| | <u>Investment Portfolio Composition</u> | <u>50</u> |
| | <u>Cash Flows</u> | <u>54</u> |
| | <u>Liquidity and Capital Resources</u> | <u>55</u> |
| | <u>Off-Balance Sheet Arrangements and Aggregate Contractual Obligations</u> | <u>58</u> |
| | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | <u>61</u> |
| | <u>Accounting Developments</u> | <u>61</u> |
| | <u>Factors That May Affect Our Future Results</u> | <u>62</u> |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | <u>64</u> |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | <u>65</u> |
| <u>PART II. OTHER INFORMATION</u> | | |
| <u>Item 1.</u> | <u>Legal Proceedings</u> | <u>66</u> |
| <u>Item 1A.</u> | <u>Risk Factors</u> | <u>66</u> |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>66</u> |
| <u>Item 3.</u> | <u>Defaults Upon Senior Securities</u> | <u>66</u> |
| <u>Item 4.</u> | <u>[Reserved]</u> | <u>66</u> |
| <u>Item 5.</u> | <u>Other Information</u> | <u>66</u> |
| <u>Item 6.</u> | <u>Exhibits</u> | <u>67</u> |

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(In thousands, except share data)**

| | June 30, 2011 | December 31, 2010 |
|--|--------------------------|------------------------------|
| | (unaudited) | |
| ASSETS | | |
| Cash | \$ 2,344 | \$ 45,447 |
| Short-term investments | 38,633 | |
| Mortgage-backed securities at fair value | 82,421 | 119,872 |
| Mortgage loans acquired for sale at fair value | 18,848 | 3,966 |
| Mortgage loans at fair value | 657,223 | 364,250 |
| Real estate acquired in settlement of loans | 48,872 | 29,685 |
| Mortgage servicing rights at fair value | 180 | |
| Principal and interest collections receivable | 14,633 | 8,249 |
| Interest receivable | 2,028 | 978 |
| Due from affiliates | 7,208 | 2,115 |
| Other assets | 11,085 | 14,533 |
| Total assets | \$ 883,475 | \$ 589,095 |
| LIABILITIES | | |
| Accounts payable and accrued liabilities | \$ 1,635 | \$ 9,080 |
| Loans sold under agreements to repurchase | 262,203 | 147,422 |
| Securities sold under agreements to repurchase at fair value | 70,978 | 101,202 |
| Real estate acquired in settlement of loans financed under agreements to repurchase | 7,808 | |
| Contingent underwriting fees payable | 5,883 | 5,883 |
| Payable to affiliates | 11,382 | 5,595 |
| Income tax payable | 662 | |
| Total liabilities | 360,551 | 269,182 |
| Commitments and contingencies | | |
| SHAREHOLDERS' EQUITY | | |
| Common shares of beneficial interest authorized, 500,000,000 shares of \$0.01 par value; issued and outstanding, 27,791,743 and 16,832,343 shares at June 30, 2011 and December 31, 2010, respectively | 278 | 168 |
| Additional paid-in capital | 507,487 | 317,175 |
| Retained earnings | 15,159 | 2,570 |
| Total shareholders' equity | 522,924 | 319,913 |
| Total liabilities and shareholders' equity | \$ 883,475 | \$ 589,095 |

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

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)****(In thousands, except per share data)**

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|---------------------------|----------|------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Investment Income | | | | |
| Net gain (loss) on investments: | | | | |
| Mortgage-backed securities | \$ (873) | \$ (207) | \$ (1,315) | \$ (150) |
| Mortgage loans | 22,951 | 9,966 | 33,283 | 11,099 |
| | 22,078 | 9,759 | 31,968 | 10,949 |
| Interest income: | | | | |
| Short-term investments | 27 | 22 | 58 | 67 |
| Mortgage-backed securities | 982 | 1,267 | 2,068 | 2,551 |
| Mortgage loans | 6,961 | 2,503 | 12,047 | 3,838 |
| | 7,970 | 3,792 | 14,173 | 6,456 |
| Net gain on mortgage loans acquired for sale | | | | |
| | 40 | 28 | 123 | 28 |
| Results of real estate acquired in settlement of loans | | | | |
| | 86 | 335 | 1,175 | 335 |
| Change in fair value of mortgage servicing rights | | | | |
| | 6 | | 3 | |
| Other income | | | | |
| | 43 | 1 | 64 | 1 |
| Net investment income | 30,223 | 13,915 | 47,506 | 17,769 |
| Expenses | | | | |
| Loan servicing fees | 3,313 | 591 | 5,519 | 676 |
| Interest | 2,970 | | 5,248 | |
| Management fees | 1,913 | 1,202 | 3,462 | 2,413 |
| Compensation | 1,250 | 836 | 2,264 | 1,639 |
| Professional services | 1,115 | 399 | 1,992 | 493 |
| Other | 1,660 | 824 | 2,733 | 1,104 |
| Total expenses | 12,221 | 3,852 | 21,218 | 6,325 |
| Income before provision for income taxes | | | | |
| | 18,002 | 10,063 | 26,288 | 11,444 |
| Provision for income taxes | | | | |
| | 1,385 | 1,912 | 2,026 | 2,039 |
| Net income | \$ 16,617 | \$ 8,151 | \$ 24,262 | \$ 9,405 |
| Earnings per share | | | | |
| Basic | \$ 0.59 | \$ 0.49 | \$ 0.96 | \$ 0.56 |
| Diluted | \$ 0.59 | \$ 0.48 | \$ 0.96 | \$ 0.55 |
| Weighted-average shares outstanding | | | | |

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| | | | | |
|---------|--------|--------|--------|--------|
| Basic | 27,778 | 16,735 | 24,874 | 16,735 |
| Diluted | 28,096 | 17,106 | 25,142 | 17,106 |

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

Table of Contents

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

(In thousands, except share data)

| | Number of shares | Par value | Additional paid-in capital | Retained earnings (accumulated deficit) | Total |
|--|---------------------|--------------|----------------------------------|--|------------|
| Balance at December 31, 2009 | 16,735,317 | \$ 167 | \$ 315,514 | \$ (1,883) | \$ 313,798 |
| Net income | | | | 9,405 | 9,405 |
| Share-based compensation | | | 1,221 | | 1,221 |
| Underwriting and offering costs | | | (150) | | (150) |
| Balance at June 30, 2010 | 16,735,317 | \$ 167 | \$ 316,585 | \$ 7,522 | \$ 324,274 |
| Balance at December 31, 2010 | 16,832,343 | \$ 168 | \$ 317,175 | \$ 2,570 | \$ 319,913 |
| Net income | | | | 24,262 | 24,262 |
| Share-based compensation | 5,900 | | 1,664 | | 1,664 |
| Dividends declared | | | | (11,673) | (11,673) |
| Proceeds from offerings of common shares | 10,953,500 | 110 | 197,052 | | 197,162 |
| Underwriting and offering costs | | | (8,404) | | (8,404) |
| Balance at June 30, 2011 | 27,791,743 | \$ 278 | \$ 507,487 | \$ 15,159 | \$ 522,924 |

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

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In thousands)**

| | Six months ended | |
|--|-------------------------|-------------|
| | June 30, | |
| | 2011 | 2010 |
| Cash flows from operating activities | | |
| Net income | \$ 24,262 | \$ 9,405 |
| Adjustments to reconcile net income to net cash used by operating activities: | | |
| Net loss on mortgage-backed securities | 1,315 | 150 |
| Net gain on mortgage loans | (33,283) | (11,099) |
| Accrual of unearned discounts on mortgage-backed securities | (1,374) | (1,561) |
| Net gain on mortgage loans acquired for sale | (123) | (28) |
| Results of real estate acquired in settlement of loans | (1,175) | (335) |
| Change in fair value of mortgage servicing rights | (3) | |
| Amortization of credit facility commitment fees | 681 | |
| Share-based compensation expense | 1,664 | 1,221 |
| Purchases of mortgage loans acquired for sale | (74,370) | (15,157) |
| Sales of mortgage loans acquired for sale | 59,488 | 14,876 |
| Increase in principal and interest collections receivable | (6,384) | (10,554) |
| Increase in interest receivable | (1,361) | (443) |
| Increase in due from affiliates | (5,093) | (147) |
| Increase in other assets | (1,991) | (3,829) |
| Decrease in accounts payable and accrued liabilities | (10,019) | (118) |
| Increase in payable to affiliates | 5,787 | 2,659 |
| Increase in income taxes payable | 662 | 1,653 |
| Net cash used by operating activities | (41,317) | (13,307) |
| Cash flows from investing activities | | |
| Net (increase) decrease in short-term investments | (38,633) | 195,431 |
| Purchases of mortgage-backed securities at fair value | | (36,898) |
| Repayments of mortgage-backed securities at fair value | 34,165 | 18,916 |
| Sales of mortgage-backed securities at fair value | 3,345 | |
| Purchases of mortgage loans at fair value | (360,403) | (198,082) |
| Repayments of mortgage loans at fair value | 55,203 | 23,901 |
| Sales of mortgage loans at fair value | 2,518 | 891 |
| Purchases of real estate acquired in settlement of loans | (1,510) | (1,238) |
| Sales of real estate acquired in settlement of loans | 29,321 | 1,634 |
| Decrease in margin deposits | 4,758 | |
| Net cash (used) provided by investing activities | (271,236) | 4,555 |
| Cash flows from financing activities | | |
| Sales of loans under agreements to repurchase | 218,737 | |
| Repurchases of loans sold under agreements to repurchase | (103,956) | |
| Sales of securities under agreements to repurchase | 822,934 | 31,362 |
| Repurchases of securities sold under agreements to repurchase | (853,158) | |
| Sales of real estate acquired in settlement of loans financed under agreements to repurchase | 7,808 | |
| Proceeds from issuance of common shares | 197,162 | |

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| | | |
|--|----------|-----------|
| Payment of underwriting and offering costs | (8,404) | (150) |
| Payment of dividends | (11,673) | |
| Net cash provided by financing activities | 269,450 | 31,212 |
| Net (decrease) increase in cash | (43,103) | 22,460 |
| Cash at beginning of period | 45,447 | 54 |
| Cash at end of period | \$ 2,344 | \$ 22,514 |

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

Table of Contents

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Organization and Basis of Presentation

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

The Company's primary investment objective is to maximize the value of the mortgage loans that it acquires, a substantial portion of which may be distressed and acquired at discounts to their unpaid principal balances, either through loan modification programs, special servicing and other initiatives focused on keeping borrowers in their homes, or, when necessary, through timely acquisition and liquidation of the property securing the loan. Accordingly, management has concluded that the Company operates as a single segment.

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

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

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

The accompanying consolidated financial statements have been prepared in compliance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and with the SEC's instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these financial statements and notes do not include all of the information required by U.S. GAAP for complete financial statements.

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

In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the periods ended June 30, 2011 are not necessarily indicative of the results for the year ending December 31, 2011.

Table of Contents

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 2 Concentration of Risks

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

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

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

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

PCM's ability to identify, and the Company's loan servicers' ability to execute, optimal resolutions of problem mortgage loans;

the accuracy of valuation information obtained during the Company's due diligence activities;

PCM's ability to effectively model, and to develop appropriate model assumptions that properly anticipate, future outcomes;

the level of government support for problem loan resolution and the effect of current and future proposed and enacted legislative and regulatory changes on the Company's ability to effect cures or resolutions to distressed loans; and

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

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

Table of Contents

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 2 Concentration of Risks (Continued)

The Company purchased \$361.9 million and \$199.3 million at fair value of mortgage loans and real estate acquired in settlement of loans for its investment portfolio during the six months ended June 30, 2011 and 2010, respectively. Of those totals, \$344.6 million and \$187.9 million, respectively, were purchased from CitiMortgage, Inc., or one of its affiliates.

As detailed in Note 21 *Subsequent Events*, after June 30, 2011 and through the date of this Report, the Company entered into an agreement with Citigroup Global Markets Realty Corp. ("CGM") to purchase certain nonperforming residential mortgage loans and residential real property acquired in settlement of loans (collectively, the "CGM Assets"). The CGM Assets were acquired by CGM from an unaffiliated, large money-center bank. The initial purchase price is approximately \$177.5 million. Subsequent adjustments may increase the purchase price to \$180.6 million based on the date the purchase is settled. The Company will also pay CGM its cost of carry on the CGM Assets pending purchase through the date such CGM Assets are ultimately acquired. The Company recognized the assets subject to the transaction and the related liability in July 2011. The CGM Assets will be serviced for PMT by PLS beginning on August 4, 2011.

As discussed in Note 3 *Transactions with Related Parties*, a portion of the Company's short-term investments is made in an uninsured institutional money market fund that is managed by a strategic investor in Private National Mortgage Acceptance Company, LLC ("PNMAC"), the parent company of PCM and PLS. The fund invests exclusively in first-tier securities as rated by a nationally recognized statistical rating organization. The fund's investments are comprised primarily of domestic commercial paper, securities issued or guaranteed by the United States Government or its agencies, obligations of foreign banks with operations in the United States, fully collateralized repurchase agreements and variable and floating rate demand notes.

Note 3 Transactions with Related Parties

The Company is managed externally by PCM under the terms of a management agreement that expires on August 4, 2012 and will be automatically renewed for a one-year term each anniversary date thereafter unless previously terminated. If the Company terminates the management agreement without cause, or PCM terminates the management agreement upon a default by the Company in its performance of any material term in the management agreement, PMT will be obligated to pay a termination fee to PCM. As more fully described in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 (the "Annual Report"), certain of the underwriting costs incurred in the Company's initial public offering ("IPO") were paid on PMT's behalf by PCM and a portion of the underwriting discount was deferred by agreement with the underwriters of the offering. Under circumstances where the termination fee is payable, PMT will reimburse PCM the underwriting costs discussed in Note 15 *Shareholders' Equity*.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 3 Transactions with Related Parties (Continued)**

PMT pays PCM a base management fee and may pay a performance incentive fee, both payable quarterly and in arrears. Following is a summary of management fee expense and the related liability recorded by the Company for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|---------------------------|----------|------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands) | | | |
| Base management fee | \$ 1,913 | \$ 1,202 | \$ 3,462 | \$ 2,413 |
| Performance incentive fee | | | | |
| Total management fee incurred during the period | 1,913 | 1,202 | 3,462 | 2,413 |
| Fee paid during the period | (1,549) | | (2,777) | (1,169) |
| Fee outstanding at beginning of period | 1,549 | 1,211 | 1,228 | 1,169 |
| Fee outstanding at period end | \$ 1,913 | \$ 2,413 | \$ 1,913 | \$ 2,413 |

Both the management and termination fees are more fully described in Note 4 *Transactions with Related Parties* to the Company's Annual Report.

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

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

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

In connection with the Company's correspondent lending business, PLS is entitled to base servicing fees, which range from 5 to 20 basis points per year of the unpaid principal balance of such loans, and

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 3 Transactions with Related Parties (Continued)**

other customary market-based fees and charges as described above. PLS also provides certain mortgage banking services, including fulfillment and disposition-related services, to the Company for a fulfillment fee based on a percentage of the unpaid principal balance of the mortgage loans. The fulfillment fee for such services is currently 50 basis points. Since November 1, 2010, the Company has collected interest income and a sourcing fee of three basis points for each mortgage loan it purchases from a correspondent lender and sells to PLS for ultimate disposition to a third party where the Company is not yet approved or licensed to sell to such third party. The sourcing fees collected by the Company during the quarter and six months ended June 30, 2011 amounted to \$4,000 and \$8,000, respectively. During the quarter and six months ended June 30, 2011, the Company recorded fulfillment fees totaling \$61,000 and \$73,000, respectively. No fulfillment fees were incurred during the quarter and six months ended June 30, 2010.

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

Following is a summary of those expenses for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|---------------------------|----------|------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands) | | | |
| Loan servicing and fulfillment fees payable to PLS | \$ 2,885 | \$ 540 | \$ 5,056 | \$ 623 |
| Reimbursement of expenses incurred on PMT's behalf: | | | | |
| Compensation | 130 | 81 | 258 | 206 |
| Other | 781 | 78 | 912 | 349 |
| | 911 | 159 | 1,170 | 555 |
| Reimbursement of common overhead incurred by PCM and its affiliates | 942 | 481 | 1,529 | 481 |
| | \$ 4,738 | \$ 1,180 | \$ 7,755 | \$ 1,659 |
| Payments made during the period | \$ 4,997 | \$ 121 | \$ 6,203 | \$ 248 |

During the Company's startup period and through the quarter ended March 31, 2010, PCM and its affiliates did not charge the Company for its proportionate share of common overhead expenses. Such expenses totaled approximately \$500,000 for the quarter ended March 31, 2010. No other charges were waived by PCM during the Company's startup period and through the quarter ended March 31, 2010. Management believes that PCM does not intend to waive recovery of common overhead costs in the future.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 3 Transactions with Related Parties (Continued)**

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

| | June 30, 2011 | December 31, 2010 |
|---------------------------|------------------|----------------------|
| | (in thousands) | |
| Contingent offering costs | \$ 2,941 | \$ 2,941 |
| Management fee | 1,913 | 1,228 |
| Expenses | 6,528 | 1,426 |
| | \$ 11,382 | \$ 5,595 |

Amounts due from affiliates totaled \$7.2 million and \$2.1 million at June 30, 2011 and December 31, 2010, respectively, and represent amounts receivable pursuant to loan sales to affiliates and reimbursable expenses paid on the affiliates' behalf by the Company.

The Company's short-term investments include investment in a liquidity management fund that is managed by a strategic investor in PNMAC.

PNMAC held 75,000 of the Company's common shares of beneficial interest at both June 30, 2011 and December 31, 2010.

