PENNYMAC FINANCIAL SERVICES, INC.
Form 10-Q
November 08, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

Or

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

For the transition period from to

Commission file number: 001-35916

PennyMac Financial Services, Inc.

(Exact name of registrant as specified in its charter)

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

3043 Townsgate Road, Westlake Village, California	91361
(Address of principal executive offices)	(Zip Code)

(818) 224-7442

(Registrant's telephone number, including area code)

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

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

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

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

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

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

Class	Outstanding at November 7, 2016
Class A Common Stock, $0.0001 par value	22,309,354
Class B Common Stock, $0.0001 par value	49

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PENNYMAC FINANCIAL SERVICES, INC.

FORM 10-Q

September 30, 2016

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SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (“Report”) contains certain forward looking statements that are subject to various risks and uncertainties. Forward looking statements are generally identifiable by use of forward looking terminology such as “may,” “will,” “should,” “potential,” “intend,” “expect,” “seek,” “anticipate,” “estimate,” “approximately,” “believe,” “ “predict,” “continue,” “plan” or other similar words or expressions.

Forward looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain financial and operating projections or state other forward looking information. Examples of forward looking statements include the following:

- projections of our revenues, income, earnings per share, capital structure or other financial items;
- descriptions of our plans or objectives for future operations, products or services;
- forecasts of our future economic performance, interest rates, profit margins and our share of future markets; and
- descriptions of assumptions underlying or relating to any of the foregoing expectations regarding the timing of generating any revenues.

Our ability to predict results or the actual effect of future events, actions, plans or strategies is inherently uncertain. Although we believe that the expectations reflected in such forward looking statements are based on reasonable assumptions, our actual results and performance could differ materially from those set forth in the forward looking statements. There are a number of factors, many of which are beyond our control that could cause actual results to differ significantly from management’s expectations. Some of these factors are discussed below.

You should not place undue reliance on any forward looking statement and should consider the following uncertainties and risks, as well as the risks and uncertainties discussed elsewhere in this Report and the section entitled “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the Securities and Exchange Commission (“SEC”) on March 10, 2016.

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

- the continually changing federal, state and local laws and regulations applicable to the highly regulated industry in which we operate;
- lawsuits or governmental actions if we do not comply with the laws and regulations applicable to our businesses;
- the mortgage lending and servicing-related regulations promulgated by the Consumer Financial Protection Bureau (“CFPB”) and its enforcement of these regulations;
- our dependence on U.S. government sponsored entities and changes in their current roles or their guarantees or guidelines;

- changes to government mortgage modification programs;
- the licensing and operational requirements of states and other jurisdictions applicable to our businesses, to which our bank competitors are not subject;
- foreclosure delays and changes in foreclosure practices;
- certain banking regulations that may limit our business activities;
- our dependence on the multi-family and commercial real estate sectors for future originations and investments in commercial mortgage loans and other commercial real estate related loans;
- changes in macroeconomic and U.S. real estate market conditions;
- difficulties inherent in growing loan production volume;
- difficulties inherent in adjusting the size of our operations to reflect changes in business levels;
- purchase opportunities for mortgage servicing rights ("MSRs") and our success in winning bids;
- changes in prevailing interest rates;

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- increases in loan delinquencies and defaults;
- our reliance on PennyMac Mortgage Investment Trust ("PMT") as a significant source of financing for, and revenue related to, our mortgage banking business;
- any required additional capital and liquidity to support business growth that may not be available on acceptable terms, if at all;
- our obligation to indemnify third party purchasers or repurchase loans if loans that we originate, acquire, service or assist in the fulfillment of, fail to meet certain criteria or characteristics or under other circumstances;
- our obligation to indemnify PMT and certain investment funds if our services fail to meet certain criteria or characteristics or under other circumstances;
- decreases in the historical returns on the assets that we select and manage for our clients, and our resulting management and incentive fees;
- the extensive amount of regulation applicable to our investment management segment;
- conflicts of interest in allocating our services and investment opportunities among ourselves and certain advised entities;
- the effect of public opinion on our reputation;
- our recent growth;
- our ability to effectively identify, manage, monitor and mitigate financial risks;
- our initiation of new business activities or expansion of existing business activities;
- our ability to detect misconduct and fraud; and
- our ability to mitigate cybersecurity risks and cyber incidents.

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

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

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30, 2016	December 31, 2015
	(in thousands, except share amounts)	
ASSETS		
Cash (includes $84,851 and $93,757 pledged to creditors)	$ 94,727	$ 105,472
Short-term investments at fair value	58,749	46,319
Mortgage loans held for sale at fair value (includes $3,094,617 and $1,079,489 pledged to creditors)	3,127,377	1,101,204
Derivative assets	135,777	50,280
Servicing advances, net (includes valuation allowance of $38,031 and $33,458)	306,150	299,354
Carried Interest due from Investment Funds pledged to creditors	70,870	69,926
Investment in PennyMac Mortgage Investment Trust at fair value	1,169	1,145
Mortgage servicing rights (includes $492,028 and $660,247 at fair value; $1,333,078 and $803,560 pledged to creditors)	1,337,674	1,411,935
Real estate acquired in settlement of loans	1,996	—
Furniture, fixtures, equipment and building improvements, net (includes $22,281 and $14,034 pledged to creditors)	29,121	16,311
Capitalized software, net (includes $444 and $783 pledged to creditors)	8,361	3,025
Note receivable from PennyMac Mortgage Investment Trust	150,000	150,000
Receivable from PennyMac Mortgage Investment Trust	14,747	18,965
Receivable from Investment Funds	1,596	1,316
Deferred tax asset	—	18,378
Mortgage loans eligible for repurchase	197,819	166,070
Other	60,061	45,594
Total assets	$ 5,596,194	$ 3,505,294
LIABILITIES		
Assets sold under agreements to repurchase	$ 2,491,366	$ 1,166,731
Mortgage loan participation and sale agreement	782,913	234,872
Notes payable	110,619	61,136
Obligations under capital lease	20,700	13,579
Excess servicing spread financing payable to PennyMac Mortgage Investment Trust at fair value	280,367	412,425
Derivative liabilities	4,426	9,083
Accounts payable and accrued expenses	106,684	89,915
Mortgage servicing liabilities at fair value	13,045	1,399

Payable to Investment Funds		27,265		30,429
Payable to PennyMac Mortgage Investment Trust		165,264		162,379
Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement		75,434		74,315
Income taxes payable		11,415		—
Liability for mortgage loans eligible for repurchase		197,819		166,070
Liability for losses under representations and warranties		18,473		20,611
Total liabilities		4,305,790		2,442,944
Commitments and contingencies				
STOCKHOLDERS' EQUITY				
Class A common stock—authorized 200,000,000 shares of $0.0001 par value; issued and outstanding, 22,274,145 and 21,990,831 shares, respectively		2		2
Class B common stock—authorized 1,000 shares of $0.0001 par value; issued and outstanding, 49 and 51 shares, respectively		—		—
Additional paid-in capital		179,134		172,354
Retained earnings		141,805		98,470
Total stockholders' equity attributable to PennyMac Financial Services, Inc. common stockholders		320,941		270,826
Noncontrolling interest in Private National Mortgage Acceptance Company, LLC		969,463		791,524
Total stockholders' equity		1,290,404		1,062,350
Total liabilities and stockholders' equity	$	5,596,194	$	3,505,294

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

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands, except earnings per share)			
Revenue				
Net gains on mortgage loans held for sale at fair value:				
From non-affiliates	$ 183,811	$ 85,744	$ 409,405	$ 247,822
Recapture payable to PennyMac Mortgage Investment Trust	(1,690)	(3,098)	(5,557)	(5,843)
	182,121	82,646	403,848	241,979
Mortgage loan origination fees	34,621	29,448	85,962	70,551
Fulfillment fees from PennyMac Mortgage Investment Trust	27,255	17,553	59,301	45,752
Net mortgage loan servicing fees:				
Mortgage loan servicing fees:				
From non-affiliates	98,865	83,424	282,962	200,392
From PennyMac Mortgage Investment Trust	11,039	11,736	38,919	34,542
From Investment Funds	770	796	2,194	1,917
Ancillary and other fees	11,913	10,096	34,183	33,131
	122,587	106,052	358,258	269,982
Amortization, impairment and change in fair value of mortgage servicing rights	(80,830)	(59,065)	(309,304)	(128,073)
Change in fair value of excess servicing spread payable to PennyMac Mortgage Investment Trust	4,107	10,271	40,984	10,674
	(76,723)	(48,794)	(268,320)	(117,399)
Net mortgage loan servicing fees	45,864	57,258	89,938	152,583
Management fees:				
From PennyMac Mortgage Investment Trust	5,025	5,742	15,576	18,524
From Investment Funds	496	714	1,587	3,384
	5,521	6,456	17,163	21,908
Carried Interest from Investment Funds	107	1,483	944	2,898
Net interest expense:				
Interest income:				
From non-affiliates	20,735	13,764	50,994	35,348
From PennyMac Mortgage Investment Trust	1,974	1,289	5,798	1,822
	22,709	15,053	56,792	37,170
Interest expense:				
To non-affiliates	22,689	12,918	56,414	31,526
To PennyMac Mortgage Investment Trust	4,827	8,026	17,555	17,596
	27,516	20,944	73,969	49,122

