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

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

ý **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

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

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

PennyMac Mortgage Investment Trust

(Exact name of registrant as specified in its charter)

Maryland	**27-0186273**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
27001 Agoura Road, Calabasas, California	**91301**
(Address of principal executive offices)	(Zip Code)

(818) 224-7442
(Registrant's telephone number, including area code)

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

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 ý No o

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 o	Accelerated filer ý	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

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

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

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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 (unaudited)	December 31, 2010
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

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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(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				

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.

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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.

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six months ended June 30, 2011	Six months ended June 30, 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	

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.

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.

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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.

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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*.

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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

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.

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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.

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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, 2011	Quarter ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 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.

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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

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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	$

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	$

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5 Fair Value (Continued)

	Six months ended June 30, 2011			
	Mortgage-backed securities	Mortgage loans	Mortgage servicing rights	Total
	(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&nb		