Note 4 Earnings Per Share

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

During the six months ended June 30, 2011, the Company made grants of restricted share units which entitle the recipients to receive dividends during the vesting period on a basis equivalent to the dividends paid to holders of common shares. Unvested share-based compensation awards containing nonforfeitable rights to dividends or dividend equivalents (collectively, "dividends") are participating securities and are included in the basic earnings per share calculation using the two-class method. Under the two-class method, all earnings (distributed and undistributed) are allocated to each class of common stock and participating securities, based on their respective rights to receive dividends.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 4 Earnings Per Share (Continued)**

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

| | Quarter ended June 30, | | Six months ended June 30, | |
|--|---------------------------|----------|------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| (in thousands except per share amounts) | | | | |
| Basic earnings per share: | | | | |
| Net income | \$ 16,617 | \$ 8,151 | \$ 24,262 | \$ 9,405 |
| Effect of participating securities share-based compensation instruments | (224) | | (274) | |
| Net income attributable to common shareholders | \$ 16,393 | \$ 8,151 | \$ 23,988 | \$ 9,405 |
| Weighted-average shares outstanding | 27,778 | 16,735 | 24,874 | 16,735 |
| Basic earnings per share | \$ 0.59 | \$ 0.49 | \$ 0.96 | \$ 0.56 |
| Diluted earnings per share: | | | | |
| Net income | \$ 16,617 | \$ 8,151 | \$ 24,262 | \$ 9,405 |
| Weighted-average shares outstanding | 27,778 | 16,735 | 24,874 | 16,735 |
| Dilutive potential common shares shares issuable under share-based compensation plan | 318 | 371 | 268 | 371 |
| Diluted weighted-average number of common shares outstanding | 28,096 | 17,106 | 25,142 | 17,106 |
| Diluted earnings per common share | \$ 0.59 | \$ 0.48 | \$ 0.96 | \$ 0.55 |

Note 5 Fair Value

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

Fair Value Accounting Elections

Management identified all of its financial assets, including the short-term investments, mortgage-backed securities ("MBS") and mortgage loans, as well as its securities sold under agreements to repurchase and its mortgage servicing rights ("MSRs") to be accounted for at estimated fair value so such changes in fair value will be reflected in income as they occur and more timely reflect the results of the Company's investment performance. For loans sold under agreements to repurchase subject to agreements made beginning in December 2010 and for real estate acquired in settlement of loans financed through agreements to repurchase beginning in June 2011, management has determined that historical cost accounting is more appropriate because under this method debt issuance costs are amortized over the term of the debt, thereby reflecting the debt issuance expense over the periods benefiting from the usage of the debt.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 5 Fair Value (Continued)***Financial Statement Items Measured at Fair Value on a Recurring Basis*

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

| | June 30, 2011 | | | |
|--|-----------------------|----------------|----------------|--------------|
| | Level 1 | Level 2 | Level 3 | Total |
| | (in thousands) | | | |
| Assets: | | | | |
| Short-term investments | \$ 38,633 | \$ | \$ | \$ 38,633 |
| Mortgage-backed securities at fair value | | | 82,421 | 82,421 |
| Mortgage loans acquired for sale at fair value | | 18,848 | | 18,848 |
| Mortgage loans at fair value | | | 657,223 | 657,223 |
| Mortgage servicing rights at fair value | | | 180 | 180 |
| | \$ 38,633 | \$ 18,848 | \$ 739,824 | \$ 797,305 |

Liabilities:

| | | | | |
|--|----|----|-----------|-----------|
| Securities sold under agreements to repurchase at fair value | \$ | \$ | \$ 70,978 | \$ 70,978 |
| | \$ | \$ | \$ 70,978 | \$ 70,978 |

| | December 31, 2010 | | | |
|--|--------------------------|----------------|----------------|--------------|
| | Level 1 | Level 2 | Level 3 | Total |
| | (in thousands) | | | |
| Assets: | | | | |
| Mortgage-backed securities at fair value | \$ | \$ | \$ 119,872 | \$ 119,872 |
| Mortgage loans acquired for sale at fair value | | 3,966 | | 3,966 |
| Mortgage loans at fair value | | | 364,250 | 364,250 |
| | \$ | \$ 3,966 | \$ 484,122 | \$ 488,088 |

Liabilities:

| | | | | |
|--|----|----|------------|------------|
| Securities sold under agreements to repurchase at fair value | \$ | \$ | \$ 101,202 | \$ 101,202 |
| | \$ | \$ | \$ 101,202 | \$ 101,202 |

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 5 Fair Value (Continued)**

The Company's MBS, mortgage loans at fair value, MSRs and securities sold under agreements to repurchase were measured using Level 3 inputs. The following is a summary of changes in items measured using Level 3 inputs on a recurring basis for the periods presented:

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

| | Securities sold under agreements to repurchase (in thousands) |
|--|---|
| Liabilities: | |
| Balance, March 31, 2011 | \$ 88,065 |
| Changes in fair value included in income | |
| Sales of securities under agreements to repurchase | 564,982 |
| Repurchases | (582,069) |
| Balance, June 30, 2011 | \$ 70,978 |

Changes in fair value recognized during the period relating to liabilities still outstanding at June 30, 2011 \$

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 5 Fair Value (Continued)**

| | Quarter ended June 30, 2010 | | |
|---|-----------------------------|-------------------|-------------------|
| | Mortgage-backed securities | Mortgage loans | Total |
| | (in thousands) | | |
| Assets: | | | |
| Balance, March 31, 2010 | \$ 76,389 | \$ 123,464 | \$ 199,853 |
| Purchases | 36,484 | 96,657 | 133,141 |
| Repayments | (10,298) | (19,034) | (29,332) |
| Accrual of unearned discounts | 796 | | 796 |
| Transfers of mortgage loans to real estate acquired in settlement of loans | | (13,029) | (13,029) |
| Sales | | (891) | (891) |
| Addition of unpaid interest to mortgage loan balances in loan modifications | | 19 | 19 |
| Changes in fair value included in income arising from: | | | |
| Changes in instrument-specific credit risk | | 2,139 | 2,139 |
| Other factors | (207) | 7,891 | 7,684 |
| | (207) | 10,030 | 9,823 |
| Balance, June 30, 2010 | \$ 103,164 | \$ 197,216 | \$ 300,380 |
| Changes in fair value recognized during the period relating to assets still held at June 30, 2010 | \$ (207) | \$ 2,118 | \$ 1,911 |

| | Securities sold under agreements to repurchase |
|---|--|
| | (in thousands) |
| Liabilities: | |
| Balance, March 31, 2010 | \$ |
| Changes in fair value included in income | |
| Sales of securities under agreements to repurchase | 31,362 |
| Repurchases | |
| Balance, June 30, 2010 | \$ 31,362 |
| Changes in fair value recognized during the period relating to liabilities still outstanding at June 30, 2010 | \$ |

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 5 Fair Value (Continued)**

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

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

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 5 Fair Value (Continued)**

| | Six months ended June 30, 2010 | | |
|--|-----------------------------------|-------------------|----------------|
| | Mortgage- backed securities | Mortgage loans | Total |
| | (in thousands) | | |
| Assets: | | | |
| Balance, December 31, 2009 | \$ 83,771 | \$ 26,046 | \$ 109,817 |
| Purchases | 36,898 | 211,864 | 248,762 |
| Repayments | (18,916) | (23,901) | (42,817) |
| Accrual of unearned discounts | 1,561 | | 1,561 |
| Transfers of mortgage loans to real estate acquired in settlement of loans | | (13,302) | (13,302) |
| Sales | | (14,673) | (14,673) |
| Addition of unpaid interest to mortgage loan balances in loan modifications | | 19 | 19 |
| Changes in fair value included in income arising from: | | | |
| Changes in instrument-specific credit risk | | 1,628 | 1,628 |
| Other factors | (150) | 9,535 | 9,385 |
| | (150) | \$ 11,163 | 11,013 |
| Balance, June 30, 2010 | 103,164 | \$ 197,216 | 300,380 |
| Changes in fair value recognized during the period relating to assets still held at June 30, 2010 | \$ (150) | \$ 1,442 | 1,292 |

| | Securities sold under agreements to repurchase (in thousands) |
|---|---|
| Liabilities: | |
| Balance, December 31, 2009 | \$ |
| Changes in fair value included in income | |
| Sales of securities under agreements to repurchase | 31,362 |
| Repurchases | |
| Balance, June 30, 2010 | \$ 31,362 |
| Changes in fair value recognized during the period relating to liabilities still outstanding at June 30, 2010 | \$ |

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 5 Fair Value (Continued)**

Following are the fair values and related principal amounts due upon maturity of mortgage loans accounted for under the fair value option as of the dates presented:

| | Fair value | June 30, 2011 Principal amount due upon maturity (in thousands) | Difference |
|------------------------------------|------------|--|--------------|
| Current through 89 days delinquent | \$ 187,393 | \$ 300,025 | \$ (112,632) |
| 90 or more days delinquent(1) | 488,678 | 961,714 | (473,036) |
| | \$ 676,071 | \$ 1,261,739 | \$ (585,668) |

| | Fair value | December 31, 2010 Principal amount due upon maturity (in thousands) | Difference |
|------------------------------------|------------|--|--------------|
| Current through 89 days delinquent | \$ 90,208 | \$ 139,475 | \$ (49,267) |
| 90 or more days delinquent(1) | 278,008 | 521,326 | (243,318) |
| | \$ 368,216 | \$ 660,801 | \$ (292,585) |

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

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 5 Fair Value (Continued)**

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

| | Changes in fair value included in current period income Quarter ended June 30, | | | | | | | | | |
|--|---|----------------------------------|---|---|-----------|--------------------|-------------------------------------|---|-----------|----|
| | Interest income | Gain (loss) on investments | 2011 Net gain on mortgage loans acquired for sale | Change in fair value of MSRs | Total | Interest income | Gain (loss) on investments | 2010 Net gain on mortgage loans acquired for sale | Total | |
| (in thousands) | | | | | | | | | | |
| Assets: | | | | | | | | | | |
| Short-term money market investments | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Mortgage-backed securities at fair value | 660 | (873) | | | (213) | 796 | (207) | | 589 | |
| Mortgage loans acquired for sale at fair value | | | 40 | | 40 | | | 28 | 28 | |
| Mortgage loans at fair value | | 22,951 | | | 22,951 | | 9,966 | | 9,966 | |
| Mortgage servicing rights at fair value | | | | 6 | 6 | | | | | |
| | \$ 660 | \$ 22,078 | \$ 40 | \$ 6 | \$ 22,784 | \$ 796 | \$ 9,759 | \$ 28 | \$ 10,583 | |
| Liabilities: | | | | | | | | | | |
| Securities sold under agreements to repurchase at fair value | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |

| | Changes in fair value included in current period income Six months ended June 30, | | | | | | | | | |
|--|--|----------------------------------|---|---|-----------|--------------------|-------------------------------------|---|-----------|----|
| | Interest income | Gain (loss) on investments | 2011 Net gain on mortgage loans acquired for sale | Change in fair value of MSRs | Total | Interest income | Gain (loss) on investments | 2010 Net gain on mortgage loans acquired for sale | Total | |
| (in thousands) | | | | | | | | | | |
| Assets: | | | | | | | | | | |
| Short-term money market investments | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Mortgage-backed securities at fair value | 1,374 | (1,315) | | | 59 | 1,561 | (150) | | 1,411 | |
| Mortgage loans acquired for sale at fair value | | | 123 | | 123 | | | 28 | 28 | |
| Mortgage loans at fair value | | 33,283 | | | 33,283 | | 11,099 | | 11,099 | |
| Mortgage servicing rights at fair value | | | | 3 | 3 | | | | | |
| | \$ 1,374 | \$ 31,968 | \$ 123 | \$ 3 | \$ 33,468 | \$ 1,561 | \$ 10,949 | \$ 28 | \$ 12,538 | |

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Liabilities:

| | | | | | | | | | |
|--|----|----|----|----|----|----|----|----|----|
| Securities sold under agreements to repurchase at fair value | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 5 Fair Value (Continued)***Financial Statement Items Measured at Fair Value on a Nonrecurring Basis*

The Company measures its investment in real estate acquired in settlement of loans at management's estimates of the respective properties' fair values less cost to sell on a nonrecurring basis. The value of the real estate acquired in settlement of loans is initially established as the lesser of (a) either the fair value of the loan at the date of transfer or the purchase price of the property, or (b) the fair value of the real estate less estimated costs to sell as of the date of transfer. Any subsequent change in fair value to a level that is less than or equal to the value at which the property was initially recorded is recognized in *Results of real estate acquired in settlement of loans* in the consolidated statements of income.

Real estate acquired in settlement of loans are summarized below:

| | Quarter ended June 30, | | Six months ended June 30, | |
|--|---------------------------|-----------|------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| | (amounts in thousands) | | | |
| Carrying value at period end | \$ 48,872 | \$ 13,241 | \$ 48,872 | \$ 13,241 |
| Transfers from mortgage loans during the period | \$ 31,648 | \$ 13,029 | \$ 45,823 | \$ 13,302 |
| Remeasurements of real estate acquired in settlement of loans at fair value during the period: | | | | |
| Fair value after remeasurement | \$ 15,923 | \$ 748 | \$ 16,006 | \$ 748 |
| Remeasurement losses recognized in <i>Results of real estate acquired in settlement of loans</i> | \$ (2,289) | \$ (206) | \$ (2,860) | \$ (206) |

Fair Value of Financial Instruments Carried at Amortized Cost

In November and December 2010 and in June 2011, the Company entered into new debt facilities to finance its investment in nonperforming loans and real estate acquired in settlement of loans in the form of repurchase agreements. As discussed in *Fair Value Accounting Elections* above, management designated these agreements to be accounted for at amortized cost. Management has concluded that the estimated fair value of loans sold under agreements to repurchase and of real estate acquired in settlement of loans financed under agreements to repurchase approximates the agreements' carrying value due to the agreements' short terms and variable interest rates.

Valuation Techniques

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

Mortgage-Backed Securities

Non-Agency MBS are categorized as "Level 3" financial statement items. Fair value of non-Agency MBS is estimated using broker indications of value. Agency MBS refers to securities issued by the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal National Mortgage Association ("Fannie Mae") (Freddie Mac and Fannie Mae are each referred to as an "Agency" and, collectively, as the "Agencies"). For indications of value received as of June 30, 2011, PCM's Capital

Table of Contents

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5 Fair Value (Continued)

Markets and Valuation staff reviewed the price indications of unrelated third party brokers ("brokers") for completeness, accuracy and consistency across all similar bonds managed by PCM. Bond-level analytics such as yield, weighted average life and projected prepayment and default speeds of the underlying collateral were computed. The reasonableness of the brokers' indications of value and of changes in value from period to period was evaluated in light of the analytical review performed and considering market conditions. The review of the Capital Markets and Valuation staff is reported to PCM's Valuation Committee as part of their review and approval of monthly valuation results. PCM does not intend to adjust its fair value estimates to amounts different than the brokers' indications of value.

Interest income on MBS is recognized over the life of the security using the interest method and is included in the consolidated statement of income under the caption *Interest income Mortgage-backed securities*. Changes in fair value arising from amortization of purchase premiums and accrual of unearned discounts are recognized as a component of interest income.

Mortgage Loans Acquired for Sale at Fair Value and Mortgage Loans at Fair Value

Fair value of mortgage loans is estimated based on whether the mortgage loans are saleable into active markets with established counterparties and transparent pricing:

Mortgage loans that are saleable into active markets, comprised of the Company's mortgage loans acquired for sale at fair value, are categorized as "Level 2" financial statement items and their fair values are estimated using their quoted market or contracted price or market price equivalent.

Loans that are not saleable into active markets are categorized as "Level 3" financial statement items, and their fair values are estimated using a discounted cash flow valuation model. Inputs to the model include current interest rates, loan amount, payment status and property type, and forecasts of future interest rates, home prices, prepayment speeds, default and loss severities. The valuation process includes the computation by strata of loan population and a review for reasonableness of various measures such as weighted average life, projected prepayment and default speeds, and projected default and loss percentages. The Valuation staff computes the impact on the valuation of changes in input variables such as interest rates, home prices, and delinquency status in order to assess the reasonableness of changes in the loan valuation.

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.

Management incorporates lack of liquidity into its fair value estimates based on the type of asset or liability measured and the valuation method used. For example, for mortgage loans where the significant inputs have become unobservable due to illiquidity in the markets for distressed mortgage loans or non-Agency, non-conforming mortgage loans, PMT uses a discounted cash flow technique to estimate fair value. This technique incorporates forecasting of expected cash flows discounted at an appropriate market discount rate that is intended to reflect the lack of liquidity in the market.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 5 Fair Value (Continued)**

Interest income on loans is recognized over the life of the loan using its contractual interest rate and is included in the consolidated statements of income under the caption *Interest income Mortgage loans*. Accrual of interest earned but not yet collected is suspended and all previously accrued interest is reversed for loans when they become 90 days delinquent, or when, in management's opinion, a full recovery of income and principal becomes doubtful. Accrual of interest is resumed when the loan becomes contractually current.

Real Estate Acquired in Settlement of Loans

Real estate acquired in settlement of loans is measured based on its fair value on a nonrecurring basis and is categorized as a "Level 3" financial statement item. Fair value of real estate acquired in settlement of loans is determined by management based on a current estimate of value from a broker's price opinion or a full appraisal. Changes in fair value of real estate acquired in settlement of loans are included in the consolidated statements of income under the caption *Results of real estate acquired in settlement of loans*.

Mortgage Servicing Rights

MSRs are categorized as "Level 3" financial statement items. The Company uses a discounted cash flow approach to estimate the fair value of MSRs. This approach consists of projecting servicing cash flows discounted at a rate that management assumes market participants would use in their determinations of value. The key assumptions used in the estimation of the fair value of MSRs include prepayment and default rates of the underlying loans, the applicable discount rate, and cost to service loans. Changes in the fair value of MSRs are included in the consolidated statements of income under the caption *Change in fair value of mortgage servicing rights*.

Securities Sold Under Agreements to Repurchase

Fair value of securities sold under agreements to repurchase is based on the accrued cost of the agreements, which approximates fair value, due to the agreements' short maturities.

Note 6 Mortgage-Backed Securities at Fair Value

Investments in MBS were as follows as of the dates presented:

| | June 30, 2011 | | | | | | | |
|---------------------------|----------------|--------|-----------|---------------|----------|----------------------|-----------|-------|
| | Total | AAA | AA | Credit rating | | Non-investment grade | Not rated | Yield |
| A | | | | BBB | | | | |
| | (in thousands) | | | | | | | |
| Security collateral type: | | | | | | | | |
| Non-Agency subprime | \$ 63,159 | \$ | \$ 4,562 | \$ 1,201 | \$ 1,053 | \$ 56,343 | \$ | 4.03% |
| Non-Agency Alt-A | 11,904 | 537 | 6,099 | | | 5,268 | | 9.50% |
| Non-Agency prime jumbo | 7,358 | | 7,358 | | | | | 3.45% |
| | \$ 82,421 | \$ 537 | \$ 18,019 | \$ 1,201 | \$ 1,053 | \$ 61,611 | \$ | 4.75% |

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 6 Mortgage-Backed Securities at Fair Value (Continued)**

| | December 31, 2010 | | | | | | | |
|------------------------------|-------------------|---------------|-----------|----------|----------|-----------|-------------------------|-----------|
| | Total | Credit rating | | | | | Non-investment grade | Not rated |
| AAA | | AA | A | BBB | | | | |
| | (in thousands) | | | | | | | |
| Security collateral type: | | | | | | | | |
| Non-Agency subprime | \$ 93,783 | \$ 382 | \$ 5,627 | \$ 2,134 | \$ 2,532 | \$ 79,138 | \$ 3,970 | 4.46% |
| Non-Agency Alt-A | 15,824 | 649 | 6,750 | | 14 | 8,411 | | 9.19% |
| Non-Agency prime jumbo | 10,265 | | 10,265 | | | | | 3.51% |
| | \$ 119,872 | \$ 1,031 | \$ 22,642 | \$ 2,134 | \$ 2,546 | \$ 87,549 | \$ 3,970 | 5.00% |

All of the Company's MBS had remaining contractual maturities of more than ten years at June 30, 2011 and at December 31, 2010. At June 30, 2011 and at December 31, 2010, the Company had pledged all of its MBS to secure agreements to repurchase.

Note 7 Mortgage Loans Acquired for Sale at Fair Value

Mortgage loans acquired for sale at fair value is comprised of recently originated mortgage loans purchased by the Company for immediate resale.

Following is a summary of the distribution of the Company's mortgage loans acquired for sale at fair value as of the dates presented:

| Loan Type | June 30, 2011 | | December 31, 2010 | |
|--|----------------|--------------------------------|-------------------|--------------------------------|
| | Fair value | Unpaid principal balance | Fair value | Unpaid principal balance |
| | (in thousands) | | | |
| Government insured or guaranteed | \$ 11,712 | \$ 11,119 | \$ 3,212 | \$ 3,115 |
| Fixed-rate: | | | | |
| Agency-eligible | 2,859 | 2,784 | 754 | 750 |
| Jumbo loans | 4,310 | 4,230 | | |
| | 18,881 | 18,133 | 3,966 | 3,865 |
| Pipeline and other hedging derivatives, net | (33) | | | |
| | \$ 18,848 | \$ 18,133 | \$ 3,966 | \$ 3,865 |

At June 30, 2011, mortgage loans acquired for sale at fair value totaling \$18.9 million were pledged to secure sales of loans under agreements to repurchase. At December 31, 2010, mortgage loans acquired for sale at fair value totaling \$2.7 million were pledged to secure sales of loans under agreements to repurchase.

Note 8 Mortgage Loans at Fair Value

Mortgage loans at fair value are comprised of all mortgage loans not acquired for immediate resale. Such loans may be sold at a later date pursuant to a management determination that such a sale represents the most advantageous liquidation strategy for the identified loan.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 8 Mortgage Loans at Fair Value (Continued)**

Following is a summary of the distribution of the Company's mortgage loans at fair value as of the dates presented:

| Loan Type | June 30, 2011 | | December 31, 2010 | |
|-----------------------|----------------|--------------------------|-------------------|--------------------------|
| | Fair value | Unpaid principal balance | Fair value | Unpaid principal balance |
| | (in thousands) | | | |
| Nonperforming loans | \$ 488,678 | \$ 961,714 | \$ 278,008 | \$ 521,326 |
| Performing loans: | | | | |
| Fixed | 82,898 | 133,175 | 49,444 | 73,256 |
| ARM/Hybrid | 76,253 | 130,448 | 31,916 | 54,430 |
| Interest rate step-up | 7,393 | 12,839 | 4,813 | 7,831 |
| Balloon | 2,001 | 5,430 | 69 | 93 |
| | 168,545 | 281,892 | 86,242 | 135,610 |
| | \$ 657,223 | \$ 1,243,606 | \$ 364,250 | \$ 656,936 |

At June 30, 2011, approximately 75% of the mortgage loan portfolio consisted of mortgage loans that were originated between 2005 and 2007. Approximately 72% of the estimated fair value of the mortgage loans in this portfolio is comprised of loans with unpaid-principal-balance-to-current-property-value ratios in excess of 100% at June 30, 2011. The mortgage loan portfolio consists of mortgage loans originated throughout the United States with loans secured by California real estate comprising approximately 26% of the loan portfolio's estimated fair value at June 30, 2011. The mortgage loan portfolio contains loans from New York, Florida and Illinois that each represent 5% or more of the portfolio's estimated fair value at June 30, 2011.

