

PENNYMAC FINANCIAL SERVICES, INC.
Form 10-K
March 09, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10 K

(Mark One)

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

For the fiscal year ended December 31, 2017

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)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Class A Common Stock of Beneficial Interest, \$0.0001 Par Value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act (check one):

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2017 the aggregate market value of the registrant's Common Stock of beneficial interest, \$0.0001 par value ("common stock"), held by non-affiliates was \$328,317,641 based on the closing price as reported on the New York Stock Exchange on that date.

As of March 8, 2018, the number of outstanding shares of common stock of the registrant was 24,092,831.

Documents Incorporated by Reference

Document	Parts Into Which Incorporated
Definitive Proxy Statement for 2018 Annual Meeting of Stockholders	Part III

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PENNYMAC FINANCIAL SERVICES, INC.

FORM 10 K

December 31, 2017

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SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

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

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

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

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

You should not place undue reliance on any forward looking statement and should consider the following uncertainties and risks, as well as the risks and uncertainties discussed elsewhere in this Report and as set forth in Item IA. of Part I hereof and any subsequent Quarterly Reports on Form 10-Q.

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;
- certain banking regulations that may limit our business activities;
- foreclosure delays and changes in foreclosure practices;
- the licensing and operational requirements of states and other jurisdictions applicable to our businesses, to which our bank competitors are not subject;

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- 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;
- any required additional capital and liquidity to support business growth that may not be available on acceptable terms, if at all;
- changes in prevailing interest rates;
- increases in loan delinquencies and defaults;
- our dependence on the success of the multifamily market for future originations of commercial mortgage loans and other commercial real estate-related loans;
- our reliance on PennyMac Mortgage Investment Trust (“PMT”) as a significant source of financing for, and revenue related to, our mortgage banking business;
- 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 ability to realize the anticipated benefit of potential future acquisitions of mortgage servicing rights (“MSRs”);
- our obligation to indemnify PMT and the Investment Funds if our services fail to meet certain criteria or characteristics or under other circumstances;
- decreases in the returns on the assets that we select and manage for our clients, and our resulting management and incentive fees;
- the extensive amount of regulation applicable to our investment management segment;
- conflicts of interest in allocating our services and investment opportunities among ourselves and our Advised Entities;

- the 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;
- our ability to mitigate cybersecurity risks and cyber incidents;
- our exposure to risks of loss resulting from adverse weather conditions and man-made or natural disasters; and
- our organizational structure and certain requirements in our charter documents.

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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

Item 1. Business

The following description of our business should be read in conjunction with the information included elsewhere in this Report. This description contains forward looking statements that involve risks and uncertainties. Actual results could differ significantly from the projections and results discussed in the forward looking statements due to the factors described under the caption “Risk Factors” and elsewhere in this Report. References in this Report to “we,” “our,” “us,” and the “Company” refer to PennyMac Financial Services, Inc. (“PFSI”).

Our Company

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

We operate and control all of the business and affairs and consolidate the financial results of Private National Mortgage Acceptance Company, LLC (“PennyMac”). PennyMac was founded in 2008 by members of our executive leadership team and two strategic partners, BlackRock Mortgage Ventures, LLC (“BlackRock” or “BlackRock, Inc.”) and HC Partners, LLC, formerly known as Highfields Capital Investments, LLC, together with its affiliates (“Highfields”).

Our principal mortgage banking subsidiary, PennyMac Loan Services, LLC (“PLS”), is a non-bank producer and servicer of mortgage loans in the United States. PLS is a seller/servicer for the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”), each of which is a government sponsored entity (“GSE”). PLS is also an approved issuer of securities guaranteed by the Government National Mortgage Association (“Ginnie Mae”), a lender of the Federal Housing Administration (“FHA”), a lender/servicer of the Veterans Administration (“VA”) and the U.S. Department of Agriculture (“USDA”), and a servicer for the Home Affordable Modification Program (“HAMP”). We refer to each of Fannie Mae, Freddie Mac, Ginnie Mae, FHA, VA and USDA as an “Agency” and collectively as the “Agencies.” PLS is able to service loans in all 50 states, the District of Columbia, Guam and the U.S. Virgin Islands, and originate loans in 49 states and the District of Columbia, either because PLS is properly licensed in a particular jurisdiction or exempt or otherwise not required to be licensed in that jurisdiction.

Our investment management subsidiary is 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 manages PennyMac Mortgage Investment Trust (“PMT”), a mortgage real estate investment trust, listed on the New York Stock Exchange under the ticker symbol PMT. PCM also manages PNMAC Mortgage Opportunity Fund, LLC and PNMAC Mortgage Opportunity Fund, LP, both registered under the Investment Company Act of 1940 (“Investment Company Act”), as amended, an affiliate of these funds and PNMAC Mortgage Opportunity Fund Investors, LLC. We refer to these funds collectively as our “Investment Funds” and, together with PMT, as our “Advised Entities.” During 2017, the Investment Funds sold substantially all of their remaining investments. We expect to liquidate the remaining investments and make final distributions to the Investment Funds’ investors during 2018.

We conduct our business in three segments: production, servicing (together, production and servicing comprise our mortgage banking activities) and investment management.

- The production segment performs mortgage loan origination, acquisition and sale activities.
- The servicing segment performs mortgage loan servicing for both newly originated and loans we service for others, including for the Advised Entities.

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The investment management segment represents our investment management activities, which include the activities associated with investment asset acquisitions and dispositions such as sourcing, due diligence, negotiation and settlement; managing correspondent production activities for PMT; and managing the acquired investments for the Advised Entities.

Following is a summary of our segment's results for the years presented:

	Year ended December 31,				
	2017	2016	2015	2014	2013
	(in thousands)				
Net revenues:					
Production	\$ 513,641	\$ 694,405	\$ 481,636	\$ 260,673	\$ 246,719
Servicing	386,203	212,886	202,322	207,239	84,684
Investment management	22,679	23,996	30,847	48,987	55,156
	\$ 922,523	\$ 931,287	\$ 714,805	\$ 516,899	\$ 386,559
Income before income taxes:					
Production	\$ 238,508	\$ 416,096	\$ 271,869	\$ 135,619	\$ 126,020
Servicing	58,672	(36,099)	1,297	65,925	20,048
Investment management	5,789	2,486	7,722	20,111	36,058
Non-segment activities (1)	32,940	600	(1,695)	1,378	—
	\$ 335,909	\$ 383,083	\$ 279,193	\$ 223,033	\$ 182,126
Total assets at year end:					
Production	\$ 2,459,014	\$ 2,195,330	\$ 1,122,242	\$ 1,040,358	\$ 607,989
Servicing	4,886,594	2,841,551	2,270,940	1,320,092	795,320
Investment management	19,880	91,517	92,893	92,881	117,341
	\$ 7,365,488	\$ 5,128,398	\$ 3,486,075	\$ 2,453,331	\$ 1,520,650

(1) Primarily represents repricing of Payable to exchanged Private National Mortgage Acceptance Company, LLC unitholders under tax receivable agreement we entered into as part of our initial public offering during 2013.

Mortgage Banking

Loan Production

In our loan production activities, we earn interest income and gains or losses during the holding period and upon the sale of these loans, and retain the associated MSR (subject to sharing with PMT cash or a portion of excess servicing spread ("ESS") with respect to certain consumer direct originated mortgage loans that refinance mortgage loans for which the related MSR or ESS was held by PMT). Our loan production segment sources mortgage loans through two channels: correspondent production and consumer direct lending.

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

Through our consumer direct lending channel, we originate new prime credit quality, first-lien residential conventional and government-insured or guaranteed mortgage loans on a national basis to allow customers to purchase or refinance their homes. We conduct our own fulfillment for mortgage loans originated through the consumer direct lending channel. Our consumer direct model relies on the Internet and call center-based staff to acquire and interact with

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customers across the country. We do not have a “brick and mortar” branch network and have been developing our consumer direct operations with call centers strategically positioned across the United States.

Our loan production activity is summarized below:

	Year ended December 31,		
	2017	2016	2015
	(in thousands)		
Unpaid principal balance ("UPB") of mortgage loans purchased and originated for sale:			
Government-insured or guaranteed mortgage loans acquired from PennyMac Mortgage Investment Trust	\$ 40,561,241	\$ 39,908,163	\$ 31,490,920
Mortgage loans sourced through our consumer direct channel	5,466,669	6,491,107	4,143,239
	46,027,910	46,399,270	35,634,159
Unpaid principal balance of conventional mortgage loans fulfilled for PennyMac Mortgage Investment Trust	22,971,119	23,188,386	14,014,603
Total loan production	\$ 68,999,029	\$ 69,587,656	\$ 49,648,762

Loan Servicing

Our loan servicing segment performs loan administration, collection, and default management activities, including the collection and remittance of loan payments; response to customer inquiries; accounting for principal and interest; holding custodial (impounded) funds for the payment of property taxes and insurance premiums; counseling delinquent mortgagors; and supervising foreclosures and property dispositions. We service mortgage loans both as the owner of MSR's and on behalf of other MSR or mortgage owners. We provide servicing for conventional and government-insured or guaranteed loans (“prime servicing”), as well as servicing for distressed mortgage loans that have been acquired as investments by our Advised Entities (“special servicing”).

The UPB of our mortgage loan servicing portfolio is summarized below:

December 31, 2017			December 31, 2016		
Servicing rights owned (in thousands)	Contract servicing and subservicing	Total mortgage loans serviced	Servicing rights owned	Contract servicing and subservicing	Total mortgage loans serviced

Investor:

Non-affiliated
entities:

Originated	\$ 120,853,138	\$ —	\$ 120,853,138	\$ 89,516,155	\$ —	\$ 89,516,155
Purchased	47,016,708	—	47,016,708	41,735,847	—	41,735,847
	167,869,846	—	167,869,846	131,252,002	—	131,252,002
Advised entities	—	74,980,268	74,980,268	—	60,886,717	60,886,717
Mortgage loans held for sale	2,998,377	—	2,998,377	2,101,283	—	2,101,283
Total	\$ 170,868,223	\$ 74,980,268	\$ 245,848,491	\$ 133,353,285	\$ 60,886,717	\$ 194,240,002

Investment Management

We are an investment manager through our subsidiary, PCM. PCM currently manages PMT and the Investment Funds. For these activities, we earn management fees as a percentage of net assets and may earn incentive compensation based on investment performance. During 2017, the Investment Funds sold substantially all of their remaining investments. We expect to liquidate the remaining investment and make final distributions to the Investment Funds' investors during 2018.

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The net assets of the Advised Entities are summarized below:

	December 31,	
	2017	2016
	(in thousands)	
PennyMac Mortgage Investment Trust	\$ 1,544,585	\$ 1,351,114
Investment Funds	29,329	197,550
	\$ 1,573,914	\$ 1,548,664

U.S. Mortgage Market

The U.S. residential mortgage market is one of the largest financial markets in the world, with approximately \$10.6 trillion of outstanding debt and average annual origination volume of \$1.7 trillion for the five years ending December 31, 2017. Many of the largest financial institutions, including banks which have traditionally held the majority of the market share in mortgage originations and servicing, have reduced their participation in the mortgage market and the industry remains in a period of significant transformation, creating opportunities for non-bank participants.

The residential mortgage industry is characterized by high barriers to entry, including the necessity for approvals required to sell loans to and service loans for the Agencies, state licensing requirements for non-federally chartered banks, sophisticated infrastructure, technology, risk management, and processes required for successful operations, and financial capital requirements.

Our Growth Strategies

Since our establishment, we have demonstrated our ability to apply our residential mortgage expertise and operating capabilities to multiple business opportunities. In the initial years of our operation, for example, we identified investing in distressed mortgage assets as an attractive opportunity and we raised and deployed capital through a series of successful transactions. As the mortgage market presented opportunities in new loan production and servicing, we expanded our management and capabilities to profitably capitalize on these businesses as well.

Our growth strategies include:

Growing our Mortgage Loan Servicing Portfolio

We expect to grow our servicing portfolio on an organic basis, as our correspondent government insured production and consumer direct lending add new prime servicing for owned MSR, and correspondent conventional production adds new subservicing. In 2017, our correspondent and consumer direct loan production totaled \$69.0 billion in UPB. We plan to supplement our organic growth with MSR acquisitions, some of which may be concentrated in delinquent or defaulted loans for which we have expertise in servicing. We have acquired MSRs from large mortgage servicers, which are selling MSRs due to continuing operational and regulatory pressures, higher regulatory capital requirements for banks, and a re-focus on core customers and business, and from independent mortgage banks, which are selling MSRs due to reduced origination volumes, operational losses, and a need for capital. In 2017, we purchased approximately \$16.2 billion in UPB of MSRs.

Growing Correspondent Production through Expanding Seller Relationships

We expect to grow our correspondent production business by expanding the number and types of sellers from which we purchase loans and increasing the volume of loans that we purchase from our sellers as we continue to add to the loan products and services we offer, and deepen our participation in certain geographic markets in the United States. Over the past several years, a number of large banks have exited or reduced the size of their correspondent production businesses, creating an opportunity for non bank entities to gain market share. We believe that we are well positioned to take advantage of this opportunity based on our management expertise in the correspondent production business, our relationships with correspondent sellers, and our supporting systems and processes.

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Growing Consumer Direct Lending through Portfolio Refinance and Non Portfolio Originations

We expect to grow our consumer direct lending business by leveraging our growing servicing portfolio through refinance and purchase-money loans for existing customers as well as increasing our non portfolio originations. As our servicing portfolio grows, we will have a greater number of leads to pursue, which we believe will lead to greater origination activity through our consumer direct business. As of December 31, 2017, we serviced 1.2 million loans for existing customers. At the same time, we are making significant investments in technology, personnel and marketing to increase our non portfolio originations. We believe that our national call center model and our technology will enable us to drive origination process efficiencies and best in class customer service.

Expansion into new markets

We regularly evaluate opportunities to grow our business, including expansion into new markets, such as the broker lending channel and non-delegated correspondent lending services. The broker lending channel involves the underwriting and funding of mortgage loans sourced by mortgage loan brokers and other financial intermediaries. We estimate that the broker lending channel represents approximately 10% of U.S. residential mortgage originations and we have recently entered that market. In 2016, we launched a non-delegated correspondent service to complement our delegated correspondent channel. The non-delegated correspondent lending service involves the purchase by PMT of loans for which PLS has provided underwriting eligibility services to the originating correspondent seller. Entry into this market leverages our existing loan fulfillment infrastructure, gives our existing sellers an additional method through which they can deliver loans to us and provides us with access to new sellers that were not previously served.

Compliance and Regulatory

Our business is subject to extensive federal, state and local regulation. The Consumer Financial Protection Bureau (“CFPB”) was established on July 21, 2010 under Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The CFPB is responsible for ensuring consumers are provided with timely and understandable information to make responsible decisions about financial transactions, federal consumer financial laws are enforced and consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination. Although the CFPB’s actions may improve consumer protection, such actions also have resulted in a meaningful increase in costs to consumers and financial services companies including mortgage originators and servicers.

In addition to federal regulation, our loan production and loan servicing operations are regulated at the state level by state licensing authorities and administrative agencies. We, along with certain PennyMac employees who engage in regulated activities, must apply for licensing as a mortgage banker or lender, loan servicer and debt collector pursuant

to applicable state law. These state licensing requirements typically require an application process, the payment of fees, background checks and administrative review. Our servicing operations are licensed (or exempt or otherwise not required to be licensed) to service mortgage loans in all 50 states, the District of Columbia, Guam and the U.S. Virgin Islands. Our consumer direct lending business is licensed to originate loans in 49 states and the District of Columbia. From time to time, we receive requests from states and Agencies and various investors for records, documents and information regarding our policies, procedures and practices regarding our loan production and loan servicing business activities, and undergo periodic examinations by federal and state regulatory agencies. We incur significant ongoing costs to comply with these licensing and examination requirements.

Furthermore, the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the “SAFE Act”) requires all states to enact laws that require all individuals acting in the United States as mortgage loan originators to be individually licensed or registered if they intend to offer mortgage loan products. These licensing requirements include enrollment in the Nationwide Mortgage Licensing System, application to state regulators for individual licenses and the completion of pre licensing education, annual education and the successful completion of both national and state exams.

