PennyMac Mortgage Investment Trust
Form 10-Q
May 06, 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 March 31, 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 (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 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 o 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 May 5, 2011**
Common Shares of Beneficial Interest, $.01 par value	27,763,243

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PENNYMAC MORTGAGE INVESTMENT TRUST
FORM 10-Q
March 31, 2011

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(In thousands, except share data)

	March 31, 2011 (unaudited)	December 31, 2010
ASSETS		
Cash	$ 10,843	$ 45,447
Short term investments	53,194	
Mortgage-backed securities at fair value	102,195	119,872
Mortgage loans at fair value	592,445	368,216
Real estate acquired in settlement of loans	31,285	29,685
Principal and interest collections receivable	26,854	8,249
Interest receivable	1,416	978
Mortgage servicing rights at fair value	37	
Due from affiliates	4,580	2,115
Other assets	17,682	14,533
Total assets	$ 840,531	$ 589,095
LIABILITIES		
Accounts payable and accrued liabilities	$ 1,200	$ 9,080
Loans sold under agreements to repurchase	220,367	147,422
Securities sold under agreements to repurchase at fair value	88,065	101,202
Contingent underwriting fees payable	5,883	5,883
Payable to affiliates	8,254	5,595
Total liabilities	323,769	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, 27,762,843 and 16,832,343 shares at March 31, 2011 and December 31, 2010, respectively	278	168
Additional paid-in capital	506,269	317,175
Retained earnings	10,215	2,570
Total shareholders' equity	516,762	319,913
Total liabilities and shareholders' equity	$ 840,531	$ 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 STATEMENT OF INCOME

(Unaudited)

(In thousands, except per share data)

	Quarter Ended March 31, 2011	Quarter Ended March 31, 2010
Investment Income		
Net gain (loss) on investments:		
Mortgage-backed securities	$ (442)	$ 57
Mortgage loans	10,353	1,133
	9,911	1,190
Interest income:		
Short term investments	31	45
Mortgage-backed securities	1,086	1,284
Mortgage loans	5,086	1,335
	6,203	2,664
Net gain on correspondent lending mortgage loans	62	
Results of real estate acquired in settlement of loans	1,089	
Change in fair value of mortgage servicing rights	(3)	
Other income	21	
Net investment income	17,283	3,854
Expenses		
Interest	2,278	
Loan servicing fees	2,206	85
Management fees	1,549	1,211
Compensation	1,014	803
Professional services	877	94
Insurance	190	197
Other	883	83
Total expenses	8,997	2,473
Income before provision for income taxes	8,286	1,381
Provision for income taxes	641	127
Net income	$ 7,645	$ 1,254
Earnings per share, basic and diluted	$ 0.35	$ 0.07
Weighted average shares outstanding		

Basic	21,938	16,735
Diluted	22,148	17,110

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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENT 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
Underwriting and offering costs			(150)		(150)
Net income				1,254	1,254
Share-based compensation			578		578
Balance at March 31, 2010	16,735,317	$ 167	$ 315,942	$ (629)	$ 315,480
Balance at December 31, 2010	16,832,343	$ 168	$ 317,175	$ 2,570	$ 319,913
Proceeds from offerings of common shares	10,925,000	110	196,540		196,650
Underwriting and offering costs			(8,241)		(8,241)
Net income				7,645	7,645
Share-based compensation	5,500		795		795
Balance at March 31, 2011	27,762,843	$ 278	$ 506,269	$ 10,215	$ 516,762

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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

(In thousands)