At December 31, 2010, approximately 94% of the mortgage loan portfolio consisted of mortgage loans that were originated between 2005 and 2007. Over 67% of the estimated fair value of the mortgage loans in this portfolio was comprised of loans with unpaid-principal-balance-to-current-property-value ratios in excess of 100% at December 31, 2010. The mortgage loan portfolio consisted of mortgage loans originated throughout the United States with loans secured by California real estate comprising approximately 27% of the loan portfolio's estimated fair value at December 31, 2010. The mortgage loan portfolio contained loans from Florida, Illinois and New York that each represented 5% or more of the portfolio's estimated fair value at December 31, 2010.

At June 30, 2011, mortgage loans at fair value totaling \$563.0 million were pledged to secure sales of loans under agreements to repurchase. At December 31, 2010, mortgage loans at fair value totaling \$326.9 million were pledged to secure sales of loans under agreements to repurchase.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 9 Real Estate Acquired in Settlement of Loans**

Following is a summary of the activity in real estate acquired in settlement of loans for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|---------------------------|-----------|------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands) | | | |
| Balance at beginning of period | \$ 31,285 | \$ 1,511 | \$ 29,685 | \$ |
| Purchases | 1,263 | | 1,510 | 1,238 |
| Transfers from mortgage loans at fair value | 31,648 | 13,029 | 45,823 | 13,302 |
| Results of real estate acquired in settlement of loans: | | | | |
| Valuation adjustments | (2,736) | 143 | (3,985) | 143 |
| Gain on sale, net | 2,822 | 192 | 5,160 | 192 |
| | 86 | 335 | 1,175 | 335 |
| Sales proceeds | (15,410) | (1,634) | (29,321) | (1,634) |
| Balance at period end | \$ 48,872 | \$ 13,241 | \$ 48,872 | \$ 13,241 |

At June 30, 2011, real estate acquired in settlement of loans totaling \$1.5 million was financed under agreements to repurchase and \$15.9 million was held in a consolidated subsidiary of the Company whose stock was pledged to secure financing of the real estate held in that subsidiary. The assets of the consolidated subsidiary are solely the real estate acquired in settlement of loans. At December 31, 2010, no real estate acquired in settlement of loans was pledged to secure repurchase agreements.

Note 10 Mortgage Servicing Rights

The activity in mortgage servicing rights carried at fair value is as follows:

| | Quarter ended June 30, | | Six months ended June 30, | |
|--|---------------------------|------|------------------------------|------|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands) | | | |
| Balance at beginning of period | \$ 37 | \$ | \$ | \$ |
| Servicing resulting from loan sales | 137 | | 177 | |
| Change in fair value: | | | | |
| Due to changes in valuation inputs or assumptions used in valuation model(1) | 8 | | 5 | |
| Other changes in fair value(2) | (2) | | (2) | |
| Balance at end of period | \$ 180 | \$ | \$ 180 | \$ |

(1)

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

(2)

Represents changes due to realization of expected cash flows.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 11 Loans Sold Under Agreements to Repurchase**

Following is a summary of financial information relating to loans sold under agreements to repurchase as of and for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|-------------------------------|------|------------------------------|------|
| | 2011 | 2010 | 2011 | 2010 |
| | (dollar amounts in thousands) | | | |
| Period end: | | | | |
| Balance | \$ 262,203 | \$ | \$ 262,203 | \$ |
| Unused amount(1) | \$ 262,797 | \$ | \$ 262,797 | \$ |
| Weighted-average interest rate at end of period | 3.64% | | 3.64% | |
| Weighted-average interest rate during the period | 4.48% | | 4.46% | |
| Average balance of loans sold under agreements to repurchase | \$ 239,343 | \$ | \$ 208,630 | \$ |
| Maximum daily amount outstanding | \$ 262,203 | \$ | \$ 262,203 | \$ |
| Total interest expense | \$ 2,708 | \$ | \$ 4,677 | \$ |
| Fair value of loans and real estate acquired in settlement of loans securing agreements to repurchase at period-end | \$ 583,304 | \$ | \$ 583,304 | \$ |

(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 collateral sold.

The repurchase agreements collateralized by loans have an average remaining term of approximately 5 months at June 30, 2011.

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 loans sold under agreements to repurchase is summarized by counterparty below as of June 30, 2011:

| Counterparty | Amount at risk (in thousands) | Weighted average repurchase agreement maturity |
|---|----------------------------------|--|
| | | |
| Wells Fargo Bank, N.A. | \$ 85,160 | November 1, 2011 |
| Citibank, N.A. | \$ 233,358 | December 8, 2011 |
| Credit Suisse First Boston Mortgage Capital LLC | \$ 1,742 | November 1, 2011 |

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 12 Securities Sold Under Agreements to Repurchase at Fair Value**

Following is a summary of financial information relating to securities sold under agreements to repurchase at fair value as of and for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|--|-------------------------------|------------|------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| | (dollar amounts in thousands) | | | |
| Period-end balance | \$ 70,978 | \$ 31,362 | \$ 70,978 | \$ 31,362 |
| Weighted-average interest rate at end of period | 0.94% | 1.28% | 0.94% | 1.28% |
| Weighted-average interest rate during the period | 1.10% | 0.0% | 1.21% | 0.0% |
| Average balance of securities sold under agreements to repurchase | \$ 79,719 | \$ 345 | \$ 87,470 | \$ 173 |
| Maximum daily amount outstanding | \$ 88,065 | \$ 31,362 | \$ 101,202 | \$ 31,362 |
| Total interest expense | \$ 222 | \$ | \$ 531 | \$ |
| Fair value of securities securing agreements to repurchase at period-end | \$ 82,421 | \$ 103,164 | \$ 82,421 | \$ 103,164 |

The repurchase agreements collateralized by securities have an average term of 20 days. All securities underlying repurchase agreements are held by the buyer. All agreements collateralized by MBS are to repurchase the same or substantially identical securities.

The amount at risk (the fair value of the securities pledged plus the related margin deposit, less the amount advanced by the counterparty and accrued interest) relating to the Company's securities sold under agreements to repurchase are summarized by counterparty below as of June 30, 2011:

| Counterparty | Amount at risk (in thousands) | Weighted average repurchase agreement maturity |
|------------------------|----------------------------------|--|
| Wells Fargo Bank, N.A. | \$ 11,441 | July 20, 2011 |

The Company is subject to margin calls during the period the agreements are outstanding and therefore may be required to repay a portion of the borrowings before the respective agreements mature if the value of the MBS securing those agreements decreases. As of June 30, 2011, the Company had made no margin deposits. As of December 31, 2010, the Company had \$4.8 million on deposit with its securities repurchase agreement counterparties. Margin deposits are included in *Other assets* in the consolidated balance sheets.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 13 Real Estate Acquired in Settlement of Loans Financed Under Agreements to Repurchase**

Following is a summary of financial information relating to real estate acquired in settlement of loans financed under agreements to repurchase as of and for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|-------------------------------|------|------------------------------|------|
| | 2011 | 2010 | 2011 | 2010 |
| | (dollar amounts in thousands) | | | |
| Period end: | | | | |
| Balance | \$ 7,808 | \$ | \$ 7,808 | \$ |
| Unused amount(1) | \$ 92,192 | \$ | \$ 92,192 | \$ |
| Weighted-average interest rate at end of period | 4.15% | | 4.15% | |
| Weighted-average interest rate during the period(2) | 4.15% | | 4.15% | |
| Average balance of real estate acquired in settlement of loans sold under agreements to repurchase | \$ 1,373 | \$ | \$ 690 | \$ |
| Maximum daily amount outstanding | \$ 7,808 | \$ | \$ 7,808 | \$ |
| Total interest expense | \$ 40 | \$ | \$ 40 | \$ |
| Fair value of real estate acquired in settlement of loans held in a consolidated subsidiary whose stock is pledged to secure agreements to repurchase at period-end | \$ 15,953 | \$ | \$ 15,953 | \$ |

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

(2) Weighted-average interest rate during the period excludes amortization of debt issuance costs of \$25,000 during the quarter and six months ended June 30, 2011.

The repurchase agreements collateralized by real estate acquired in settlement of loans have an average term of approximately 11.6 months at June 30, 2011.

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 real estate acquired in settlement of loans sold under agreements to repurchase is summarized by counterparty below as of June 30, 2011:

| Counterparty | Amount at risk |
|--------------|----------------|
|--------------|----------------|

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Weighted average
repurchase agreement
maturity

(in thousands)

| | | | |
|---|----|-------|---------------|
| Credit Suisse First Boston Mortgage Capital LLC | \$ | 8,131 | June 11, 2012 |
|---|----|-------|---------------|

Note 14 Commitments and Contingencies

From time to time, the Company may be involved in various proceedings, claims and legal actions arising in the ordinary course of business. As of June 30, 2011, the Company was not involved in any

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 14 Commitments and Contingencies (Continued)**

such proceedings, claims or legal actions that would be reasonably likely to have a material adverse effect on the Company.

Mortgage Loan Commitments

The following table summarizes the Company's outstanding contractual loan commitments as of the date presented:

| | June 30, 2011 |
|--|-----------------------|
| | (in thousands) |
| Correspondent lending: | |
| Commitments to purchase mortgage loans | \$ 30,369 |
| Other mortgage loans: | |
| Commitments to purchase mortgage loans | \$ 126,663 |

Note 15 Shareholders' Equity

On February 16, 2011, the Company issued and sold 9,500,000 common shares in an underwritten public offering at a price of \$18 per share, for net proceeds of approximately \$163.8 million after the underwriting discount and estimated offering expenses and the reimbursement of certain expenses. On March 3, 2011, the Company issued and sold an additional 1,425,000 common shares at a price of \$18 per share pursuant to the exercise of an over-allotment option by the public offering's underwriters and received \$24.6 million of proceeds after the underwriting discount and reimbursement of certain expenses.

On November 19, 2010, the Company entered into a Controlled Equity Offering Sales Agreement (the "2010 Sales Agreement") with Cantor Fitzgerald & Co. During the quarter ended June 30, 2011, the Company sold a total of 28,500 of its common shares under the 2010 Sales Agreement at a weighted average price of \$18.34 per share, providing net proceeds to the Company of approximately \$512,000, net of sales commissions. The sales agent received a total of approximately \$10,000, which represents an average commission of approximately 2.0% of the gross sales price per share.

As more fully described in the Company's Annual Report, certain of the underwriting costs incurred in the Company's IPO were paid on PMT's behalf by PCM and a portion of the underwriting discount was deferred by agreement with the underwriters of the offering. Reimbursement to PCM and payment to the underwriters of the deferred underwriting discount are both contingent on PMT's performance during any full four calendar quarter period during the 24 full calendar quarters after the date of the completion of its IPO, August 4, 2009. If PMT meets the specified performance levels during any full four calendar quarter period during the 24-quarter period, the Company will reimburse PCM approximately \$2.9 million of underwriting costs paid by PCM on the offering date and pay the underwriters approximately \$5.9 million in deferred underwriting discount. If this requirement is not satisfied by the end of such 24-quarter period, the Company's obligation to reimburse PCM and make the conditional payment of the underwriting discount will terminate. Management has concluded that this contingency is probable of being met during the 24-quarter period and has recognized a liability for reimbursement to PCM and payment of the contingent underwriting discount as a reduction of additional paid-in capital.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 16 Share-Based Compensation Plan**

The Company's equity incentive plan allows for grants of equity-based awards up to a total of 8% of PMT's issued and outstanding shares on a diluted basis at the time of the award. Restricted share units have been awarded to trustees and officers of the Company and to employees of PCM and its affiliates at no cost to the grantees. Such awards generally vest over a one- to four-year period. Expense relating to awards is included in the consolidated statements of income under the caption *Compensation*.

The table below summarizes restricted share unit activity and compensation expense for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|--|-----------------------------------|---------|------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands, except share data) | | | |
| Number of shares: | | | | |
| Outstanding at beginning of period | 607,984 | 374,690 | 272,984 | 374,810 |
| Granted | | 1,600 | 340,500 | 23,600 |
| Vested | (400) | | (5,900) | |
| Canceled | (1,264) | (5,080) | (1,264) | (27,200) |
| Outstanding at end of period | 606,320 | 371,210 | 606,320 | 371,210 |
| Expense recorded during the period | \$ 869 | \$ 643 | \$ 1,664 | \$ 1,221 |
| Unamortized compensation cost at period-end | \$ 4,076 | \$ 772 | | |
| At June 30, 2011: | | | | |
| Weighted average grant date fair value per share | \$ 15.42 | | | |
| Shares available for future awards(1) | 1,666,000 | | | |

- (1) Based on shares outstanding as of June 30, 2011. Total shares available for future awards may be adjusted in accordance with the equity incentive plan based on future issuances of PMT's shares as described above.

Note 17 Income Taxes

The Company has elected to be taxed as a REIT for U.S. federal income tax purposes under Sections 856 through 860 of the Internal Revenue Code. Therefore, PMT generally will not be subject to corporate federal or state income tax to the extent that qualifying distributions are made to shareholders and the Company meets REIT requirements including certain asset, income, distribution and share ownership tests. The Company believes that it has met the distribution requirements, as it has declared dividends sufficient to distribute substantially all of its taxable income. Taxable income will generally differ from net income. The primary difference between net income and the REIT taxable income (before deduction for qualifying distributions) is the income of the taxable REIT subsidiaries ("TRSs"). Other than the TRS income, the other differences between REIT book income and REIT taxable income are not material.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 17 Income Taxes (Continued)**

In general, cash dividends declared by the Company will be considered ordinary income to the shareholders for income tax purposes. Some portion of the dividends may be characterized as capital gain distributions or a return of capital.

The Company has elected to treat two of its subsidiaries as TRSs. Income from the TRSs is only included as a component of REIT taxable income to the extent that the TRS makes dividend distributions of income to the REIT. No such dividend distributions were made in the quarters ended June 30, 2011 and 2010. A TRS is subject to corporate federal and state income tax. Accordingly, a provision for income taxes for the TRSs is included in the accompanying consolidated statements of income.

The Company files U.S. federal and state income tax returns for both the REIT and TRSs. These returns for 2009 and forward are subject to examination by the respective tax authorities. No returns are currently under examination.

The following table details the Company's provision for income taxes which relates primarily to the TRSs, for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|-------------------------------------|---------------------------|----------|------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands) | | | |
| Current expense (benefit): | | | | |
| Federal | \$ 2,061 | \$ 1,419 | \$ 2,299 | \$ 1,547 |
| State | 716 | 493 | 743 | 537 |
| Total current | 2,777 | 1,912 | 3,042 | 2,084 |
| Deferred expense (benefit): | | | | |
| Federal | (1,033) | | (754) | |
| State | (359) | | (262) | |
| Total deferred expense | (1,392) | | (1,016) | |
| Valuation allowance | | | | (45) |
| Total provision for income taxes | \$ 1,385 | \$ 1,912 | \$ 2,026 | \$ 2,039 |

The provision for deferred income taxes for the quarter ended June 30, 2011 relates to unrealized valuation gains on real estate acquired in settlement of loans. There was no provision for deferred income taxes for the quarter ended June 30, 2010.

Table of Contents**PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 17 Income Taxes (Continued)**

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

| | Quarter ended June 30, | | Quarter ended June 30, | | Six months ended June 30, | | Six months ended June 30, | |
|--|------------------------|---------|------------------------|---------|---------------------------|---------|---------------------------|---------|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| | Amount | Rate | Amount | Rate | Amount | Rate | Amount | Rate |
| | (dollars in thousands) | | | | | | | |
| Federal provision for income taxes at statutory tax rate | \$ 6,290 | 35.0% | \$ 3,523 | 35.0% | \$ 9,201 | 35.0% | \$ 4,006 | 35.0% |
| Effect of non-taxable REIT income | (5,134) | (28.6)% | (2,000) | (19.9)% | (7,655) | (29.1)% | (2,340) | (20.5)% |
| Provision for state income taxes, net of federal benefit | 232 | 1.3% | 320 | 3.2% | 313 | 1.2% | 349 | 3.1% |
| Other | (3) | | 69 | 0.7% | 167 | 0.6% | 69 | 0.6% |
| Valuation allowance | | | | | | | (45) | (0.4)% |
| Provision for income taxes | \$ 1,385 | 7.7% | \$ 1,912 | 19.0% | \$ 2,026 | 7.7% | \$ 2,039 | 17.8% |

At June 30, 2011 and June 30, 2010, the Company has no unrecognized tax benefits and does not anticipate any increase in unrecognized tax benefits. Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is the Company's policy to record such accruals in the Company's income tax accounts. No such accruals existed at June 30, 2011 or at June 30, 2010.

Note 18 Supplemental Cash Flow Information

| | Six months ended | |
|---|------------------|-----------|
| | 2011 | 2010 |
| | (in thousands) | |
| Income taxes paid | \$ 660 | \$ 386 |
| Interest paid | \$ 5,311 | \$ |
| Non-cash investing activities: | | |
| Transfer of mortgage loans to real estate acquired in settlement of loans | \$ 45,823 | \$ 13,302 |
| Addition of unpaid interest to mortgage loan balances in loan modifications | \$ 311 | \$ 19 |
| Receipt of MSR as proceeds from sales of loans | \$ 177 | \$ |

Note 19 Regulatory Net Worth Requirement

On September 23, 2010, PennyMac Corp., an indirect subsidiary of the Company, received conditional approval as a seller-servicer for Fannie Mae. Fannie Mae's conditional approval required PennyMac Corp. to deposit, for a period of 12 months, \$5.0 million in a pledged cash account to secure its performance under its master agreement with Fannie Mae. PennyMac Corp. established the pledged cash account. The pledged cash is included in *Other assets* in the consolidated balance sheets at June 30, 2011 and December 31, 2010.

Table of Contents

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 19 Regulatory Net Worth Requirement (Continued)

To retain its status as an approved seller-servicer, PennyMac Corp. is required to meet Fannie Mae's capital standards, which require PennyMac Corp. to maintain a minimum net worth of \$2.5 million. Management believes PennyMac Corp. complies with Fannie Mae's net worth requirement as of June 30, 2011.

Note 20 Recently Issued Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board issued an Accounting Standards Update ("ASU"), ASU 2011-04 to the *Fair Value Measurements* topic of the Accounting Standards Codification ("ASC"). ASU 2011-04 eliminates unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards, expands the disclosure requirements of the *Fair Value Measurements and Disclosure* topic of the ASC for fair value measurements and makes other amendments, including:

limiting the highest-and-best-use valuation-premise concepts only to measuring the fair value of nonfinancial assets;

permitting an exception to fair value measurement principles for financial assets and financial liabilities (and derivatives) with offsetting positions in market risks or counterparty credit risk when several criteria are met. When the criteria are met, an entity can measure the fair value of the net risk position;

clarifying that premiums or discounts that reflect size as a characteristic of the reporting entity's holding rather than as a characteristic of the asset or liability (for example, a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement; and

prescribing a model for measuring the fair value of an instrument classified in shareholders' equity; this model is consistent with the guidance on measuring the fair value of liabilities.

ASU 2011-04 expands the *Fair Value Measurements* topic's disclosure requirements, particularly for fair value measurements categorized in Level 3 of the fair value hierarchy: (1) a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, (2) a description of the valuation processes in place (e.g., how the entity decides its valuation policies and procedures, as well as changes in its analyses of fair value measurements, from period to period), and (3) a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs.