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In addition, we must comply with a number of federal consumer protection laws, including, among others:

- the Real Estate Settlement Procedures Act (“RESPA”), and Regulation X thereunder, which require certain disclosures to mortgagors regarding the costs of mortgage loans, the administration of tax and insurance escrows, the transferring of servicing of mortgage loans, the response to consumer complaints, and payments between lenders and vendors of certain settlement services;
- the Truth in Lending Act (“TILA”), and Regulation Z thereunder, which require certain disclosures to mortgagors regarding the terms of their mortgage loans, notices of sale, assignments or transfers of ownership of mortgage loans, new servicing rules involving payment processing, and adjustable rate mortgage change notices and periodic statements;
- the Equal Credit Opportunity Act and Regulation B thereunder, which prohibit discrimination on the basis of age, race and certain other characteristics, in the extension of credit;
- the Fair Housing Act, which prohibits discrimination in housing on the basis of race, sex, national origin, and certain other characteristics;
- the Home Mortgage Disclosure Act and Regulation C thereunder, which require financial institutions to report certain public loan data;
- the Homeowners Protection Act, which requires the cancellation of private mortgage insurance once certain equity levels are reached, sets disclosure and notification requirements, and requires the return of unearned premiums
- the Servicemembers Civil Relief Act, which provides, among other things, interest and foreclosure protections for service members on active duty;
- the Gramm Leach Bliley Act and Regulation P thereunder, which require us to maintain privacy with respect to certain consumer data in our possession and to periodically communicate with consumers on privacy matters;
- the Fair Debt Collection Practices Act, which regulates the timing and content of debt collection communications;
- the Fair Credit Reporting Act and Regulation V thereunder, which regulate the use and reporting of information related to the credit history of consumers; and
- the National Flood Insurance Reform Act of 1994, which provides for lenders to require from borrowers or to purchase flood insurance on behalf of borrower/owners of properties in special flood hazard areas.

Many of these laws are further impacted by the SAFE Act and implementation of new rules by the CFPB.

Our senior management team has established a comprehensive compliance management system ("CMS") that is designed to ensure compliance with applicable mortgage origination and servicing laws and regulations. The components of our CMS include: (a) oversight by senior management and our Board to ensure that our compliance culture, guidance, and resources are appropriate; (b) a compliance program to ensure that our policies, training and monitoring activities are complete and comprehensive; (c) a complaint management program to ensure that consumer complaints are appropriately addressed and that any required actions are implemented on a timely basis; and (d) independent oversight to ensure that our CMS is functioning as designed.

An important component of the CMS is management's Mortgage Regulatory Compliance Committee ("MRCC"). This committee oversees the CMS and supports our cultural initiatives that reinforce the importance of regulatory compliance. The Committee also monitors changes in the internal and external environment, approves

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mortgage compliance policies, monitors compliance with those policies and ensures any required remediation is implemented on a timely basis. The MRCC has identified individuals throughout the organization to oversee specific areas of compliance. MRCC membership includes senior management from all areas of the Company impacted by mortgage compliance laws and regulations and meets on a regular basis throughout the year.

Intellectual Property

We hold various registered trademarks, including trademarks with respect to the name PennyMac®, the swirl design and rooftop design appearing in certain PennyMac drawings and logos and various additional designs and word marks relating to the PennyMac name. We do not otherwise rely on any copyright, patent or other form of registration to protect our rights in our intellectual property. Our other intellectual property includes proprietary know how and technological innovations, such as our proprietary loan level analytics systems and models for distressed loan management, and other trade secrets that we have developed to maintain our competitive position.

Competition

Given the diverse and specialized nature of our businesses, we do not believe we have a direct competitor for the totality of our business. We compete with a number of nationally focused companies in each of our businesses.

In our mortgage banking segments, we compete with large financial institutions and with other independent residential mortgage loan producers and servicers, such as Wells Fargo, JP Morgan Chase, Bank of America, U.S. Bank, Quicken Loans and Nationstar Mortgage. In our loan production segment, we compete on the basis of product offerings, technical knowledge, manufacturing quality, speed of execution, rate and fees. In our servicing segment, we compete on the basis of experience in the residential loan servicing business, quality of high touch special servicing and historical servicing performance, and quality of execution, especially in high touch special servicing.

In our investment management segment, we compete for capital with both traditional and alternative investment managers. We compete on the basis of historical track record of risk adjusted returns, experience of investment management team, the return profile of prospective investment opportunities and on the level of fees and expenses.

Employees

As of December 31, 2017, we, through a subsidiary, had 3,189 employees.

Available Information

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and amendments to those reports filed with or furnished to United States Securities and Exchange Commission (the "SEC") pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge at www.pennymacfinancial.com through the investor relations section of our website as soon as reasonably practicable after electronically filing such material with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding our filings at www.sec.gov. In addition, the public may read and copy the materials we file with the SEC at the SEC's Public Reference Room at 100 F. Street, NE, Washington, D.C. 20549. Information regarding the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The above references to our website and the SEC's website do not constitute incorporation by reference of the information contained on those websites and should not be considered part of this document.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the following factors, which could materially affect our business, financial condition, liquidity and results of operations in future periods. The risks described below are not the only risks that we face. Additional risks not presently known to us or that we currently

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deem immaterial may also materially adversely affect our business, financial condition, liquidity and results of operations in future periods.

Risks Related to Our Mortgage Banking Segment

Regulatory Risks

We operate in a highly regulated industry and the continually changing federal, state and local laws and regulations could materially and adversely affect our business, financial condition, liquidity and results of operations.

We are required to comply with a wide array of federal, state and local laws and regulations that regulate, among other things, the manner in which we conduct our loan production and servicing businesses. These regulations directly impact our business and require constant compliance, monitoring and internal and external audits and examinations by federal and state regulators. This can result in increases in our administrative costs, and we or PLS may be required to pay substantial penalties imposed by these regulators due to compliance errors, or PLS may lose its licenses. Negative publicity or fines and penalties incurred in one jurisdiction may cause investigations or other actions by regulators in other jurisdictions.

Federal, state and local governments have proposed or enacted numerous laws, regulations and rules related to mortgage loans. Laws, regulations, rules and judicial and administrative decisions relating to mortgage loans include those pertaining to real estate settlement procedures, equal credit opportunity, fair lending, fair credit reporting, truth in lending, fair debt collection practices, service members protections, compliance with net worth and financial statement delivery requirements, compliance with federal and state disclosure and licensing requirements, the establishment of maximum interest rates, finance charges and other charges, qualified mortgages, licensing of loan officers and other personnel, loan officer compensation, secured transactions, property valuations, servicing transfers, payment processing, escrow, communications with consumers, loss mitigation, collection, foreclosure, bankruptcy, repossession and claims handling procedures, and other trade practices and privacy regulations providing for the use and safeguarding of non public personal financial information of borrowers. Service providers we use must also comply with some of these legal requirements, including outside counsel retained to process foreclosures and bankruptcies.

Our failure to operate effectively and in compliance with any of these laws, regulations and rules could subject us to lawsuits or governmental actions and damage our reputation, which could materially and adversely affect our business, financial condition, liquidity and results of operations. In addition, our failure to comply with these laws, regulations and rules may result in increased costs of doing business, reduced payments by borrowers, modification of the original terms of mortgage loans, permanent forgiveness of debt, delays in the foreclosure process, increased servicing advances, litigation, reputational damage, enforcement actions, and repurchase and indemnification

obligations. Our failure to adequately supervise service providers, including outside foreclosure counsel, may also have these negative results.

The failure of the mortgage lenders from whom loans were acquired through our correspondent production activities to comply with any applicable laws, regulations and rules may also result in these adverse consequences. We have in place a due diligence program designed to assess areas of risk with respect to these acquired loans, including, without limitation, compliance with underwriting guidelines and applicable laws or regulations. However, we may not detect every violation of law by these mortgage lenders. Further, to the extent any other third party originators or servicers with whom we do business fail to comply with applicable laws or regulations and any of their mortgage loans or MSRMs become part of our assets, it could subject us, as an assignee or purchaser of the related mortgage loans or MSRMs, to monetary penalties or other losses. In general, if any of our loans are found to have been originated, serviced or owned by us or a third party in violation of applicable laws or regulations, we could be subject to lawsuits or governmental actions, or we could be fined or incur losses. While we have may contractual rights to seek indemnity or repurchase from certain of these lenders and third party originators and servicers, if any of them are unable to fulfill their indemnity or repurchase obligations to us to a material extent, our business, liquidity, financial condition and results of operations could be materially and adversely affected.

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On December 22, 2017, H.R. 1, commonly known as the Tax Cuts and Jobs Act of 2017 (the “Tax Act”), was signed into law. The Tax Act includes significant changes to the Internal Revenue Code. While the Tax Act has reduced our applicable federal tax rate, we cannot predict what impact the Tax Act will have on the mortgage industry or our operations, including among other things, the availability of mortgage financing, interest rates, consumer spending, the economy and the geopolitical landscape. To the extent that the Tax Act has an overall negative impact on our industry, such legislation may have a material adverse effect on our business, liquidity, financial condition and results of operations.

The CFPB is active in its monitoring of the residential mortgage origination and servicing sectors. New rules and regulations and more stringent enforcement of existing rules and regulations by the CFPB could result in enforcement actions, fines, penalties and the inherent reputational risk that results from such actions.

Under the Dodd-Frank Act, the CFPB is empowered with broad supervision, rulemaking and examination authority to enforce laws involving consumer financial products and services and to ensure, among other things, that consumers receive clear and accurate disclosures regarding financial products and are protected from hidden fees and unfair, deceptive or abusive acts or practices. The CFPB has adopted a number of final regulations under the Dodd-Frank Act regarding truth in lending, “ability to repay,” home mortgage loan disclosure, home loan origination, fair credit reporting, fair debt collection practices, foreclosure protections, and mortgage servicing rules, including provisions regarding loss mitigation, early intervention, periodic statement requirements and lender-placed insurance. In October 2016, the CFPB further revised its rules under Regulations X and Z impacting lender-placed insurance notices, delinquency and early intervention, loss mitigation, periodic statement requirements, and successors-in-interest to borrowers. With the exception of the revised rules regarding periodic statement requirements for borrowers in bankruptcy and successors-in-interest to borrowers, which will become effective in April 2018, these revised rules became effective in October 2017. In January 2018, certain Home Mortgage Disclosure Act rules also became effective that require us to collect, record and report additional data about loans that we originate and service.

The CFPB also has enforcement authority with respect to the conduct of third-party service providers of financial institutions. The CFPB has made it clear that it expects non-bank entities to maintain an effective process for managing risks associated with third-party vendor relationships, including compliance-related risks. In connection with this vendor risk management process, we are expected to perform due diligence reviews of potential vendors, review vendors’ policies and procedures and internal training materials to confirm compliance-related focus, include enforceable consequences in contracts with vendors regarding failure to comply with consumer protection requirements, and take prompt action, including terminating the relationship, in the event that vendors fail to meet our expectations. The CFPB is also applying greater scrutiny to compensation payments to third-party providers for marketing services and may issue guidance that narrows the range of acceptable payments to third-party providers as part of marketing services agreements, lead generation agreements and other third-party marketer relationships.

In addition to its supervision and examination authority, the CFPB is authorized to conduct investigations to determine whether any person is engaging in, or has engaged in, conduct that violates federal consumer financial protection laws, and to initiate enforcement actions for such violations, regardless of its direct supervisory authority. Investigations may be conducted jointly with other regulators. In furtherance of its supervision and examination

powers, the CFPB has the authority to impose monetary penalties for violations of applicable federal consumer financial laws, require remediation of practices and pursue administrative proceedings or litigation for violations of applicable federal consumer financial laws. The CFPB also has the authority to obtain cease and desist orders (which can include orders for restitution or rescission of contracts, as well as other kinds of affirmative relief) and monetary penalties ranging from \$5,000 per day for ordinary violations of federal consumer financial laws to \$25,000 per day for reckless violations and \$1 million per day for knowing violations.

Rules and regulations promulgated under the Dodd-Frank Act or by the CFPB, uncertainty regarding recent changes in leadership (including interim leadership) or authority levels within the CFPB, and actions taken or not taken by the CFPB could result in heightened federal and state regulation and oversight of our business activities, materially and adversely affect the manner in which we conduct our business, and increase costs and potential litigation associated with our business activities. Our failure to comply with the laws, rules or regulations to which we are subject, whether actual or alleged, would expose us to fines, penalties or potential litigation liabilities, including costs, settlements and

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judgments, any of which could have a material adverse effect on our business, liquidity, financial condition and results of operations.

We are highly dependent on U.S. government sponsored entities and government agencies, and any changes in these entities or their current roles could materially and adversely affect our business, financial condition, liquidity and results of operations.

Our ability to generate revenues through mortgage loan sales depends to a significant degree on programs administered by GSEs, such as Fannie Mae and Freddie Mac, government agencies, including Ginnie Mae, and others that facilitate the issuance of mortgage backed securities (“MBS”), in the secondary market. These Agencies play a critical role in the mortgage industry and we have significant business relationships with many of them. Presently, almost all of the newly originated conforming loans that we originate directly with borrowers or assist PMT in acquiring from mortgage lenders through our correspondent production activities qualify under existing standards for inclusion in MBS issued by Fannie Mae or Freddie Mac or guaranteed by Ginnie Mae. We also derive other material financial benefits from our Agency relationships, including the assumption of credit risk by certain of these Agencies on loans included in such MBS in exchange for our payment of guarantee fees and the ability to avoid certain loan inventory finance costs through streamlined loan funding and sale procedures.

Any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the U.S. federal government, could adversely affect our business and prospects. Although the U.S. Treasury has committed capital to Fannie Mae and Freddie Mac, these actions may not be adequate for their needs. Any discontinuation of, or significant reduction in, the operation of Fannie Mae or Freddie Mac or any significant adverse change in their capital structure, financial condition, activity levels in the primary or secondary mortgage markets or in underwriting criteria could materially and adversely affect our business, financial condition, liquidity and results of operations.

The roles of Fannie Mae and Freddie Mac could be significantly restructured, reduced or eliminated and the nature of the guarantees could be considerably limited relative to historical measurements. Elimination of the traditional roles of Fannie Mae and Freddie Mac, or any changes to the nature or extent of the guarantees provided by Fannie Mae and Freddie Mac or the fees, terms and guidelines that govern our selling and servicing relationships with them, such as increases in the guarantee fees we are required to pay, initiatives that increase the number of repurchase requests and/or the manner in which they are pursued, or possible limits on delivery volumes imposed upon us and other seller/servicers, could also materially and adversely affect our business, including our ability to sell and securitize loans through our loan production segment, and the performance, liquidity and market value of our investments. Our ability to generate revenues from newly originated loans that we assist PMT in acquiring through its correspondent production business would be similarly affected. Moreover, any changes to the nature of the GSEs or their guarantee obligations could redefine what constitutes an Agency MBS and could have broad adverse implications for the market and our business, financial condition, liquidity and results of operations.

Our ability to generate revenues from newly originated loans that we assist PMT in acquiring through its correspondent production business is also highly dependent on the fact that the Agencies have not historically acquired such loans directly from mortgage lenders, but have instead relied on banks and non bank aggregators such as

us to acquire, aggregate and securitize or otherwise sell such loans to investors in the secondary market. Certain of the Agencies have approved new and smaller lenders that traditionally may not have qualified for such approvals. To the extent that these lenders choose to sell directly to the Agencies rather than through loan aggregators like us, the number of loans available for purchase by aggregators is reduced, which could materially and adversely affect our business and results of operations. Similarly, to the extent the Agencies increase the number of purchases and sales for their own accounts, our business and results of operations could be materially and adversely affected.

We are required to hold various Agency approvals in order to conduct our business and there is no assurance that we will be able to obtain or maintain those Agency approvals or that changes in Agency guidelines will not materially and adversely affect our business, financial condition, liquidity and results of operations.