Net interest expense	(4,807)	(5,891)	(17,177)	(11,952)
Change in fair value of investment in and dividends received from PennyMac Mortgage Investment Trust	(13)	(158)	130	(295)
Result of real estate acquired in settlement of loans	42	—	—	—
Other	684	410	2,493	2,446
Total net revenue	291,395	189,205	642,602	525,870
Expenses				
Compensation	96,132	74,129	247,577	202,695
Servicing	22,177	16,770	56,494	55,108
Technology	9,733	6,676	24,313	18,104
Loan origination	6,471	4,314	15,567	12,813
Professional services	4,631	3,803	12,923	10,710
Other	12,973	9,590	32,053	24,480
Total expenses	152,117	115,282	388,927	323,910
Income before provision for income taxes	139,278	73,923	253,675	201,960
Provision for income taxes	16,976	8,575	30,535	23,308
Net income	122,302	65,348	223,140	178,652
Less: Net income attributable to noncontrolling interest	98,617	52,668	179,805	144,195
Net income attributable to PennyMac Financial Services, Inc. common stockholders	$ 23,685	$ 12,680	$ 43,335	$ 34,457
Earnings per share				
Basic	$ 1.07	$ 0.58	$ 1.96	$ 1.59
Diluted	$ 1.06	$ 0.58	$ 1.95	$ 1.58
Weighted average common shares outstanding				
Basic	22,217	21,810	22,101	21,702
Diluted	76,355	76,138	76,331	76,098

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

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

	Class A Common Stock					
	Number of shares (in thousands)	Par value	Additional paid-in capital	Retained earnings	Noncontrolling interest in Private National Mortgage Acceptance Company, LLC	Total stockho equity
e at December 31, 2014	21,578	$ 2	$ 162,720	$ 51,242	$ 593,302	$ 807,2
ome	—	—	—	34,457	144,195	178,6
nd unit-based nsation	75	—	3,746	—	9,358	13,10
utions	—	—	—	—	(9,627)	(9,62
e of common stock in ent of directors' fees	13	—	223	—	—	223
ge of Class A units of National Mortgage ance Company, LLC to common stock of Mac Financial Services,	177	—	2,919	—	(2,919)	—
ect of exchange of Class of Private National ge Acceptance ny, LLC to common stock of Mac Financial Services,	—	—	(311)	—	—	(311)
e at September 30, 2015	21,843	$ 2	$ 169,297	$ 85,699	$ 734,309	$ 989,3
e at December 31, 2015	21,991	$ 2	$ 172,354	$ 98,470	$ 791,524	$ 1,062
ome	—	—	—	43,335	179,805	223,1
nd unit-based nsation	99	—	3,341	—	8,914	12,25
utions	—	—	—	—	(6,742)	(6,74
e of common stock in ent of directors' fees	18	—	230	—	—	230
ge of Class A units of National Mortgage ance Company, LLC to common stock of Mac Financial Services,	166	—	4,038	—	(4,038)	—

ect of exchange of Class of Private National ge Acceptance ny, LLC to common stock of Mac Financial Services,	—	—	(829)	—	—	(829)
e at September 30, 2016	22,274	$ 2	$ 179,134	$ 141,805	$ 969,463	$ 1,290

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

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PENNYMAC FINANCIAL SERVICES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine months ended September 30,	
	2016	2015
	(in thousands)	
Cash flow from operating activities		
Net income	$ 223,140	$ 178,652
Adjustments to reconcile net income to net cash used in operating activities:		
Net gains on mortgage loans held for sale at fair value	(403,848)	(241,979)
Accrual of servicing rebate payable to Investment Funds	209	1,193
Amortization, impairment and change in fair value of mortgage servicing rights and excess servicing spread	268,320	117,399
Carried Interest from Investment Funds	(944)	(2,898)
Capitalization of interest on mortgage loans held for sale at fair value	(20,451)	(11,703)
Accrual of interest on excess servicing spread financing	17,555	17,596
Amortization of debt issuance costs and commitment fees relating to financing facilities	7,944	5,688
Change in fair value of investment in common shares of PennyMac Mortgage Investment Trust	(24)	422
Stock and unit-based compensation expense	12,255	13,104
Provision for servicing advance losses	19,799	23,538
Depreciation and amortization	3,965	1,585
Purchase of mortgage loans held for sale from PennyMac Mortgage Investment Trust	(29,144,685)	(24,864,698)
Originations of mortgage loans held for sale	(4,428,426)	(3,106,147)
Purchase of mortgage loans from Ginnie Mae securities and early buyout investors for modification and subsequent sale	(1,588,711)	(989,009)
Sale and principal payments of mortgage loans held for sale	33,124,241	28,346,871
Sale of mortgage loans held for sale to PennyMac Mortgage Investment Trust	13,146	13,708
Repurchase of mortgage loans subject to representations and warranties	(13,525)	(17,112)
Increase in servicing advances	(28,591)	(47,080)
Increase in receivable from Investment Funds	(489)	(444)
Decrease in receivable from PennyMac Mortgage Investment Trust	5,491	8,889
Decrease in deferred tax asset	18,668	21,399
Payments to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement	—	(4,299)
Increase in other assets	(24,325)	(23,113)
Increase in accounts payable and accrued expenses	12,992	22,280

Decrease in payable to Investment Funds	(3,164)	(5,697)
Increase in payable to PennyMac Mortgage Investment Trust	1,971	22,698
Increase in income taxes payable	11,415	—
Net cash used in operating activities	(1,916,072)	(519,157)
Cash flow from investing activities		
Increase in short-term investments	(12,430)	(3,079)
Advance on note receivable from PennyMac Mortgage Investment Trust	—	(168,546)
Repayment of note receivable from PennyMac Mortgage Investment Trust	—	18,546
Purchase of mortgage servicing rights	(23)	(379,264)
Net settlement of derivative financial instruments used for hedging	173,696	(3,678)
Purchase of furniture, fixtures, equipment and leasehold improvements	(17,539)	(5,716)
Acquisition of capitalized software	(5,572)	(1,745)
(Increase) decrease in margin deposits and restricted cash	(39,467)	5,331
Net cash provided by (used in) investing activities	98,665	(538,151)
Cash flow from financing activities		
Sale of assets under agreements to repurchase	31,708,423	25,947,385
Repurchase of assets sold under agreements to repurchase	(30,384,066)	(25,482,890)
Issuance of mortgage loan participation certificates	21,895,964	13,265,896
Repayment of mortgage loan participation certificates	(21,347,920)	(13,162,123)
Advances on notes payable	97,000	289,556
Repayment of notes payable	(48,661)	(29,411)
Issuance of excess servicing spread financing	—	271,452
Repayment of excess servicing spread financing	(54,623)	(55,800)
Repurchase of excess servicing spread financing	(59,045)	—
Advances of obligations under capital lease	12,651	—
Repayment of obligation under capital lease	(5,530)	(6)
Payment of debt issuance costs	(6,525)	(5,965)
Assumption of mortgage servicing liability	5,736	—
Distribution to Private National Mortgage Acceptance Company, LLC members	(6,742)	(9,627)
Net cash provided by financing activities	1,806,662	1,028,467
Net decrease in cash	(10,745)	(28,841)
Cash at beginning of period	105,472	76,256
Cash at end of period	$ 94,727	$ 47,415

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

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PENNYMAC FINANCIAL SERVICES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1—Organization and Basis of Presentation

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

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

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

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

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

PLS is approved as a seller/servicer of mortgage loans by the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”) and as an issuer of securities guaranteed by the

Government National Mortgage Association ("Ginnie Mae"). PLS is a licensed Federal Housing Administration Nonsupervised Title II Lender with the U.S. Department of Housing and Urban Development ("HUD") and a lender/servicer with the Veterans Administration ("VA") and U.S. Department of Agriculture ("USDA") (each an "Agency" and collectively the "Agencies").