	Quarter ended March 31, 2011	Quarter ended March 31, 2010
Cash flows from operating activities:		
Net income	$ 7,645	$ 1,254
Adjustments to reconcile net income to net cash used by operating activities:		
Net loss (gain) on mortgage-backed securities	442	(57)
Net gain on non-correspondent lending mortgage loans	(10,353)	(1,133)
Accrual of unearned discounts on mortgage-backed securities	(714)	(765)
Net gain on correspondent lending mortgage loans	(62)	
Results of real estate acquired in settlement of loans	(1,089)	
Change in fair value of mortgage servicing rights	3	
Amortization of credit facility commitment fees	312	
Share-based compensation expense	795	578
Purchases of mortgage loans acquired for sale	(19,576)	(13,782)
Sales of mortgage loans acquired for sale	19,155	13,782
Increase in principal and interest collections receivable	(18,605)	(1,264)
Increase in interest receivable	(478)	(110)
Increase in due from affiliates	(2,465)	(51)
Increase in other assets	(2,215)	(475)
(Decrease) increase in accounts payable and accrued liabilities	(3,384)	36
Increase in income taxes payable		127
Increase in payable to affiliates	2,659	397
Net cash used in operating activities	(27,930)	(1,463)
Cash flows from investing activities:		
Net (increase) decrease in short term investments	(53,194)	98,143
Purchases of mortgage-backed securities at fair value		(414)
Repayments of mortgage-backed securities at fair value	17,949	8,618
Purchases of mortgage loans at fair value	(243,128)	(101,425)
Repayments of mortgage loans at fair value	15,569	
Sales of mortgage loans at fair value	2,565	
Purchases of real estate acquired in settlement of loans	(247)	(1,238)
Sales of real estate acquired in settlement of loans	13,911	
Increase in margin deposits	(1,246)	
Net cash (used) provided in investing activities	(247,821)	3,684
Cash flows from financing activities:		
Sales of loans under agreements to repurchase	121,844	
Repurchases of loans sold under agreements to repurchase	(48,899)	
Sales of securities under agreements to repurchase	257,952	
Repurchases of securities sold under agreements to repurchase	(271,089)	
Proceeds from issuance of common shares	196,650	
Payment of underwriting and offering costs	(8,241)	(150)

Payment of dividends		(7,070)		
Net cash provided (used) in financing activities		241,147		(150)
Net (decrease) increase in cash		(34,604)		2,071
Cash at beginning of period		45,447		54
Cash at end of period	$	10,843	$	2,125

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

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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" or the "Manager"), 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 period ended March 31, 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. Most of the non-correspondent lending loans purchased by the Company have been acquired from one major financial institution.

Through its management agreement with PCM and its loan servicing agreements with its loan servicers, including 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. Department of 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 writedown 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 $243.1 million and $101.4 million at fair value of mortgage loans for its investment portfolio during the quarters ended March 31, 2011 and 2010, respectively. Of those totals, $227.3 million and $91.3 million at fair value of mortgage loans were purchased from subsidiaries of one money-center bank.

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 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 in the Company's 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 12 *Shareholders' Equity*.

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 March 31,	
	2011	**2010**
	(in thousands)	
Base management fee	$ 1,549	$ 1,211
Performance incentive fee		
Total management fee incurred during the period	1,549	1,211
Fee paid during the period	(1,228)	(1,169)
Fee outstanding at beginning of period	1,228	1,169
Fee outstanding at period end	$ 1,549	$ 1,211

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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 3 Transactions with Related Parties (Continued)

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 or escrow 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 an origination fee of 1.0% of the unpaid principal balance of the loan plus $750. Similarly, when PLS originates a loan to facilitate the disposition of real estate that it acquires in settlement of a loan, PLS will be entitled to a fee in the same amount.

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 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 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 and sells to PLS for ultimate disposition to a third party only where the Company is not approved or licensed to sell to such third party. During the quarter ended March 31, 2011, the Company recorded fulfillment fees totaling $12,000. No fulfillment fees were incurred during the quarter ended March 31, 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.

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 3 Transactions with Related Parties (Continued)

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

	Quarter ended March 31, 2011	Quarter ended March 31, 2010
	(in thousands)	
Loan servicing and fulfillment fees payable to PLS	$ 2,171	$ 84
Reimbursement of expenses incurred on PMT's behalf:		
Compensation	128	125
Other	659	271
	787	396
Reimbursement of common overhead incurred by PCM and its affiliates	587	
	$ 3,545	$ 480
Payments made during the period	$ 1,206	$ 128

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.

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

	March 31, 2011	December 31, 2010
	(in thousands)	
Contingent offering costs	$ 2,941	$ 2,941
Management fee	1,549	1,228
Expenses	3,764	1,426
	$ 8,254	$ 5,595

Amounts due from affiliates totaled $4.6 million and $2.1 million at March 31, 2011 and December 31, 2010, respectively, and represent 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 the parent company of PCM and PLS.

PCM's parent company, Private National Mortgage Acceptance Company, LLC, held 75,000 of the Company's common shares of beneficial interest at both March 31, 2011 and December 31, 2010.

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 quarter ended March 31, 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.

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

	Quarter ended March 31, 2011	Quarter ended March 31, 2010
	(amounts in thousands except per share amounts)	
Basic earnings per share:		
Net income	$ 7,645	$ 1,254
Effect of participating securities share-based compensation instruments	(31)	
Net income attributable to common shareholders	$ 7,614	$ 1,254
Weighted-average shares outstanding	21,938	16,735
Basic earnings per share	$ 0.35	$ 0.07
Diluted earnings per share:		
Net income	$ 7,645	$ 1,254
Weighted-average shares outstanding	21,938	16,735
Dilutive potential common shares shares issuable under share based compensation plan	210	375
Diluted weighted-average number of common shares outstanding	22,148	17,110
Diluted earnings per common share	$ 0.35	$ 0.07

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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, 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 and not expensed as incurred, thereby reflecting the debt issuance expense over the periods benefiting from the usage of the debt.