ASU 2011-04 is applicable to the Company for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 is not expected to have a material effect on the Company's financial statements.

Table of Contents

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 21 Subsequent Events

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

On July 12, 2011, the Company entered an agreement to purchase the CGM Assets from CGM. The CGM Assets were acquired by CGM from an unaffiliated large money-center bank (the "Initial Seller"). As part of the agreement and in connection with the Company's purchase of the CGM Assets, CGM will assign, and the Company will assume, all of CGM's rights and obligations under a separate purchase agreement with the Initial Seller. The Company will record the transaction as a purchase of loans in the third quarter of 2011.

Under the terms of the agreement, the Company will purchase the CGM Assets at a purchase price based, in part, on a percentage of the unpaid principal balance of the mortgage loans or, as applicable, the mortgage loans at the time the real property was acquired in settlement thereof. The unpaid principal balance of each CGM Asset is measured as of the cut-off date agreed to with the Initial Seller (the "Cut-off Date"). Pending settlement, the purchase price for each CGM Asset will be reduced by any collections of principal and interest on such CGM Asset after the closing date agreed to with the Initial Seller (the "Closing Date") and prior to the related settlement date.

The total unpaid principal balance of the CGM Assets as of the Cut-off Date was approximately \$348 million. The initial purchase price is approximately \$177.5 million. Subsequent adjustments may increase the purchase price to a maximum of \$180.6 million based on the date the Company settles the purchase. The CGM Assets will be serviced by PLS from and after August 4, 2011 and interim serviced by the Initial Seller prior thereto.

On the settlement date for any CGM Asset, in addition to the payment of the purchase price, the Company will reimburse CGM for certain out-of-pocket costs and other expenses, including servicing fees and servicing advances, and a cost of carry for such CGM Asset.

Any CGM Asset that liquidates prior to its settlement by the Company will be settled between the Company and CGM in the month following liquidation, in an amount based on the difference between the liquidation proceeds and the sum of the purchase price and reimbursement amounts that would have applied to such CGM Asset had it been purchased on the liquidation date.

The agreement requires that the Company settle the purchases of the CGM Assets on or before the date that is 180 days following the Closing Date; provided, however, that if on or prior to such date the Company reduces the total purchase price of the CGM Assets (measured as of the Cut-off Date) by 35% or more through collections of principal and interest, liquidations and settlements of purchases of CGM Assets, the date by which the CGM Assets must be settled shall be extended until 360 days following the Closing Date. In the event that the Company fails to settle the purchase of any CGM Assets on or before the 180-day or 360-day period described herein, as applicable, the agreement provides for a net settlement between the Company and CGM, in an amount based on the difference between the fair value of such CGM Assets on the date of determination and the sum of the purchase price and reimbursement amounts that would have applied to such CGM Assets had they been purchased on such date.

Table of Contents

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 21 Subsequent Events (Continued)

The agreement also contains various representations, warranties and covenants, repurchase and indemnity obligations, and other terms and conditions customary for transactions involving the transfer of nonperforming loans.

The settlement of the purchase of the CGM Assets is subject to the Company obtaining additional capital sufficient to fund the transaction. There can be no assurance that the purchase of the CGM Assets will ultimately be settled.

On July 15, 2011, the Company completed the purchase of \$6.1 million in fair value of CGM Assets.

On August 2, 2011, the Company's Board of Trustees declared cash distributions of \$0.50 per share payable on August 31, 2011 to holders of record of the Company's common shares as of August 16, 2011.

Table of Contents

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

We are a specialty finance company that invests primarily in residential mortgage loans and mortgage-related assets. Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective primarily by investing in mortgage loans, a substantial portion of which may be distressed and acquired at discounts to their unpaid principal balances. We acquire these loans through direct acquisitions of mortgage loan portfolios from institutions such as banks, mortgage companies and insurance companies and direct acquisitions or participations in structured transactions. A substantial portion of the nonperforming loans we have purchased have been acquired from CitiMortgage, Inc, and/or its affiliates.

We seek to maximize the value of the mortgage loans that we acquire using means that are appropriate for the particular loan, including both proprietary and nonproprietary loan modification programs (such as the U.S. Departments of the Treasury and Housing and Urban Development's Home Affordable Modification Program, or HAMP), special servicing and other initiatives focused on avoiding foreclosure, when possible. When we are unable to effect a cure for a mortgage delinquency, our objective is to effect timely acquisition and/or liquidation of the property securing the loan. We supplement these activities through participation in other mortgage-related activities, which are in various states of analysis, planning or implementation and include the following:

acquisition and sale or securitization of mortgage loans, including jumbo loans, from originators of mortgage loans to be resold to the Agency and securitization markets. Changes in the mortgage market have significantly reduced the outlets for sales of mortgage loans by smaller mortgage originators who have traditionally sold their loans to larger mortgage companies and banks who, in turn, sold those loans to Agencies or into securitizations. We believe these changes, along with scheduled reductions to government-sponsored entity ("GSE") loan size limits and the reduced participation of large bank lenders in anticipation of regulatory changes to securitization-related capital requirements, provide us with the opportunity to act as a link between these loan originators and the Agency and securitization markets. During the quarter and six months ended June 30, 2011, we purchased loans with fair values totaling \$54.8 million and \$74.4 million, respectively, in furtherance of our correspondent lending strategy. We held an inventory of mortgage loans in furtherance of this strategy totaling \$18.8 million at June 30, 2011. To the extent that we transfer these loans into securitizations in the future, we intend to retain a portion of the securities created in the securitization transaction.

acquisition of real estate investment trust ("REIT")-eligible mortgage-backed securities ("MBS"). We believe that the recent dislocations of the residential mortgage markets have disproportionately affected the pricing of certain classes of MBS, thereby providing attractive investment opportunities in certain residential and commercial mortgage-backed and asset-backed securities. Such securities include securities backed by Alt-A and subprime mortgage loans. We did not purchase any MBS during the six months ended June 30, 2011. Our portfolio of MBS totaled \$82.4 million at June 30, 2011.

providing inventory financing of mortgage loans for smaller mortgage originators. We believe this activity will supplement and make our correspondent lending business more attractive to lenders from which we acquire newly originated loans.

acquisition of mortgage servicing rights ("MSRs"). We believe that opportunities exist to acquire MSRs from liquidating and other institutions. We believe that MSR investments allow us to capture attractive current returns and to leverage the capabilities and efficiencies of PennyMac Loan Services, LLC ("PLS") to improve the asset's value. We also intend to retain the MSRs that we receive as a portion of the proceeds from our sale or securitization of mortgage loans through our correspondent lending operation. We received MSRs as proceeds on sale of

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Table of Contents

mortgage loans with fair values totaling \$137,000 and \$177,000 during the quarter and six months ended June 30, 2011, respectively, and held MSRs with fair values totaling \$180,000 as of June 30, 2011.

We are externally managed by PNMAC Capital Management, LLC ("PCM" or our "Manager"), an investment adviser that specializes in, and focuses on, residential mortgage loans. Most of our mortgage loan portfolio is serviced by PLS, an affiliate of PCM.

We conduct substantially all of our operations, and make substantially all of our investments, through PennyMac Operating Partnership, L.P. (the "Operating Partnership") and its subsidiaries. One of our subsidiaries is the sole general partner, and we are the sole limited partner, of the Operating Partnership.

We believe that we qualify to be taxed as a REIT. We believe that we will not be subject to federal income tax on that portion of our income that is distributed to shareholders as long as we meet certain asset, income and share ownership tests. If we fail to qualify as a REIT, and do not qualify for certain statutory relief provisions, our profits will be subject to income taxes and we may be precluded from qualifying as a REIT for the four tax years following the year we lose our REIT qualification. A portion of our activities are conducted in two taxable REIT subsidiaries, which are subject to corporate federal and state income taxes. Accordingly, we have made a provision for income taxes with respect to the operations of our taxable REIT subsidiaries. We expect that the effective rate for the provision for income taxes will be volatile in future periods. Our goal is to manage the business to take full advantage of the tax benefits afforded to us as a REIT.

Observations on Current Market Opportunities

The U.S. economy continues its pattern of modest growth, with economic data providing mixed reports on the economic recovery. During the second quarter of 2011, the U.S. gross domestic product expanded at a 1.3% annual rate compared to 0.4% and 3.8% during the first quarter of 2011 and the second quarter of 2010, respectively. Slowing economic growth and pressure on state and federal government spending impacted unemployment rates during the quarter ended June 30, 2011, reaching 9.2% at June 30, 2011. Economic growth appears to be constrained by uncertainties surrounding government fiscal and tax policies as well as consumer restraint following the recent recession.

Distress in the banking industry persists at historically high levels. However, the rate of growth in the number of problem banks as identified by the FDIC appears to be slowing. As of March 31, 2011, the most recent date for which problem bank information is available, the number of problem banks as identified by the FDIC increased to 888 from 884 at December 31, 2010 and 775 at March 31, 2010. The number of banks that have been seized is leveling off with 22 depository institutions seized during the second quarter of 2011 compared to 26 depository institutions in the first quarter of 2011 and 45 in the second quarter of 2010.

Residential real estate transactions continue to see historically low levels of activity as a result of continuing historically high levels of unemployment, restrictive loan underwriting standards and uncertainties about economic prospects. Foreclosure activity decreased substantially during the quarter ended June 30, 2011; however much of the decline has been attributed to mortgage lenders' efforts to remedy their foreclosure processes and the reduction in foreclosure activity is seen as temporary.

Thirty-year mortgage interest rates decreased from 4.86% for the week ended March 31, 2011 to 4.51% for the week ended June 30, 2011 (Source: Freddie Mac's Weekly Primary Mortgage Market Survey). Interest rates have been trending slightly downward throughout the quarter ended June 30, which contrasts with an upward trend during the first quarter.

Our Manager continues to see substantial volumes of distressed residential mortgage loan sales by a limited number of sellers, which remain primarily sales of nonperforming loan pools (with a small but

Table of Contents

increasing number of sales of troubled but performing loans). During the quarter ended June 30, 2011, our Manager reviewed 27 mortgage loan pools with unpaid principal balances totaling approximately \$4.5 billion. These mortgage loan pools were offered by 17 prospective sellers. This compares to our manager's review of 19 mortgage loan pools with unpaid principal balances totaling approximately \$2.5 billion offered by 15 prospective sellers during the quarter ended March 31, 2011. During the quarter and six months ended June 30, 2011, we made acquisitions of distressed mortgage loans totaling \$117.3 million and \$360.4 million, respectively, of which \$117.3 million and \$344.6 million were acquired from one seller, CitiMortgage, Inc. and/or its affiliates.

On July 12, 2011, we entered an agreement to purchase a pool of mortgage loans and real estate acquired in settlement of loans from Citigroup Global Markets Realty Corp. ("CGM"). The initial purchase price is approximately \$177.5 million. Subsequent adjustments may increase the purchase price to a maximum of \$180.6 million based on the date we settle the purchase. Our settlement of the purchase of these loans and real estate acquired in settlement of loans is subject to our obtaining additional capital sufficient to fund the transaction. There can be no assurance that the purchase will ultimately be settled.

We expect that our mortgage loan portfolio may continue to grow at an uneven pace, as opportunities to acquire distressed mortgage loans may be irregularly timed and may involve large portfolios of mortgage loans, and the timing and extent of our success in acquiring such mortgage loans, along with availability of capital to complete such transactions, cannot be predicted.

We believe that the collapse of the independent mortgage company business model and the weakened condition of banks and other traditional mortgage lenders have created additional opportunities for our business. Under current market conditions, these opportunities include the purchase from smaller mortgage lenders of newly originated mortgage loans that are eligible for sale to a GSE such as the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal National Mortgage Association ("Fannie Mae") (Freddie Mac and Fannie Mae are each referred to as an "Agency" and, collectively, as the "Agencies"). These opportunities also include the purchase of newly originated mortgage loans that can be resold in the non-Agency whole loan market or securitized in the private label market as well as providing inventory financing to originators of such loans. During the quarter ended June 30, 2011, we acquired \$54.8 million in fair value of newly originated mortgage loans, an increase of \$35.2 million or 180% when compared to the quarter ended March 31, 2011.

Table of Contents**Results of Operations**

The following is a summary of our key performance measures for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|--------------------------------------|--|------------|------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands, except per share amounts) | | | |
| Net investment income | \$ 30,223 | \$ 13,915 | \$ 47,506 | \$ 17,769 |
| Net income | \$ 16,617 | \$ 8,151 | \$ 24,262 | \$ 9,405 |
| Earnings per share: | | | | |
| Basic | \$ 0.59 | \$ 0.49 | \$ 0.96 | \$ 0.56 |
| Diluted | \$ 0.59 | \$ 0.48 | \$ 0.96 | \$ 0.55 |
| Distributions per share: | | | | |
| Declared | \$ 0.42 | \$ 0.42 | \$ 0.42 | \$ 0.42 |
| Paid | \$ 0.42 | \$ 0.42 | \$ 0.84 | \$ 0.84 |
| Investment acquisitions | \$ 118,538 | \$ 133,141 | \$ 361,913 | \$ 236,218 |
| Correspondent lending loan purchases | \$ 54,794 | \$ 1,375 | \$ 74,370 | \$ 1,375 |
| Share price: | | | | |
| High | \$ 18.62 | \$ 17.90 | \$ 19.04 | \$ 17.90 |
| Low | \$ 16.14 | \$ 15.82 | \$ 16.14 | \$ 15.82 |
| At period end | \$ 16.57 | \$ 15.90 | | |
| At period end: | | | | |
| Total investments(1) | \$ 788,516 | \$ 313,621 | | |
| Total assets | \$ 883,475 | \$ 370,478 | | |
| Book value per share | \$ 18.82 | \$ 19.38 | | |

(1) Mortgage-backed securities, mortgage loans at fair value and real estate acquired in settlement of loans

During the quarter and six months ended June 30, 2011, we recorded net income of \$16.6 million and \$24.3 million, or \$0.59 and \$0.96 per diluted share, respectively. Our net income for the three and six months ended June 30, 2011 reflects net gains on our investments totaling \$22.1 million and \$32.0 million, including \$17.4 million and \$25.7 million of valuation gains, supplemented by \$8.0 million and \$14.2 million of interest income, respectively.

During the quarter and six months ended June 30, 2010, we recorded net income of \$8.2 million and \$9.4 million, or \$0.48 and \$0.55 per diluted share, respectively. Net income for the quarter and six months ended June 30, 2010 reflected net gains on our investments totaling \$9.8 million and \$10.9 million, including \$2.8 million and \$4.0 million of valuation gains, supplemented by \$3.8 million and \$6.5 million of interest income, respectively.

Net Investment Income

During the quarter and six months ended June 30, 2011, we recorded net investment income on financial instruments of \$30.1 million and \$46.3 million, respectively, comprised of net gains on investments of \$22.1 million and \$32.1 million supplemented by \$8.0 million and \$14.2 million of interest income and \$86,000 and \$1.2 million of gains from results of real estate acquired in settlement of loans, respectively. This compares to net investment income on financial instruments of \$13.6 million and \$17.4 million recognized during the quarter and six months ended June 30, 2010, comprised primarily of \$9.8 million and \$11.0 million of net gains on investments, supplemented by interest income totaling \$3.8 million and \$6.5 million, respectively, and \$335,000 of gains from results of real estate acquired in settlement of loans for both quarter and year-to-date periods.

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Table of Contents

The growth and shift in net investment income reflects the incomplete deployment of the proceeds from our IPO and the short time in which we held the assets during the first part of 2010, followed by growth through leveraging of our shareholders' equity and additional issuances of common shares beginning in late 2010 through June 30, 2011. A significant contribution to our net investment income for the quarter and six months ended June 30, 2011 was attributable to \$7.4 million of valuation gains relating to an increase in the collectibility of claims on government-insured loans.

Net investment income on financial instruments is summarized below for the periods presented:

| | Quarter ended June 30, 2011 | | | | | | | |
|--|--------------------------------------|-------------------------|----------------------|--------------|------------------------------|--------------------|------------------------|-----------------|
| | Net gain (loss) on investments | Interest income/expense | | | Total revenue/ expense | Average balance | Annualized % | |
| | | Coupon | Discount/ fees(1) | Total | | | Interest yield/cost | Total return |
| (dollars in thousands) | | | | | | | | |
| Assets: | | | | | | | | |
| Short-term investments | \$ | \$ 27 | \$ | \$ 27 | \$ 27 | \$ 50,271 | 0.21% | 0.21% |
| Mortgage-backed securities: | | | | | | | | |
| Non-Agency subprime | (906) | 94 | 556 | 650 | (256) | 73,457 | 3.50% | (1.38)% |
| Non-Agency Alt-A | 119 | 172 | 103 | 275 | 394 | 12,351 | 8.82% | 12.64% |
| Non-Agency prime jumbo | (86) | 56 | 1 | 57 | (29) | 8,133 | 2.78% | (1.40)% |
| Total mortgage-backed securities | (873) | 322 | 660 | 982 | 109 | 93,941 | 4.14% | 0.46% |
| Mortgage loans: | | | | | | | | |
| At fair value | 22,951 | 6,929 | | 6,929 | 29,880 | 586,681 | 4.67% | 20.15% |
| Acquired for sale at fair value | 40 | 32 | | 32 | 72 | 8,779 | 1.47% | 3.28% |
| Total mortgage loans | 22,991 | 6,961 | | 6,961 | 29,952 | 595,460 | 4.63% | 19.90% |
| | \$ 22,118 | \$ 7,310 | \$ 660 | \$ 7,970 | \$ 30,088 | \$ 739,672 | 4.26% | 16.09% |
| Liabilities: | | | | | | | | |
| Loans sold under agreements to repurchase | \$ | \$ 2,109 | \$ 599 | \$ 2,708 | \$ 2,708 | \$ 239,343 | 4.48% | |
| Securities sold under agreements to repurchase | | 222 | | 222 | 222 | 79,719 | 1.10% | |
| Real estate acquired in settlement of loans financed through agreements to repurchase(2) | | 15 | 25 | 40 | 40 | 1,373 | 4.15% | |
| | \$ | \$ 2,346 | \$ 624 | \$ 2,970 | \$ 2,970 | \$ 320,435 | 3.67% | |

- (1) Amounts in this column represent accrual of unearned discounts for assets and amortization of facility commitment fees for liabilities.
- (2) Interest cost excludes the effect of amortization of debt issuance costs totaling \$25,000.

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Table of Contents

| Quarter ended June 30, 2010 | | | | | | | | |
|--|--------------------------------------|-----------------|----------------------|--------------|------------------------------|--------------------|-------------------|-----------------|
| | Net gain (loss) on investments | Interest income | | | Total revenue/ expense | Average balance | Annualized % | |
| | | Coupon | Discount/ fees(1) | Total | | | Interest yield | Total return |
| (dollars in thousands) | | | | | | | | |
| Assets: | | | | | | | | |
| Short-term money market investments | \$ | \$ 22 | \$ | \$ 22 | \$ 22 | \$ 63,333 | 0.14% | 0.14% |
| Mortgage-backed securities: | | | | | | | | |
| Non-Agency subprime | (268) | 45 | 536 | 581 | 313 | 34,243 | 6.71% | 3.61% |
| Non-Agency Alt-A | (127) | 303 | 265 | 568 | 441 | 23,019 | 9.77% | 7.58% |
| Non-Agency prime jumbo | 188 | 123 | (5) | 118 | 306 | 15,364 | 3.02% | 7.87% |
| Total mortgage-backed securities | (207) | 471 | 796 | 1,267 | 1,060 | 72,626 | 6.90% | 5.77% |
| Mortgage loans: | | | | | | | | |
| At fair value | 9,966 | 2,502 | | 2,502 | 12,468 | 176,433 | 5.61% | 27.96% |
| Acquired for sale at fair value | 28 | 1 | | 1 | 29 | 238 | 1.69% | 49.68% |
| Total mortgage loans | 9,994 | 2,503 | | 2,503 | 12,497 | 176,671 | 5.61% | 27.99% |
| | \$ 9,787 | \$ 2,996 | \$ 796 | \$ 3,792 | \$ 13,579 | \$ 312,630 | 4.80% | 17.18% |
| Liabilities: | | | | | | | | |
| Securities sold under agreements to repurchase | \$ | \$ | \$ | \$ | \$ | \$ 345 | | |

(1) Amounts in this column represent accrual of unearned discounts for assets and amortization of facility commitment fees for liabilities.