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

The accompanying consolidated financial statements have been prepared in compliance with accounting principles generally accepted in the United States ("GAAP") as codified in the Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") for interim financial information and with the SEC's instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these financial statements and notes do not include all of the information required by GAAP for complete financial statements. The interim consolidated information should be read together with the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

The accompanying unaudited consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, income, and cash flows for the interim periods, but are not necessarily

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indicative of income to be anticipated for the full year ending December 31, 2016. Intercompany accounts and transactions have been eliminated.

Preparation of financial statements in compliance with GAAP requires management to make estimates and judgments 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.

Note 2—Concentration of Risk

A substantial portion of the Company's activities relate to the Advised Entities. Fees (generally comprised of fulfillment fees, mortgage loan servicing fees, management fees, Carried Interest and servicing recapture fees) and interest charged to these entities totaled 15% and 20% of total net revenue for the quarters ended September 30, 2016 and 2015, respectively, and 22% and 18% for the nine months ended September 30, 2016 and 2015, respectively.

Note 3—Transactions with Affiliates

Transactions with PMT

Operating Activities

Mortgage Loan Production Activities

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

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			

Mortgage servicing rights and excess servicing spread recapture incurred	$ 1,690	$ 3,098	$ 5,557	$ 5,843
Fulfillment fee revenue	$ 27,255	$ 17,553	$ 59,301	$ 45,752
Unpaid principal balance of mortgage loans fulfilled for PMT	$ 7,263,557	$ 4,073,201	$ 15,696,940	$ 10,542,411
Sourcing fees paid to PMT	$ 3,509	$ 3,236	$ 8,282	$ 7,084
Unpaid principal balance of mortgage loans purchased from PMT	$ 11,694,065	$ 10,783,882	$ 27,599,186	$ 23,602,020
Proceeds from sale of mortgage loans held for sale to PMT	$ 5,007	$ 1,047	$ 13,146	$ 11,875
Tax service fees received from PMT	$ 2,006	$ 1,291	$ 4,537	$ 3,293
Early purchase program fees earned from PMT	$ 5	$ —	$ 7	$ —

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Mortgage Loan Servicing Activities

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

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Mortgage loans acquired for sale at fair value:				
Base and supplemental	$ 90	$ 130	$ 225	$ 198
Activity-based	210	153	497	243
	300	283	722	441
Mortgage loans at fair value:				
Base and supplemental	2,615	3,930	8,881	12,145
Activity-based	3,014	2,961	14,981	8,948
	5,629	6,891	23,862	21,093
Mortgage servicing rights:				
Base and supplemental	4,978	4,473	13,999	12,783
Activity-based	132	89	336	225
	5,110	4,562	14,335	13,008
	$ 11,039	$ 11,736	$ 38,919	$ 34,542

Investment Management Activities

The base management fee and the performance incentive fee are both receivable quarterly in arrears. The performance incentive fee may be paid in cash or a combination of cash and PMT's common shares (subject to a limit of no more than 50% paid in common shares), at PMT's option.

Following is a summary of the base management and performance incentive fees earned from PMT:

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Base management	$ 5,025	$ 5,742	$ 15,576	$ 17,181
Performance incentive	—	—	—	1,343

$ 5,025	$ 5,742	$ 15,576	$ 18,524

The management agreement, as amended, expires on September 12, 2020, subject to automatic renewal for additional 18 month periods, unless terminated earlier in accordance with the terms of the management agreement.

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

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Expense Reimbursement

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

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Reimbursement of:				
Common overhead incurred by the Company	$ 1,417	$ 2,694	$ 6,413	$ 8,125
Expenses incurred on PMT's (the Company's) behalf, net	13	(85)	(102)	377
	$ 1,430	$ 2,609	$ 6,311	$ 8,502
Payments and settlements during the period (1)	$ 45,988	$ 17,709	$ 102,600	$ 64,575

(1) Payments and settlements include payments for operating, investment and financing activities itemized in this Note and netting settlements made pursuant to master netting agreements between the Company and PMT.

Amounts due from and payable to PMT are summarized below:

	September 30, 2016	December 31, 2015
	(in thousands)	
Receivable from PMT:		
Management fees	$ 5,025	$ 5,670
Servicing fees	3,641	3,682
Allocated expenses and expenses incurred on PMT's behalf	3,227	4,490
Fulfillment fees	926	1,082
Conditional reimbursement	900	900
Interest on note receivable	536	412
Correspondent production fees	492	2,729
	$ 14,747	$ 18,965
Payable to PMT:		
Deposits made by PMT to fund servicing advances	$ 159,488	$ 153,573
Mortgage servicing rights ("MSR") recapture payable	450	781
Other	5,326	8,025
	$ 165,264	$ 162,379

Conditional Reimbursement of Underwriting Fees

In connection with its initial public offering of common shares on August 4, 2009 ("IPO"), PMT conditionally agreed to reimburse the Company up to $2.9 million for underwriting fees paid to the IPO underwriters by the Company on PMT's behalf. The Company received reimbursement payments from PMT totaling $7,000 and $237,000 for the quarter and nine months ended September 30, 2015, respectively, and received no reimbursement from PMT during the nine months ended September 30, 2016.

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

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Investing Activities

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

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Note receivable from PennyMac Mortgage Investment Trust:				
Interest income	$ 1,974	$ 1,289	$ 5,798	$ 1,822
Common shares of beneficial interest of PennyMac Mortgage Investment Trust:				
Dividends received and change in fair value	$ (13)	$ (158)	$ 130	$ (295)

	September 30, 2016	December 31, 2015
	(in thousands)	
Note receivable from PennyMac Mortgage Investment Trust:	$ 150,000	$ 150,000
Common shares of beneficial interest of PennyMac Mortgage Investment Trust:		
Fair value	$ 1,169	$ 1,145
Number of shares	75	75

Financing Activities

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

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Excess servicing spread financing:				
Issuance:				
Cash	$ —	$ 84,165	$ —	$ 271,452
Pursuant to recapture agreement	$ 1,438	$ 2,268	$ 5,039	$ 4,833
Repayment	$ (16,342)	$ (24,717)	$ (54,623)	$ (55,800)
Repurchase	$ —	$ —	$ (59,045)	$ —

Change in fair value	$ (4,107)	$ (10,271)	$ (40,984)	$ (10,674)
Interest expense	$ 4,827	$ 8,026	$ 17,555	$ 17,596
Excess servicing spread recapture incurred pursuant to refinancings by the Company of mortgage loans subject to excess servicing spread	$ 1,283	$ 2,428	$ 4,709	$ 5,173

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Investment Funds

Amounts due from and payable to the Investment Funds are summarized below:

	September 30, 2016	December 31, 2015
	(in thousands)	
Carried Interest due from Investment Funds:		
PNMAC Mortgage Opportunity Fund, LLC	$ 42,357	$ 41,893
PNMAC Mortgage Opportunity Fund Investors, LLC	28,513	28,033
	$ 70,870	$ 69,926
Receivable from Investment Funds:		
Management fees	$ 503	$ 655
Expense reimbursements	429	45
Mortgage loan servicing fees	425	392
Mortgage loan servicing rebate	239	224
	$ 1,596	$ 1,316
Payable to Investment Funds—Servicing advances	$ 27,265	$ 30,429

Exchanged Private National Mortgage Acceptance Company, LLC Unitholders

The Company entered into a tax receivable agreement with PennyMac's existing unitholders on the date of the IPO that will provide for the payment by the Company to PennyMac's exchanged unitholders an amount equal to 85% of the amount of the benefits, if any, that the Company is deemed to realize as a result of (i) increases in tax basis of PennyMac's assets resulting from such unitholders' exchanges and (ii) certain other tax benefits related to entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement. Based on the PennyMac unitholder exchanges to date, the Company has recorded a $75.4 million and $74.3 million Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement as of September 30, 2016 and December 31, 2015, respectively. The Company made payments under the tax receivable agreement totaling $4.3 million during the nine months ended September 30, 2015. There were no payments made during the nine months ended September 30, 2016.