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:

	March 31, 2011			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short term investments	$ 53,194	$	$	$ 53,194
Mortgage-backed securities			102,195	102,195
Mortgage loans		4,409	588,036	592,445
Mortgage servicing rights			37	37
	$ 53,194	$ 4,409	$ 690,268	$ 747,871
Liabilities:				
Securities sold under agreements to repurchase	$	$	$ 88,065	$ 88,065
	$	$	$ 88,065	$ 88,065

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5 Fair Value (Continued)

	December 31, 2010			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Mortgage-backed securities	$	$	$ 119,872	$ 119,872
Mortgage loans		3,966	364,250	368,216
	$	$ 3,966	$ 484,122	$ 488,088
Liabilities:				
Securities sold under agreements to repurchase	$	$	$ 101,202	$ 101,202
	$	$	$ 101,202	$ 101,202

The Company's MBS, mortgage loans (excluding its correspondent lending loans), 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 March 31, 2011			
	Mortgage-backed securities	Mortgage loans	Mortgage servicing rights	Total
	(in thousands)			
Assets:				
Balance, December 31, 2010	$ 119,872	$ 364,250	$	$ 484,122
Purchases		243,128		243,128
Repayments	(17,949)	(15,569)		(33,518)
Accrual of unearned discounts	714			714
Transfers of mortgage loans to real estate acquired in settlement of loans		(14,175)		(14,175)
Sales		(2,565)		(2,565)
Addition of unpaid interest to mortgage loan balances in loan modifications		40		40
Servicing received as proceeds from sales of mortgage loans			40	40
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk		5,470		5,470
Other factors	(442)	7,457	(3)	7,012
	(442)	12,927	(3)	12,482
Balance, March 31, 2011	$ 102,195	$ 588,036	37	$ 690,268
	$ (442)	$ 24,157	$ (3)	$ 23,712

Changes in fair value recognized during the period relating to assets still held at March 31, 2011	

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5 Fair Value (Continued)

		Securities sold under agreements to repurchase
Liabilities:		
Balance, December 31, 2010	$	101,202
Changes in fair value included in income		
Sales of securities under agreements to repurchase		257,952
Repurchases		(271,089)
Balance, March 31, 2011	$	88,065
Changes in fair value recognized during the period relating to liabilities still outstanding at March 31, 2011	$	

	Quarter ended March 31, 2010					
		Mortgage-backed securities		Mortgage loans		Total
	(in thousands)					
Balance, December 31, 2009	$	83,771	$	26,046	$	109,817
Total changes in fair value included in income		57		1,133		1,190
Purchases		414		115,207		115,621
Accrual of unearned discounts		765				765
Repayments		(8,618)		(4,867)		(13,485)
Transfers of mortgage loans to real estate acquired in settlement of loans				(273)		(273)
Sale				(13,782)		(13,782)
Balance, March 31, 2010	$	76,389	$	123,464	$	199,853
Changes in gains relating to assets still held at March 31, 2010	$	57	$	(790)	$	(733)

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:

	March 31, 2011					
		Fair value		Principal amount due upon maturity		Difference
	(in thousands)					
Current through 89 days delinquent	$	119,673	$	189,782	$	(70,109)
90 or more days delinquent(1)		472,772		929,681		(456,909)
	$	592,445	$	1,119,463	$	(527,018)

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5 Fair Value (Continued)

	December 31, 2010		
	Fair value	Principal amount due upon maturity	Difference
	(in thousands)		
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.

Following are the changes in fair value included in current period income by consolidated statement of income line item:

	Changes in fair value included in current period income						
	Quarter ended March 31,						
	2011				2010		
	Interest income	Gain (loss) on investments	Change in fair value of MSRs	Total	Interest income	Gain (loss) on investments	Total
	(in thousands)						
Assets:							
Short term investments	$	$	$	$	$	$	$
Mortgage-backed securities	714	(442)		272	765	57	822
Mortgage loans		10,415		10,415		1,133	1,133
Mortgage servicing rights			(3)	(3)			
	$ 714	$ 9,973	$ (3)	$ 10,684	$ 765	$ 1,190	$ 1,955
Liabilities:							
Loans and securities sold under agreements to repurchase	$	$	$	$	$	$	$
	$	$	$	$	$	$	$

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, and (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*.