We are required to hold certain Agency approvals in order to sell mortgage loans to the Agencies and service such mortgage loans on their behalf. Our failure to satisfy the various requirements necessary to obtain and maintain such

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Agency approvals over time would restrict our direct business activities and could materially adversely impact our business, financial condition, liquidity and results of operations.

We are also required to follow specific guidelines that impact the way that we originate and service Agency loans, including guidelines with respect to:

- credit standards for mortgage loans;
- collections, remittances and other payments;
- our staffing levels and other servicing practices;
- the servicing and ancillary fees that we may charge;
- our modification standards and procedures; and
- the amount of non reimbursable advances.

We generally cannot negotiate these terms with the Agencies and they are subject to change at any time. A significant change in these guidelines that has the effect of decreasing the fees we charge or requires us to expend additional resources in providing mortgage services could decrease our revenues or increase our costs, which would also adversely affect our business, financial condition, liquidity and results of operations.

In addition, the Federal Housing Finance Agency (“FHFA”) has directed the GSEs to align their guidelines for servicing delinquent mortgages that they own or that back securities which they guarantee, which can result in monetary incentives for servicers that perform well and penalties for those that do not. The FHFA has also directed the GSEs to assess compensatory penalties against servicers in connection with the failure to meet specified timelines relating to delinquent loans and foreclosure proceedings, and other breaches of servicing obligations. Our failure to operate efficiently and effectively within the prevailing regulatory framework and in accordance with the applicable origination and servicing guidelines and/or the loss of our seller/servicer license approval or approved issuer status with the Agencies could result in our failure to benefit from available monetary incentives and/or expose us to monetary penalties and curtailments, all of which could materially and adversely affect our business, financial condition, liquidity and results of operations.

Our inability to meet certain net worth and liquidity requirements imposed by the Agencies could have a material adverse effect on our business, financial condition, liquidity and results of operation.

We are subject to minimum financial eligibility requirements established by the Agencies. These eligibility requirements align the minimum financial requirements for entities to do business with the Agencies. These minimum financial requirements, which are described in Liquidity and Capital Resources, include net worth, capital ratio and/or liquidity criteria in order to set a minimum level of capital needed to adequately absorb potential losses and a minimum amount of liquidity needed to service Agency mortgage loans and MBS and cover the associated financial obligations and risks.

In order to meet these minimum financial requirements, we are required to maintain cash and cash equivalents in amounts that may adversely affect our business, financial condition, liquidity and results of operations, and this could significantly impede us from growing our business and place us at a competitive disadvantage in relation to federally chartered banks and certain other financial institutions. To the extent that such minimum financial requirements are not met, the Agencies may suspend or terminate our Agency approvals or agreements, which could cause us to cross default under financing arrangements and/or have a material adverse effect on our business, financial condition liquidity and results of operations.

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We may be subject to certain banking regulations that may limit our business activities.

As of September 30, 2017, PNC Financial Services Group Inc. (“PNC”) owned approximately 22% of the outstanding voting common shares of BlackRock, Inc. Based on PNC’s interests in and relationships with BlackRock, Inc., BlackRock, Inc. is deemed to be a non-bank subsidiary of PNC. BlackRock, Inc. is an affiliate of BlackRock Mortgage Ventures, LLC, which is one of our largest equity holders. Due to these relationships, we are deemed to be a non-bank subsidiary of PNC, which is regulated as a financial holding company under the Bank Holding Company Act of 1956, as amended. As a non-bank subsidiary of PNC, we may be subject to certain banking regulations, including the supervision and regulation of the Board of Governors of the Federal Reserve System (the “Federal Reserve”). Such banking regulations could limit the activities and the types of businesses that we may conduct. The Federal Reserve has broad enforcement authority over financial holding companies and their subsidiaries. The Federal Reserve could exercise its power to restrict PNC from having a non-bank subsidiary that is engaged in any activity that, in the Federal Reserve’s opinion, is unauthorized or constitutes an unsafe or unsound business practice, and could exercise its power to restrict us from engaging in any such activity. The Federal Reserve may also impose substantial fines and other penalties for violations that we may commit. To the extent that we, as a non-bank mortgage lender, are subject to banking regulations, we could be at a competitive disadvantage because many of our non-bank competitors are not subject to these same regulations.

In addition, provisions of the Dodd-Frank Act referred to as the “Volcker Rule” prohibit or restrict a bank holding company and its affiliates from conducting certain transactions with certain investment funds, including hedge funds and private equity funds (collectively “covered funds”), when it has an ownership interest in, sponsors or advises a covered fund. The Volcker Rule prohibits proprietary trading as defined by such rule, unless the trading is permitted by an exemption, such as for risk-mitigating hedging purposes. The Volcker Rule applies to us by virtue of our affiliation with PNC through BlackRock. The Volcker Rule limits our ability to acquire or retain an ownership interest in, sponsor, advise or manage covered funds, and limits investments in certain covered funds by our employees, among other restrictions. If a fund, whether newly created or existing, becomes a covered fund, then certain transactions between us and the covered fund could be prohibited or restricted, or the fund may need to be restructured. These prohibitions, restrictions and limitations could disadvantage us against those competitors that are not subject to the Volcker Rule in the ability to manage covered funds and to retain employees. Our failure to comply with the requirements of the Volcker Rule may adversely affect our business, financial condition, liquidity and results of operations.

Unlike competitors that are federally chartered banks, we are subject to the licensing and operational requirements of states and other jurisdictions that result in substantial compliance costs, and our business would be adversely affected if we lose our licenses.

Because we are not a federally chartered depository institution, we do not benefit from exemptions to state mortgage lending, loan servicing or debt collection licensing and regulatory requirements. We must comply with state licensing requirements and varying compliance requirements in all 50 states, the District of Columbia, Guam and the U.S. Virgin Islands, and regulatory changes may increase our costs through stricter licensing laws, disclosure laws or increased fees or may impose conditions to licensing that we or our personnel are unable to meet.

In most states in which we operate, a regulatory agency or agencies regulate and enforce laws relating to mortgage servicers and mortgage originators. These rules and regulations generally provide for licensing as a mortgage servicer, mortgage originator, loan modification underwriter, or third party debt default specialist (or a combination thereof), requirements as to the form and content of employee compensation contracts and other documentation, licensing of our employees and those of independent contractors with whom we contract, and employee hiring background checks. They also set forth restrictions on advertising and collection practices and disclosure and record keeping requirements, and they establish a variety of borrowers' rights. Future state legislation and changes in existing regulation may significantly increase our compliance costs or reduce the amount of ancillary income we are entitled to collect from borrowers or otherwise. This could make our business cost prohibitive in the affected state or states and could materially affect our business.

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The failure of PennyMac Loan Services, LLC to avail itself of an appropriate exemption from registration as an investment company under the Investment Company Act could have a material and adverse effect on our business.

We intend to operate so that we and each of our subsidiaries are not required to register as investment companies under the Investment Company Act. We believe that our subsidiary, PennyMac Loan Services, LLC (“PLS”), qualifies for the exemption provided in Section 3(c)(6) because it has been, and is expected to continue to be, primarily engaged, directly or through majority-owned subsidiaries, in (1) the business of purchasing or otherwise acquiring mortgages or other liens on and interests in real estate (from which not less than 25 percent of its gross income during its last fiscal year was and will continue to be derived), together with (2) an additional business or businesses other than investing, reinvesting, owning, holding, or trading in securities, namely the business of servicing mortgages. Although we expect not less than twenty five percent (25%) of PLS’ gross income to be derived from originating, purchasing, or acquiring mortgages or liens on and interests in real estate, there can be no assurances that the composition of PLS’ gross income will remain the same over time.

To date, the SEC staff has provided limited guidance with respect to the applicability of Section 3(c)(6), and PLS has not sought a no-action letter from the SEC staff respecting its position. If PLS is ultimately unable to rely on the Section 3(c)(6) exemption due to a failure to meet the 25 percent of gross income test or to the extent that the SEC staff provides negative guidance regarding the applicability or scope of the exemption, we may be required to either (a) register as an investment company, or (b) substantially restructure our business, change our investment strategy and/or the manner in which we conduct our operations in order to qualify for another Investment Company Act exemption and avoid being required to register as an investment company, either of which could materially and adversely affect our business, financial condition, liquidity and results of operations.

In the case of a restructuring, PLS could temporarily rely on Rule 3a-2 for its exemption from registration. Rule 3a-2 provides a safe harbor exemption, not to exceed one year, for companies that have a bona fide intent to be engaged in an excepted activity but temporarily fail to meet the requirements for an exemption. In such case, PLS would likely be required to restructure its business by acquiring and/or disposing of assets in order to meet an exemption under Section 3(c)(5)(C), depending on the composition of its assets at the time. The SEC staff’s position on Section 3(c)(5)(C) generally requires that an issuer maintain at least 55% of its assets in mortgages and other liens on and interests in real estate (qualifying assets) and at least 80% of its assets in qualifying assets plus real estate-related assets. PLS would be more limited in its ability to hold MSRMs or would be required to acquire and hold more mortgage loans and real estate to adjust the composition of its assets to meet the 55% and 80% tests.

If PLS is required to register as an investment company, we would be required to comply with a variety of substantive requirements under the Investment Company Act that impose, among other things: limitations on capital structure; restrictions on specified investments; prohibitions on transactions with affiliates; compliance with reporting, record keeping, voting and proxy disclosure; and, other rules and regulations that would significantly increase our operating expenses. Further, if PLS was or is required to register as an investment company, PLS would be in breach of various representations and warranties contained in its credit and other agreements resulting in a default as to certain of our contracts and obligations. This could also subject us to civil or criminal actions or regulatory proceedings, or result in a court appointed receiver to take control of us and liquidate our business, any or all of which could have a material

adverse effect on our business, financial condition, liquidity and results of operations.

Liability relating to environmental matters may impact the value of properties that we may acquire or the properties underlying our investments.

Under various U.S. federal, state and local laws, an owner or operator of real property may become liable for the costs of removal of certain hazardous substances released on its property. These laws often impose liability without regard to whether the owner or operator was responsible for, or aware of, the release of such hazardous substances. The presence of hazardous substances may also adversely affect an owner's ability to sell real estate, borrow using real estate as collateral or make debt payments to us. In addition, if we take title to a property, the presence of hazardous substances may adversely affect our ability to sell the property, and we may become liable to a governmental entity or to third parties for various fines, damages or remediation costs. Any of these liabilities or events may materially and adversely affect the fair value of the relevant asset and/or our business, financial condition, liquidity and results of operations.

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Market Risks

Our mortgage banking revenues are highly dependent on macroeconomic and United States real estate market, mortgage market and financial market conditions.

The success of our business strategies and our results of operations are materially affected by current or future conditions in the real estate market, mortgage markets, financial markets and the economy generally. Factors such as inflation, deflation, unemployment, personal and business income taxes, healthcare, energy costs, geopolitical issues and the availability and cost of credit may contribute to increased volatility and unclear expectations for the economy in general and the real estate, mortgage market and financial markets in particular going forward. A destabilization of the real estate market, mortgage market and financial markets or deterioration in these markets also could reduce our loan production volume, reduce the profitability of servicing mortgages or adversely affect our ability to sell mortgage loans that we originate or acquire, either at a profit or at all. Any of the foregoing could materially and adversely affect our business, financial condition, liquidity and results of operations.

The industry in which we operate is highly competitive, and is likely to become more competitive, and decreased margins resulting from increased competition or our inability to compete successfully could adversely affect our business, financial condition, liquidity and results of operations.

We operate in a highly competitive industry that could become even more competitive as a result of economic, legislative, regulatory and technological changes. With respect to mortgage loan production, we face competition in such areas as mortgage loan offerings, rates, fees and customer service. With respect to servicing, we face competition in areas such as fees, cost to service and service levels, including our performance in reducing delinquencies and entering into successful modifications.

Large commercial banks and savings institutions and other non-bank mortgage originators and servicers are becoming increasingly competitive in the origination or acquisition of newly originated mortgage loans and the servicing of mortgage loans. Many of these institutions have significantly greater resources and access to capital than we do, which may give them the benefit of a lower cost of funds. Additionally, our existing and potential competitors may decide to modify their business models to compete more directly with our loan production and servicing models. For example, other non-bank loan servicers may try to leverage their servicing relationships and expertise to develop or expand a loan origination business. Since the withdrawal or decreased participation of a number of large participants from these markets following the financial crisis in 2008, there has been a steady increase in the number of non-bank participants. As more non-bank entities enter these markets and as more commercial banks aggressively compete, our mortgage banking businesses may generate lower volumes and/or margins.

In addition, technological advances and heightened e-commerce activities have increased consumers' access to products and services. This has intensified competition among banks and non-banks in offering and servicing mortgage loans. We may be unable to compete successfully in our mortgage banking businesses and this could materially and adversely affect our business, financial condition, liquidity and results of operations.

We may not be able to effectively manage significant increases or decreases in our loan production volume, which could negatively affect our business, financial condition, liquidity and results of operations.

Our loan production segment consists of our consumer direct lending activities, in which we originate mortgage loans directly with borrowers through telephone call centers or the Internet, and our correspondent production activities, in which we facilitate the acquisition by PMT from correspondent sellers of newly originated mortgage loans that have been underwritten to our standards and, in the case of government loans, acquire such loans from PMT.

Our correspondent production activities are relationship driven. As of December 31, 2017, we worked with 613 approved mortgage lenders, but these lenders are not contractually obligated to do business with us or PMT, and our competitors also have relationships with these lenders and actively compete against us in our efforts to expand PMT's network of approved mortgage lenders. To date, we have grown our loan production volumes with mortgage lenders on the basis of our product offerings, technical knowledge, manufacturing quality, speed of execution, interest rates and

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fees. If we are not able to consistently maintain these qualities of execution, our reputation and existing relationships with mortgage lenders could be damaged. We may not be able to maintain PMT's existing relationships or develop new relationships with mortgage lenders or our new mortgage products may not gain widespread acceptance.

Our current volume of consumer direct lending originations, which is based in large part on the refinancing of existing mortgage loans that we service, is highly dependent on interest rates and may decline if interest rates increase. Our non-servicing portfolio consumer direct lending platform may not succeed because of the referral driven nature of our industry. For example, the origination of purchase money mortgage loans is greatly influenced by traditional business clients in the home buying process such as real estate agents and builders. As a result, our ability to secure relationships with such traditional business clients will influence our ability to grow our purchase money mortgage loan volume and, thus, our consumer direct lending business. We may not be successful in establishing such relationships. In addition, to grow our consumer direct lending business, we will need to convert leads regarding prospective borrowers into funded loans, the success of which depends on the pricing we offer relative to the pricing of our competitors and our operational ability to process, underwrite and close loans. Institutions that compete with us in this regard may have significantly greater access to capital or other resources than we do, which may give them the benefit of a lower cost of operations.

On the other hand, we may experience significant growth in our correspondent production and consumer direct lending loan volumes. If we do not effectively manage our growth, the quality of our correspondent production and consumer direct lending operations could suffer, which could negatively affect our brand and operating results. Our correspondent production and consumer direct lending operations are also subject to overall market factors that can impact our ability to grow our loan production volume. For example, increased competition from new and existing market participants, reductions in the overall level of refinancing activity or slow growth in the level of new home purchase activity can impact our ability to continue to grow our loan production volumes, and we may be forced to accept lower margins in our respective businesses in order to continue to compete and keep our volume of activity consistent with past or projected levels. We believe that changes in supply and demand within the marketplace have been driving lower margins in recent periods, which is reflected in our results of operations and in our gains on mortgage loans held for sale. If we are unable to grow our loan production volumes or if our margins become compressed, then our business, financial condition, liquidity and results of operations could be materially and adversely affected.

We may be unable to maintain sufficient capital and liquidity to meet the financing requirements of our business.