Note 4—Earnings Per Share of Common Stock

Basic earnings per share of common stock is determined using net income attributable to the Company's common stockholders divided by the weighted average number of shares of common stock outstanding during the period.

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

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

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

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands, except per share amounts)			
Basic earnings per share of common stock:				
Net income attributable to PennyMac Financial Services, Inc. common stockholders	$ 23,685	$ 12,680	$ 43,335	$ 34,457
Weighted average shares of common stock outstanding	22,217	21,810	22,101	21,702
Basic earnings per share of common stock	$ 1.07	$ 0.58	$ 1.96	$ 1.59
Diluted earnings per share of common stock:				
Net income attributable to PennyMac Financial Services, Inc. common stockholders	$ 23,685	$ 12,680	$ 43,335	$ 34,457
Effect of net income attributable to PennyMac Class A units exchangeable to common stock, net of income taxes	57,444	31,418	105,480	86,012
Diluted net income attributable to common stockholders	$ 81,129	$ 44,098	$ 148,815	$ 120,469
Weighted average shares of common stock outstanding	22,217	21,810	22,101	21,702
Dilutive shares:				
PennyMac Class A units exchangeable to common stock	53,923	54,042	53,996	53,744
Non-vested PennyMac Class A units issuable under unit-based stock compensation plan and exchangeable to common stock	—	163	—	528
Common shares issuable under stock-based compensation plan	215	123	234	124
Diluted weighted average shares of common stock outstanding	76,355	76,138	76,331	76,098
Diluted earnings per share of common stock	$ 1.06	$ 0.58	$ 1.95	$ 1.58

Potentially dilutive securities are excluded from the calculation of diluted earnings per share when their inclusion would be anti-dilutive. The following table summarizes the anti-dilutive weighted-average number of outstanding stock options and performance-based restricted stock units ("RSUs") excluded from the calculation of diluted earnings per share:

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands except for weighted-average exercise price)			
Stock options (1)	2,768	1,864	2,559	1,712
Performance-based RSUs (2)	2,505	2,377	2,510	2,210
Total anti-dilutive stock-based compensation units	5,273	4,241	5,069	3,922

Weighted-average exercise price of anti-dilutive stock options (1)	$ 15.81	$ 18.17	$ 15.82	$ 18.17

(1) Certain stock options were outstanding but not included in the computation of diluted earnings per share because the weighted-average exercise prices were anti-dilutive.

(2) Certain performance-based RSUs were outstanding but not included in the computation of diluted earnings per share because the performance thresholds included in such RSUs have not been achieved.

Note 5—Loan Sales and Servicing Activities

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

The following table summarizes cash flows between the Company and transferees as a result of the sale of mortgage loans in transactions where the Company maintains continuing involvement with the mortgage loans:

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Cash flows:				
Sales proceeds	$ 13,947,544	$ 12,738,035	$ 33,124,241	$ 28,357,226
Servicing fees received (1)	$ 67,371	$ 33,745	$ 186,474	$ 103,057
Net servicing advance recoveries	$ 4,608	$ 9,778	$ 14,153	$ 18,733

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

	September 30, 2016	December 31, 2015
	(in thousands)	
Unpaid principal balance of mortgage loans outstanding at end of period	$ 78,942,489	$ 60,687,246
Delinquencies:		
30-89 days	$ 2,157,646	$ 1,539,568
90 days or more:		
Not in foreclosure	$ 457,909	$ 340,313
In foreclosure or bankruptcy	$ 328,396	$ 227,025
Foreclosed	$ 2,435	$ 755

The unpaid principal balance ("UPB") of the Company's mortgage loan servicing portfolio is summarized as follows:

	September 30, 2016		
	Servicing rights owned	Contract servicing and subservicing	Total mortgage loans serviced
	(in thousands)		
Investor:			
Non-affiliated entities	$ 123,030,847	$ —	$ 123,030,847

Affiliated entities	—	56,100,331	56,100,331
Mortgage loans held for sale	2,945,465	—	2,945,465
	$ 125,976,312	$ 56,100,331	$ 182,076,643
Commercial real estate loans subserviced for the Company	$ 16,403	$ —	$ 16,403
Delinquent mortgage loans:			
30 days	$ 2,954,504	$ 366,538	$ 3,321,042
60 days	989,384	126,411	1,115,795
90 days or more:			
Not in foreclosure	1,740,732	591,872	2,332,604
In foreclosure or bankruptcy	801,461	798,585	1,600,046
Foreclosed	29,560	471,956	501,516
	$ 6,515,641	$ 2,355,362	$ 8,871,003
Custodial funds managed by the Company (1)	$ 3,754,860	$ 1,058,632	$ 4,813,492

(1) Borrower and investor custodial cash accounts relate to mortgage loans serviced under the servicing agreements and are not recorded on the Company’s consolidated balance sheets. The Company earns placement fees on certain of the custodial funds it manages on behalf of the mortgage loans’ investors, which is included in Interest income in the Company’s consolidated statements of income.

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	December 31, 2015		
	Servicing rights owned	Contract servicing and subservicing	Total mortgage loans serviced
	(in thousands)		
Investor:			
Non-affiliated entities	$ 111,409,601	$ —	$ 111,409,601
Affiliated entities	—	47,810,632	47,810,632
Mortgage loans held for sale	1,052,485	—	1,052,485
	$ 112,462,086	$ 47,810,632	$ 160,272,718
Commercial real estate loans subserviced for the Company	$ 14,454	$ —	$ 14,454
Delinquent mortgage loans:			
30 days	$ 2,666,435	$ 349,859	$ 3,016,294
60 days	834,617	136,924	971,541
90 days or more:			
Not in foreclosure	1,270,236	788,410	2,058,646
In foreclosure or bankruptcy	656,617	1,180,014	1,836,631
Foreclosed	23,372	542,031	565,403
	$ 5,451,277	$ 2,997,238	$ 8,448,515
Custodial funds managed by the Company (1)	$ 2,242,146	$ 502,751	$ 2,744,897

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

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

State	September 30, 2016	December 31, 2015
	(in thousands)	
California	$ 40,854,288	$ 39,007,363
Texas	14,851,369	12,191,722
Virginia	12,164,535	9,816,114
Florida	11,830,839	9,709,940
Maryland	7,755,698	6,151,945
All other states	94,619,914	83,395,634
	$ 182,076,643	$ 160,272,718

Note 6—Netting of Financial Instruments

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

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Offsetting of Derivative Assets

Following are summaries of derivative assets and related netting amounts.

	September 30, 2016			December 31, 2015		
	Gross amount of recognized assets	Gross amount offset in the consolidated balance sheet	Net amount of assets in the consolidated balance sheet	Gross amount of recognized assets	Gross amount offset in the consolidated balance sheet	Net amount of assets in the consolidated balance sheet
	(in thousands)					
Derivatives not subject to a master netting arrangement - Interest rate lock commitments	$ 107,127	$ —	$ 107,127	$ 45,885	$ —	$ 45,885
Derivatives subject to a master netting arrangement:						
Forward purchase contracts	54,574	—	54,574	4,181	—	4,181
Forward sale contracts	3,588	—	3,588	4,965	—	4,965
Mortgage-backed security ("MBS") put options	6,019	—	6,019	404	—	404
Put options on interest rate futures purchase contracts	6,707	—	6,707	1,832	—	1,832
Call options on interest rate futures purchase contracts	4,430	—	4,430	1,555	—	1,555
Netting	—	(46,668)	(46,668)	—	(8,542)	(8,542)
	75,318	(46,668)	28,650	12,937	(8,542)	4,395
	$ 182,445	$ (46,668)	$ 135,777	$ 58,822	$ (8,542)	$ 50,280

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Derivative Assets, Financial Assets, and Collateral Held by Counterparty