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5 Fair Value (Continued)

The Company carried $31.3 million and $29.7 million of real estate acquired in settlement of loans on its consolidated balance sheet at March 31, 2011 and December 31, 2010, respectively. During the quarters ended March 31, 2011 and 2010, mortgage loans with fair values of $14.2 million and $0.3 million, respectively, were transferred to real estate acquired in settlement of loans. Real estate acquired in settlement of loans with fair values of $9.2 million was remeasured at fair value less estimated costs to sell during the quarter ended March 31, 2011. Losses totaling $1.3 million were recognized in *Results of real estate acquired in settlement of loans* as a result of these remeasurements for the quarter ended March 31, 2011. No real estate acquired in settlement of loans was remeasured at fair value during the quarter ended March 31, 2010.

Fair Value of Financial Instruments Carried at Amortized Cost

In November and December 2010, the Company acquired new debt facilities to finance its investment in nonperforming loans in the form of repurchase agreements. As discussed 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 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 March 31, 2011, PCM's Capital Markets staff reviewed, and its senior management Valuation Committee reviewed and approved, the securities' values. PCM's review is for the purpose of evaluating the reasonableness of the broker's indication of value and may result in the broker modifying its indications of value. PCM does not intend to adjust its fair value estimates to amounts different from the broker's 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.

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5 Fair Value (Continued)

Mortgage Loans

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 correspondent lending loans, are categorized as "Level 2" financial statement items and their fair values are estimated using their quoted market 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, defaults and loss severities. Changes in fair value attributable to changes in instrument-specific credit risk are measured by the change in value attributable to 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.

Interest income on loans is recognized over the life of the loan using its contractual interest rate and is included in the consolidated statement 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. At March 31, 2011, the Company had suspended accrual of interest relating to approximately 80% of its investment in mortgage loans, as measured by their estimated fair values, due to delinquency.

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 that is based on 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 statement 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

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5 Fair Value (Continued)

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. The Company identified MSRs resulting from its correspondent lending activities as a class of servicing rights and elected to apply fair value accounting to these MSRs. Presently, this class represents all of the Company's MSRs. Changes in the fair value of MSRs are included in the consolidated statement of income under the caption *Changes 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:

	March 31, 2011							
		Credit rating						
	Total	AAA	AA	A	BBB	Non-investment grade	Not rated	Yield
	(in thousands)							
Security collateral type:								
Non-Agency subprime	$ 79,938	$	$ 5,173	$ 1,603	$ 1,638	$ 68,050	$ 3,474	4.14%
Non-Agency Alt-A	13,604	589	6,350			6,665		9.38%
Non-Agency prime jumbo	8,653		8,653					3.50%
	$ 102,195	$ 589	$ 20,176	$ 1,603	$ 1,638	$ 74,715	$ 3,474	4.78%

	December 31, 2010							
		Credit rating						
	Total	AAA	AA	A	BBB	Non-investment grade	Not rated	Yield
	(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 March 31, 2011 and at December 31, 2010. At March 31, 2011 and at December 31, 2010, the Company had pledged all of its MBS to secure agreements to repurchase.

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 7 Mortgage Loans at Fair Value

The Company's mortgage loans at fair value include correspondent lending loans as well as other mortgage loans.

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

	March 31, 2011		December 31, 2010	
Loan Type	Fair value	Unpaid principal balance	Fair value	Unpaid principal balance
	(in thousands)			
Correspondent lending loans:				
Government insured or guaranteed	$ 1,995	$ 1,909	$ 3,212	$ 3,115
Fixed-rate:				
Agency-eligible	1,552	1,540	754	750
Jumbo loans	858	841		
	4,405	4,290	3,966	3,865
Pipeline and forward-sale derivatives, net	4			
	4,409	4,290	3,966	3,865
Other mortgage loans:				
Nonperforming loans	472,772	929,681	278,008	521,326
Performing loans:				
Fixed	61,325	94,867	49,444	73,256
ARM/Hybrid	46,511	77,492	31,916	54,430
Interest rate step-up	7,364	13,040	4,813	7,831
Balloon	64	93	69	93
	115,264	185,492	86,242	135,610
	588,036	1,115,173	364,250	656,936
	$ 592,445	$ 1,119,463	$ 368,216	$ 660,801

At March 31, 2011, approximately 74% of the non-correspondent lending 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 March 31, 2011. The non-correspondent lending 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 March 31, 2011. The non-correspondent lending 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 March 31, 2011.