We will require new and continued debt financing to facilitate our anticipated growth. Accordingly, our ability to finance our operations and repay maturing obligations rests in large part on our ability to borrow money. We are generally required to renew our financing arrangements each year, which exposes us to refinancing and interest rate risks. Our ability to refinance existing debt and borrow additional funds is affected by a variety of factors beyond our control including:

- limitations imposed on us under our financing agreements that contain restrictive covenants and borrowing conditions, which may limit our ability to raise additional debt;

- restrictions imposed upon us by regulatory agencies that mandate certain minimum capital and liquidity requirements;

- liquidity in the credit markets;

- prevailing interest rates;

- the strength of the lenders from which we borrow, and the regulatory environment in which they operate, including proposed capital strengthening requirements;

- limitations on borrowings on credit facilities imposed by the amount of eligible collateral pledged, which may be less than the borrowing capacity of the credit facility; and

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- accounting changes that may impact calculations of covenants in our debt agreements.

No assurance can be given that any refinancing or additional financing will be possible when needed, that we will be able to negotiate acceptable terms or that market conditions will be favorable at the times that we require such refinancing or additional financing. If we are unable to obtain sufficient capital to meet the financing requirements of our business, financial condition, liquidity and results of operations would be materially and adversely affected.

We are also dependent on a limited number of banking institutions that extend us credit on terms that we have determined to be commercially reasonable. These banking institutions are subject to their own regulatory supervision, liquidity and capital requirements, risk management frameworks, profitability and risk thresholds and tolerances, any of which may change materially and negatively impact their business strategies, including their extension of credit to us specifically or mortgage lenders and servicers generally. Certain banking institutions have already exited, and others may in the future decide to exit, the mortgage business. Such actions may increase our cost of capital and limit or otherwise eliminate our access to capital, in which case our business, financial condition, liquidity and results of operations would be materially and adversely affected.

We leverage our assets under credit and other financing agreements and utilize various other sources of borrowings, which exposes us to significant risk and may materially and adversely affect our business, financial condition, liquidity and results of operations.

We currently leverage and, to the extent available, we intend to continue to leverage the mortgage loans produced through our consumer direct lending business and the government insured loans acquired through our correspondent production operations from PMT with borrowings under repurchase agreements. When we enter into repurchase agreements, we sell mortgage loans to lenders, which are the repurchase agreement counterparties, and receive cash from the lenders. The lenders are obligated to resell the same assets back to us at the end of the term of the transaction. Because the cash that we receive from a lender when we initially sell the assets to that lender is less than the fair value of those assets (this difference is referred to as the haircut), if the lender defaults on its obligation to resell the same assets back to us we could incur a loss on the transaction equal to the amount of the haircut (assuming that there was no change in the fair value of the assets). In addition, repurchase agreements generally allow the counterparties, to varying degrees, to determine a new fair value of the collateral to reflect current market conditions. If a counterparty lender determines that the fair value of the collateral has decreased, it may initiate a margin call and require us to either post additional collateral to cover such decrease or repay a portion of the outstanding borrowing. Should this occur, in order to obtain cash to satisfy a margin call, we may be required to liquidate assets at a disadvantageous time, which could cause us to incur further losses. If we are unable to satisfy a margin call, our counterparty may sell the collateral, which may result in significant losses to us.

In addition, we invest in certain assets, including MSR, for which financing has historically been difficult to obtain. We currently leverage certain of our MSR under secured financing arrangements. Our Fannie Mae and Freddie Mac MSR are pledged to secure borrowings under a loan and security agreement, while our Ginnie Mae MSR and related ESS are pledged to a special purpose entity, which issues variable funding notes and term notes that are secured by

such Ginnie Mae assets and repaid through the cash flows received by the special purpose entity as the lender under a repurchase agreement with PLS. In each case, similar to our repurchase agreements, the cash that we receive under these secured financing arrangements is less than the fair value of the assets and a decrease in the fair value of the pledged collateral can result in a margin call. Should a margin call occur, we may be required to liquidate assets at a disadvantageous time, which could cause us to incur further losses. If we are unable to satisfy a margin call, the secured parties may sell the collateral, which may result in significant losses to us.

Each of the secured financing arrangements pursuant to which we finance MSRs and ESS is further subject to the terms of an acknowledgement agreement with Fannie Mae, Freddie Mac or Ginnie Mae, as applicable, pursuant to which our and the secured parties' rights are subordinate in all respects to the rights of the applicable Agency. Accordingly, the exercise by any of Fannie Mae, Freddie Mac or Ginnie Mae of its rights under the applicable acknowledgment agreement could result in the extinguishment of our and the secured parties' rights in the related collateral and result in significant losses to us.

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We leverage certain of our other assets under a capital lease and a revolving credit agreement and may in the future utilize other sources of borrowings, including term loans, bank credit facilities and structured financing arrangements, among others. The amount of leverage we employ varies depending on the asset class being financed, our available capital, our ability to obtain and access financing arrangements with lenders and the lenders' and rating agencies' estimate of, among other things, the stability of our cash flows. We cannot assure you that we will have access to any debt or equity capital on favorable terms or at the desired times, or at all. Our inability to raise such capital or obtain financing on favorable terms could materially and adversely impact our business, financial condition, liquidity and results of operations.

Our credit and financing agreements contain financial and restrictive covenants that could adversely affect our business, financial condition, liquidity and results of operations.

Although our governing documents contain no limitation on the amount of debt we may incur, the lenders under our credit and financing agreements require us and/or our subsidiaries to comply with various financial covenants, including those relating to tangible net worth, profitability and our ratio of total liabilities to tangible net worth. Incurring substantial debt subjects us to the risk that our cash flows from operations may be insufficient to repurchase the assets that we have sold to the lenders under our repurchase agreements or otherwise service the debt incurred under our other credit and financing agreements. Our lenders also require us to maintain minimum amounts of cash or cash equivalents sufficient to maintain a specified liquidity position. If we are unable to maintain these liquidity levels, we could be forced to sell additional assets at a loss and our financial condition could deteriorate rapidly.

Our existing credit and financing agreements also impose other financial and non financial covenants and restrictions on us that impact our flexibility to determine our operating policies and investment strategies by limiting our ability to incur certain types of indebtedness; grant liens; engage in consolidations, mergers and asset sales, make restricted payments and investments; enter into transactions with affiliates; and amend, modify or prepay certain indebtedness. In our credit and financing agreements, we agree to certain covenants and restrictions and we make representations about the assets sold or pledged under these agreements. We also agree to certain events of default (subject to certain materiality thresholds and grace periods), including payment defaults, breaches of financial and other covenants and/or certain representations and warranties, cross-defaults, servicer termination events, ratings downgrades, guarantor defaults, bankruptcy or insolvency proceedings and other events of default and remedies customary for these types of agreements. If we default on our obligations under a credit or financing agreement, fail to comply with certain covenants and restrictions or breach our representations and are unable to cure, the lender may be able to terminate the transaction or its commitments, accelerate any amounts outstanding, require us to post additional collateral or repurchase the assets, and/or cease entering into any other credit transactions with us.

Because our credit and financing agreements typically contain cross default provisions, a default that occurs under any one agreement could allow the lenders under our other agreements to also declare a default, thereby exposing us to a variety of lender remedies, such as those described above, and potential losses arising therefrom. Any losses that we incur on our credit and financing agreements could materially and adversely affect our business, financial condition, liquidity and results of operations.

Our earnings may decrease because of changes in prevailing interest rates.

Our profitability is directly affected by changes in prevailing interest rates. The following are the material risks we face related to increases in prevailing interest rates:

- an increase in prevailing interest rates could adversely affect our loan production volume because refinancing an existing loan would be less attractive for homeowners and qualifying for a loan may be more difficult for consumers;
- an increase in prevailing interest rates could adversely affect our Ginnie Mae early buyout program because loan modifications would become less economically feasible;

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- an increase in prevailing interest rates would increase the cost of servicing our outstanding debt, including debt related to servicing assets and loan production; and
- an increase in prevailing interest rates could increase payments for servicing customers with adjustable rate mortgages and generate an increase in delinquency, default and foreclosure rates, resulting in an increase in our loan servicing expenses.

The following are the material risks we face related to decreases in prevailing interest rates:

- a decrease in prevailing interest rates may cause more borrowers to refinance existing loans that we service or may cause the expected volume of refinancing to increase, which would require us to record decreases in fair value and a higher level of amortization, impairment or both on our MSRs; and
- a decrease in prevailing interest rates could reduce our earnings from our custodial deposit accounts.

An event of default, a negative ratings action by a rating agency, the perception of financial weakness, an adverse action by a regulatory authority, a lengthening of foreclosure timelines or a general deterioration in the economy that constricts the availability of credit may increase our cost of funds and make it difficult for us to refinance existing debt and borrow additional funds. In addition, we may not be able to adjust our operational capacity in a timely fashion, or at all, in response to increases or decreases in mortgage production volume resulting from changes in prevailing interest rates.

Any of the increases or decreases discussed above could have a material adverse effect on our business, financial condition, liquidity and results of operations.

Hedging against interest rate exposure may materially and adversely affect our results of operations and cash flows.

We pursue hedging strategies to reduce our exposure to adverse changes in interest rates. Our hedging activity will vary in scope based on the risks hedged, the level of interest rates, the type of investments held, and other changing market conditions. Hedging instruments involve risk because they often are not traded on regulated exchanges, guaranteed by an exchange or its clearing house, or regulated by any U.S. or foreign governmental authorities, and our interest rate hedging may fail to protect or could adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;

- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedge may not match the duration of the related liability or asset;
- the credit quality of the hedging counterparty owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the hedging counterparty owing the money in the hedging transaction may default on its obligation to pay.

In addition, we may fail to recalculate, re-adjust and execute hedges in an efficient manner. Any hedging activity, which is intended to limit losses, may materially and adversely affect our results of operations and cash flows. Therefore, while we may enter into such transactions seeking to reduce interest rate risk, unanticipated changes in interest rates may result in worse overall investment performance than if we had not engaged in any such hedging transactions. A liquid secondary market may not exist for a hedging instrument purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in significant losses. In addition, the degree of correlation between price movements of the instruments used in hedging strategies and price movements in the portfolio positions or liabilities being hedged may vary materially. Moreover, for a variety of reasons, we may not establish an effective correlation between such hedging instruments and the portfolio positions or liabilities being

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hedged. Any such ineffective correlation may prevent us from achieving the intended hedge and expose us to risk of loss. Numerous regulations currently apply to hedging and any new regulations or changes in existing regulations may significantly increase our administrative or compliance costs. Our derivative agreements generally provide for the daily mark to market of our hedge exposures. If a hedge counterparty determines that its exposure to us exceeds its exposure threshold, it may initiate a margin call and require us to post collateral. If we are unable to satisfy a margin call, we would be in default of our agreement, which could have a material adverse effect on our business, financial condition, liquidity and results of operations.

We use estimates in determining the fair value of our MSR's, which are highly volatile assets with continually changing values. If our estimates of their value prove to be inaccurate, we may be required to write down the fair values of the MSR's which could adversely affect our business, financial condition, liquidity and results of operations.

The fair value of our MSR's is based on the cash flows projected to result from the servicing of the related mortgage loans and continually fluctuates due to a number of factors. These factors include prepayment speeds, changes in interest rates and other market conditions, which affect the number of loans that are repaid or refinanced and thus no longer result in cash flows, and the number of loans that become delinquent.

We use internal financial models that utilize our understanding of inputs and assumptions used by market participants to value our MSR's for purposes of financial reporting and for purposes of determining the price that we pay for portfolios of MSR's and to acquire loans for which we will retain MSR's. These models are complex and use asset specific collateral data and market inputs for interest and discount rates. In addition, the modeling requirements of MSR's are complex because of the high number of variables that drive cash flows associated with MSR's. Even if the general accuracy of our valuation models is validated, valuations are highly dependent upon the reasonableness of our inputs and the results of the models.

If loan delinquencies or prepayment speeds are different than anticipated or other factors perform differently than modeled, the recorded value of certain of our MSR's may change. Significant differences in performance could increase the chance that we do not adequately estimate the impact of these factors on our valuations which could result in misstatements of our financial results, restatements of our financial statements, or otherwise materially and adversely affect our business, financial condition, liquidity and results of operations.

The geographic concentration of our servicing portfolio may decrease the fair value of our MSR's and adversely affect our consumer direct business, which would adversely affect our business, financial condition, liquidity and results of operations.

As of December 31, 2017, approximately 19% of the aggregate outstanding loan balance in our servicing portfolio was secured by properties located in California. To the extent that California or other states in which we have greater

concentrations of business in the future experience weaker economic conditions or greater rates of decline in real estate values than the United States generally, such concentration may disproportionately decrease the fair value of our MSRs and adversely affect our consumer direct lending business. The impact of property value declines may increase in magnitude and it may continue for a long period of time. Additionally, if states in which we have greater concentrations of business were to change their licensing or other regulatory requirements to make our business cost prohibitive, we may be required to stop doing business in those states or may be subject to a higher cost of doing business in those states, which could have a material adverse effect on our business, financial condition, liquidity and results of operations.

Increases in delinquencies and defaults may adversely affect our business, financial condition, liquidity and results of operations.

A decrease in home prices may result in higher loan to value ratios (“LTVs”), lower recoveries in foreclosure and an increase in loss severities above those that would have been realized had property values remained the same or continued to increase. Some borrowers do not have sufficient equity in their homes to permit them to refinance their existing loans, which may reduce the volume or growth of our loan production business. This may also provide borrowers with an incentive to default on their mortgage loans even if they have the ability to make principal and interest payments. Further, despite recent increases, interest rates have remained near historical lows for an extended period of

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time. Borrowers with adjustable rate mortgage loans must make larger monthly payments when the interest rates on those mortgage loans adjust upward from their initial fixed rates or low introductory rates to the rates computed in accordance with the applicable index and margin. Increases in monthly payments may increase the delinquencies, defaults and foreclosures on a significant number of the loans that we service.

Increased mortgage delinquencies, defaults and foreclosures may result in lower revenue for loans that we service for the Agencies because we only collect servicing fees from the Agencies for performing loans, and our failure to service delinquent and defaulted loans in accordance with the applicable servicing guidelines could result in our failure to benefit from available monetary incentives and/or expose us to monetary penalties and curtailments. Additionally, while increased delinquencies generate higher ancillary fees, including late fees, these fees are not likely to be recoverable in the event that the related loan is liquidated. In addition, an increase in delinquencies lowers the interest income that we receive on cash held in collection and other accounts because there is less cash in those accounts. Also, increased mortgage defaults may ultimately reduce the number of mortgages that we service.

Increased mortgage delinquencies, defaults and foreclosures will also result in a higher cost to service those loans due to the increased time and effort required to collect payments from delinquent borrowers and to acquire and liquidate the properties securing the loans or otherwise resolve loan defaults if payment collection is unsuccessful, and only a portion of these increased costs are recoverable under our servicing agreements. Increased mortgage delinquencies, defaults and foreclosures may also result in an increase in our interest expense and affect our liquidity as a result of borrowing under our credit facilities to fund an increase in the advances we are obligated to make to fulfill our obligations to MBS holders and to protect our investors' interests in the properties securing the delinquent mortgage loans.

A disruption in the MBS market could materially and adversely affect our business, financial condition, liquidity and results of operations.

Most of the loans that we produce are pooled into MBS issued by Fannie Mae or Freddie Mac or guaranteed by Ginnie Mae. Disruptions in the general MBS market have occurred in the past. Any significant disruption or period of illiquidity in the general MBS market would directly affect our own liquidity and the liquidity of PMT because no existing alternative secondary market would likely be willing and able to accommodate on a timely basis the volume of loans that we typically sell in any given period. Furthermore, we would remain contractually obligated to fund loans under our outstanding IRLCs without being able to sell our existing inventory of mortgage loans. Accordingly, if the MBS market experiences a period of illiquidity, we might be prevented from selling the loans that we produce into the secondary market in a timely manner or at favorable prices and we would be required to hold a larger inventory of loans than we have committed facilities to fund or we may be required to repay a portion of the debt secured by these assets, which could have a material adverse effect on our business, financial condition, liquidity and results of operations.

Our originations of multifamily mortgage loans are dependent upon the success of the multifamily real estate market and may be affected by substantial competition in the market and other conditions that could materially and adversely affect our business and results of operations.