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

	September 30, 2016				December 31, 2015			
		Gross amount not offset in the consolidated balance sheet				Gross amount not offset in the consolidated balance sheet		
	Net amount of assets in the consolidated balance sheet	Financial instruments	Cash collateral received	Net amount	Net amount of assets in the consolidated balance sheet	Financial instruments	Cash collateral received	Net amount
	(in thousands)							
Interest rate lock commitments	$ 107,127	$ —	$ —	$ 107,127	$ 45,885	$ —	$ —	$ 45,885
RJ O'Brien	8,634	—	—	8,634	2,246	—	—	2,246
Barclays Capital	8,431	—	—	8,431	72	—	—	72
JP Morgan	4,067	—	—	4,067	—	—	—	—
Federal National Mortgage Association	3,471	—	—	3,471	453	—	—	453
Citibank, N.A.	1,738	—	—	1,738	—	—	—	—
Goldman Sachs	836	—	—	836	471	—	—	471
Morgan Stanley Bank, N.A.	731	—	—	731	—	—	—	—
Jefferies & Co.	343	—	—	343	888	—	—	888
Wells Fargo Bank, N.A.	—	—	—	—	53	—	—	53
Others	399	—	—	399	212	—	—	212
	$ 135,777	$ —	$ —	$ 135,777	$ 50,280	$ —	$ —	$ 50,280

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Offsetting of Derivative Liabilities and Financial Liabilities

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

	September 30, 2016			December 31, 2015		
	Gross amount of recognized liabilities (in thousands)	Gross amount offset in the consolidated balance sheet	Net amount of liabilities in the consolidated balance sheet	Gross amount of recognized liabilities	Gross amount offset in the consolidated balance sheet	Net amount of liabilities in the consolidated balance sheet
Derivatives not subject to a master netting arrangement - IRLCs	$ 1,609	$ —	$ 1,609	$ 2,112	$ —	$ 2,112
Derivatives subject to a master netting arrangement:						
Forward purchase contracts	2,584	—	2,584	9,004	—	9,004
Forward sale contracts	45,085	—	45,085	7,497	—	7,497
Put options on interest rate futures purchase contracts	1,500	—	1,500	203	—	203
Call options on interest rate futures purchase contracts	398	—	398	47	—	47
Netting	—	(46,750)	(46,750)	—	(9,780)	(9,780)
	49,567	(46,750)	2,817	16,751	(9,780)	6,971
	51,176	(46,750)	4,426	18,863	(9,780)	9,083

Total derivatives						
Mortgage loans sold under agreements to repurchase:						
Amount outstanding	2,491,762	—	2,491,762	1,167,405	—	1,167,405
Unamortized debt issuance costs	(396)	—	(396)	(674)	—	(674)
	2,491,366	—	2,491,366	1,166,731	—	1,166,731
	$ 2,542,542	$ (46,750)	$ 2,495,792	$ 1,185,594	$ (9,780)	$ 1,175,814

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Derivative Liabilities, Financial Liabilities, and Collateral Held by Counterparty

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

	September 30, 2016				December 31, 2015			
		Gross amounts not offset in the consolidated balance sheet				Gross amounts not offset in the consolidated balance sheet		
	Net amount of liabilities in the consolidated balance sheet	Financial instruments	Cash collateral pledged	Net amount	Net amount of liabilities in the consolidated balance sheet	Financial instruments	Cash collateral pledged	Net amount
	(in thousands)							
Interest rate lock commitments	$ 1,609	$ —	$ —	$ 1,609	$ 2,112	$ —	$ —	$ 2,112
Credit Suisse First Boston Mortgage Capital LLC	1,174,487	(1,174,288)	—	199	795,179	(794,470)	—	709
Bank of America, N.A.	449,502	(449,371)	—	131	271,130	(269,510)	—	1,620
Citibank, N.A.	396,423	(396,423)	—	—	55,948	(53,904)	—	2,044
Morgan Stanley Bank, N.A.	185,688	(185,688)	—	—	49,763	(49,521)	—	242
Barclays Capital	154,665	(154,665)	—	—	—	—	—	—
JP Morgan Chase Bank, N.A.	131,327	(131,327)	—	—	672	—	—	672
Wells Fargo Bank, N.A.	1,323	—	—	1,323	—	—	—	—
Nomura Securities International, Inc.	396	—	—	396	—	—	—	—
	232	—	—	232	—	—	—	—

Raymond James & Associates								
Bank of Oklahoma	167	—	—	167	135	—	—	135
BNP Paribas	128	—	—	128	738	—	—	738
Bank of New York Mellon	77	—	—	77	154	—	—	154
Others	164	—	—	164	657	—	—	657
	$ 2,496,188	$ (2,491,762)	$ —	$ 4,426	$ 1,175,814	$ (1,166,731)	$ —	$ 9,083

Note 7—Fair Value

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

The Company groups its assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the observability of the inputs used to determine fair value. These levels are:

- Level 1—Quoted prices in active markets for identical assets or liabilities.

- Level 2—Prices determined or determinable using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing an asset or liability and are developed based on market data obtained from sources independent of the Company. These may include quoted prices for similar assets and liabilities, interest rates, prepayment speeds, credit risk and other inputs.

- Level 3—Prices determined using significant unobservable inputs. In situations where observable inputs are unavailable, unobservable inputs may be used. Unobservable inputs reflect the Company's own judgments about the factors that market participants use in pricing an asset or liability, and are based on the best information available in the circumstances.

As a result of the difficulty in observing certain significant valuation inputs affecting "Level 3" fair value assets and liabilities, the Company is required to make judgments regarding these items' fair values. Different persons in possession of the same facts may reasonably arrive at different conclusions as to the inputs to be applied in valuing these assets and liabilities and their fair values. Likewise, due to the general

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illiquidity of some of these assets and liabilities, subsequent transactions may be at values significantly different from those reported.

Fair Value Accounting Elections

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

Financial Statement Items Measured at Fair Value on a Recurring Basis

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

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	$ 58,749	$ —	$ —	$ 58,749
Mortgage loans held for sale at fair value	—	3,081,003	46,374	3,127,377
Derivative assets:				
Interest rate lock commitments	—	—	107,127	107,127
Forward purchase contracts	—	54,574	—	54,574
Forward sales contracts	—	3,588	—	3,588
MBS put options	—	6,019	—	6,019
Put options on interest rate futures purchase contracts	6,707	—	—	6,707
Call options on interest rate futures purchase contracts	4,430	—	—	4,430
Total derivative assets before netting	11,137	64,181	107,127	182,445
Netting	—	—	—	(46,668)
Total derivative assets	11,137	64,181	107,127	135,777
Investment in PennyMac Mortgage Investment Trust	1,169	—	—	1,169
Mortgage servicing rights at fair value	—	—	492,028	492,028
	$ 71,055	$ 3,145,184	$ 645,529	$ 3,815,100
Liabilities:				
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	$ —	$ —	$ 280,367	$ 280,367

Derivative liabilities:				
Interest rate lock commitments	—	—	1,609	1,609
Forward purchase contracts	—	2,584	—	2,584
Forward sales contracts	—	45,085	—	45,085
Put options on interest rate futures purchase contracts	1,500	—	—	1,500
Call options on interest rate futures purchase contracts	398	—	—	398
Total derivative liabilities before netting	1,898	47,669	1,609	51,176
Netting	—	—	—	(46,750)
Total derivative liabilities	1,898	47,669	1,609	4,426
Mortgage servicing liabilities	—	—	13,045	13,045
	$ 1,898	$ 47,669	$ 295,021	$ 297,838

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	December 31, 2015			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Short-term investments	$ 46,319	$ —	$ —	$ 46,319
Mortgage loans held for sale at fair value	—	1,052,673	48,531	1,101,204
Derivative assets:				
Interest rate lock commitments	—	—	45,885	45,885
Forward purchase contracts	—	4,181	—	4,181
Forward sales contracts	—	4,965	—	4,965
MBS put options	—	404	—	404
Put options on interest rate futures purchase contracts	1,832	—	—	1,832
Call options on interest rate futures purchase contracts	1,555	—	—	1,555
Total derivative assets before netting	3,387	9,550	45,885	58,822
Netting	—	—	—	(8,542)
Total derivative assets	3,387	9,550	45,885	50,280
Investment in PennyMac Mortgage Investment Trust	1,145	—	—	1,145
Mortgage servicing rights at fair value	—	—	660,247	660,247
	$ 50,851	$ 1,062,223	$ 754,663	$ 1,859,195
Liabilities:				
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	$ —	$ —	$ 412,425	$ 412,425
Derivative liabilities:				
Interest rate lock commitments	—	—	2,112	2,112
Forward purchase contracts	—	9,004	—	9,004
Forward sales contracts	—	7,497	—	7,497
Put options on interest rate futures purchase contracts	203	—	—	203
Call options on interest rate futures purchase contracts	47	—	—	47
Total derivative liabilities before netting	250	16,501	2,112	18,863
Netting	—	—	—	(9,780)
Total derivative liabilities	250	16,501	2,112	9,083
Mortgage servicing liabilities	—	—	1,399	1,399
	$ 250	$ 16,501	$ 415,936	$ 422,907