At December 31, 2010, approximately 94% of the non-correspondent lending 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.

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 7 Mortgage Loans at Fair Value (Continued)

The non-correspondent lending 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 non-correspondent lending 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 March 31, 2011, mortgage loans at fair value totaling $486.6 million were pledged to secure sales of loans under agreements to repurchase. At December 31, 2010, mortgage loans at fair value totaling $329.6 million were pledged to secure sales of loans under agreements to repurchase.

Note 8 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 March 31,	
	2011	**2010**
	(in thousands)	
Balance at beginning of period	$ 29,685	$
Purchases	247	1,238
Transfers from mortgage loans at fair value	14,175	273
Valuation adjustments, including net gains on sale	1,089	
Sales proceeds	(13,911)	
Balance at period end	$ 31,285	$ 1,511

At March 31, 2011, real estate acquired in settlement of loans totaling $4.3 million was pledged in connection with sales of loans under agreements to repurchase. At December 31, 2010, no real estate acquired in settlement of loans was pledged to secure borrowings.

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 9 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 March 31, 2011	2010
	(dollar amounts in thousands)	
Period end:		
Balance	$ 220,367	$
Unused amount(1)	$ 204,633	$
Weighted-average interest rate at end of period	3.70%	
Weighted-average interest rate during the period	4.43%	
Average balance of loans sold under agreements to repurchase	$ 177,575	$
Maximum daily amount outstanding	$ 240,767	$
Total interest expense	$ 1,969	$
Fair value of loans and real estate acquired in settlement of loans securing agreements to repurchase at period-end	$ 490,875	$

(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 8 months at March 31, 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 March 31, 2011:

Counterparty	Amount at risk	Weighted-average maturity
	(in thousands)	
Wells Fargo Bank, N.A.	$ 84,826	November 1, 2011
Citibank, N.A.	$ 184,998	December 8, 2011
Credit Suisse First Boston Mortgage Capital LLC	$ 493	November 1, 2011

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 10 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 March 31,	
	2011	2010
	(dollar amounts in thousands)	
Period-end balance	$ 88,065	$
Weighted-average interest rate at end of period	1.26%	
Weighted-average interest rate during the period	1.30%	
Average balance of securities sold under agreements to repurchase	$ 95,307	$
Maximum daily amount outstanding	$ 101,202	$
Total interest expense	$ 309	$
Fair value of securities securing agreements to repurchase at period-end	$ 102,195	$

The repurchase agreements collateralized by securities have an average term of 21 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 March 31, 2011:

Counterparty	Amount at risk	Weighted-average maturity
	(in thousands)	
Credit Suisse First Boston Mortgage Capital LLC	$ 9,946	May 2, 2011
Wells Fargo Bank, N.A.	$ 9,692	April 9, 2011
Bank of America Securities LLC	$ 387	June 30, 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 March 31, 2011 and December 31, 2010, the Company had margin deposits totaling $6.0 million and $4.8 million, respectively, on deposit with its securities repurchase agreement counterparties. Margin deposits are included in *Other assets* in the consolidated balance sheet.

Note 11 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 March 31, 2011, the Company was not involved in any such proceedings, claims or legal actions that would be reasonably likely to have a material adverse effect on the Company.

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 11 Commitments and Contingencies (Continued)

Mortgage Loan Commitments

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

	March 31, 2011 (in thousands)
Correspondent lending:	
Commitments to purchase mortgage loans	$ 5,422
Commitments to sell mortgage loans	$ 3,528
Other mortgage loans:	
Commitments to purchase mortgage loans	$ 30,520

Note 12 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.

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 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 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.

Note 13 Share-Based Compensation Plan

The Company's equity incentive plan allows for grants of equity-based awards up to an aggregate 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 statement of income under the caption *Compensation*.

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PENNYMAC MORTGAGE INVESTMENT TRUST AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 13 Share-Based Compensation Plan (Continued)

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

	Quarter ended 2011	Quarter ended 2010
	(In thousands, except share data)	
Number of shares:		
Outstanding at beginning of period	272,984	374,810
Granted	340,500	22,000
Vested	(5,500)	
Canceled		(22,120)
Outstanding at end of period	607,984	374,690
Expense recorded during the period	$ 795	$ 578
Unamortized compensation cost at period-end	$ 5,991	$ 2,361
At March 31, 2011:		
Weighted average grant date fair value per share	$ 11.42	
Shares available for future awards(1)	1,661,682	

(1) Based on shares outstanding as of March 31, 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 14 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.

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.

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