The multifamily real estate market is highly competitive. We originate loans and acquire real estate assets secured by multifamily properties. The profitability of these business activities will be closely tied to the overall success of and competition in the multifamily real estate market. Various changes in real estate conditions may impact the multifamily real estate sector. Any negative trends in such real estate conditions may reduce demand for our products and services and, as a result, adversely affect our results of operations. These conditions include:

- increased competition in the multifamily real estate sector based on considerations such as the attractiveness, location, rental rates, amenities and safety record of various properties;
- our ability to effectively compete in the multifamily real estate market;
- oversupply of, or a reduction in demand for, multifamily housing properties;

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- a favorable single-family real estate or interest rate environment that may result in a significant number of potential residents of multifamily properties deciding to purchase homes instead of renting;
- rent control or stabilization laws, or other laws regulating multifamily housing, which could affect the profitability of multifamily developments;
- the inability of residents or tenants to pay rent; and
- increased operating costs, including increased real property taxes, maintenance, insurance and utilities costs.

Moreover, other factors may adversely affect the multifamily real estate market, including changes in government regulations and other laws, rules and regulations governing real estate, zoning or taxes, changes in interest rate levels, the potential liability under environmental and other laws, delinquency, foreclosure and other unforeseen events. Any or all of these factors could negatively impact the multifamily real estate market and, as a result, reduce the demand for our products and services. Any such reduction could adversely affect us.

Related Party Risks

We rely on PMT as a significant source of financing for, and revenue related to, our mortgage banking business, and the termination of, or material adverse change in, the terms of this relationship, or a material adverse change to PMT or its operations, would adversely affect our business, financial condition, liquidity and results of operations.

PMT is the counterparty that currently acquires all of the newly originated mortgage loans in connection with our correspondent production operations. A significant portion of our income is derived from a fulfillment fee earned in connection with PMT's acquisition of conventional loans. We are able to conduct our correspondent production operations without having to incur the significant additional debt financing that would be required for us to purchase those loans from the originating lender. In the case of government insured loans, we purchase them from PMT at PMT's cost plus a sourcing fee and fulfill them for our own account and sell the loans, typically by pooling the federally insured or guaranteed loans together into an MBS which Ginnie Mae guarantees. We earn interest income and gains or losses during the holding period and upon the sale of these securities, and we retain the MSR with respect to the loans. If this relationship with PMT is terminated by PMT or PMT reduces the volume of these loans that it acquires for any reason, we would have to acquire these loans from the correspondent sellers for our own account, something that we may be unable to do, or enter into another similar counterparty arrangement with a third party, which we may not be able to enter into on terms that are as favorable to us, or at all.

We are also dependent upon PMT as a source of capital in connection with our ability to originate and service multifamily loans. Through one of its subsidiaries, PMT is an approved multifamily seller/servicer for Fannie Mae,

and we rely upon PMT to purchase the multifamily loans that we originate in accordance with Fannie Mae guidelines and deliver such loans to Fannie Mae under this approval. If this relationship with PMT is terminated by PMT or Fannie Mae no longer permits PMT to sell multifamily loans it acquires from us, it would require us to obtain additional debt financing, and there is no assurance that we would be able to sell such loans to another Agency or third party investor on favorable terms, or at all. Accordingly, a change in this relationship by and among PMT, Fannie Mae and us could have a material and adverse effect on our multifamily loan business.

The management agreement, the mortgage banking services agreement and certain of the other agreements that we have entered into with PMT contain cross termination provisions that allow PMT to terminate one or more of those agreements under certain circumstances where another one of such agreements is terminated. Accordingly, the termination of this relationship with PMT, or a material change in the terms thereof that is adverse to us, would likely have a material adverse effect our business, financial condition, liquidity and results of operations. The terms of these agreements extend until September 12, 2020, subject to automatic renewal for additional 18-month periods, but any of the agreements may be terminated earlier under certain circumstances or otherwise non-renewed. If any agreement is terminated or non-renewed and not replaced by a new agreement, it would materially and adversely affect our ability to continue to execute our business plan.

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We expect that PMT will continue to qualify as a REIT for U.S. federal income tax purposes. However, it is possible that PMT may not meet the requirements for qualification as a REIT. If PMT were to lose its REIT status, corporate-level income taxes, including alternative minimum taxes, would apply to all of PMT's taxable income at federal and state tax rates. Either of these scenarios would potentially impair PMT's financial position and its ability to raise capital, which could have a material adverse effect on our business, financial condition, liquidity and results of operations. In addition, while the effect of the recently passed Tax Act is uncertain at this time, it may decrease the attractiveness of a REIT investment relative to investments in other securities.

A significant portion of our loan servicing operations are conducted pursuant to subservicing contracts with PMT, and any termination by PMT of these contracts, or a material change in the terms thereof that is adverse to us, would adversely affect our business, financial condition, liquidity and results of operations.

PMT, as the owner of a substantial number of all of the MSR or mortgage loans that we subservice, may, under certain circumstances, terminate our subservicing contract with or without cause, in some instances with little notice and little to no compensation. Upon any such termination, it would be difficult to replace such a large volume of subservicing in a short period of time, or perhaps at all. Accordingly, we may not generate as much revenue from subservicing for other third parties. If we were to have our subservicing terminated by PMT, or if there was a change in the terms under which we perform subservicing for PMT that was material and adverse to us, this would have a material adverse effect on our business, financial condition, liquidity and results of operations.

PMT has an exclusive right to acquire the loans that are produced through our correspondent production operations, which may limit the revenues that we could otherwise earn in respect of those loans.

Our mortgage banking services agreement with PMT requires PLS to provide fulfillment services for correspondent production activities exclusively to PMT as long as PMT has the legal and financial capacity to purchase correspondent loans. As a result, unless PMT sells some of these loans back to us, the revenue that we earn with respect to these loans will be limited to the fulfillment fees that we earn in connection with the production of these loans, which may be less than the revenues that we might otherwise be able to realize by acquiring these loans ourselves and selling them in the secondary loan market.

Our financings of MSRs using excess servicing spread exposes us to significant risks.

We sell to PMT or its subsidiaries, from time to time, the right to receive certain ESS arising from MSRs that we own or acquire. The ESS represents the difference between our contractual servicing fee with the applicable Agency and the base servicing fee that we retain as compensation for servicing the related mortgage loans upon our sale of the ESS.

As a condition of our sale of the ESS, PMT is required to subordinate its interests in the ESS to those of the applicable Agency. With respect to our Ginnie Mae MSR, we pledged our interest in such MSR and PMT's interest in the related ESS to a special purpose entity, which issues variable funding notes and term notes that are secured by such Ginnie Mae assets and repaid through the cash flows received by the special purpose entity as the lender under a repurchase agreement with PLS. Accordingly, our interest in the Ginnie Mae MSR and PMT's interest in the related ESS are also subordinated to the rights of an indenture trustee on behalf of the note holders to which the special purpose entity issues its variable funding notes and term notes under an indenture, pursuant to which the indenture trustee has a blanket lien on all of our Ginnie Mae MSR (including the ESS we sell to PMT and record as a financing).

The indenture trustee, on behalf of the note holders, may liquidate our Ginnie Mae MSR along with PMT's interest in the ESS to the extent there exists an event of default under the indenture, the result of which could have a material adverse effect on our business, financial condition, liquidity and results of operations. In the event PMT's ESS is liquidated as a result of certain of our actions or inactions, we generally would be required to indemnify PMT under the applicable spread acquisition agreement. A claim by PMT for the loss of its ESS as a result of our actions or inactions would likely be significant in size and could also have a material adverse effect on our business, financial condition, liquidity and results of operations.

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In connection with PLS' repurchase agreement with the special purpose entity, we also provide pass through financing to PMT under a repurchase agreement to facilitate its financing of the ESS it acquires from us. The repurchase agreement subjects us to the credit risk of PMT. To the extent PMT defaults in its payments of principal and interest under its repurchase agreement with us, we would still be required to make the allocable and corresponding payments under our repurchase agreement with the special purpose entity. To the extent PMT fails to make such payments of principal and interest to us or otherwise defaults under its repurchase agreement and we are unable to make the allocable and corresponding payments under our repurchase agreement with the special purpose entity, this could also create an event of default that could cause a cross default under other financing arrangements and/or have a material adverse effect on our business, financial condition, liquidity and results of operations.

Other Risks

We may be required to indemnify the purchasers of loans that we originate, acquire or assist in the fulfillment of, or repurchase those loans, if those loans fail to meet certain criteria or characteristics or under other circumstances.

Our contracts with purchasers of newly originated loans that we fund through our consumer direct lending business or acquire from PMT through our correspondent production activities contain provisions that require us to indemnify the purchaser of the related loans or repurchase such loans under certain circumstances. We believe that, as a result of the current market environment, many purchasers of mortgage loans, including the Agencies, are particularly aware of the conditions under which loan originators or sellers must indemnify them against losses related to purchased loans, or repurchase such loans, and would benefit from enforcing any indemnity or repurchase remedies they may have. Our loan sale agreements with purchasers, including the Agencies, contain provisions that generally require us to indemnify or repurchase these loans if:

- our representations and warranties concerning loan quality and loan characteristics are inaccurate; or
- the loans fail to comply with the respective Agency's underwriting or regulatory requirements.

Repurchased loans typically can only be financed at a steep discount to their repurchase price, if at all. They are also typically valued and, therefore, can generally only be sold at a significant discount to the underlying UPBs. In certain cases involving mortgage lenders from whom loans were acquired through our correspondent production activities, we may have contractual rights to either recover some or all of our indemnification losses or otherwise demand repurchase of these loans. Depending on the volume of repurchase and indemnification requests, some of these mortgage lenders may not be able to financially fulfill their obligation to indemnify us or repurchase the affected loans. If a material amount of recovery cannot be obtained from these mortgage lenders, our business, financial condition, liquidity and results of operations could be materially and adversely affected.

Although our indemnification and repurchase exposure cannot be quantified with certainty, to recognize these potential indemnification and repurchase losses, we have recorded a liability of \$20.1 million as of December 31, 2017. Because of the increase in our loan production over time, we expect that indemnification and repurchase requests are also likely to increase. Should home values decrease and negatively impact the related loan values, our realized loan losses from indemnifications and repurchases may increase as well. As such, our indemnification and repurchase costs may increase well beyond our current expectations. In addition, our mortgage banking services agreement with PMT requires us to indemnify it with respect to loans for which we provide fulfillment services in certain instances. If we are required to indemnify PMT, or other purchasers against loans, or repurchase loans, that result in losses that exceed the recorded liability, this could have a material adverse effect on our business, financial condition, liquidity and results of operations.

We depend on the accuracy and completeness of information about borrowers and counterparties and any misrepresented information could adversely affect our business, financial condition, liquidity and results of operations.

In deciding whether to approve loans or to enter into other transactions with borrowers and counterparties in our consumer direct lending and correspondent production operations, we may rely on information furnished to us by or on

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behalf of borrowers and counterparties, including financial statements and other financial information. We also may rely on representations of borrowers and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. If any of this information is intentionally or negligently misrepresented and such misrepresentation is not detected prior to loan funding, the fair value of the loan may be significantly lower than expected. Whether a misrepresentation is made by the loan applicant, another third party or one of our employees, we generally bear the risk of loss associated with the misrepresentation. Our controls and processes may not have detected or may not detect all misrepresented information in our loan originations or acquisitions. Any such misrepresented information could have a material adverse effect on our business, financial condition, liquidity and results of operations.

Our prime servicing portfolio, which consists primarily of recently originated loans, has a limited performance history, which makes our future results of operations more difficult to predict.

The likelihood of mortgage delinquencies and defaults, and the associated risks to our business, including higher costs to service such loans and a greater risk that we may incur losses due to repurchase or indemnification demands, change as loans season. Newly originated loans typically exhibit low delinquency and default rates as the changes in economic conditions, individual financial circumstances and other factors that drive borrower delinquency often do not appear for months or years. Highly seasoned loan portfolios, in which borrowers have demonstrated years of performance on their mortgage payments, also tend to exhibit low delinquency and default rates. Most of the loans in our prime servicing portfolio were originated in the years 2014 through 2017. As a result, we expect the delinquency rate and defaults in the prime servicing portfolio to increase in future periods as the portfolio seasons, but we cannot predict the magnitude of this impact on our results of operations.

Our counterparties may terminate our MSR's, which could adversely affect our business, financial condition, liquidity and results of operations.

As is standard in the industry, under the terms of our master servicing agreements with the Agencies in respect of Agency MSR's that we retain in connection with our loan production, the Agencies have the right to terminate us as servicer of the loans we service on their behalf at any time (and, in certain instances, without the payment of any termination fee) and also have the right to cause us to sell the MSR's to a third party. In addition, our failure to comply with applicable servicing guidelines could result in our termination under such master servicing agreements by the Agencies with little or no notice and without any compensation. The owners of other non-Agency loans that we service may also terminate certain of our MSR's if we fail to comply with applicable servicing guidelines. If the MSR's are terminated on a material portion of our servicing portfolio, our business, financial condition, liquidity and results of operations could be adversely affected.

We are required to make servicing advances that can be subject to delays in recovery or may not be recoverable in certain circumstances, which could adversely affect our business, financial condition, liquidity and results of operations.

During any period in which a borrower is not making payments, we are required under most of our servicing agreements in respect of our MSR's to advance our own funds to pay property taxes and insurance premiums, legal expenses and other protective advances. We also advance funds under these agreements to maintain, repair and market real estate properties on behalf of investors. As home values change, we may have to reconsider certain of the assumptions underlying our decisions to make advances and, in certain situations, our contractual obligations may require us to make advances for which we may not be reimbursed. In addition, if a mortgage loan serviced by us is in default or becomes delinquent, the repayment to us of the advance may be delayed until the mortgage loan is repaid or refinanced or a liquidation occurs. A delay in our ability to collect advances may adversely affect our liquidity, and our inability to be reimbursed for advances could have a material adverse effect on our business, financial condition, liquidity and results of operations.

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We may not realize all of the anticipated benefits of potential future acquisitions of MSR, which could adversely affect our business, financial condition, liquidity and results of operations.

Our ability to realize the anticipated benefits of potential future acquisitions of servicing portfolios will depend, in part, on our ability to appropriately service any such assets. The process of acquiring these assets may disrupt our business and may not result in the full benefits expected. The risks associated with these acquisitions include, among others, unanticipated issues in integrating information regarding the new loans to be serviced into our information technology systems, and the diversion of management's attention from other ongoing business concerns. We have also seen increased scrutiny by the Agencies and regulators with respect to large servicing acquisitions, the effect of which could reduce the willingness of selling institutions to pursue MSR sales and/or impede our ability to complete MSR acquisitions. Moreover, if we inappropriately value the assets that we acquire or the fair value of the assets that we acquire declines after we acquire them, the resulting charges may negatively affect both the carrying value of the assets on our balance sheet and our earnings. Furthermore, if we incur additional indebtedness to finance an acquisition, the acquired servicing portfolio may not be able to generate sufficient cash flows to service that additional indebtedness. Unsuitable or unsuccessful acquisitions could have a material adverse effect on our business, financial condition, liquidity and results of operations.

Risks Related to our Investment Management Segment

The investment management industry is intensely competitive.

The investment management industry is intensely competitive, with competition based on a variety of factors, including investment performance, management fee rates, reputation, and the continuity of the management team, client relationships and buying and selling arrangements with intermediaries. A number of factors, including the following, serve to increase our competitive risks:

- a number of our competitors have greater financial, technical, marketing and other resources, more comprehensive name recognition and more personnel than we do;
- potential competitors have a relatively low cost of entering the investment management industry;
- some investors may prefer to invest with a manager that is not publicly traded based on the perception that a publicly traded investment manager may focus on the manager's own growth to the detriment of asset performance for clients;
-

other industry participants, hedge funds and alternative investment managers may seek to recruit our investment professionals; and

- some competitors charge lower fees for their investment services than we do.

If we are unable to compete effectively, our business, financial condition, liquidity and results of operations may be materially and adversely affected.

Market conditions could reduce the fair value of the assets that we manage, which would reduce our management and incentive fees.