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As shown above, all or a portion of the Company's mortgage loans held for sale, IRLCs, MSRs, ESS and MSLs are measured using Level 3 fair value inputs. Following are roll forwards of these items for the quarters and nine month periods ended September 30, 2016 and 2015:

	Quarter ended September 30, 2016			
	Mortgage loans held for sale	Net interest rate lock commitments (1)	Mortgage servicing rights	Total
	(in thousands)			
Assets:				
Balance, June 30, 2016	$ 38,079	$ 90,262	$ 526,294	$ 654,635
Purchases	750,709	—	12	750,721
Sales	(621,446)	—	—	(621,446)
Repayments	(9,629)	—	—	(9,629)
Interest rate lock commitments issued, net	—	148,315	—	148,315
Mortgage servicing rights resulting from mortgage loan sales	—	—	3,913	3,913
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk	2,487	—	—	2,487
Other factors	—	68,241	(38,191)	30,050
	2,487	68,241	(38,191)	32,537
Transfers of mortgage loans held for sale from Level 3 to Level 2 (2)	(113,826)	—	—	(113,826)
Transfers of interest rate lock commitments to mortgage loans held for sale	—	(201,300)	—	(201,300)
Balance, September 30, 2016	$ 46,374	$ 105,518	$ 492,028	$ 643,920
Changes in fair value recognized during the period relating to assets still held at September 30, 2016	$ (234)	$ 105,518	$ (38,191)	$ 67,093

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

(2) Mortgage loans held for sale are transferred from Level 3 to Level 2 as a result of the mortgage loan becoming saleable into active mortgage markets pursuant to a loan modification, borrower reperformance or resolution of deficiencies found in the borrowers' credit files.

	Quarter ended September 30, 2016	
	Excess servicing spread	Mortgage servicing

	financing	liabilities	Total
	(in thousands)		
Liabilities:			
Balance, June 30, 2016	$ 294,551	$ 4,681	$ 299,232
Issuance of excess servicing spread financing pursuant to a recapture agreement with PennyMac Mortgage Investment Trust	1,438	—	1,438
Accrual of interest	4,827	—	4,827
Repayments	(16,342)	—	(16,342)
Mortgage servicing liabilities assumed	—	5,736	5,736
Mortgage servicing liabilities resulting from mortgage loan sales	—	6,401	6,401
Changes in fair value included in income	(4,107)	(3,773)	(7,880)
Balance, September 30, 2016	$ 280,367	$ 13,045	$ 293,412
Changes in fair value recognized during the period relating to liabilities still outstanding at September 30, 2016	$ (4,107)	$ (3,773)	$ (7,880)

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	Quarter ended September 30, 2015			
	Mortgage loans held for sale	Net interest rate lock commitments (1)	Mortgage servicing rights	Total
	(in thousands)			
Assets:				
Balance, June 30, 2015	$ 34,085	$ 27,737	$ 581,269	$ 643,091
Purchases	391,578	—	109,131	500,709
Sales	(286,481)	—	—	(286,481)
Repayments	(14,465)	—	—	(14,465)
Interest rate lock commitments issued, net	—	73,133	—	73,133
Mortgage servicing rights resulting from mortgage loan sales	—	—	6,989	6,989
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk	—	—	—	—
Other factors	826	58,659	(27,722)	31,763
	826	58,659	(27,722)	31,763
Transfers of mortgage loans held for sale from Level 3 to Level 2 (2)	(61,921)	—	—	(61,921)
Transfers of interest rate lock commitments to mortgage loans held for sale	—	(115,991)	—	(115,991)
Balance, September 30, 2015	$ 63,622	$ 43,538	$ 669,667	$ 776,827
Changes in fair value recognized during the period relating to assets still held at September 30, 2015	$ (614)	$ 43,538	$ (27,722)	$ 15,202

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

(2) Mortgage loans held for sale are transferred from Level 3 to Level 2 as a result of the mortgage loan becoming saleable into active mortgage markets pursuant to a loan modification, borrower reperformance or resolution of deficiencies found in the borrowers' credit files.

	Quarter ended September 30, 2015		
	Excess servicing spread financing	Mortgage servicing liabilities	Total
	(in thousands)		
Liabilities:			
Balance, June 30, 2015	$ 359,102	$ 11,791	$ 370,893
Issuance of excess servicing spread financing:			

For cash	84,165	—	84,165
Pursuant to a recapture agreement with PennyMac Mortgage Investment Trust	2,268	—	2,268
Mortgage servicing liabilities resulting from mortgage loan sales	—	8,358	8,358
Accrual of interest	8,026	—	8,026
Repayments	(24,717)	—	(24,717)
Changes in fair value included in income	(10,271)	(9,425)	(19,696)
Balance, September 30, 2015	$ 418,573	$ 10,724	$ 429,297
Changes in fair value recognized during the period relating to liabilities still outstanding at September 30, 2015	$ (10,271)	$ (9,425)	$ (19,696)

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	Nine months ended September 30, 2016			
	Mortgage loans held for sale	Net interest rate lock commitments (1)	Mortgage servicing rights	Total
	(in thousands)			
Assets:				
Balance, December 31, 2015	$ 48,531	$ 43,773	$ 660,247	$ 752,551
Purchases	1,239,507	—	23	1,239,530
Sales	(899,763)	—	—	(899,763)
Repayments	(29,488)	—	—	(29,488)
Interest rate lock commitments issued, net	—	329,533	—	329,533
Mortgage servicing rights resulting from mortgage loan sales	—	—	13,201	13,201
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk	3,178	—	—	3,178
Other factors	—	217,429	(181,443)	35,986
	3,178	217,429	(181,443)	39,164
Transfers of mortgage loans held for sale from Level 3 to Level 2 (2)	(315,591)	—	—	(315,591)
Transfers of interest rate lock commitments to mortgage loans held for sale	—	(485,217)	—	(485,217)
Balance, September 30, 2016	$ 46,374	$ 105,518	$ 492,028	$ 643,920
Changes in fair value recognized during the period relating to assets still held at September 30, 2016	$ 506	$ 105,518	$ (181,443)	$ (75,419)

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

(2) Mortgage loans held for sale are transferred from Level 3 to Level 2 as a result of the mortgage loan becoming saleable into active mortgage markets pursuant to a loan modification, borrower reperformance or resolution of deficiencies found in the borrowers' credit files.

	Nine months ended September 30, 2016		
	Excess servicing spread financing	Mortgage servicing liabilities	Total
	(in thousands)		
Liabilities:			
Balance, December 31, 2015	$ 412,425	$ 1,399	$ 413,824

Issuance of excess servicing spread financing pursuant to a recapture agreement with PennyMac Mortgage Investment Trust	5,039	—	5,039
Accrual of interest	17,555	—	17,555
Repurchase	(59,045)	—	(59,045)
Repayments	(54,623)	—	(54,623)
Mortgage servicing liabilities resulting from mortgage loan sales	—	11,810	11,810
Mortgage servicing liabilities assumed	—	5,736	5,736
Changes in fair value included in income	(40,984)	(5,900)	(46,884)
Balance, September 30, 2016	$ 280,367	$ 13,045	$ 293,412
Changes in fair value recognized during the period relating to liabilities still outstanding at September 30, 2016	$ (33,774)	$ (5,900)	$ (39,674)

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	Nine months ended September 30, 2015			
	Mortgage loans held for sale	Net interest rate lock commitments (1)	Mortgage servicing rights	Total
	(in thousands)			
Assets:				
Balance December 31, 2014	$ 209,908	$ 32,401	$ 325,383	$ 567,692
Purchases	857,863	—	379,264	1,237,127
Sales	(798,335)	—	—	(798,335)
Repayments	(34,467)	—	—	(34,467)
Interest rate lock commitments issued, net	—	217,278	—	217,278
Mortgage servicing rights resulting from mortgage loan sales	—	—	13,107	13,107
Changes in fair value included in income arising from:				
Changes in instrument-specific credit risk	4,054	—	—	4,054
Other factors	35	48,367	(48,087)	315
	4,089	48,367	(48,087)	4,369
Transfers of mortgage loans held for sale from Level 3 to Level 2 (2)	(175,436)	—	—	(175,436)
Transfers of interest rate lock commitments to mortgage loans held for sale	—	(254,508)	—	(254,508)
Balance, September 30, 2015	$ 63,622	$ 43,538	$ 669,667	$ 776,827
Changes in fair value recognized during the period relating to assets still held at September 30, 2015	$ (1,145)	$ 43,538	$ (48,087)	$ (5,694)

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

(2) Mortgage loans held for sale are transferred from Level 3 to Level 2 as a result of the mortgage loan becoming saleable into active mortgage markets pursuant to a loan modification, borrower reperformance or resolution of deficiencies found in the borrowers' credit files.