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Table of Contents

| | Six months ended June 30, 2011 | | | | | | | |
|--|--------------------------------------|-------------------------|----------------------|---------------|------------------------------|--------------------|------------------------|-----------------|
| | Net gain (loss) on investments | Interest income/expense | | | Total revenue/ expense | Average balance | Annualized % | |
| | | Coupon | Discount/ fees(1) | Total | | | Interest yield/cost | Total return |
| (dollars in thousands) | | | | | | | | |
| Assets: | | | | | | | | |
| Short-term investments | \$ | \$ 58 | \$ | \$ 58 | \$ 58 | \$ 54,901 | 0.21% | 0.21% |
| Mortgage-backed securities: | | | | | | | | |
| Non-Agency subprime | (1,197) | 204 | 1,142 | 1,346 | 149 | 81,065 | 3.30% | 0.36% |
| Non-Agency Alt-A | 71 | 367 | 220 | 587 | 658 | 13,368 | 8.73% | 9.79% |
| Non-Agency prime jumbo | (189) | 123 | 12 | 135 | (54) | 8,781 | 3.07% | (1.21)% |
| Total mortgage-backed securities | (1,315) | 694 | 1,374 | 2,068 | 753 | 103,214 | 3.98% | 1.45% |
| Mortgage loans: | | | | | | | | |
| At fair value | 33,283 | 11,978 | | 11,978 | 45,261 | 507,894 | 4.69% | 17.72% |
| Acquired for sale at fair value | 123 | 69 | | 69 | 192 | 6,720 | 2.04% | 5.67% |
| Total mortgage loans | 33,406 | 12,047 | | 12,047 | 45,453 | 514,614 | 4.66% | 17.57% |
| | \$ 32,091 | \$ 12,799 | \$ 1,374 | \$ 14,173 | \$ 46,264 | \$ 672,729 | 4.19% | 13.68% |
| Liabilities: | | | | | | | | |
| Loans sold under agreements to repurchase | \$ | \$ 3,662 | \$ 1,015 | \$ 4,677 | \$ 4,677 | \$ 208,630 | 4.46% | |
| Securities sold under agreements to repurchase | | 531 | | 531 | 531 | 87,470 | 1.21% | |
| Real estate acquired in settlement of loans financed through agreements to repurchase(2) | | 15 | 25 | 40 | 40 | 690 | 4.15% | |
| | \$ | \$ 4,208 | \$ 1,040 | \$ 5,248 | \$ 5,248 | \$ 296,790 | 3.52% | |

(1) Amounts in this column represent accrual of unearned discounts for assets and amortization of facility commitment fees for liabilities.

(2) Interest cost excludes the effect of amortization of debt issuance costs totaling \$25,000 during the period.

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Table of Contents

| | Six months ended June 30, 2010 | | | | | | | |
|--|--------------------------------------|-------------------------|----------------------|--------------|------------------------------|--------------------|-------------------|-----------------|
| | Net gain (loss) on investments | Interest income/expense | | | Total revenue/ expense | Average balance | Annualized % | |
| | | Coupon | Discount/ fees(1) | Total | | | Interest yield | Total return |
| (dollars in thousands) | | | | | | | | |
| Assets: | | | | | | | | |
| Short-term money market investments | \$ | \$ 67 | \$ | \$ 67 | \$ 67 | \$ 118,579 | 0.11% | 0.11% |
| Mortgage-backed securities: | | | | | | | | |
| Non-Agency subprime | (298) | 79 | 1,131 | 1,210 | 912 | 36,125 | 6.66% | 5.02% |
| Non-Agency Alt-A | (10) | 645 | 418 | 1,063 | 1,053 | 24,473 | 8.64% | 8.56% |
| Non-Agency prime jumbo | 158 | 266 | 12 | 278 | 436 | 16,276 | 3.40% | 5.32% |
| Total mortgage-backed securities | (150) | 990 | 1,561 | 2,551 | 2,401 | 76,874 | 6.60% | 6.21% |
| Mortgage loans: | | | | | | | | |
| At fair value | 11,099 | 3,837 | | 3,837 | 14,936 | 119,449 | 6.39% | 24.87% |
| Acquired for sale at fair value | 28 | 1 | | 1 | 29 | 120 | 1.69% | 49.68% |
| Mortgage loans | 11,127 | 3,838 | | 3,838 | 14,965 | 119,569 | 6.38% | 24.89% |
| | \$ 10,977 | \$ 4,895 | \$ 1,561 | \$ 6,456 | \$ 17,433 | \$ 315,022 | 4.08% | 11.01% |
| Liabilities: | | | | | | | | |
| Securities sold under agreements to repurchase | \$ | \$ | \$ | \$ | \$ | \$ 173 | | |

(1) Amounts in this column represent accrual of unearned discounts for assets and amortization of facility commitment fees for liabilities.

Net Gain (Loss) on Investments

During the quarter and six month periods ended June 30, 2011, we recognized net gains on financial instruments totaling \$22.1 million and \$32.1 million, respectively. This compares to \$9.8 million and \$11.0 million for the quarter and six months ended June 30, 2010. The increase for the quarter and six months ended June 30, 2011 as compared to the comparable prior year periods is due primarily to growth in our portfolio of investments in financial instruments. Our average portfolio balance increased 137% and 114% during the quarter and six month periods ended June 30, 2011 as compared to the comparable prior year periods.

During the quarter and six month periods ended June 30, 2011, we recognized net valuation losses on our portfolios of MBS totaling \$873 thousand and \$1.3 million, respectively. The valuation losses reflect, in part, growing marketplace supply of MBS similar to those we hold as a result of sales by the Federal Reserve Bank of their holdings of MBS acquired during the recent financial crisis, and to marketplace discounting of distressed MBS resulting from expectations that involuntary prepayments of mortgages underlying the securities may slow due to regulatory actions relating to lenders' foreclosure activities. The weighted average discount rate of the non-Agency subprime MBS, the most sizable component of our MBS portfolio, increased from 4.5% at December 31, 2010 to 7.7% at June 30, 2011, reflective of these market factors.

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Table of Contents

Net gains on mortgage loans at fair value, excluding mortgage loans acquired for sale, are summarized below for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|------------------------------|---------------------------|----------|------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| (in thousands) | | | | |
| Valuation changes(1): | | | | |
| Performing loans | \$ 2,822 | | \$ 3,835 | |
| Nonperforming loans | 15,627 | | 23,348 | |
| | \$ 18,449 | \$ 3,005 | \$ 27,183 | \$ 4,138 |
| Payoffs | 4,477 | 6,789 | 5,867 | 6,789 |
| Sales | 25 | 172 | 233 | 172 |
| | \$ 22,951 | \$ 9,966 | \$ 33,283 | \$ 11,099 |

(1) Comparative prior period information was not maintained.

The net gains on mortgage loans arising from valuation changes were due primarily to the changes in value of loans as the loans moved through the resolution process. During the quarter ended June 30, 2011, we recognized valuation gains totaling approximately \$7.4 million relating to an increase in the collectibility of claims on government-insured loans. In addition, approximately \$8.0 million of valuation gains during the quarter resulted from changes in the delinquency of the loan portfolio, both from transitions of seriously delinquent loans toward a liquidation event as well as reinstatements of nonperforming loans. Our valuation gains for the six months ended June 30, 2011 also reflect increasing demand for distressed mortgage loans as reflected in increased transaction prices. As a result of this market observation, the discount rates we use to estimate the fair value of certain of our mortgage loans were decreased.

The increase in valuation changes during the quarter and six months ended June 30, 2011, as compared to the comparable periods ended June 30, 2010, is due to the growth and seasoning of our portfolio of mortgage loans at fair value. Our average investment in mortgage loans at fair value increased \$410.2 million and \$388.4 million, or 233% and 325% for the quarter and six months ended June 30, 2011 as compared to the comparable periods ended June 30, 2010. Furthermore, our initial acquisitions of mortgage loans at fair value occurred in December of 2009 and were only beginning to move through the resolution process during 2010.

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Table of Contents

Following is a comparison of the valuation techniques and key inputs we use in the valuation of our financial assets:

| Financial Statement Item | Fair Value | | Valuation Technique | Key Inputs | Range (Weighted Average) | |
|-------------------------------|---------------|-------------------|----------------------|---|--------------------------|------------------------|
| | June 30, 2011 | December 31, 2010 | | | June 30, 2011 | December 31, 2010 |
| (in thousands) | | | | | | |
| Mortgage-backed securities(1) | | | Broker quote | | | |
| Non-Agency subprime | \$ 63,159 | \$ 93,783 | | Discount rate | 3.5% - 13.3% (7.7%) | 2.9% - 17.3% (4.5%) |
| | | | | Prepayment speed(2) | 0.2% - 5.6% (3.3%) | 0.1% - 5.3% (1.5%) |
| | | | | Collateral remaining loss percentage(3) | 22.3% - 55.6% (42.5%) | 12.1% - 56.6% (36.9%) |
| Non-Agency Alt-A | 11,904 | 15,824 | | Discount rate | 4.5% - 11.7% (6.0%) | 5.0% - 11.4% (7.1%) |
| | | | | Prepayment speed(2) | 0.4% - 6.9% (5.7%) | 0.9% - 10.1% (6.7%) |
| | | | | Collateral remaining loss percentage(3) | 7.8% - 51.3% (25.2%) | 10.5% - 41.1% (22.8%) |
| Non-Agency prime jumbo | 7,358 | 10,265 | | Discount rate | 5.1% - 5.1% (5.1%) | 2.7% - 2.7% (2.7%) |
| | | | | Prepayment speed(2) | 13.4% - 13.4% (13.4%) | 14.7% - 14.7% (14.7%) |
| | | | | Collateral remaining loss percentage(3) | 0.8% - 0.8% (0.8%) | 0.6% - 0.6% (0.6%) |
| Mortgage loans | \$ 657,223 | \$ 364,250 | Discounted cash flow | Discount rate | 9.1% - 20.7% (14.0%) | 9.1% - 18.7% (13.8%) |
| | | | | Twelve-month projected housing price index change | -9.5% - 9.7% (-1.7%) | -18.4% - 10.7% (-2.4%) |
| | | | | Prepayment speed(2) | 0.2% - 6.1% (2.2%) | 0.2% - 7.5% (2.8%) |
| | | | | Total prepayment speed (Life total CPR) | 0.4% - 37.1% (29.7%) | 0.4% - 38.6% (31.9%) |

- (1) With respect to mortgage-backed securities, key inputs are those used to evaluate broker indications of value.
- (2) Prepayment speed is measured using Life Voluntary CPR
- (3) The projected future losses on the loans in the collateral groups paying to each bond as a percentage of the current balance of the loans.

The weighted average discount rate used in the valuation of mortgage loans increased slightly from December 31, 2010 to June 30, 2011 due to portfolio additions during the six months ended June 30, 2011 with higher discount rates, partially offset by a decrease in certain pools' discount rates resulting from increasing market demand for distressed mortgage loans.

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The weighted average twelve-month projected housing price index ("HPI") change improved from -2.4% at December 31, 2010 to -1.7% at June 30, 2011. This improvement reflects the impact of portfolio additions during the period with higher initial HPI forecasts and the movement of the portfolio toward the projected housing price bottom with the passage of time. Changes in the projected HPI did not have a significant impact on the valuation of mortgage loans during the six months ended June 30, 2011.

The total prepayment speed of our mortgage loan portfolio decreased from 31.9% at December 31, 2010 to 29.7% at June 30, 2011, primarily due to a greater than expected volume of reinstatements of nonperforming loans and lower than expected rates of defaults of distressed performing loans.

While we believe that the Company's current fair value estimates are representative of fair value at the reporting date, the market for our mortgage assets is illiquid with very few market participants. Furthermore, our business strategy is to enhance value during the period in which the loans are held; any resulting appreciation or depreciation in the fair value of the loans would be recorded during such holding period and ultimately realized at the end of the holding period.

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Table of Contents

During the quarter and six months ended June 30, 2011, we recognized gains on mortgage loan payoffs as summarized below:

| | Quarter ended June 30, | | Six months ended June 30, | |
|---------------------------|---------------------------|-----------|------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| | (dollars in thousands) | | | |
| Number of loans | 183 | 100 | 268 | 100 |
| Unpaid principal balance | \$ 60,724 | \$ 17,417 | \$ 85,613 | \$ 17,417 |
| Gain recognized at payoff | \$ 4,477 | \$ 6,789 | \$ 5,867 | \$ 6,789 |

The decrease in gains recognized at payoff reflects gains we recorded on certain of our acquisitions during 2010 whereby the loans subject to the purchase agreement paid off during the settlement period and the gains accrued to us. Subsequent transactions have not provided for the transfer of these gains to PMT during the settlement period.

During the quarter and six months ended June 30, 2011, we recognized gains on sales of distressed mortgage loans as summarized below:

| | Quarter ended June 30, | | Six months ended June 30, | |
|--------------------------|---------------------------|----------|------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| | (dollars in thousands) | | | |
| Number of loans | 10 | 13 | 10 | 10 |
| Unpaid principal balance | \$ 2,909 | \$ 2,909 | \$ 5,524 | \$ 2,909 |
| Gain recognized at sale | \$ 25 | \$ 172 | \$ 233 | \$ 172 |

Our loan servicer offers HAMP as well as proprietary loan modification programs. HAMP modifications are available for borrowers who meet certain criteria, including occupying their properties and having debt-to-income ratios in excess of 31%. Borrowers who receive a HAMP modification may receive rate reduction, term extension, forbearance of principal and principal forgiveness. HAMP modifications may utilize either a stepped-rate or fixed-rate schedule. Borrowers who do not require payment relief, or who do not occupy their properties, may be eligible for a proprietary loan modification program, which may include capitalization of arrearages, term extension, rate reduction, and principal forgiveness. The proprietary programs can also take the form of either a stepped-rate or fixed-rate schedule.

The following tables present a summary of loan modifications completed for the periods presented:

| Modification type(1) | Quarter ended June 30, | | | | Six months ended June 30, | | | |
|-------------------------------------|------------------------|------------------------|-----------------------|------------------------|---------------------------|------------------------|-----------------------|------------------------|
| | 2011 | | 2010 | | 2011 | | 2010 | |
| | Number of Loans | Balance of loans(2) | Number of Loans | Balance of loans(2) | Number of Loans | Balance of loans(2) | Number of Loans | Balance of loans(2) |
| | (dollars in thousands) | | | | | | | |
| Rate reduction | 59 | \$ 14,406 | 1 | \$ 351 | 89 | \$ 19,778 | 1 | \$ 351 |
| Term extension | 17 | \$ 5,002 | | | 27 | \$ 7,270 | | |
| Capitalization of interest and fees | 72 | \$ 17,033 | 1 | \$ 351 | 104 | \$ 23,224 | 1 | \$ 351 |
| Principal forbearance | 6 | \$ 2,351 | 1 | \$ 351 | 7 | \$ 2,457 | 1 | \$ 351 |
| Principal reduction | 38 | \$ 9,524 | 1 | \$ 351 | 57 | \$ 13,481 | 1 | \$ 351 |
| Total* | 72 | \$ 17,033 | 1 | \$ 351 | 104 | \$ 23,224 | 1 | \$ 351 |

(1) Modification type categories are not mutually exclusive, and a modification of a single loan may be counted in multiple categories if applicable. The total number of modifications noted in the table is therefore lower than the sum of all of the categories.

(2) Before modification.

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Table of Contents

The following tables summarize the average impact of the modifications noted above to the terms of the loans impacted:

| Category | Quarter ended June 30, | | | | Six months ended June 30, | | | |
|-------------------------|------------------------|--------------------|---------------------|--------------------|---------------------------|--------------------|---------------------|--------------------|
| | 2011 | | 2010 | | 2011 | | 2010 | |
| | Before Modification | After Modification | Before Modification | After Modification | Before Modification | After Modification | Before Modification | After Modification |
| | (dollars in thousands) | | | | | | | |
| Loan balance | \$ 237 | \$ 215 | \$ 351 | \$ 305 | \$ 223 | \$ 205 | \$ 351 | \$ 305 |
| Remaining term (months) | 316 | 347 | 460 | 459 | 316 | 350 | 460 | 459 |
| Interest rate | 6.86% | 3.86% | 9.53% | 3.03% | 6.88% | 3.67% | 9.53% | 3.03% |
| Forbeared principal | \$ 3 | \$ 10 | \$ 6 | \$ 6 | \$ 3 | \$ 9 | \$ 6 | \$ 6 |

Interest Income

The effects of changes in the composition of our investments on our interest income during the periods presented are summarized below:

| | Quarter ended June 30, 2011 | | | Six months ended June 30, 2011 | | |
|---|---------------------------------------|----------|----------------|---------------------------------------|-----------|----------------|
| | vs. Quarter ended June 30, 2010 | | | vs. Six months ended June 30, 2010 | | |
| | Increase (decrease) due to changes in | | Total change | Increase (decrease) due to changes in | | Total change |
| | Rate | Volume | (in thousands) | Rate | Volume | (in thousands) |
| Assets: | | | | | | |
| Short-term investments | \$ 34 | \$ (29) | \$ 5 | \$ 83 | \$ (92) | \$ (9) |
| Mortgage-backed securities: | | | | | | |
| Non-Agency subprime | (1,532) | 1,600 | 68 | (1,687) | 1,823 | 136 |
| Non-Agency Alt-A | (51) | (242) | (293) | 34 | (510) | (476) |
| Non-Agency prime jumbo | (9) | (51) | (60) | (25) | (118) | (143) |
| Total mortgage-backed securities | (1,592) | 1,307 | (285) | (1,678) | 1,195 | (483) |
| Mortgage loans | (2,922) | 7,380 | 4,458 | (3,199) | 11,408 | 8,209 |
| | \$ (4,480) | \$ 8,658 | \$ 4,178 | \$ (4,794) | \$ 12,511 | \$ 7,717 |
| Liabilities: | | | | | | |
| Loans sold under agreements to repurchase | \$ 2,708 | \$ 2,708 | \$ 4,677 | \$ 4,677 | \$ 4,677 | \$ 4,677 |
| Securities sold under agreements to repurchase | 222 | 222 | 531 | 531 | 531 | 531 |
| Real estate acquired in settlement of loans financed through agreements to repurchase | 40 | 40 | 40 | 40 | 40 | 40 |
| | \$ 2,970 | \$ 2,970 | \$ 5,248 | \$ 5,248 | \$ 5,248 | \$ 5,248 |

In the quarter and six months ended June 30, 2011, we earned interest income of \$8.0 million and \$14.2 million, compared to \$3.8 million and \$6.5 million for the quarter and six months ended June 30, 2010.

Interest income on our portfolio of MBS decreased primarily due to a decrease in yields of these securities from 6.90% during the quarter ended June 30, 2010 to 4.14% during the quarter ended June 30, 2011, partially offset by an increase of \$21.3 million in the average balance of our investment in such securities. Similarly, the yield on our portfolio of MBS decreased from 6.60% during the six

Table of Contents

months ended June 30, 2010, to 3.98% during the six months ended June 30, 2011, partially offset by an increase in the average balance of our investment in MBS of \$26.3 million.

The decrease in yields for the quarter and six months ended June 30, 2011 as compared to the comparable prior year periods was due to a decrease in prepayment experience and market prepayment expectations on the mortgage loans underlying our MBS during 2011 as compared to 2010. The increase in average balance of securities reflects the lower balances of our investment portfolio during 2010 as we were deploying the proceeds of our initial share offerings during 2010.

At June 30, 2011, our portfolio of MBS was comprised of currently cash flowing securities with an average yield of 4.75% and a contractual remaining life of more than ten years. We invest in MBS as a complement to our investments in mortgage loans and as a means of ensuring our compliance with REIT tax regulations governing our asset composition.