A significant portion of the fees that we earn under our investment management agreements with clients are based on the fair value of the assets that we manage. The fair values of the securities and other assets held in the portfolios that we manage and, therefore, our assets under management may decline due to any number of factors beyond our control, including, among others, a decline in housing, changes to interest rates, stock or bond market movements a general economic downturn, political uncertainty or acts of terrorism. The economic outlook cannot be predicted with certainty and we continue to operate in a challenging business environment. If volatile market conditions cause a decline in the fair value of our assets under management, that decline in fair value could materially reduce our management fees and incentive fees under our management contracts with our Advised Entities and adversely affect our

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revenues. If our revenues decline without a commensurate reduction in our expenses, our net income will be reduced and our business, financial condition, liquidity and results of operations could be materially and adversely affected.

We currently manage assets primarily for a single client, the loss of which could significantly reduce our management and incentive fees and have a material adverse effect on our results of operations.

Substantially all of our management and incentive fees result from our management of PMT. The term of the management agreement that we have entered into with PMT, 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 agreement. In the event of a termination of one or more related party agreements by PMT in certain circumstances, we may be entitled to a termination fee under our management agreement. However, the termination of such management agreement and the loss of PMT as a client would significantly affect our investment management segment and negatively impact our management fees and incentive fees, and could have a material and adverse effect on our business, financial condition, liquidity and results of operations.

Also, because the management agreement we entered into with PMT was negotiated between related parties without the benefit of the type of negotiations normally conducted with unaffiliated third parties, the terms of this agreement, including the fees payable to us, may prove to be more favorable to us than they would be if this agreement had been negotiated with unaffiliated third parties. Accordingly, we may not generate as much revenue from management agreements that we enter into with other third parties.

The Investment Funds we manage are limited life funds that were established in 2008. On August 9, 2017, the Investment Funds completed the sale of substantially all of their remaining assets and final distributions are expected to be made to the investors in the Investment Funds during 2018. Accordingly, we will no longer receive management and servicing fees from the Investment Funds after such time.

The historical returns on the assets that we select and manage for PMT, and our resulting management and incentive fees, may not be indicative of future results.

The historical returns of the assets that we manage should not be considered indicative of the future returns on those assets or future returns on other assets that we may select for investment by PMT. The investment performance that is achieved for the assets that we manage varies over time and the variance can be significant. Accordingly, the management and incentive fees that we have earned in the past based on those returns should not be considered indicative of the management or incentive fees that we may earn in the future from managing those same assets or from managing other assets for PMT. A decline in the investment performance of our managed assets will also adversely affect our ability to attract and retain clients.

Changes in regulations applicable to our investment management segment could materially and adversely affect our business, financial condition, liquidity and results of operations.

The legislative and regulatory environment in which we operate has undergone significant changes in the recent past. We believe that significant regulatory changes in the investment management industry are likely to continue, which is likely to subject industry participants to additional, more costly and generally more detailed regulation. New laws or regulations, or changes in the enforcement of existing laws or regulations, applicable to us and our clients may adversely affect our business. Our ability to function in this environment will depend on our ability to monitor and promptly react to legislative and regulatory changes.

Certain provisions of the Dodd Frank Act will, and other provisions may, increase regulatory burdens and reporting and related compliance costs on our investment management segment. The scope of many provisions of the Dodd Frank Act is being determined by implementing regulations, some of which will require lengthy proposal and promulgation periods. The SEC requires investment advisers such as us who are registered with the SEC and advise one or more private funds to provide certain information about their funds and assets under management, including the amount of borrowings, concentration of ownership and other performance information. These filings have required, and will continue to require, significant investments in people, resources and systems to ensure timely and accurate

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reporting. The Dodd Frank Act will affect a broad range of market participants with whom we interact or may interact, including banks, non bank financial institutions, rating agencies, mortgage brokers, credit unions, insurance companies and broker dealers, and may cause us or our Advised Entities to become subject to further regulation by the Commodity Futures Trading Commission. Regulatory changes that will affect other market participants are likely to change the way in which we conduct business with our counterparties. The uncertainty regarding the continued implementation of the Dodd Frank Act and its impact on the investment management industry and us cannot be predicted at this time but will continue to be a risk for our business.

We may be adversely affected as a result of new or revised legislation or regulations imposed by the SEC, other U.S. or non U.S. governmental regulatory authorities or self regulatory organizations that supervise the financial markets. We also may be adversely affected by changes in the interpretation or enforcement of existing laws and rules by these governmental authorities and self regulatory organizations, as well as by U.S. and non U.S. courts. It is impossible to determine the extent of the impact of any new laws, regulations or initiatives that may be imposed on us or the markets in which we trade, or whether any of the proposals will become law. Compliance with any new laws or regulations could add to our compliance burden and costs and adversely affect the manner in which we conduct business, as well as our financial condition, liquidity and results of operations.

Our failure to comply with the extensive amount of regulation applicable to our investment management segment could materially and adversely affect our business, financial condition, liquidity and results of operations.

Our investment management segment is subject to extensive regulation in the United States, primarily at the federal level, including regulation of PCM by the SEC under the Advisers Act and regulation of PNMAC Mortgage Opportunity Fund LLC and PNMAC Mortgage Opportunity Fund, LP under the Investment Company Act. The requirements imposed by our regulators are designed primarily to ensure the integrity of the financial markets and to protect investors in our Advised Entities and are not designed to protect our stockholders. Consequently, these regulations often serve to limit our activities.

These requirements relate to, among other things, fiduciary duties to clients, maintaining an effective compliance program, solicitation agreements, conflicts of interest, recordkeeping and reporting requirements, disclosure requirements, limitations on agency cross and principal transactions between an adviser and advisory clients and general anti fraud prohibitions. Similar requirements apply to registered investment companies and to PCM's management of those companies under the Investment Company Act which, among other things, regulates the relationship between a registered investment company and its investment adviser and prohibits or severely restricts principal transactions and joint transactions. Registered investment advisers and registered investment companies are also subject to routine periodic examinations by the staff of the SEC.

We also regularly rely on exemptions and exclusions from various requirements of the Securities Act of 1933, as amended (the "Securities Act"), the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Investment Company Act and ERISA. These exemptions are sometimes highly complex and may in certain circumstances depend

on compliance by third parties and service providers who we do not control. If for any reason these exemptions were to be revoked or challenged or otherwise become unavailable to us, we could be subject to regulatory action or third party claims, and our business could be materially and adversely affected.

Our business combines the production and servicing of loans and investment management, the combination of which presents particular compliance challenges. For example, regulations applicable to our investment management business that are easily applied to traditional investments, such as stocks and bonds, may be more difficult to apply to a portfolio of mortgage loans, and the regulations applicable to our investment management business can require procedures that are uncommon, impractical or difficult in our loan production and servicing businesses.

The failure by us to comply with applicable laws or regulations could result in fines, suspensions of individual employees or other sanctions, any of which could have a material adverse effect on our business, financial condition, liquidity and results of operations. Even if an investigation or proceeding did not result in a fine or sanction or the fine or sanction imposed against us or our employees by a regulator were small in monetary amount, the adverse publicity

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relating to an investigation, proceeding or imposition of these fines or sanctions could harm our reputation and cause us to lose existing clients.

We may encounter conflicts of interest in trying to appropriately allocate our time and services between activities for our own account and the accounts that we manage, or in trying to appropriately allocate investment opportunities among ourselves and the accounts that we manage.

Pursuant to our management agreements with PMT and the Investment Funds, we are obligated to provide PMT and the Investment Funds with the services of our senior management team, and the members of that team are required to devote such time as is necessary and appropriate, commensurate with the level of activity of PMT and the Investment Funds. The members of our senior management team may have conflicts in allocating their time and services between our operations and the activities of PMT, the Investment Funds and other entities or accounts managed by us now or in the future.

Certain of the funds that we currently advise have, and certain of the funds that we may in the future advise may have, overlapping investment objectives, including funds which have different fee structures, and potential conflicts may arise with respect to our decisions regarding how to allocate investment opportunities among those funds. In addition, we and the other entities or accounts that we manage or will manage may participate in some of PMT's investments now or in the future, which may not be the result of arm's length negotiations and may involve or later result in potential conflicts between our interests in the investments and those of PMT or such other entities. Any such potential or actual conflicts of interest could damage our reputation and materially and adversely affect our business, financial condition, liquidity and results of operations.

We are subject to third party litigation risk, which could result in significant liabilities and reputational harm to us.

In general, we may be exposed to the risk of litigation by investors in our client funds if our management of or advice to any Advised Entity, including any advice relating to wind-down strategies, is alleged to constitute gross negligence or willful misconduct. Investors could sue us to recover amounts lost by those entities due to our alleged misconduct, up to the entire amount of loss. Further, we may be subject to litigation arising from investor dissatisfaction with the performance of entities that we manage or from allegations that we improperly exercised control or influence over those entities. In addition, we are exposed to risks of litigation or investigation relating to transactions which presented conflicts of interest that were not properly addressed. In such actions we would be obligated to bear legal, settlement and other costs (which may be in excess of available insurance coverage). In addition, although we are generally indemnified by the entities that we manage, our rights to indemnification may be challenged. If we are required to incur all or a portion of the costs arising out of litigation or investigations as a result of inadequate insurance proceeds or failure to obtain indemnification from the entities that we manage, our business, financial condition, liquidity and results of operations would be materially and adversely affected.

Risks Related to Our Business in General

We have experienced rapid growth, which may be difficult to sustain and which may place significant demands on our administrative, operational and financial resources.

Our rapid growth has caused, and if it continues will continue to cause, significant demands on our legal, accounting and operational infrastructure, and increased expenses. In addition, we are required to continuously develop our systems and infrastructure in response to the increasing sophistication of the investment management and mortgage lending markets and legal, accounting and regulatory developments relating to all of our business activities. Our future growth will depend, among other things, on our ability to maintain an operating platform and management systems sufficient to address our growth and will require us to incur significant additional expenses and to commit additional senior management and operational resources. As a result, we face significant challenges in:

- maintaining adequate financial and business controls;
- implementing new or updated information and financial systems and procedures; and

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- training, managing and appropriately sizing our work force and other components of our business on a timely and cost effective basis.

We may not be able to manage our expanding operations effectively and we may not be able to continue to grow, and any failure to do so could adversely affect our ability to generate revenue and control our expenses.

The loss of the services of our senior managers could adversely affect our business.

The experience of our senior managers is a valuable asset to us. Our management team has significant experience in the mortgage loan production and servicing industry and the investment management industry. We do not maintain key person life insurance policies relating to our senior managers. The loss of the services of our senior managers for any reason could have a material adverse effect on our business, financial condition, liquidity and results of operations.

Our business could suffer if we fail to attract and retain a highly skilled workforce.

Our future success will depend on our ability to identify, hire, develop, motivate and retain highly qualified personnel for all areas of our organization, in particular skilled managers, loan officers, underwriters, loan servicers and debt default specialists. Trained and experienced personnel are in high demand and may be in short supply in some areas. Many of the companies with which we compete for experienced employees have greater resources than we have and may be able to offer more attractive terms of employment. In addition, we invest significant time and expense in training our employees, which increases their value to competitors who may seek to recruit them. We may not be able to attract, develop and maintain an adequate skilled workforce necessary to operate our businesses and labor expenses may increase as a result of a shortage in the supply of qualified personnel. If we are unable to attract and retain such personnel, we may not be able to take advantage of acquisitions and other growth opportunities that may be presented to us and this could have a material adverse effect on our business, financial condition, liquidity and results of operations.

We depend on counterparties and vendors, some of whom operate in other countries, to provide services that are critical to our business, which subjects us to a variety of risks.

We have a number of counterparties and vendors, some of whom have significant operations outside of the United States. These counterparties and vendors provide us with financial, technology and other services to support our businesses. If our current counterparties and vendors were to stop providing services to us on acceptable terms, we

may be unable to procure alternative services from other counterparties or vendors in a timely and efficient manner and on similarly acceptable terms, or at all. If we or our vendors had to curtail or cease operations in these countries due to political unrest or natural disasters and then transfer some or all of these operations to another geographic area, we could experience disruptions in service and incur significant transition costs as well as higher future overhead costs. With respect to vendors engaged to perform certain servicing activities, we are required to assess their compliance with various regulations and establish procedures to provide reasonable assurance that the vendor's activities comply in all material respects with such regulations. In the event that a vendor's activities are not in compliance, it could negatively impact our relationships with our regulators, as well as our business and operations. Further, we may incur significant costs to resolve any such disruptions in service which could have a material adverse effect on our business, financial condition, liquidity and results of operations.

Our failure to deal appropriately with various issues that may give rise to reputational risk, including conflicts of interest, legal and regulatory requirements, could cause harm to our business and adversely affect our earnings.

Maintaining our reputation is critical to attracting and retaining clients, customers, trading counterparties, investors and employees. If we fail to deal with, or appear to fail to deal with various issues that may give rise to reputational risk, we could significantly harm our business prospects and earnings. Such issues include, but are not limited to, conflicts of interest, legal and regulatory requirements, and any of the other risks discussed in this Item 1A.

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Certain of our officers also serve as officers of PMT. As we expand the scope of our businesses, we increasingly confront potential conflicts of interest relating to investment activities that we manage for our clients. In addition, investors may perceive conflicts of interest regarding investment decisions and wind-down strategies for funds in which certain of our officers have made and may continue to make personal investments. Similarly, conflicts of interest may exist regarding decisions about the allocation of specific investment opportunities between funds in which we receive an allocation of profits as the general partner and funds in which we do not.

The SEC and certain regulators have increased their scrutiny of potential conflicts of interest, and as we experience growth in our businesses, we must continue to monitor and mitigate or otherwise address any conflicts between our interests and those of our clients. We have implemented procedures and controls to be followed when real or potential conflicts of interest arise, but it is possible that potential or perceived conflicts could give rise to the dissatisfaction of, or litigation by, our stockholders, investors in our Advised Entities or regulatory enforcement actions. Appropriately dealing with conflicts of interest is complex and difficult and our reputation could be damaged if we fail, or appear to fail, to deal appropriately with one or more potential or actual conflicts of interest. Reputational risk incurred in connection with conflicts of interest could negatively affect our business, strain our working relationships with regulators and government agencies, expose us to litigation and regulatory action, impact our ability to attract and retain clients, customers, trading counterparties, investors and employees and adversely affect our results of operations.

Reputational risk, or the risk to our business, earnings and capital from negative public opinion, is inherent in our business and can result from a number of factors. Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending and debt collection practices, corporate governance, and actions taken by government regulators and community organizations in response to those activities. Negative public opinion can also result from social media and media coverage, whether accurate or not. These factors can tarnish or otherwise strain our working relationships with regulators and government agencies, expose us to litigation and regulatory action, negatively affect our ability to attract and retain customers, trading counterparties and employees and adversely affect our results of operations.

Initiating new business activities or significantly expanding existing business activities may expose us to new risks and will increase our cost of doing business.

Initiating new business activities or significantly expanding existing business activities, such as our entry into broker direct lending, non-delegated correspondent production and multifamily lending, are ways to grow our businesses and respond to changing circumstances in our industry; however, they may expose us to new risks and regulatory compliance requirements. We cannot be certain that we will be able to manage these risks and compliance requirements effectively. Furthermore, our efforts may not succeed, and any revenues we earn from any new or expanded business initiative may not be sufficient to offset the initial and ongoing costs of that initiative, which would result in a loss with respect to that initiative.

Our risk management efforts may not be effective.

We could incur substantial losses and our business operations could be disrupted if we are unable to effectively identify, manage, monitor, and mitigate financial risks, such as credit risk, interest rate risk, prepayment risk, liquidity risk, and other market-related risks, as well as operational and legal risks related to our business, assets, and liabilities. We also are subject to various laws, regulations and rules that are not industry specific, including employment laws related to employee hiring and termination practices, health and safety laws, environmental laws and other federal, state and local laws, regulations and rules in the jurisdictions in which we operate. Our risk management policies, procedures, and techniques may not be sufficient to identify all of the risks to which we are exposed, mitigate the risks we have identified, or identify additional risks to which we may become subject in the future. Expansion of our business activities may also result in our being exposed to risks to which we have not previously been exposed or may increase our exposure to certain types of risks, and we may not effectively identify, manage, monitor, and mitigate these risks as our business activities change or increase.