	Nine months ended September 30, 2015		
	Excess servicing spread financing	Mortgage servicing liabilities	Total
	(in thousands)		
Liabilities:			
Balance December 31, 2014	$ 191,166	$ 6,306	$ 197,472
Issuance of excess servicing spread financing:			
For cash	271,452	—	271,452

Pursuant to a recapture agreement with PennyMac Mortgage Investment Trust	4,833	—	4,833
Mortgage servicing liabilities resulting from mortgage loan sales	—	20,442	20,442
Accrual of interest	17,596	—	17,596
Repayments	(55,800)	—	(55,800)
Changes in fair value included in income	(10,674)	(16,024)	(26,698)
Balance, September 30, 2015	$ 418,573	$ 10,724	$ 429,297
Changes in fair value recognized during the period relating to liabilities still outstanding at September 30, 2015	$ (10,674)	$ (16,024)	$ (26,698)

The information used in the preceding roll forwards represents activity for any financial statement items measured at fair value on a recurring basis and identified as using “Level 3” significant fair value inputs at either the beginning or the end of the periods presented. The Company had transfers among the fair value levels arising from transfers of IRLCs to mortgage loans held for sale at fair value upon purchase or funding of the respective mortgage loans and from the return to salability in the active secondary market of certain mortgage loans held for sale.

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Financial Statement Items Measured at Fair Value under the Fair Value Option

Net changes in fair values included in income for financial statement items carried at fair value as a result of management’s election of the fair value option by income statement line item are summarized below:

	Quarter ended September 30,					
	2016			2015		
	Net gains on mortgage loans held for sale at fair value	Net mortgage loan servicing fees	Total	Net gains on mortgage loans held for sale at fair value	Net mortgage loan servicing fees	Total
	(in thousands)					
Assets:						
Mortgage loans held for sale at fair value	$ 198,449	$ —	$ 198,449	$ 136,119	$ —	$ 136,119
Mortgage servicing rights at fair value	—	(38,191)	(38,191)	—	(27,722)	(27,722)
	$ 198,449	$ (38,191)	$ 160,258	$ 136,119	$ (27,722)	$ 108,397
Liabilities:						
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	$ —	$ 4,107	$ 4,107	$ —	$ 10,271	$ 10,271
Mortgage servicing liabilities at fair value	—	3,773	3,773	—	9,425	9,425
	$ —	$ 7,880	$ 7,880	$ —	$ 19,696	$ 19,696

	Nine months ended September 30,					
	2016			2015		
	Net gains on mortgage loans held for sale at fair value	Net mortgage loan servicing fees	Total	Net gains on mortgage loans held for sale at fair value	Net mortgage loan servicing fees	Total
	(in thousands)					
Assets:						

Mortgage loans held for sale at fair value	$ 499,058	$ —	$ 499,058	$ 285,936	$ —	$ 285,936
Mortgage servicing rights at fair value	—	(181,443)	(181,443)	—	(48,087)	(48,087)
	$ 499,058	$ (181,443)	$ 317,615	$ 285,936	$ (48,087)	$ 237,849
Liabilities:						
Excess servicing spread financing at fair value payable to PennyMac Mortgage Investment Trust	$ —	$ 40,984	$ 40,984	$ —	$ 10,674	$ 10,674
Mortgage servicing liabilities at fair value	—	5,900	5,900	—	16,024	16,024
	$ —	$ 46,884	$ 46,884	$ —	$ 26,698	$ 26,698

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

	September 30, 2016		
	Fair value	Principal amount due upon maturity	Difference
	(in thousands)		
Mortgage loans held for sale:			
Current through 89 days delinquent	$ 3,107,437	$ 2,924,778	$ 182,659
90 days or more delinquent:			
Not in foreclosure	15,223	15,343	(120)
In foreclosure	4,717	5,344	(627)
	$ 3,127,377	$ 2,945,465	$ 181,912

	December 31, 2015		
	Fair value	Principal amount due upon maturity	Difference
	(in thousands)		
Mortgage loans held for sale:			
Current through 89 days delinquent	$ 1,068,548	$ 1,016,314	$ 52,234
90 days or more delinquent:			
Not in foreclosure	26,399	26,999	(600)
In foreclosure	6,257	6,598	(341)
	$ 1,101,204	$ 1,049,911	$ 51,293

Financial Statement Items Measured at Fair Value on a Nonrecurring Basis

Following is a summary of financial statement items that were measured at fair value on a nonrecurring basis during the periods presented:

	September 30, 2016			
	Level 1	Level 2	Level 3	Total

	Level 1	Level 2	Level 3	Total
	(in thousands)			
Mortgage servicing rights at lower of amortized cost or fair value	$ —	$ —	$ 845,646	$ 845,646
Real estate acquired in settlement of loans	—	—	173	173
	$ —	$ —	$ 845,819	$ 845,819

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Mortgage servicing rights at lower of amortized cost or fair value	$ —	$ —	$ 202,991	$ 202,991
	$ —	$ —	$ 202,991	$ 202,991

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

	Quarter ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Mortgage servicing rights at lower of amortized cost or fair value	$ (25,206)	$ (33,301)	$ (174,926)	$ (51,427)
Real estate acquired in settlement of loans	42	—	—	—
	$ (25,164)	$ (33,301)	$ (174,926)	$ (51,427)

Fair Value of Financial Instruments Carried at Amortized Cost

The Company's Cash as well as its Carried Interest due from Investment Funds, Note receivable from PMT, Assets sold under agreements to repurchase, Mortgage loan participation and sale agreements, Notes payable, Obligations under capital lease and amounts receivable from and payable to the Advised Entities are carried at amortized cost.

Cash is measured using a "Level 1" fair value input.

The Company has concluded that the carrying value of the Carried Interest due from Investment Funds approximates its fair value as the balance represents the amount distributable to the Company at the balance sheet date assuming liquidation of the Investment Funds.

The Company's borrowings carried at amortized cost do not have observable inputs and the fair value is measured using management's estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation. The Company has classified these financial instruments as "Level 3" fair value financial statement items due to the lack of observable inputs to estimate their fair values.

The Company has concluded that the fair value of the Note receivable from PMT and the receivables from and payables to the Advised Entities approximate the carrying value due to their short terms and/or variable interest rates.

Valuation Techniques and Inputs

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

Due to the difficulty in estimating the fair values of “Level 3” fair value financial statement items, management has assigned the responsibility for estimating the fair value of these items to specialized staff and subjects the valuation process to significant senior management oversight. The Company’s Financial Analysis and Valuation group (the “FAV group”) is the Company’s specialized staff responsible for estimating the fair values of “Level 3” fair value financial statement items other than IRLCs and maintaining its valuation policies and procedures.

With respect to the non-IRLC “Level 3” valuations, the FAV group reports to the Company’s senior management valuation committee, which oversees and approves the valuations. The FAV group monitors the models used for valuation of the Company’s “Level 3” fair value financial statement items, including the models’ performance versus actual results, and reports those results to the Company’s senior management valuation committee. The Company’s senior management valuation committee includes the Company’s chief executive, financial, operating, risk, business development and asset/liability management officers.

The FAV group is responsible for reporting to the Company’s senior management valuation committee on a monthly basis on the changes in the valuation of the “Level 3” fair value financial statement items, including major factors affecting the valuation and any changes in model methods and inputs. To assess the reasonableness of its

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valuations, the FAV group presents an analysis of the effect on the valuation of changes to the significant inputs to the models.

With respect to IRLCs, the Company has assigned responsibility for developing fair values to its Capital Markets Risk Management staff. The fair values developed by the Capital Markets Risk Management staff are reviewed by the Company's Capital Markets Operations group.

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

Mortgage Loans Held for Sale

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

Certain of the Company's mortgage loans held for sale may become non-saleable into active markets due to identification of a defect by the Company or to the repurchase by the Company of a mortgage loan with an identified defect. The Company may also purchase certain delinquent government guaranteed or insured mortgage loans from Ginnie Mae guaranteed pools in its mortgage loan servicing portfolio.