In the quarter and six months ended June 30, 2011, we recognized interest income on mortgage loans of \$7.0 million and \$12.0 million, which compares to \$2.5 million and \$3.8 million for the comparable periods ended June 30, 2010. During the quarter and six months ended June 30, 2011, we recognized annualized interest of 4.67% and 4.69%, respectively, on our portfolio of mortgage loans (excluding mortgage loans acquired for sale at fair value) as measured by the portfolio's average fair value. This compares to 5.61% and 6.39% for the comparable periods ended June 30, 2010.

The increase in interest income is due primarily to growth in our mortgage loan portfolio of \$418.8 million and \$395.0 million or 237% and 330% for the quarter and six months ended June 30, 2011 when compared to the quarter and six months ended June 30, 2010. This growth in interest income was partially offset by a decrease in the yield on the loans from 5.61% and 6.38% during the quarter and six months ended June 30, 2010 as compared to 4.63% and 4.66% for the comparable periods ended June 30, 2011. The decrease in yield in 2011 as compared to 2010 is due primarily to the addition of pools of loans with lower interest rates during the period from June 30, 2010 through June 30, 2011. At June 30, 2010, our investment in performing mortgage loans had a weighted-average coupon of 6.46%; at June 30, 2011, our investment in performing mortgage loans had a weighted-average coupon of 5.06%.

At June 30, 2011, approximately 74% of the fair value of our portfolio of mortgage loans was nonperforming, which compares to 75% at June 30, 2010. We do not accrue interest on nonperforming loans and generally do not recognize revenues during the period we hold real estate acquired in settlement of loans. We calculate the yield on our mortgage loan portfolio based on the portfolio's average fair value, which most closely reflects our investment in the mortgage loans. Accordingly, the yield we realize is substantially higher than would be recorded based on the loans' unpaid balances as we purchase our mortgage loans at substantial discounts to their unpaid principal balances.

The revenue benefits of nonperforming loans and real estate acquired in settlement of loans generally take longer to realize than those of performing loans due to the time required to work with borrowers to resolve payment issues through our modification programs and to acquire and liquidate the property securing the mortgage loans. The value and returns we realize from these assets are determined by our ability to cure the borrowers' defaults, or when curing of borrower defaults is not a viable solution, by our ability to effectively manage the liquidation process. As a participant in HAMP, we are required to comply with the process specified by the HAMP program before liquidating a loan, and this may extend the liquidation process. At June 30, 2011, we held \$488.7 million in fair value of nonperforming loans and \$48.9 million in carrying value of real estate acquired in settlement of loans.

Interest Expense

During the quarter and six months ended June 30, 2011, we incurred interest expense totaling \$3.0 million and \$5.2 million, respectively. Our interest cost was 3.67% and 3.52% for the quarter and

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Table of Contents

six month periods ended June 30, 2011, respectively. We had negligible interest expense during the quarter and six months ended June 30, 2010 as we were in the process of investing the proceeds of our initial equity offerings and had no borrowings until June 30, 2010. Interest expense during 2011 reflects our efforts to leverage our investing capacity after fully deploying the proceeds of our initial equity offerings.

Net Gain on Mortgage Loans Acquired for Sale

During the quarter and six months ended June 30, 2011, we recorded net gains of \$40,000 and \$123,000 on mortgage loans acquired for sale. These gains included approximately \$137,000 and \$177,000 in fair values of MSRs received as part of the proceeds from our correspondent lending loan sales. During the quarter and six months ended June 30, 2010, we recorded gains of \$28,000 on mortgage loans acquired for sale.

Results of Real Estate Acquired in Settlement of Loans

Results from real estate acquired in settlement of loans includes the gains or losses we record upon sale of the properties as well as valuation adjustments we record during the period we hold those properties. During the quarter and six months ended June 30, 2011, we recorded net gains of \$86,000 and \$1.2 million, respectively, in results of real estate acquired in settlement of loans as compared to net gains totaling \$335,000 for the quarter and six months ended June 30, 2010. The decrease in gain is primarily due to valuation adjustments recorded during 2011 as compared to gains recorded on the sale of recently acquired real estate during the comparable period of 2010.

Expenses

Our expenses are summarized below for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|-----------------------|---------------------------|-----------------|------------------------------|-----------------|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands) | | | |
| Loan servicing fees | \$ 3,313 | \$ 591 | \$ 5,519 | \$ 676 |
| Interest | 2,970 | | 5,248 | |
| Management fees | 1,913 | 1,202 | 3,462 | 2,413 |
| Compensation | 1,250 | 836 | 2,264 | 1,639 |
| Professional services | 1,115 | 399 | 1,992 | 493 |
| Other | 1,660 | 824 | 2,733 | 1,104 |
| Total expenses | \$ 12,221 | \$ 3,852 | \$ 21,218 | \$ 6,325 |

Increased expenses during the quarter and six month periods ended June 30, 2011 compared to the same periods in 2010 was a result of the growth in the Company's investment portfolio and the use of borrowings beginning in the fourth quarter of 2010 to finance that growth.

Loan servicing fees also grew substantially as our average investment in mortgage loans increased by over 237% and 330% during the quarter and six months ended June 30, 2011, respectively; and we began incurring activity-based fees relating to the liquidation of loans during 2011 that we did not incur due to the short period we held the loans through June 30, 2010.

Compensation expense increased as the result of additional grants of restricted share units to our officers and trustees as well as certain employees of PCM and its affiliates during the quarter ended March 31, 2011. Professional services expense increased due to our heightened level of mortgage investment acquisition activity during the quarter and six months ended June 30, 2011 as compared to the comparable periods ended June 30, 2010.

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Table of Contents

Balance Sheet Analysis

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

| | June 30, 2011 | December 31, 2010 |
|---|-------------------|----------------------|
| ASSETS | | |
| Cash | \$ 2,344 | \$ 45,447 |
| Mortgage loans held for sale at fair value | 18,848 | 3,966 |
| Investments: | | |
| Short-term investments | 38,633 | |
| Mortgage-backed securities at fair value | 82,421 | 119,872 |
| Mortgage loans at fair value | 657,223 | 364,250 |
| Real estate acquired in settlement of loans | 48,872 | 29,685 |
| | 827,149 | 513,807 |
| Other assets | 35,134 | 25,875 |
| Total assets | \$ 883,475 | \$ 589,095 |
| LIABILITIES | | |
| Borrowings: | | |
| Loans sold under agreements to repurchase | \$ 262,203 | \$ 147,422 |
| Securities sold under agreements to repurchase at fair value | 70,978 | 101,202 |
| Real estate acquired in settlement of loans financed under agreements to repurchase | 7,808 | |
| | 340,989 | 248,624 |
| Other liabilities | 19,562 | 20,558 |
| Total liabilities | 360,551 | 269,182 |
| SHAREHOLDERS' EQUITY | 522,924 | 319,913 |
| Total liabilities and shareholders' equity | \$ 883,475 | \$ 589,095 |

Total assets increased \$294.4 million, or 50% during the period from December 31, 2010 to June 30, 2011. Growth in total assets reflects growth of investments totaling \$313.3 million or 61% during the period. We financed our asset growth through issuance of additional shares for net proceeds of \$188.8 million and through additional borrowings of \$92.4 million. We made investments totaling \$361.9 million and received proceeds from sales and repayments of those assets totaling \$124.6 million. Our acquisitions are summarized below.

Table of Contents**Asset Acquisitions**

Following is a summary of our acquisitions of mortgage investments for the periods presented:

| | Quarter ended June 30, | | Six months ended June 30, | |
|---|---------------------------|------------|------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands) | | | |
| Mortgage-backed securities | \$ | \$ 36,484 | \$ | \$ 36,898 |
| Distressed mortgage loans(1)(2)(3) | | | | |
| Performing | 22,480 | 1,309 | 44,377 | 11,428 |
| Nonperforming | 94,795 | 95,348 | 316,026 | 186,654 |
| | 117,275 | 96,657 | 360,403 | 198,082 |
| Real estate acquired in settlement of loans | 1,263 | | 1,510 | 1,238 |
| | \$ 118,538 | \$ 133,141 | \$ 361,913 | \$ 236,218 |

(1) Performance status as of the date of acquisition.

(2) All of our distressed asset purchases during the quarters ended June 30, 2011 and 2010 and subsequent purchases through the date of this Report totaling \$177.5 million were acquired from CitiMortgage, Inc. and CGM. We also have pending purchases in the amount of \$126.7 million from CitiMortgage, Inc. as of the date of this Report. The pending transactions are subject to changes in the loans allocated to us by PCM, continuing due diligence, customary closing conditions, and our obtaining additional capital adequate to fund the transactions. There can be no assurance that the committed amounts will ultimately be acquired or that the transactions will be completed at all.

(3) Amounts exclude \$54.8 million and \$74.4 million, and \$15.2 million and \$1.4 million of loans purchased for immediate resale during the quarters and six month periods ended June 30, 2011 and 2010, respectively.

Our acquisitions during the quarter and six months ended June 30, 2010 reflect continuing investment of the proceeds from our initial public offering which we completed during August of 2009. Our acquisitions during the quarter and six months ended June 30, 2011 primarily reflect a subsequent underwritten public offering completed in the first quarter of 2011 and the use of borrowings to leverage our equity. We continue to identify additional means of increasing our investment portfolio through cash flow from existing investments, borrowings and transactions that minimize current cash outlays. However, we expect that, over time, our ability to continue our portfolio growth will depend on our ability to raise additional equity capital.

On July 12, 2011, we entered an agreement to purchase a pool of mortgage loans and real estate acquired in settlement of loans from CGM. The initial purchase price is approximately \$177.5 million. Subsequent adjustments may increase the purchase price to a maximum of \$180.6 million based on the date we settle the purchase. Our purchase of these loans and real estate acquired in settlement of loans is subject to continuing due diligence, customary closing conditions and our obtaining additional capital sufficient to fund the transaction. There can be no assurance that these assets will ultimately be acquired or that the transaction will be completed at all.

Investment Portfolio Composition

Our portfolio of MBS is backed by non-Agency subprime, Alt-A and prime jumbo loans and consists of currently cash flowing senior priority securities with an average remaining life of

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Table of Contents

approximately 0.78 years. We acquired these securities to supplement our investments in mortgage loans and to ensure compliance with the REIT tax regulations relating to our asset composition.

The following is a summary of our portfolio of MBS as of the dates presented:

| June 30, 2011 | | | | | | |
|----------------------------------|-------------------------------|------------------|----------------------------|---------------------------|--------------|--|
| | Fair value | Principal | Life (in years) | Average Coupon | Yield | |
| | (dollars in thousands) | | | | | |
| Security collateral type: | | | | | | |
| Non-Agency subprime | \$ 63,159 | \$ 66,085 | 0.67 | 0.46% | 4.03% | |
| Non-Agency Alt-A | 11,904 | 12,072 | 1.32 | 5.48% | 9.50% | |
| Non-Agency prime jumbo | 7,358 | 7,507 | 0.87 | 2.84% | 3.45% | |
| | \$ 82,421 | \$ 85,664 | 0.78 | 1.37% | 4.75% | |

| December 31, 2010 | | | | | | |
|----------------------------------|-------------------------------|-------------------|----------------------------|---------------------------|--------------|--|
| | Fair value | Principal | Life (in years) | Average Coupon | Yield | |
| | (dollars in thousands) | | | | | |
| Security collateral type: | | | | | | |
| Non-Agency subprime | \$ 93,783 | \$ 96,653 | 0.82 | 0.51% | 4.46% | |
| Non-Agency Alt-A | 15,824 | 16,282 | 1.48 | 5.35% | 9.19% | |
| Non-Agency prime jumbo | 10,265 | 10,240 | 1.12 | 2.90% | 3.51% | |
| | \$ 119,872 | \$ 123,175 | 0.93 | 1.35% | 5.00% | |

The relationship of the fair value of our mortgage loans at fair value to the fair value of the real estate collateral underlying the loans is summarized below:

| | June 30, 2011 | | December 31, 2010 | |
|---------------------|-----------------------|-------------------|--------------------------|-------------------|
| | Fair Values | | | |
| | Loan | Collateral | Loan | Collateral |
| | (in thousands) | | | |
| Performing loans | \$ 168,545 | \$ 260,890 | \$ 86,242 | \$ 139,393 |
| Nonperforming loans | 488,678 | 713,338 | 278,008 | 424,856 |
| | \$ 657,223 | \$ 974,228 | \$ 364,250 | \$ 564,249 |

Following is a summary of the distribution of our mortgage loans at fair value at June 30, 2011:

| Loan type | June 30, 2011 | | | | | | December 31, 2010 | | | | | |
|------------------|-------------------------------|----------------|--------------------------|----------------------------|----------------|--------------------------|--------------------------|----------------|--------------------------|----------------------------|----------------|--------------------------|
| | Performing loans | | | Nonperforming loans | | | Performing loans | | | Nonperforming loans | | |
| | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate |
| | (dollars in thousands) | | | | | | | | | | | |
| Fixed | \$ 82,898 | 13% | 6.07% | \$ 212,203 | 32% | 6.79% | \$ 49,444 | 14% | 6.86% | \$ 105,669 | 29% | 7.17% |
| ARM/Hybrid | 76,253 | 12% | 4.31% | 272,763 | 41% | 6.24% | 31,916 | 9% | 4.68% | 171,591 | 47% | 6.13% |

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| | | | | | | | | | | | | |
|---------------|------------|-----|-------|------------|-----|-------|-----------|-----|-------|------------|-----|-------|
| Interest rate | | | | | | | | | | | | |
| step-up | 7,393 | 1% | 2.25% | 708 | 0% | 6.25% | 4,813 | 1% | 2.43% | 247 | 0% | 6.73% |
| Balloon | 2,001 | 0% | 4.90% | 3,004 | 1% | 6.62% | 69 | 0% | 9.94% | 501 | 0% | 7.70% |
| | \$ 168,545 | 26% | 5.06% | \$ 488,678 | 74% | 6.49% | \$ 86,242 | 24% | 5.73% | \$ 278,008 | 76% | 6.54% |

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Table of Contents

| Lien position | June 30, 2011 | | | | | | December 31, 2010 | | | | | |
|------------------------|------------------|---------|-------------------|---------------------|---------|-------------------|-------------------|---------|-------------------|---------------------|---------|-------------------|
| | Performing loans | | | Nonperforming loans | | | Performing loans | | | Nonperforming loans | | |
| | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate |
| (dollars in thousands) | | | | | | | | | | | | |
| 1st lien | \$ 168,507 | 26% | 5.06% | \$ 488,678 | 74% | 6.49% | \$ 86,238 | 24% | 5.73% | \$ 278,008 | 76% | 6.54% |
| 2nd lien | 34 | 0% | 5.17% | | 0% | | | 0% | | | 0% | |
| Unsecured | 4 | 0% | 0.01% | | 0% | | 4 | 0% | 0.00% | | 0% | |
| | \$ 168,545 | 26% | 5.06% | \$ 488,678 | 74% | 6.49% | \$ 86,242 | 24% | 5.73% | \$ 278,008 | 76% | 6.54% |

| Occupancy | June 30, 2011 | | | | | | December 31, 2010 | | | | | |
|------------------------|------------------|---------|-------------------|---------------------|---------|-------------------|-------------------|---------|-------------------|---------------------|---------|-------------------|
| | Performing loans | | | Nonperforming loans | | | Performing loans | | | Nonperforming loans | | |
| | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate |
| (dollars in thousands) | | | | | | | | | | | | |
| Owner occupied | \$ 146,646 | 22% | 5.02% | \$ 384,719 | 58% | 6.42% | \$ 75,049 | 21% | 5.72% | \$ 213,959 | 59% | 6.53% |
| Investment property | 21,563 | 3% | 5.34% | 103,365 | 16% | 6.74% | 11,032 | 3% | 5.85% | 63,305 | 17% | 6.56% |
| Other | 336 | 1% | 4.15% | 594 | 0% | 6.97% | 161 | 0% | 5.39% | 744 | 0% | 6.45% |
| | \$ 168,545 | 26% | 5.06% | \$ 488,678 | 74% | 6.49% | \$ 86,242 | 24% | 5.73% | \$ 278,008 | 76% | 6.54% |

| Loan age | June 30, 2011 | | | | | | December 31, 2010 | | | | | |
|------------------------|------------------|---------|-------------------|---------------------|---------|-------------------|-------------------|---------|-------------------|---------------------|---------|-------------------|
| | Performing loans | | | Nonperforming loans | | | Performing loans | | | Nonperforming loans | | |
| | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate |
| (dollars in thousands) | | | | | | | | | | | | |
| Less than 12 months | \$ 38 | 0% | 4.80% | \$ | 0% | | \$ 4 | 0% | | \$ | | |
| 12 - 35 months | 5,013 | 1% | 4.68% | 24,580 | 4% | 6.33% | 2,210 | 1% | 5.77% | 16,596 | 5% | 6.27% |
| 36 - 59 months | 87,562 | 13% | 5.39% | 280,104 | 42% | 6.70% | 46,617 | 13% | 6.21% | 154,628 | 42% | 6.80% |
| 60 months or more | 75,932 | 12% | 4.65% | 183,994 | 28% | 6.13% | 37,411 | 10% | 5.06% | 106,784 | 29% | 6.10% |
| | \$ 168,545 | 26% | 5.06% | \$ 488,678 | 74% | 6.49% | \$ 86,242 | 24% | 5.73% | \$ 278,008 | 76% | 6.54% |

| Origination FICO score | June 30, 2011 | | | | | | December 31, 2010 | | | | | |
|------------------------|------------------|---------|-------------------|---------------------|---------|-------------------|-------------------|---------|-------------------|---------------------|---------|-------------------|
| | Performing loans | | | Nonperforming loans | | | Performing loans | | | Nonperforming loans | | |
| | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate |
| (dollars in thousands) | | | | | | | | | | | | |
| Less than 600 | \$ 36,471 | 6% | 5.89% | \$ 82,216 | 12% | 6.95% | \$ 20,404 | 6% | 5.66% | \$ 44,930 | 12% | 6.62% |
| 600 - 649 | 32,847 | 5% | 5.56% | 89,387 | 14% | 6.85% | 19,235 | 5% | 5.92% | 49,096 | 13% | 6.45% |
| 650 - 699 | 45,274 | 7% | 4.79% | 139,626 | 21% | 6.42% | 20,521 | 6% | 5.77% | 78,528 | 22% | 6.18% |

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| | | | | | | | | | | | | |
|----------------|------------|-----|-------|------------|-----|-------|-----------|-----|-------|------------|-----|-------|
| 700 - 749 | 41,133 | 6% | 4.39% | 121,632 | 19% | 6.06% | 20,748 | 6% | 5.55% | 70,493 | 19% | 6.30% |
| 750 or greater | 12,820 | 2% | 4.34% | 55,817 | 8% | 6.24% | 5,334 | 1% | 6.38% | 34,961 | 10% | 5.94% |
| | \$ 168,545 | 26% | 5.06% | \$ 488,678 | 74% | 6.49% | \$ 86,242 | 24% | 5.73% | \$ 278,008 | 76% | 6.54% |

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Table of Contents

| Current loan-to-value(1) | June 30, 2011 | | | | | | December 31, 2010 | | | | | |
|--------------------------|------------------------|---------|-------------------|---------------------|---------|-------------------|-------------------|---------|-------------------|---------------------|---------|-------------------|
| | Performing loans | | | Nonperforming loans | | | Performing loans | | | Nonperforming loans | | |
| | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate |
| | (dollars in thousands) | | | | | | | | | | | |
| Less than 80% | \$ 35,252 | 6% | 5.93% | \$ 45,414 | 7% | 6.57% | \$ 21,867 | 6% | 5.94% | \$ 36,667 | 10% | 6.52% |
| 80% - 99.99% | 27,587 | 4% | 6.00% | 73,844 | 11% | 6.42% | 15,296 | 4% | 6.53% | 46,002 | 13% | 6.42% |
| 100% - 119.99% | 31,986 | 5% | 5.29% | 101,569 | 15% | 6.30% | 19,585 | 6% | 5.58% | 62,228 | 17% | 6.49% |
| 120% or greater | 73,720 | 11% | 4.51% | 267,851 | 41% | 6.54% | 29,494 | 8% | 5.43% | 133,111 | 36% | 6.58% |
| | \$ 168,545 | 26% | 5.06% | \$ 488,678 | 74% | 6.49% | \$ 86,242 | 24% | 5.73% | \$ 278,008 | 76% | 6.54% |