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We could be harmed by misconduct or fraud that is difficult to detect.

We are exposed to risks relating to misconduct by our employees, contractors we use, or other third parties with whom we have relationships. For example, our employees could execute unauthorized transactions, use our assets improperly or without authorization, perform improper activities, use confidential information for improper purposes, or misrecord or otherwise try to hide improper activities from us. This type of misconduct could also relate to assets we manage for others through our investment advisory subsidiary, and can be difficult to detect. If not prevented or detected, misconduct by employees, contractors, or others could result in losses, claims or enforcement actions against us, or could seriously harm our reputation. Our controls may not be effective in detecting this type of activity.

If we fail to maintain an effective system of internal controls, we may not be able to accurately determine our financial results or prevent fraud. As a result, our stockholders could lose confidence in our financial results, which could harm our business and the market value of our common stock.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. We may in the future discover areas of our internal controls that need improvement. Section 404 of the Sarbanes Oxley Act of 2002 (the “Sarbanes Oxley Act”) requires that we evaluate and report on our internal control over financial reporting. We cannot be certain that we will be successful in maintaining adequate control over our financial reporting and financial processes. Furthermore, as we rapidly grow our businesses, our internal controls will become more complex, and we will require significantly more resources to ensure our internal controls remain effective. Section 404(b) of the Sarbanes-Oxley Act requires our auditors to formally attest to and report on the effectiveness of our internal control over financial reporting.

If we cannot maintain effective internal control over financial reporting, or our independent registered public accounting firm cannot provide an unqualified attestation report on the effectiveness of our internal control over financial reporting, investor confidence and, in turn, the market price of our common stock could decline. If we or our independent auditors discover a material weakness, the disclosure of that fact, even if quickly remedied, could result in an event of default under one or more of our lending arrangements and/or reduce the market value of shares of our Class A common stock. Additionally, the existence of any material weakness or significant deficiency could require management to devote significant time and incur significant expense to remediate any such material weakness or significant deficiency, and management may not be able to remediate any such material weakness or significant deficiency in a timely manner, or at all. Accordingly, our failure to maintain effective internal control over financial reporting could result in misstatements of our financial results or restatements of our financial statements or otherwise have a material adverse effect on our business, financial condition, liquidity and results of operations.

Accounting rules for certain of our transactions are highly complex and involve significant judgment and assumptions. Changes in accounting interpretations or assumptions could impact our financial statements.

Accounting rules for mortgage loan sales and securitizations, valuations of financial instruments and MSRs, investment consolidations and other aspects of our operations are highly complex and involve significant judgment and assumptions. These complexities could lead to a delay in preparation of financial information and the delivery of this information to our stockholders and also increase the risk of errors and restatements, as well as the cost of compliance. Changes in accounting interpretations or assumptions could impact our financial statements and our ability to timely prepare our financial statements. Our inability to timely prepare our financial statements in the future would likely adversely affect our share price significantly.

The success and growth of our business will depend upon our ability to adapt to and implement technological changes.

Our mortgage loan production businesses are dependent upon our ability to effectively interface with our borrowers, mortgage lenders and other third parties and to efficiently process loan applications and closings. The consumer direct lending and correspondent production processes are becoming more dependent upon technological advancement, such as our continued ability to process applications over the Internet, accept electronic signatures, provide process status updates instantly and other borrower or counterparty expected conveniences. Maintaining and

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improving this new technology and becoming proficient with it may also require significant capital expenditures. As these requirements increase in the future, we will have to fully develop these technological capabilities to remain competitive and any failure to do so could have a material adverse effect on our business, financial condition and results of operations.

Cybersecurity risks, cyber incidents and technology failures may adversely affect our business by causing a disruption to our operations, a compromise or corruption of our confidential information, and/or damage to our business relationships, all of which could negatively impact our financial results.

A cyber incident is considered to be any adverse event that threatens the confidentiality, integrity or availability of our information resources. These incidents may be an intentional attack or an unintentional event and could involve gaining unauthorized access to our information systems for purposes of theft of certain personally identifiable information of consumers, misappropriating assets, stealing confidential information, corrupting data or causing operational disruption. The result of these incidents may include disrupted operations, misstated or unreliable financial data, liability for stolen assets or information, increased cybersecurity protection and insurance costs, litigation and damage to our investor relationships.

As our reliance on rapidly changing technology has increased, so have the risks posed to its information systems, both proprietary and those provided to us by third-party service providers. System disruptions and failures caused by fire, power loss, telecommunications outages, unauthorized intrusion, computer viruses and disabling devices, natural disasters and other similar events may interrupt or delay our ability to provide services to our customers.

Despite our efforts to ensure the integrity of our systems our investment in significant physical and technological security measures, employee training, contractual precautions and business continuity plans, and our implementation of policies and procedures designed to help mitigate cybersecurity risks and cyber intrusions, there can be no assurance that any such cyber intrusions will not occur or, if they do occur, that they will be adequately addressed. We also may not be able to anticipate or implement effective preventive measures against all security breaches, especially because the methods of attack change frequently or may not be recognized until after such attack has been launched, and because security attacks can originate from a wide variety of sources, including third parties such as persons involved with organized crime or associated with external service providers. We are also held accountable for the actions and inactions of our third-party vendors regarding cybersecurity and other consumer-related matters.

Any of the foregoing events could result in violations of applicable privacy and other laws, financial loss to us or to our customers, loss of confidence in our security measures, customer dissatisfaction, additional regulatory scrutiny, significant litigation exposure and harm to our reputation, any of which could have a material adverse effect on our business, financial condition, liquidity and results of operations, any of which could have a material adverse effect on our business, financial condition, liquidity and results of operations.

Terrorist attacks and other acts of violence or war may cause disruptions in our operations and in the financial markets, and could materially and adversely affect the real estate industry generally and our business, financial condition, liquidity and results of operations.

Terrorist attacks and other acts of violence or war may cause disruptions in the U.S. financial markets, including the real estate capital markets, and negatively impact the U.S. economy in general. Such attacks could also cause disruptions in our operations. Any future terrorist attacks, the anticipation of any such attacks, the consequences of any military or other response by the United States and its allies, and other armed conflicts could cause consumer confidence and spending to decrease or result in increased volatility in the United States and worldwide financial markets and economy. The economic impact of these events could also materially and adversely affect the credit quality of some of our loans and investments and the properties underlying our interests.

We may suffer losses as a result of the adverse impact of any future attacks and these losses may adversely impact our performance and may cause the market value of our common stock to decline or be more volatile. A prolonged economic slowdown, recession or declining real estate values could impair the performance of our investments and harm our financial condition and results of operations, increase our funding costs, limit our access to the

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capital markets or result in a decision by lenders not to extend credit to us. We cannot predict the severity of the effect that potential future armed conflicts and terrorist attacks would have on us. Losses resulting from these types of events may not be fully insurable.

We are subject to certain risks associated with investing in real estate and real estate related assets, including risks of loss from adverse weather conditions and man-made or natural disasters, which may cause disruptions in our operations and could materially and adversely affect the real estate industry generally and our business, financial condition, liquidity and results of operations.

Weather conditions and man-made or natural disasters such as hurricanes, tornadoes, earthquakes, floods, droughts, fires and other environmental conditions can damage properties that we own or that collateralize loans we own or service. In addition, the properties where we conduct business could be adversely impacted. Future adverse weather conditions and man-made or natural disasters could also adversely impact the demand for, and value of, our assets, as well as the cost to service or manage such assets, directly impact the value of our assets through damage, destruction or loss, and thereafter materially impact the availability or cost of insurance to protect against these events. Although we believe our owned real estate and the properties collateralizing our loan assets or underlying our MSR assets are adequately covered by insurance, we cannot predict at this time if we or our borrowers will be able to obtain appropriate coverage at a reasonable cost in the future, or if we will be able to continue to pass along all of the costs of insurance. In addition, there is a risk that one or more of the insurers of property in which we hold an interest may not be able to fulfill their obligations with respect to claims payments due to a deterioration in its financial condition.

Risks Related to Our Organizational Structure

Owners of PennyMac other than us will initially be able to significantly influence the outcome of votes of our outstanding shares of Class A common stock, and their interests may differ from those of our public stockholders.

Pursuant to separate stockholder agreements with BlackRock and Highfields, each of BlackRock and Highfields has the right to nominate one or two individuals for election to our board of directors, depending on the percentage of the voting power of our outstanding shares of Class A and Class B common stock that it holds, and we are obligated to use our best efforts to cause the election of those nominees. In addition, these stockholder agreements require that we obtain the consent of BlackRock and Highfields with respect to amendments to our certificate of incorporation or bylaws, and the limited liability company agreement of PennyMac requires the consent of BlackRock and Highfields for us to conduct certain activities. As a result, each of BlackRock and Highfields may be able to significantly influence our management and affairs. In addition, as a result of the size of their individual equity holding they will initially be able to significantly influence the outcome of all matters requiring stockholder approval, including mergers and other material transactions, and may be able to cause or prevent a change in the composition of our board of directors or a change in control of our Company that could deprive our stockholders of an opportunity to receive a premium for their Class A common stock as part of a sale of our company and might ultimately affect the market price of our Class A common stock.

In addition, because they hold their ownership interest in our business through PennyMac, rather than through the public company, these owners may have conflicting interests with holders of shares of our Class A common stock. For example, other owners of PennyMac may have different tax positions from us which could influence their decisions regarding whether and when to dispose of assets, whether and when to incur new or refinance existing indebtedness, especially in light of the existence of the tax receivable agreement that we entered into in connection with the initial public offering of our Class A common stock, and whether and when we should terminate the tax receivable agreement and accelerate its obligations thereunder. Further, the structuring of future transactions may take into consideration these owners' tax or other considerations even where no similar benefit would accrue to us.

We will be required to pay the owners of PennyMac other than us for certain tax benefits that we may claim, and the amounts we may pay could be significant.

We are a party to a tax receivable agreement with certain owners of PennyMac other than us that provides for the payment by us to those owners of 85% of the tax benefits, if any, that we are deemed to realize under certain circumstances as a result of (i) increases in tax basis resulting from exchanges of Class A units of PennyMac for shares

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of our Class A common stock and (ii) certain other tax benefits related to our entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

We expect that the payments that we may make under the tax receivable agreement will be substantial. It is possible that future transactions or events could increase or decrease the actual tax benefits realized and the corresponding tax receivable agreement payments. There may be a material negative effect on our liquidity if, as a result of timing discrepancies or otherwise, the payments under the tax receivable agreement exceed the actual benefits we realize in respect of the tax attributes subject to the tax receivable agreement or distributions to us by PennyMac are not sufficient to permit us to make payments under the tax receivable agreement after we have paid our taxes.

Furthermore, our obligations to make payments under the tax receivable agreement could make us a less attractive target for an acquisition, particularly in the case of an acquirer that cannot use some or all of the tax benefits that are deemed realized under the tax receivable agreement. The payments under the tax receivable agreement are not conditioned upon the continued ownership of us by owners of PennyMac.

In certain cases, payments under the tax receivable agreement to owners of PennyMac other than us may be accelerated and/or significantly exceed the actual benefits we realize in respect of the tax attributes subject to the tax receivable agreement.

The tax receivable agreement provides that upon certain mergers, asset sales, other forms of business combinations or other changes of control, or if, at any time, we elect an early termination of the tax receivable agreement, our (or our successor's) obligations with respect to exchanged or acquired Class A units of PennyMac (whether exchanged or acquired before or after such transaction) would be based on certain assumptions, including that we would have sufficient taxable income to fully utilize the deductions arising from the increased tax deductions and tax basis and other benefits related to entering into the tax receivable agreement. As a result, we could be required to make payments under the tax receivable agreement that differ from the percentage specified in the tax receivable agreement of the actual benefits that we realize in respect of the tax attributes that are subject to the tax receivable agreement. Also, if we elect to terminate the tax receivable agreement early, we would be required to make an immediate payment equal to the present value of the anticipated future tax benefits, which upfront payment may be made years in advance of the actual realization of such future benefits (if any). In these situations, our obligations under the tax receivable agreement could have a substantial negative impact on our liquidity, as well as our attractiveness as a target for an acquisition. In addition, we may not be able to finance our obligations under the tax receivable agreement.

Payments under the tax receivable agreement will be based on the tax reporting positions that we determine. Although we are not aware of any issue that would cause the Internal Revenue Service, or IRS, to challenge a tax basis increase, we will not be reimbursed for any payments previously made under the tax receivable agreement. As a result, in certain circumstances, payments could be made under the tax receivable agreement in excess of the tax benefits that we actually realize in respect of (i) increases in tax basis resulting from exchanges of Class A units of PennyMac for shares of our Class A common stock and (ii) certain other tax benefits related to our entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

Our only material asset is our interest in PennyMac and its subsidiaries, and we are accordingly dependent upon distributions from PennyMac and its subsidiaries to pay taxes, make payments under the tax receivable agreement or pay dividends.

We are a holding company and have no material assets other than our ownership of Class A units of PennyMac. We have no independent means of generating revenue. We are required to pay tax on our allocable share of the taxable income of PennyMac and payments under the tax receivable agreement without regard to whether PennyMac distributes to us any cash or other property. To the extent that we need funds, and PennyMac is restricted from making such distributions under applicable laws or regulations or under the terms of financing arrangements, or is otherwise unable to provide such funds, it could materially and adversely affect our liquidity and financial condition.

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We may not pay dividends on our common stock in the foreseeable future.

We are entitled to receive a pro rata portion of the tax distributions made by PennyMac. The cash received from such distributions will first be used to satisfy any of our tax liabilities and then to make any payments under the tax receivable agreement with the owners of PennyMac other than us. The declaration, amount and payment of any dividends on shares of Class A common stock with respect to any remaining excess cash will be at the sole discretion of our board of directors. Our board of directors may take into account general and economic conditions, our financial condition and operating results, our available cash and current and anticipated cash needs, capital requirements, contractual, legal, tax and regulatory restrictions and implications on the payment of dividends by us to our stockholders or by our subsidiaries to us, and such other factors as our board of directors may deem relevant. We may also enter into credit agreements or other borrowing arrangements in the future that restrict or limit our ability to pay cash dividends on our common stock. Accordingly, we may not pay any dividends on our common stock in the foreseeable future.

Anti takeover provisions in our charter documents and Delaware law might discourage or delay acquisition attempts for us that you might consider favorable.

Our certificate of incorporation and bylaws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors. Among other things, these provisions:

- authorize the issuance of undesignated preferred stock, the terms of which may be established and the shares of which may be issued without stockholder approval, and which may include super voting, special approval, dividend, or other rights or preferences superior to the rights of the holders of Class A common stock;
- prohibit stockholder action by written consent unless the matter as to which action is being taken has been approved by our board of directors, which requires all stockholder actions regarding matters not approved by our board of directors to be taken at a meeting of our stockholders;
- provide that our board of directors is expressly authorized to make, alter, or repeal our bylaws (provided that, if that action adversely affects BlackRock or Highfields when that entity, together with its affiliates, holds at least 5% of the voting power of our outstanding shares of capital stock, our stockholder agreements provide that such action must be approved by that entity);
- establish advance notice requirements for nominations for elections to our board or for proposing matters that can be acted upon by stockholders at stockholder meetings; and
-

prevent us from selling substantially all of our assets or completing a merger or other business combination that constitutes a change of control without the approval of a majority of those of our directors who are not also our officers.

These anti takeover provisions and other provisions under Delaware law could discourage, delay or prevent a transaction involving a change in control of our company, including actions that our stockholders may deem advantageous, or negatively affect the trading price of our Class A common stock. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors of your choosing and to cause us to take other corporate actions you desire.

Our certificate of incorporation contains provisions renouncing our interest and expectancy in certain corporate opportunities identified by or presented to BlackRock and Highfields.