The Company's right to purchase delinquent government guaranteed or insured mortgage loans arises as the result of the borrower's failure to make payments for at least three consecutive months preceding the month of repurchase by the Company and provides an alternative to the Company's obligation to continue advancing principal and interest at the coupon rate of the related Ginnie Mae security. Such repurchased mortgage loans may be resold to third-party investors and thereafter may be repurchased to the extent eligible for resale into a new Ginnie Mae guaranteed pool.

To the extent such mortgage loans have not become saleable into another Ginnie Mae guaranteed security by becoming current either through the borrower's reperformance or through completion of a modification of the mortgage loan's terms, the Company measures such mortgage loans along with mortgage loans with identified defects using "Level 3" fair value inputs.

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

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

Key inputs	September 30, 2016	December 31, 2015
Discount rate		
Range	2.5% – 8.1%	2.5% – 9.1%
Weighted average	3.1%	2.8%
Twelve-month projected housing price index change		
Range	2.8% – 5.2%	1.8% – 5.0%
Weighted average	4.5%	3.7%
Voluntary prepayment / resale speed (1)		
Range	0.1% – 25.8%	0.6% – 20.1%
Weighted average	20.8%	16.6%
Total prepayment speed (2)		
Range	0.1% – 41.3%	0.7% – 37.6%
Weighted average	33.1%	30.9%

(1) Voluntary prepayment/resale speed is measured using Life Voluntary Conditional Prepayment Rate ("CPR").

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

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

Derivative Financial Instruments

Interest Rate Lock Commitments

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

The significant unobservable inputs used in the fair value measurement of the Company's IRLCs are the pull-through rate and the MSR component of the Company's estimate of the fair value of the mortgage loans it has committed to purchase. Significant changes in the pull-through rate or the MSR component of the IRLCs, in isolation, could result in significant changes in fair value measurement. The financial effects of changes in these inputs are generally inversely correlated as increasing interest rates have a positive effect on the fair value of the MSR component of IRLC fair value, but increase the pull-through rate for the mortgage loan principal and interest payment cash flow component, which has decreased in fair value. Changes in fair value of IRLCs are included in Net gains on mortgage loans acquired for sale at fair value in the consolidated statements of income.

Following is a quantitative summary of key "Level 3" fair value inputs used in the valuation of IRLCs:

Key inputs	September 30, 2016	December 31, 2015
Pull-through rate		
Range	35.0% – 100.0%	54.1% – 100.0%
Weighted average	83.7%	90.1%
Mortgage servicing rights value expressed as:		
Servicing fee multiple		
Range	1.2 – 5.5	1.0 – 5.8
Weighted average	4.2	4.4

Percentage of unpaid principal balance		
Range	0.2% – 2.7%	0.2% – 3.8%
Weighted average	1.2%	1.5%

Hedging Derivatives

The Company estimates the fair value of commitments to sell mortgage loans based on quoted MBS prices. These derivative financial instruments are categorized by the Company as “Level 1” fair value financial statement items for those based on exchange traded market prices or as “Level 2” fair value financial statement items for those based on observable MBS prices or interest rate volatilities in the MBS market. Changes in the fair value of hedging derivatives are included in Net gains on mortgage loans acquired for sale at fair value, or Net mortgage loan servicing fees, as applicable, in the consolidated statements of income.

Mortgage Servicing Rights

MSRs are categorized as “Level 3” fair value financial statement items. The Company uses a discounted cash flow approach to estimate the fair value of MSRs. This approach consists of projecting net servicing cash flows discounted at a rate that management believes market participants would use in their determinations of fair value. The key inputs used in the estimation of the fair value of MSRs include the prepayment rates of the underlying mortgage loans, the applicable pricing spread (discount rate), and the per-loan annual cost to service the respective mortgage loans. Changes in the fair value of MSRs are included in Net servicing fees—Amortization, impairment and change in fair value of mortgage servicing rights in the consolidated statements of income.

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Following are the key "Level 3" fair value inputs used in determining the fair value of MSRs at the time of initial recognition, excluding MSR purchases:

	Quarter ended September 30,			
	2016		2015	
	Fair value	Amortized cost	Fair value	Amortized cost
	(Amount recognized and unpaid principal balance of underlying mortgage loans in thousa			
MSR and pool characteristics:				
Amount recognized	$3,913	$146,448	$6,989	$154,707
Unpaid principal balance of underlying mortgage loans	$340,562	$12,313,082	$550,073	$11,369,493
Weighted average servicing fee rate (in basis points)	33	29	32	34
Key inputs:				
Pricing spread (1)				
Range	7.6% – 10.5%	7.6% – 14.4%	7.0% – 14.4%	6.8% – 16.2%
Weighted average	9.3%	9.5%	8.9%	9.1%
Annual total prepayment speed (2)				
Range	5.0% – 42.8%	3.4% – 42.9%	7.7% – 52.3%	7.5% – 35.0%
Weighted average	12.4%	9.7%	11.9%	9.2%
Life (in years)				
Range	1.7 – 10.8	1.7 – 12.2	1.4 – 7.5	1.9 – 9.1
Weighted average	6.5	7.6	6.5	7.0
Per-loan annual cost of servicing				
Range	$78 – $103	$78 – $102	$59 – $101	$59 – $95
Weighted average	$92	$91	$75	$78

(1) Pricing spread represents a margin that is applied to a reference interest rate's forward rate curve to develop periodic discount rates. The Company applies a pricing spread to the United States Dollar London Interbank Offered Rate ("LIBOR") curve for purposes of discounting cash flows relating to MSRs.
(2) Prepayment speed is measured using Life Total CPR.

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	Nine months ended September 30,			
	2016		2015	
	Fair value	Amortized cost	Fair value	Amortized cost
	(Amount recognized and unpaid principal balance of underlying mortgage loans in thousar			
MSR and pool characteristics:				
Amount recognized	$13,201	$370,414	$13,107	$347,549
Unpaid principal balance of underlying mortgage loans	$1,108,802	$29,667,803	$1,072,203	$25,268,602
Weighted average servicing fee rate (in basis points)	33	30	32	35
Key inputs:				
Pricing spread (1)				
Range	7.2% – 10.5%	7.2% – 14.4%	7.0% – 14.4%	6.8% – 16.2%
Weighted average	8.9%	9.2%	9.4%	9.2%
Annual total prepayment speed (2)				
Range	3.3% – 52.3%	3.4% – 50.9%	7.7% – 62.4%	7.5% – 39.4%
Weighted average	12.6%	10.0%	11.6%	8.8%
Life (in years)				
Range	1.3 – 11.8	1.3 – 12.2	1.1 – 7.5	1.8 – 9.1
Weighted average	6.5	7.5	6.5	7.0
Per-loan annual cost of servicing				
Range	$68 – $105	$68 – $106	$59 – $101	$59 – $95
Weighted average	$87	$88	$75	$76

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

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

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

	September 30, 2016		December 31, 2015	
	Fair value	Amortized cost	Fair value	Amortized cost
	(Carrying value, unpaid principal balance of underlying mortgage loans and effect on fair value amounts in thousands)			
MSR and pool characteristics:				
Carrying value	$ 492,028	$ 845,646	$ 660,247	$ 751,688
Unpaid principal balance of underlying mortgage loans	$ 46,236,558	$ 75,076,431	$ 54,182,477	$ 56,420,227
Weighted average note interest rate	4.1%	3.8%	4.1%	3.8%
Weighted average servicing fee rate (in basis points)	32	31	32	32
Key inputs:				
Pricing spread (1)				
Range	7.6% – 14.4%	7.6% – 14.4%	7.2% – 14.1%	7.2% – 12.8%
Weighted average	9.7%	10.2%	8.9%	8.9%
Effect on fair value of (2):				
5% adverse change	$ (8,318)	$ (15,356)	$ (11,115)	$ (13,467)
10% adverse change	$ (16,346)	$ (30,149)	$ (21,857)	$ (26,472)
20% adverse change	$ (31,585)	$ (58,160)	$ (42,293)	$ (51,183)
Average life (in years)				
Range	2.1 – 8.9	1.5 – 9.3	1.9 – 9.0	1.8 – 9.1
Weighted average	6.0	6.5	6.9	7.4
Prepayment speed (3)				