(1) Current loan-to-value is calculated based on the unpaid principal balance of the mortgage loan and our estimate of the value of the mortgaged property.

| Geographic distribution | June 30, 2011 | | | | | | December 31, 2010 | | | | | |
|-------------------------|------------------------|---------|-------------------|---------------------|---------|-------------------|-------------------|---------|-------------------|---------------------|---------|-------------------|
| | Performing loans | | | Nonperforming loans | | | Performing loans | | | Nonperforming loans | | |
| | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate |
| | (dollars in thousands) | | | | | | | | | | | |
| California | \$ 49,044 | 8% | 4.36% | \$ 120,273 | 18% | 5.90% | \$ 20,372 | 6% | 4.75% | \$ 75,533 | 21% | 5.86% |
| New York | 14,010 | 2% | 4.85% | 58,975 | 9% | 6.71% | 5,502 | 1% | 5.32% | 20,767 | 6% | 6.89% |
| Florida | 8,978 | 2% | 4.52% | 58,162 | 9% | 6.73% | 5,832 | 2% | 5.31% | 35,231 | 10% | 6.59% |
| Illinois | 7,891 | 1% | 4.98% | 25,181 | 4% | 6.22% | 4,987 | 1% | 5.86% | 13,746 | 4% | 6.55% |
| Other | 88,622 | 13% | 5.56% | 226,087 | 34% | 6.70% | 49,549 | 14% | 6.33% | 132,731 | 35% | 6.89% |
| | \$ 168,545 | 26% | 5.06% | \$ 488,678 | 74% | 6.49% | \$ 86,242 | 24% | 5.73% | \$ 278,008 | 76% | 6.54% |

| Payment status | June 30, 2011 | | | | | | December 31, 2010 | | | | | |
|----------------------------|------------------------|---------|-------------------|---------------------|---------|-------------------|-------------------|---------|-------------------|---------------------|---------|-------------------|
| | Performing loans | | | Nonperforming loans | | | Performing loans | | | Nonperforming loans | | |
| | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate | Fair value | % total | Average note rate |
| | (dollars in thousands) | | | | | | | | | | | |
| Current | \$ 105,972 | 16% | 4.83% | \$ 0 | 0% | | \$ 56,504 | 16% | 5.60% | \$ 0 | 0% | |
| 30 days delinquent | 34,111 | 5% | 5.35% | 0 | 0% | | 16,274 | 4% | 5.83% | 0 | 0% | |
| 60 days delinquent | 28,462 | 5% | 5.52% | 0 | 0% | | 13,464 | 4% | 6.11% | 0 | 0% | |
| 90 days or more delinquent | | 0% | | 166,136 | 25% | 6.30% | | 0% | | 115,586 | 32% | 6.44% |
| In foreclosure | | 0% | | 322,542 | 49% | 6.59% | | 0% | | 162,422 | 44% | 6.60% |
| | \$ 168,545 | 26% | 5.06% | \$ 488,678 | 74% | 6.49% | \$ 86,242 | 24% | 5.73% | \$ 278,008 | 76% | 6.54% |

Following is a summary of our real estate acquired in settlement of loans by attribute as of the dates presented:

| Property type | June 30, 2011 | | December 31, 2010 | |
|--------------------------|---------------|---------|-------------------|---------|
| | Fair value | % total | Fair value | % total |
| 1 - 4 dwelling units | \$ 33,338 | 68% | \$ 22,729 | 77% |
| Planned unit development | 11,422 | 23% | 4,460 | 15% |

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| | | | | |
|-------------------|-----------|------|-----------|------|
| 5+ dwelling units | 1,742 | 4% | 918 | 3% |
| Condominium/Co-op | 2,370 | 5% | 1,578 | 5% |
| | \$ 48,872 | 100% | \$ 29,685 | 100% |

Table of Contents

| Geographic distribution | June 30, 2011 | | December 31, 2010 | |
|-------------------------|---------------|---------|-------------------|---------|
| | Fair value | % total | Fair value | % total |
| California | \$ 19,870 | 41% | \$ 11,078 | 37% |
| Florida | 4,022 | 8% | 2,291 | 8% |
| Arizona | 2,271 | 5% | 1,659 | 6% |
| Colorado | 2,161 | 4% | * | * |
| Michigan | 1,714 | 4% | 1,263 | 4% |
| Maryland | * | * | 1,220 | 4% |
| Other | 18,834 | 38% | 12,174 | 41% |
| | \$ 48,872 | 100% | \$ 29,685 | 100% |

*

Not included in the states representing the largest balances as of the date presented.

Cash Flows

We invested the Company's cash at the beginning of 2011 in the acquisition of loans, resulting in a net decrease in cash of \$43.1 million during the six months ended June 30, 2011. Cash used by operating activities totaled \$41.3 million during the six months ended June 30, 2011. This use of cash was primarily due to the cash requirements related to the growth in our operating balance sheet which tracked our overall growth. Cash used by operating activities during the six months ended June 30, 2010 also reflects the effects of growth in our operating balance sheet accounts.

Net cash used by investing activities was \$271.2 million for the six months ended June 30, 2011. This use of cash reflects the growth of our investment portfolio. We purchased mortgage loans and real estate acquired in settlement of loans with fair values of \$360.4 million and \$1.5 million, respectively, during the first half of 2011. This contrasts with cash provided by investing activities totaling \$4.6 million during the first half of 2010. While we purchased \$198.1 million in fair value of mortgage loans during that period, we effected those purchases by redeploying a portion of our short-term investments.

Approximately 68% of our investments, comprised of non-correspondent lending mortgage loans, MBS and real estate acquired in settlement of loans, were nonperforming assets as of June 30, 2011. Nonperforming assets include mortgage loans delinquent 90 or more days and real estate acquired in settlement of loans. Accordingly, we expect that these assets will require a longer period to begin producing cash flow and the timing and amount of cash flows from these assets is less certain than for performing assets. During the six months ended June 30, 2011, we transferred \$45.8 million of mortgage loans to real estate acquired in settlement of loans and realized cash proceeds from the sale of real estate acquired in settlement of loans and mortgage-backed securities totaling \$29.3 million and \$3.3 million, respectively.

Net cash provided by financing activities was \$269.5 million for the six months ended June 30, 2011. These funds were procured to finance the acquisition of additional mortgage loans. As discussed above, during the quarter ended March 31, 2010, we were able to complete our acquisitions through the redeployment of our short-term investments. Therefore, we did not procure cash flow to finance our investments during the quarter ended March 31, 2010. As discussed below in *Liquidity and Capital Resources*, our Manager continues to evaluate and pursue additional sources of financing to provide us with future investing capacity.

Table of Contents

Liquidity and Capital Resources

Our liquidity reflects our ability to meet our current obligations (including our operating expenses and, when applicable, retirement of, and margin calls relating to, our debt), make investments as our Manager identifies them and make distributions to our shareholders. We generally need to distribute at least 90% of our taxable income each year (subject to certain adjustments) to our shareholders to qualify as a REIT under the Internal Revenue Code. These distribution requirements limit our ability to retain earnings and thereby replenish or increase capital to support our activities. We expect our primary sources of liquidity to become proceeds from earnings on our investments, proceeds from sales and repayments on our investments, and proceeds from borrowings and/or additional equity offerings. We believe our current liquidity is sufficient to meet our short-term liquidity needs.

Our current leverage strategy is to finance our assets where we believe such borrowing is prudent and appropriate. We expect in the future to obtain long-term financing for assets with estimated future lives of more than one year; this may include term financing and securitization of nonperforming and/or re-performing mortgage loans, to the extent that these sources are available to us.

Until attractive long-term financing is procured, we will continue to finance our assets on a short-term basis through agreements to repurchase and other secured lending and structured finance facilities, pending the ultimate disposition of the assets, whether through sale, securitization or liquidation. Because our current debt facilities consist solely of short-term borrowings, we expect to renew these facilities in advance of maturity in order to ensure our ongoing liquidity and access to capital or otherwise allow ourselves sufficient time to replace any necessary financing.

During the six months ended June 30, 2011, we received proceeds from the issuance of common shares as follows:

On February 16, 2011, we issued and sold 9,500,000 common shares in an underwritten public offering and received \$163.8 million of proceeds, after the underwriting discount and estimated offering expenses and the reimbursement of certain expenses.

On March 3, 2011, we issued and sold an additional 1,425,000 common shares pursuant to the exercise of an over-allotment option by the public offering's underwriters and received \$24.6 million of proceeds after the underwriting discount and reimbursement of certain expenses.

During the three months ended June 30, 2011, the Company sold a total of 28,500 of its common shares under a controlled equity offering sales agreement with Cantor Fitzgerald & Co. at a weighted average price of \$18.34 per share, providing net proceeds to the Company of approximately \$512,000 net of sales commissions. The sales agent received a total of approximately \$10,000, which represents an average commission of approximately 2.0% of the gross sales price per share.

These sources of liquidity were used to partially finance acquisitions of \$360.4 million in fair value of mortgage loans during the first half of 2011. We acquired mortgage loans totaling \$6.1 million after June 30, 2011, through the date of this Report.

On July 12, 2011, the Company entered into an agreement with CGM, pursuant to which the Company agreed to purchase from CGM certain nonperforming residential mortgage loans and residential real property acquired in settlement of loans (collectively, the "CGM Assets"). The CGM Assets were acquired by CGM from an unaffiliated large money-center bank (the "Initial Seller"). As part of the agreement and in connection with the Company's purchase of the CGM Assets, CGM will assign, and the Company will assume, all of CGM's rights and obligations under a separate purchase agreement with the Initial Seller. The Company will record the transaction as a purchase of loans in the third quarter of 2011.

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Table of Contents

Under the terms of the agreement, the Company will purchase the CGM Assets at a purchase price based, in part, on a percentage of the unpaid principal balance of the mortgage loans or, as applicable, the mortgage loans at the time the real property was acquired in settlement thereof. The unpaid principal balance of each CGM Asset is measured as of the cut-off date agreed to with the Initial Seller (the "Cut-off Date"). Pending purchase, the purchase price for each CGM Asset will be reduced by any collections of principal and interest on such CGM Asset after the closing date agreed to with the Initial Seller (the "Closing Date") and prior to the related purchase date.

The total unpaid principal balance of the CGM Assets as of the Cut-off Date was approximately \$348 million. The initial purchase price is approximately \$177.5 million. Subsequent adjustments may increase the purchase price to \$180.6 million based on the date the Company settles the purchase. The CGM Assets will be serviced by PLS from and after August 4, 2011 and interim serviced by the Initial Seller prior thereto. On the settlement date for any CGM Asset, in addition to the payment of the purchase price, the Company will reimburse CGM for certain out-of-pocket costs and other expenses, including servicing fees and servicing advances, and a cost of carry for such CGM Asset.

Any CGM Asset that liquidates prior to its settlement by the Company will be settled between the Company and CGM in the month following liquidation, in an amount based on the difference between the liquidation proceeds and the sum of the purchase price and reimbursement amounts that would have applied to such CGM Asset had it been purchased on the liquidation date.

The agreement requires that the Company settle the purchase of the CGM Assets on or before the date that is 180 days following the Closing Date; provided, however, that if on or prior to such date the Company reduces the total purchase price of the CGM Assets (measured as of the Cut-off Date) by 35% or more through collections of principal and interest, liquidations and settlements of CGM Assets, the date by which the CGM Assets must be purchased shall be extended until 360 days following the Closing Date. In the event that the Company fails to settle any CGM Assets on or before the 180-day or 360-day period described herein, as applicable, the agreement provides for a net settlement between the Company and CGM, in an amount based on the difference between the fair value of such CGM Assets on the date of determination and the sum of the purchase price and reimbursement amounts that would have applied to such CGM Assets had they been purchased on such date.

The Company's settlement of the purchase of the CGM Assets is subject to the Company obtaining additional capital adequate to fund the transaction. There can be no assurance that the purchase of the CGM Assets will ultimately be settled.

Our Manager continues to explore a variety of additional means of financing our continued growth, including debt financing through bank warehouse lines of credit, additional repurchase agreements, term financing, securitization transactions and additional equity offerings. However, there can be no assurance as to how much additional financing capacity such efforts will produce, what form the financing will take or that such efforts will be successful. Further, counterparty credit sensitivity and collateral documentation requirements have made it difficult to obtain financing for real estate acquired in settlement of loans, the result of which could place stress on our capital and liquidity positions at certain times during the foreclosure cycles of the related nonperforming loans.

During 2011, we have increased our use of debt financing as a means of extending our balance sheet capacity, primarily through the use of repurchase agreements. The transactions relating to securities sold under agreements to repurchase contain margin call provisions that, upon notice from the applicable lender at its option, require us to transfer cash or additional securities in an amount sufficient to eliminate any margin deficit. A margin deficit will generally result from any decline in the market value of the assets sold subject to an agreement to repurchase, although in some instances we may agree with the lender upon certain thresholds (in dollar amounts or percentages based on the market value of the assets) that must be exceeded before a margin deficit will arise. Upon notice from

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Table of Contents

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.

As of June 30, 2011, our debt financing consists of short-term borrowings in the form of the sale of securities and mortgage loans under agreements to repurchase and secured financings relating to real estate acquired in settlement of loans.

The transactions relating to securities sold under agreements to repurchase mature on or before July 20, 2011 and provide for sale to major financial institution counterparties of MBS in our investment portfolios at advance rates based on the estimated fair value of the securities sold. The agreements provide for repurchase by us of the securities at terms of either three weeks or three months, depending on the facility under which the securities are sold. All transactions maturing before the date of this Report have been refinanced by renewing the agreements at maturity.

The transactions relating to mortgage loans under agreements to repurchase mature between November 1, 2011 and June 6, 2012 and provide for sale to major financial institution counterparties based on the estimated fair value of the mortgage loans sold. The agreements provide for terms of approximately one year.

The transactions relating to real estate acquired in settlement of loans are secured financings that mature between November 1, 2011 and June 6, 2012 and provide for sale to major financial counterparties at advance rates based on the estimated fair value of the real estate acquired in settlement of loans.

Our debt financing agreements require us and certain of our subsidiaries to comply with various financial covenants. These financial covenants currently include the following:

profitability at each of the Company and two of our subsidiaries, PennyMac Corp. ("PMC") and PennyMac Mortgage Investment Trust Holdings I, LLC ("PMITH"), for at least one (1) of the previous two consecutive fiscal quarters, as of the end of each fiscal quarter

a minimum of \$10 million in unrestricted cash and cash equivalents among the Company and/or its subsidiaries; a minimum of \$7.75 million in unrestricted cash and cash equivalents between PMC and PMITH; and a minimum of \$7.5 million in unrestricted cash and cash equivalents at PMC

a minimum tangible net worth for the Company of \$265 million, plus 75% of the total net proceeds received by it in connection with equity issuances after November 2, 2010; a minimum tangible net worth for PMITH of \$195 million; and a minimum tangible net worth for PMC of the sum of (y) \$65 million and (z) 50% of its positive quarterly income after November 2, 2010

a maximum ratio of total liabilities to tangible net worth of less than 3:1 for the Company, 10:1 for PMC and 5:1 for PMITH

at least two warehouse or repurchase facilities that finance amounts and assets similar to those being financed under our existing debt financing agreements.

Although these financial covenants limit the amount of indebtedness we may incur and impact 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.

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The transactions relating to securities sold under agreements to repurchase contain margin call provisions that, upon notice from the applicable lender at its option, require us to transfer cash or additional securities in an amount sufficient to eliminate any margin deficit. A margin deficit will generally result from any decline in the market value of the assets subject to an agreement to

Table of Contents

repurchase, although in some instances we may agree with the lender upon certain thresholds (in dollar amounts or percentages based on the market value of the assets) that must be exceeded before a margin deficit will arise. 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. At June 30, 2011, all of our securities sold under agreements to repurchase were sold to one lender. With respect to these agreements, we have agreed with the lender to a threshold of \$250,000 in market value decline that must be exceeded before a margin deficit will arise.

Similarly, the transactions relating to mortgage loans and/or equity interests in special purpose entities holding real property under agreements to repurchase contain margin call provisions that, upon notice from the applicable lender at its option, require us to transfer cash or additional mortgage loans or real property, as applicable, in an amount sufficient to eliminate any margin deficit. A margin deficit will generally result from any decline in the market value of the assets subject to an agreement to repurchase. 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.

At June 30, 2011, we financed all of our MBS of \$119.9 million, all of our mortgage loans acquired for sale at fair value of \$18.8 million, \$569.2 million of our mortgage loans at fair value, and \$17.4 million of real estate acquired in settlement of loans, or approximately 90% of our investments in mortgage loans, MBS and real estate acquired in settlement of loans. This compares to the 24% of such assets that we financed at December 31, 2010. Accordingly, repurchase agreements represent a significant source of funding for our investment portfolio.

During the quarter ended June 30, 2011, the average balance outstanding under agreements to repurchase MBS and mortgage loans and real estate acquired in settlement of loans financed under agreements to repurchase totaled \$320.4 million, and the maximum daily amount outstanding under the agreements to repurchase MBS and mortgage loans totaled \$358.1 million. The difference between the maximum and average daily amounts outstanding was due to increasing utilization of our existing facilities and our entry into a new credit facility during the six months ended June 30, 2011.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

Off-Balance Sheet Arrangements and Guarantees

As of June 30, 2011, we have not entered into any off-balance sheet arrangements or guarantees.

Contractual Obligations

As of June 30, 2011, our on-balance sheet contractual obligations are limited to \$341.0 million of agreements to repurchase loans and securities sold with maturities between July 20, 2011 and June 11, 2012. All agreements to repurchase that matured between June 30, 2011 and the date of this Report have been renewed and are described in Note 10 *Loans Sold Under Agreements to Repurchase* and Note 11 *Securities Sold Under Agreements to Repurchase at Fair Value* in the accompanying financial statements.

As of the date of this Report, PCM has committed to acquire, on our behalf, mortgage loans with purchase prices totaling approximately \$126.7 million. The pending transaction is subject to changes in the loans allocated to us by PCM, continuing due diligence, customary closing conditions and our obtaining additional capital adequate to fund the transaction. There can be no assurance that the committed amount will ultimately be acquired or that the transaction will be completed at all.

On July 12, 2011, we purchased a pool of mortgage loans and real estate acquired in settlement of loans from CGM. The initial purchase price is approximately \$177.5 million. Subsequent adjustments may increase the purchase price to a maximum of \$180.6 million based on the date we settle the

Table of Contents

purchase. Our settlement of the purchase of these loans and real estate acquired in settlement of loans is subject to our obtaining additional capital sufficient to fund the transaction. There can be no assurance that the transaction will ultimately be settled. This transaction is more fully described in Note 21 *Subsequent Events* in the accompanying financial statements and *Liquidity and Capital Resources* above.

Management Agreement. Pursuant to the management agreement between PCM and us, we pay PCM a base management fee and a performance incentive fee, both payable quarterly and in arrears. The base management fee is calculated at the annual rate of 1.5% of shareholders' equity. "Shareholders' equity" is defined as the sum of the net proceeds from any issuances of our equity securities since inception (weighted for the time outstanding during the measurement period); plus our retained earnings at the end of the quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods); less any amount we pay for repurchases of our common shares (weighted for the time held during the measurement period); excluding any unrealized gains, losses or other non-cash items that have impacted our shareholders' equity as reported in our financial statements, regardless of whether those items are included in other comprehensive income or loss or net income; and excluding one-time events pursuant to changes in U.S. GAAP and certain other non-cash charges after discussions between PCM and our independent trustees and approval by a majority of our independent trustees.

The performance incentive fee is calculated at 20% per year of the amount by which "core earnings," on a rolling four-quarter basis and before the incentive fee, exceeds an 8% "hurdle rate." "Core earnings," for purposes of determining the amount of the performance incentive fee, is defined as U.S. GAAP net income (loss) adjusted to exclude non-cash equity compensation expense, unrealized gains and losses or other non-cash items recognized during the period, any conditional payment amounts relating to our IPO paid to PCM and the underwriters of our IPO, and certain other non-cash charges after discussions between PCM and our independent trustees and approval by a majority of our independent trustees. The "hurdle rate" is calculated as the product of (1) the weighted average of the issue price per share of all of our public offerings multiplied by the weighted average number of shares outstanding (including, for the avoidance of doubt, restricted share units) in the four-quarter period and (2) 8%. During our first four quarters, core earnings were calculated based on the annualized results of each of the preceding quarters. For purposes of calculating the incentive fee, to the extent we have a net loss in core earnings from a period prior to the rolling four-quarter period that has not been offset by core earnings in a subsequent period, such loss will continue to be included in the rolling four-quarter calculation until it has been fully offset. This term is not applicable for purposes of determining whether the conditional payment of the underwriting discount is payable.

Under the management agreement, PCM is entitled to reimbursement of organizational and operating expenses, including third party expenses, incurred on our behalf. Our reimbursement obligation is not subject to any dollar limitation. Expenses are reimbursed in cash on a quarterly basis.

Under the management agreement, PCM may be entitled to a termination fee under certain circumstances. Specifically, the termination fee is payable for (1) our termination of the management agreement without cause or (2) PCM's termination of the management agreement upon a default in the performance of any material term of the management agreement. The termination fee is equal to three times (a) the average annual base management fee and (b) the average annual (or, if the period is less than 24 months, annualized) incentive fee earned by PCM during the prior 24-month period before termination. Under circumstances where the termination fee is payable, we will agree to pay to PCM its portion of the conditional payment of the underwriting discount described below.

Loan Servicing Agreement. For its services under our loan servicing agreement, PLS is entitled to base servicing fees that are competitive with those charged by other servicers or specialty servicers, as applicable. Base servicing fees are calculated as a percentage of the unpaid principal balance of the

Table of Contents

mortgage loans, with the actual percentage being based on the risk characteristics of the loans in a particular pool. Such risk characteristics include market value of the underlying properties, creditworthiness of the borrowers, seasoning of the loans, degree of current and expected loan defaults, current loan-to-value ratios, borrowers' payment history and debt-to-income levels.

The base servicing fees for nonperforming loans range from 30 to 100 basis points per year of the unpaid principal balance of such loans. PLS is also entitled to certain customary market-based fees and charges, including boarding and deboarding fees, liquidation and disposition fees, assumption, modification and origination fees and late charges, as well as interest on funds on deposit in custodial or escrow accounts.

When PLS effects a refinancing of a loan on our behalf and not through a third party lender and the resulting loan is readily saleable, PLS is entitled to receive from us market-based fees and compensation. Similarly, when PLS originates a loan to facilitate the disposition of real estate that we acquire in settlement of a loan, PLS is entitled to a fee in the same amount.

To the extent we participate in HAMP (or other similar mortgage loan modification programs), PLS is entitled to retain any incentive payments made to it and to which it is entitled under HAMP; provided, however, that with respect to any such incentive payments paid to PLS in connection with a mortgage loan modification for which we previously paid PLS a modification fee, PLS is required to reimburse us an amount equal to the lesser of such modification fee or such incentive payments.

Under the loan servicing agreement, PLS is also entitled to reimbursement for all customary, reasonable and necessary out of pocket expenses incurred by PLS in connection with the performance of its servicing obligations.

In connection with our correspondent lending business, PLS is entitled to base servicing fees, which range from 5 to 20 basis points per year of the unpaid principal balance of such loans, and other customary market-based fees and charges as described above. PLS also provides us with certain mortgage banking services, including fulfillment and disposition-related services, for a fulfillment fee based on a percentage of the unpaid principal balance of the mortgage loans. The fulfillment fee for such services is currently 50 basis points. Since November 1, 2010, we collect interest income and a sourcing fee of three basis points for each mortgage loan we buy from a correspondent and sell to PLS for ultimate disposition to a third party only where we are not approved or licensed to sell to such third party. During the quarter ended June 30, 2011, we recorded fulfillment fees totaling \$61,000.

We paid servicing fees to PLS as described above and as provided in our loan servicing agreement, and recorded other expenses, including common overhead expenses incurred on our behalf by PCM and its affiliates in accordance with the terms of our management agreement.

Conditional Payment of Underwriting Discount. Certain of the underwriting costs incurred in our IPO were paid on our behalf by PCM and a portion of the underwriting discount was deferred by agreement with the underwriters of the offering. Reimbursement to PCM and payment to the underwriters of the deferred underwriting discount are both contingent on our performance as follows: we will reimburse PCM approximately \$2.9 million of underwriting costs paid by PCM on the offering date and pay the underwriters approximately \$5.9 million in deferred underwriting discount if, during any full four calendar quarter period during the 24 full calendar quarters after the date of the completion of our IPO, August 4, 2009, our "core earnings" for such four-quarter period and before the incentive portion of PCM's management fee equals or exceeds an 8% incentive fee "hurdle rate" (both defined above). If this requirement is not satisfied by the end of such 24 calendar quarter period, our obligation to reimburse PCM and make the conditional payment of the underwriting discount will terminate. We have concluded that this contingency is probable of being met during the 24-quarter period and have recognized a liability for reimbursement to PCM and payment of the contingent underwriting discount as a reduction of additional paid-in capital.

Table of Contents**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 real estate risk, credit risk, interest rate risk, prepayment risk, inflation risk and market value risk. A substantial portion of our investments are comprised of nonperforming loans. We believe that such assets' fair values respond primarily to changes in the fair value of the real estate securing such loans.

The following table summarizes the estimated change in fair value of our portfolio of mortgage loans as of the dates presented, given several hypothetical (instantaneous) changes in home values from those used in the determination of fair value:

| Property value shift | -15% | -10% | -5% | +5% | +10% | +15% |
|--|-------------|-------------|-------------|------------|------------|------------|
| (dollar amounts in thousands) | | | | | | |
| As of June 30, 2011: | | | | | | |
| Fair value | \$ 574,040 | \$ 602,385 | \$ 630,390 | \$ 684,842 | \$ 711,013 | \$ 736,303 |
| Change in fair value: | | | | | | |
| \$ | \$ (83,183) | \$ (54,838) | \$ (26,833) | \$ 27,619 | \$ 53,790 | \$ 79,080 |
| % | (12.66)% | (8.34)% | (4.08)% | 4.20% | 8.18% | 12.03% |
| Change in fair value as of December 31, 2010 | | | | | | |
| | \$ (44,013) | \$ (29,054) | \$ (14,371) | \$ 14,019 | \$ 27,575 | \$ 40,588 |

The following table summarizes the estimated change in fair value of our portfolio of MBS as of the dates presented, given several hypothetical (instantaneous) shifts in interest rates and parallel shifts in the yield curve:

| Interest rate shift in basis points | -200 | -100 | -50 | +50 | +100 | +200 |
|--|-----------|-----------|-----------|-----------|-----------|-----------|
| (dollar amounts in thousands) | | | | | | |
| As of June 30, 2011: | | | | | | |
| Fair value | \$ 82,357 | \$ 82,341 | \$ 82,335 | \$ 82,550 | \$ 82,694 | \$ 83,005 |
| Change in fair value: | | | | | | |
| \$ | \$ (64) | \$ (79) | \$ (86) | \$ 129 | \$ 274 | \$ 584 |
| % | (0.08)% | (0.10)% | (0.10)% | 0.16% | 0.33% | 0.71% |
| Change in fair value as of December 31, 2010 | | | | | | |
| | \$ (298) | \$ (303) | \$ (246) | \$ 326 | \$ 679 | \$ 1,475 |

These sensitivity analyses are limited in that they were performed at a particular point in time; only contemplate certain movements in real estate values as they relate to mortgage loans and interest rates as they relate to MBS; do not incorporate changes in interest rate volatility or changes in the relationship of one interest rate index to another; are subject to the accuracy of various models and assumptions used, including prepayment forecasts and discount rates; and 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 preceding estimates should not be viewed as an earnings forecast.

Accounting Developments

In May 2011, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") 2011-04 to the *Fair Value Measurements* topic of the Accounting Standards Codification ("ASC"). ASU 2011-04 eliminates unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards, expands the disclosure requirements of the *Fair Value*

Table of Contents

Measurements and Disclosure topic of the ASC for fair value measurements and makes other amendments, including:

limiting the highest-and-best-use valuation-premise concepts only to measuring the fair value of nonfinancial assets;

permitting an exception to fair value measurement principles for financial assets and financial liabilities (and derivatives) with offsetting positions in market risks or counterparty credit risk when several criteria are met. When the criteria are met, an entity can measure the fair value of the net risk position;

clarifying that premiums or discounts that reflect size as a characteristic of the reporting entity's holding rather than as a characteristic of the asset or liability (for example, a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement; and

prescribing a model for measuring the fair value of an instrument classified in shareholders' equity; this model is consistent with the guidance on measuring the fair value of liabilities.

ASU 2011-04 expands the *Fair Value Measurements* topic's disclosure requirements, particularly for fair value measurements categorized in Level 3 of the fair value hierarchy: (1) a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, (2) a description of the valuation processes in place (e.g., how the entity decides its valuation policies and procedures, as well as changes in its analyses of fair value measurements, from period to period), and (3) a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs.

ASU 2011-04 is applicable to the Company for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 is not expected to have a material effect on our financial statements.

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," "estimate," "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

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Table of Contents

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 1A. "Risk Factors" in our Annual Report and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2011.

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

changes in our investment objectives or investment or operational strategies, including any new lines of business or new products and services that may subject us to additional risks;

volatility in our industry, interest rates and spreads, the debt or equity markets, the general economy or the residential finance and real estate markets specifically, whether the result of market events or otherwise;

events or circumstances which undermine confidence in the financial markets or otherwise have a broad impact on financial markets, such as a credit downgrade of U.S. Government obligations, the sudden instability or collapse of large depository institutions or other significant corporations, terrorist attacks, natural or man-made disasters, or threatened or actual armed conflicts;

changes in general business, economic, market, employment, consumer confidence and spending habits and political conditions from those expected;

continued declines in residential real estate and significant changes in U.S. housing prices and/or activity in the U.S. housing market;

the availability of, and level of competition for, attractive risk-adjusted investment opportunities in residential mortgage loans and mortgage-related assets that satisfy our investment objective and investment strategies;

our success in winning bids to acquire loans;

the concentration of credit risks to which we are exposed;

the degree and nature of our competition;

changes in personnel and lack of availability of qualified personnel;

our dependence on PCM, potential conflicts of interest with PCM and its affiliated entities, and the performance of such entities;

the availability, terms and deployment of short-term and long-term capital;

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the adequacy of our cash reserves and working capital;

our ability to match the interest rates and maturities of our assets with our financing;

the timing and amount of cash flows, if any, from our investments;

unanticipated increases in financing and other costs, including a rise in interest rates;

the performance, financial condition and liquidity of borrowers;

incomplete or inaccurate information or documentation provided by customers or counterparties, or adverse changes in the financial condition of our customers and counterparties;

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Table of Contents

the quality and enforceability of the collateral documentation evidencing our ownership and rights in the assets in which we invest;

increased rates of delinquency, default and/or decreased recovery rates on our investments;

our ability to foreclose on our investments in a timely manner or at all;

increased prepayments of the mortgages and other loans underlying our MBS and other investments;

the degree to which our hedging strategies may or may not protect us from interest rate volatility;

the effect of the accuracy of or changes in the estimates we make about uncertainties and contingencies when measuring and reporting upon our financial condition and income;

our failure to maintain appropriate internal controls over financial reporting;

developments in the secondary markets for our mortgage loan products;

legislative and regulatory changes that impact the mortgage loan industry or housing market;

changes in regulations or the occurrence of other events that impact the business, operation or prospects of GSEs;

the Dodd-Frank Wall Street Reform and Consumer Protection Act and any other legislative and regulatory changes that impact the business, operations or governance of publicly-traded companies;

changes in government support of homeownership;

changes in governmental regulations, accounting treatment, tax rates and similar matters (including changes to laws governing the taxation of REITs or the exclusions from registration as an investment company);

limitations imposed on our business and our ability to satisfy complex rules for us to qualify as a REIT for U.S. federal income tax purposes and qualify for an exclusion from the Investment Company Act of 1940 and the ability of certain of our subsidiaries to qualify as REITs and certain of our subsidiaries to qualify as TRSs for U.S. federal income tax purposes, and our ability and the ability of our subsidiaries to operate effectively within the limitations imposed by these rules;

estimates relating to our ability to make distributions to our shareholders in the future;

the effect of public opinion on our reputation; and

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the occurrence of natural disasters or other events or circumstances that could impact our operations.

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

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

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

In response to this Item 3, the information set forth on page 61 is incorporated herein by reference.

Table of Contents

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. However, 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 failures to disclose material information otherwise required to be set forth in our periodic reports.

Our management has conducted an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Report as required by paragraph (b) of Rules 13a-15 and 15d-15 under the Exchange Act. Based on our evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective, as of the end of the period covered by this Report, to provide reasonable assurance that information required to be disclosed by us in the 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.

Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter ended June 30, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

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, 2011, we were not involved in any such legal proceedings, claims or actions that 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, 2010, filed with the SEC on March 7, 2011, and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, filed with the SEC on May 6, 2011.

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

None

Item 3. *Defaults Upon Senior Securities*

None

Item 4. *[Reserved]*

Item 5. *Other Information*

At our 2011 Annual Meeting of Shareholders held on May 17, 2011, a plurality of our outstanding common shares of beneficial interest were voted in favor of conducting future non-binding, advisory votes on executive compensation on an "every year" basis. We have considered this shareholder vote and, consistent with the recommendation of our shareholders, we intend to conduct future non-binding, advisory votes on executive compensation on an "every year" basis until the next vote by our shareholders on the frequency of such votes, no later than our 2017 Annual Meeting of Shareholders.

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Table of Contents

Item 6. Exhibits

| Exhibit Number | Exhibit Description |
|-----------------------|---|
| 3.1 | Declaration of Trust of PennyMac Mortgage Investment Trust, as amended and restated (incorporated by reference to Exhibit 3.1 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2009). |
| 3.2 | Bylaws of PennyMac Mortgage Investment Trust (incorporated by reference to Exhibit 3.2 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2009). |
| 4.1 | Specimen Common Share Certificate of PennyMac Mortgage Investment Trust (incorporated by reference to Exhibit 4.1 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2009). |
| 10.1 | Registration Rights Agreement among PennyMac Mortgage Investment Trust, Stanford L. Kurland, David A. Spector, BlackRock Holdco II, Inc., Highfields Capital Investments LLC and Private National Mortgage Acceptance Company, LLC (incorporated by reference to Exhibit 10.1 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2009). |
| 10.2 | Underwriting Fee Reimbursement Agreement among PennyMac Mortgage Investment Trust, PennyMac Operating Partnership, L.P. and PNMAC Capital Management, LLC (incorporated by reference to Exhibit 10.7 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2009). |
| 10.3 | Amended and Restated Limited Partnership Agreement of PennyMac Operating Partnership, L.P. (incorporated by reference to Exhibit 10.2 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2009). |
| 10.4 | Management Agreement among PennyMac Mortgage Investment Trust, PennyMac Operating Partnership, L.P. and PNMAC Capital Management, LLC (incorporated by reference to Exhibit 10.3 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2009). |
| 10.5 | Amendment No. 1 to Management Agreement among PennyMac Mortgage Investment Trust, PennyMac Operating Partnership, L.P. and PNMAC Capital Management, LLC (incorporated by reference to Exhibit 10.4 of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010). |
| 10.6 | Flow Servicing Agreement, dated as of August 4, 2009, between PennyMac Operating Partnership, L.P. and PennyMac Loan Services, LLC (incorporated by reference to Exhibit 10.4 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2009). |
| 10.7 | Amendment No. 1 to Flow Servicing Agreement, dated as of March 3, 2010, between PennyMac Operating Partnership, L.P. and PennyMac Loan Services, LLC (incorporated by reference to Exhibit 10.6 of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010). |
| 10.8 | Amendment No. 2 to Flow Servicing Agreement, dated as of March 8, 2011, between PennyMac Operating Partnership, L.P. and PennyMac Loan Services, LLC (incorporated by reference to Exhibit 10.8 of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2011). |
| 10.9 | Amendment No. 3 to Flow Servicing Agreement, dated as of May 17, 2011, by and between PennyMac Operating Partnership, L.P. and PennyMac Loan Services, LLC. |

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Table of Contents

| Exhibit Number | Exhibit Description |
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| 10.10 | PennyMac Mortgage Investment Trust 2009 Equity Incentive Plan (incorporated by reference to Exhibit 10.5 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2009). |
| 10.11 | Form of Restricted Share Unit Award Agreement under the PennyMac Mortgage Investment Trust 2009 Equity Incentive Plan (incorporated by reference to Exhibit 10.8 to Amendment No. 3 to the Company's Registration Statement on Form S-11, filed with the SEC on July 24, 2009). |
| 10.12 | Master Repurchase Agreement among PennyMac Corp., PennyMac Mortgage Investment Trust Holdings I, LLC, and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.11 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2010). |
| 10.13 | Guaranty Agreement by PennyMac Mortgage Investment Trust in favor of Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.12 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2010). |
| 10.14 | Master Repurchase Agreement among Credit Suisse First Boston Mortgage Capital, LLC, PennyMac Corp., PennyMac Mortgage Investment Trust and PennyMac Operating Partnership, L.P. (incorporated by reference to Exhibit 10.13 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2010). |
| 10.15 | Amendment Number One to Master Repurchase Agreement, dated as of May 20, 2011, among Credit Suisse First Boston Mortgage Capital LLC, PennyMac Corp., PennyMac Mortgage Investment Trust and PennyMac Operating Partnership, L.P. |
| 10.16 | Guaranty by PennyMac Mortgage Investment Trust and PennyMac Operating Partnership, L.P. and Credit Suisse First Boston Mortgage Capital, LLC (incorporated by reference to Exhibit 10.14 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2010). |
| 10.17 | Master Repurchase Agreement among PennyMac Corp., PennyMac Mortgage Investment Trust Holdings I, LLC, and PennyMac Loan Services, LLC, and Citibank, N.A. (incorporated by reference to Exhibit 1.1 of our Current Report on Form 8-K filed on December 15, 2010). |
| 10.18 | Amendment Number One to Master Repurchase Agreement, by and among Citibank, N.A. and PennyMac Corp., PennyMac Mortgage Investment Trust Holdings I, LLC and PennyMac Loan Services, LLC (incorporated by reference to Exhibit 1.1 of our Current Report on Form 8-K filed on March 3, 2011). |
| 10.19 | Guaranty Agreement by PennyMac Mortgage Investment Trust in favor of Citibank, N.A. (incorporated by reference to Exhibit 1.2 of our Current Report on Form 8-K filed on December 15, 2010). |
| 10.20 | Master Repurchase Agreement, dated as of June 8, 2011, among Credit Suisse First Boston Mortgage Capital LLC, PennyMac Corp., PennyMac Mortgage Investment Trust Holdings I, LLC and PennyMac Mortgage Investment Trust (incorporated by reference to Exhibit 1.1 of our Current Report on Form 8-K filed on June 14, 2011). |
| 10.21 | Guaranty, dated as of June 8, 2011, of PennyMac Mortgage Investment Trust in favor of Credit Suisse First Boston Mortgage Capital LLC (incorporated by reference to Exhibit 1.2 of our Current Report on Form 8-K filed on June 14, 2011). |

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Table of Contents

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| 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. |
| 101 | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of June 30, 2011 and December 31, 2010, (ii) the Consolidated Statements of Income for the quarter and six months ended June 30, 2011 and June 30, 2010, (iii) the Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2011 and June 30, 2010, (iv) the Consolidated Statements of Cash Flows for the six months ended June 30, 2011 and June 30, 2010, and (v) the Notes to the Consolidated Financial Statements.* |

*

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 Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is otherwise not subject to liability under those sections.

Table of Contents

PENNYMAC MORTGAGE INVESTMENT TRUST

FORM 10-Q
June 30, 2011

INDEX OF EXHIBITS

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Edgar Filing: PennyMac Mortgage Investment Trust - Form 10-Q

Table of Contents

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Edgar Filing: PennyMac Mortgage Investment Trust - Form 10-Q

Table of Contents

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