BlackRock, Highfields and their respective affiliates are in the business of providing capital to growing companies, and may acquire interests in businesses that directly or indirectly compete with certain portions of our business. Our certificate of incorporation provides that neither BlackRock nor Highfields nor their respective affiliates has any duty to refrain from (i) engaging, directly or indirectly, in a corporate opportunity in the same or similar lines of business in which we now engage or propose to engage, or (ii) doing business with any of our clients, customers or

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vendors. In the event that either of BlackRock or Highfields or their respective affiliates acquires knowledge of a potential transaction or other business opportunity which may be a corporate opportunity for itself or its affiliates and for us or our affiliates other than in the capacity as one of our officers or directors, then neither BlackRock nor Highfields has any duty to communicate or offer such transaction or business opportunity to us and may take any such opportunity for themselves or offer it to another person or entity. Neither BlackRock nor Highfields nor any officer, director or employee thereof, shall be liable to us or to any of our stockholders (or any affiliates thereof) for breach of any fiduciary or other duty by engaging in any such activity and we waive and renounce any claim based on such activity. This provision applies even if the business opportunity is one that we might reasonably be deemed to have pursued or had the ability or desire to pursue if granted the opportunity to do so. Our separate stockholder agreements with BlackRock and Highfields provide that any amendment or repeal of the provisions related to corporate opportunities described above requires the consent of each of BlackRock and Highfields as long as it, or any of its affiliates, holds any equity interest in us. These potential conflicts of interest could have a material and adverse effect on our business, financial condition, liquidity, results of operations or prospects if attractive corporate opportunities are allocated by BlackRock or Highfields to themselves or their other affiliates instead of to us.

Our bylaws include an exclusive forum provision that could limit our stockholders' ability to obtain a judicial forum viewed by the stockholders as more favorable for disputes with us or our directors, officers or other employees.

Our bylaws provide that the state or federal court located within the State of Delaware is the exclusive forum for any derivative action or proceeding brought on our behalf; any action asserting a claim of breach of fiduciary duty; any action asserting a claim against us arising pursuant to the Delaware General Corporation Law, our certificate of incorporation or our bylaws; or any action asserting a claim against us that is governed by the internal affairs doctrine. This exclusive forum provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers or other associates, which may discourage such lawsuits against us and our directors, officers and other employees. Alternatively, if a court were to find the exclusive forum provision contained in our bylaws to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could adversely affect our business, financial condition, liquidity and results of operations.

Risks Related to Our Class A Common Stock

The market price and trading volume of our Class A common stock may be volatile, which could result in rapid and substantial losses for our stockholders.

The market price of our Class A common stock has fluctuated significantly in the past and may be highly volatile in the future and could be subject to wide fluctuations. In addition, the trading volume in our Class A common stock may fluctuate and cause significant price variations to occur. Because the trading volume of our Class A common stock is relatively low, even in times of fluctuation, certain investors may be unwilling or prohibited as a matter of policy from making investments. Further, if the market price of our Class A common stock declines significantly, you may be

unable to resell your shares at or above your purchase price, if at all. The market price of our Class A common stock may decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our Class A common stock include:

- variations in our quarterly or annual operating results;
- changes in our earnings estimates (if provided) or differences between our actual financial and operating results and those expected by investors and analysts;
- the contents of published research reports about us or our industry or the failure of securities analysts to cover our Class A common stock;
- additions or departures of key management personnel;
- any increased indebtedness we may incur in the future;

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- announcements by us or others and developments affecting us;
- actions by institutional stockholders;
- litigation and governmental investigations;
- changes in market valuations of similar companies;
- speculation or reports by the press or investment community with respect to us or our industry in general;
- increases in market interest rates that may lead purchasers of our shares to demand a higher yield;
- announcements by us or our competitors of significant contracts, acquisitions, dispositions, strategic relationships, joint ventures or capital commitments; and
- general market, political and economic conditions, including any such conditions and local conditions in the markets in which our customers are located.

These broad market and industry factors may decrease the market price of our Class A common stock, regardless of our actual operating performance. The stock market in general has from time to time experienced extreme price and volume fluctuations, including in recent months. In addition, in the past, following periods of volatility in the overall market and the market price of a company's securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

The market price of our Class A common stock could be negatively affected by sales of substantial amounts of our Class A common stock in the public markets.

Sales of substantial numbers of shares of our Class A common stock, including shares issued upon the exchange of Class A Units of PennyMac, in the public market, or the perception that such sales could occur, could adversely affect the market price of our Class A common stock and could impair our future ability to raise capital through the sale of equity securities or equity related securities.

As of December 31, 2017, we have a total of 23,529,970 shares of Class A common stock outstanding. The issuance and sale (or resale) of up to 46,003,552 additional shares of our Class A common stock have been registered under the Securities Act so those shares, upon issuance, will be freely tradable without restriction or further registration under the Securities Act.

A decline in the price of our Class A common stock might impede our ability to raise capital through the issuance of additional Class A common stock or other equity securities.

The future issuance of additional Class A common stock in connection with our incentive plans, acquisitions or otherwise will dilute all other stockholdings.

As of December 31, 2017, we have an aggregate of 18,837,717 shares of Class A common stock authorized and remaining available for future issuance under our 2013 Equity Incentive Plan or upon the exchange of Class A Units of PennyMac. We may issue all of these shares of Class A common stock without any action or approval by our stockholders, subject to certain exceptions. We also intend to continue to evaluate acquisition opportunities and may issue Class A common stock in connection with these acquisitions. Any Class A common stock issued in connection with our incentive plans, acquisitions, the exercise of outstanding stock options or otherwise would dilute the percentage ownership held by investors who purchase Class A common stock.

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Future offerings of debt or equity securities by us may adversely affect the market price of our Class A common stock.

In the future, we may attempt to obtain financing or to further increase our capital resources by issuing additional shares of our Class A common stock or offering debt or other equity securities, including commercial paper, medium term notes, senior or subordinated notes, debt securities convertible into equity or shares of preferred stock. In particular, we intend to seek opportunities to acquire MSR portfolios. Future acquisitions could require substantial additional capital in excess of cash from operations. We would expect to obtain the capital required for acquisitions through a combination of additional issuances of equity, corporate indebtedness, asset backed acquisition financing and/or cash from operations.

Issuing additional shares of our Class A common stock or other equity securities or securities convertible into equity may dilute the economic and voting rights of our existing stockholders or reduce the market price of our Class A common stock or both. Upon liquidation, holders of such debt securities and preferred shares, if issued, and lenders with respect to other borrowings would receive a distribution of our available assets prior to the holders of our Class A common stock. Debt securities convertible into equity could be subject to adjustments in the conversion ratio pursuant to which certain events may increase the number of equity securities issuable upon conversion. Preferred shares, if issued, could have a preference with respect to liquidating distributions or a preference with respect to dividend payments that could limit our ability to pay dividends to the holders of our Class A common stock. Our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, which may adversely affect the amount, timing or nature of our future offerings. In addition, the limited liability company agreement of PennyMac provides that new classes of units or other equity interests of PennyMac may be issued to third parties other than us only with the approval of BlackRock and Highfields as long as they, or any of their affiliates, hold any Class A units of PennyMac. Any such issuance will dilute the ownership of holders of our Class A common stock in substantially all of our operating assets. Thus, holders of our Class A common stock bear the risk that our future offerings, including any future offerings by PennyMac, may reduce the market price of our Class A common stock and dilute their stockholdings in us.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our corporate offices are housed in a 60,000 square foot leased facility located at 3043 Townsgate Road, Westlake Village, California 91361. Our primary loan servicing operation is housed in a 142,000 square foot leased facility located in Moorpark, CA. Much of our California-based mortgage fulfillment division is housed in a leased 60,000 square foot facility in close proximity to our corporate offices. Our information technology division is housed in a

50,000 square foot facility in Agoura Hills, CA.

We lease several additional locations throughout the country generally housing loan production and servicing activities. Our consumer direct lending business occupies a 36,000 square foot facility in Pasadena, CA. Loan servicing and its call center operations occupy a 116,000 square foot facility in Fort Worth, TX, and a 75,000 square foot facility in Plano, TX. We have six loan production branches located in Sacramento, CA, Honolulu, HI, Eagan, MN, St. Louis, MO, Kansas City, MO, and Henderson, NV. PennyMac's commercial real estate finance business is housed in Irvine, CA, and we lease a 20,000 square foot facility in Tampa, FL devoted to our correspondent production activities.

The financial commitments of our leases are immaterial to the scope of our operations.

Item 3. Legal Proceedings

From time to time, we may be involved in various legal actions, claims and proceedings, arising in the ordinary course of business. As of December 31, 2017, we were not involved in any material legal actions, claims or proceedings.

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Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our shares of Class A common stock are listed on the New York Stock Exchange (Symbol: PFSI). As of March 1, 2018, our shares of Class A common stock were held by 3,005 holders of record. The following table sets forth the high and low sales prices (as reported by the New York Stock Exchange) for our shares of Class A common stock:

Period ended	For the year ended December 31, 2017		Cash dividends declared
	Stock price High	Low	
March 31, 2017	\$ 19.30	\$ 15.75	\$ —
June 30, 2017	\$ 17.60	\$ 15.65	\$ —
September 30, 2017	\$ 18.05	\$ 16.00	\$ —
December 31, 2017	\$ 22.45	\$ 17.70	\$ —

Period ended	For the year ended December 31, 2016		Cash dividends declared
	Stock price High	Low	
March 31, 2016	\$ 15.38	\$ 10.48	\$ —
June 30, 2016	\$ 14.43	\$ 10.96	\$ —
September 30, 2016	\$ 18.13	\$ 11.47	\$ —
December 31, 2016	\$ 19.35	\$ 15.73	\$ —

We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described in Item 1A of this Report in the section entitled Risk Factors. All distributions are made at the discretion of our board of directors and depend on our earnings, our financial condition and such other factors as our board of directors may deem relevant from time to time.

Unregistered Sales of Equity Securities and Use of Proceeds

There were no sales of unregistered equity securities during the year ended December 31, 2017.

Repurchase of our Common Stock

The following table summarized the stock repurchase activity for the year ended December 31, 2017:

	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or program (1)	Approximate dollar value of shares that may yet be purchased under the plans or program (1)
July 1, 2017 – July 31, 2017	—	\$ —	—	\$ 50,000,000
August 1, 2017 – August 31, 2017	270,905	\$ 17.06	270,905	\$ 45,379,288
September 1, 2017 – September 30, 2017	233,911	\$ 17.01	233,911	\$ 41,401,192
October 1, 2017 – December 31, 2017	—	\$ —	—	\$ 41,401,192
Total	504,816	\$ 17.03	504,816	\$ 41,401,192

(1) As disclosed in our current report on Form 8-K filed on June 21, 2017, our board of directors approved a stock repurchase program authorizing us to repurchase up to \$50.0 million of our outstanding Class A common stock. The

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stock repurchase program does not require us to purchase a specific number of shares, and the timing and amount of any shares repurchased are based on market conditions and other factors, including price, regulatory requirements and capital availability. Stock repurchases may be effected through negotiated transactions or open market purchases, including pursuant to a trading plan implemented pursuant to Rule 10b5-1 of the Securities Exchange Act of 1934, as amended. The stock repurchase program does not have an expiration date but may be suspended, modified or discontinued at any time without prior notice.

Equity Compensation Plan Information

We have adopted an equity incentive plan, the 2013 Equity Incentive Plan, which provides for the grant of incentive stock option and nonstatutory stock options, stock appreciation rights, restricted stock and stock unit awards, performance units, stock grants and qualified performance based awards, which we collectively refer to as “awards.” Directors, officers and other employees of our Company and our subsidiaries, as well as others performing consulting or advisory services for us, are eligible for grants under the 2013 Equity Incentive Plan. The plan administrator of the equity incentive plan is the compensation committee of the board of directors. The board of directors itself may also exercise any of the powers and responsibilities under the 2013 Equity Incentive Plan. Subject to the terms of the 2013 Equity Incentive Plan, the plan administrator will select the recipients of awards and determine, among other things, the:

- number of shares of common stock covered by the awards and the dates upon which such awards become exercisable or any restrictions lapse, as applicable;
- type of award and the exercise or purchase price and method of payment for each such award;
- performance measures, if applicable, required to be satisfied prior to vesting;
- vesting period for awards, risks of forfeiture and any potential acceleration of vesting or lapses in risks of forfeiture; and
- duration of awards.

The following table provides information as of December 31, 2017 concerning our shares of Class A common stock authorized for issuance under our equity incentive plan.

(a)	(b)	(c) Number of securities
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Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights (1)	remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (2)
Equity compensation plans approved by security holders (3)	6,445,503	\$ 16.40	18,837,717
Equity compensation plans not approved by security holders (4)	—	—	—
Total	6,445,503	\$ 16.40	18,837,717

(1) The weighted average exercise price set forth in this column relates only to 3,457,014 stock options outstanding under our 2013 Equity Incentive Plan. The remaining securities included in column (a) of this table are performance based restricted stock units and time based restricted stock units, for which no exercise price applies.

(2) This number includes a specific pool of 17,118,283 shares of common stock authorized for issuance upon the future exchange of outstanding Class A units of PennyMac that were originally issued pursuant to compensatory arrangements. It also includes a general pool of 1,719,434 shares of common stock authorized for future awards (excluding securities reflected in column (a)). This general pool initially consisted of 3,906,433 shares of common

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stock authorized under the 2013 Equity Incentive Plan for future awards, and has been, and will continue to be, increased pursuant to the terms of the 2013 Equity Incentive Plan on January 1st of each calendar year by an amount equal to the lesser of (i) 1.75% of our outstanding common stock on a fully diluted basis as of the end of our immediately preceding fiscal year, (ii) 1,322,024 shares, and (iii) any lower amount determined by our board of directors. The annual increase to this general pool on January 1, 2017 pursuant to the foregoing formula was 1,322,024.

(3) Represents our 2013 Equity Incentive Plan.

(4) We do not have any equity plans that have not been approved by our stockholders

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Item 6. Selected Financial Data

The following financial data should be read in conjunction with Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Item 8, “Financial Statements and Supplementary Data.” The table below presents, as of and for the dates indicated, selected historical financial information for us. The condensed consolidated statements of income data for the years ended December 31, 2017, 2016, and 2015 and the condensed consolidated balance sheets data at December 31, 2017, and 2016 have been derived from our audited financial statements included elsewhere in this Report. The condensed consolidated statements of income data for the years ended December 31, 2014 and 2013 and the condensed consolidated balance sheets data at December 31, 2015, 2014, and 2013 have been derived from our Company’s audited consolidated financial statements that are not included in this Report.

	Year ended December 31,				
	2017	2016	2015	2014	2013
	(in thousands, except per share data)				
Condensed Consolidated Statements of Income:					
Revenues					
Net gains on mortgage loans held for sale	\$ 391,804	\$ 531,780	\$ 320,715	\$ 167,024	\$ 138,013
Loan origination fees	119,202	125,534	91,520	41,576	23,575
Fulfillment fees from PennyMac Mortgage Investment Trust	80,359	86,465	58,607	48,719	79,712
Net mortgage loan servicing fees	306,059	185,466	229,543	216,919	90,010
Management fees and Carried Interest	22,545	23,726	30,865	48,664	53,749
Net interest expense	(1,341)	(25,079)	(19,382)	(9,486)	(1,041)
Other	36,835	3,995	1,242	4,861	2,541
Total net revenue	955,463	931,887	713,110	518,277	386,559
Expenses					
Compensation	358,721	342,153	274,262	190,707	148,576
Servicing	117,696	85,857	68,085	48,430	7,028
Other	143,137	120,794	91,570	56,107	48,829
Total expenses	619,554	548,804	433,917	295,244	204,433

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Income before provision for income taxes	335,909	383,083	279,193	223,033	182,126
Provision for income taxes	24,387	46,103	31,635	26,722	9,961
Net income	311,522	336,980	247,558	196,311	172,165
Less: Net income attributable to noncontrolling interest	210,765	270,901	200,330	159,469	157,765
Net income attributable to PennyMac Financial Services, Inc. common stockholders	\$ 100,757	\$ 66,079	\$ 47,228	\$ 36,842	\$ 14,400

Condensed Consolidated Balance Sheets at Year End:

Assets

Mortgage loans held for sale at fair value	\$ 3,099,103	\$ 2,172,815	\$ 1,101,204	\$ 1,147,884	\$ 531,004
Mortgage servicing rights	2,119,588	1,627,672	1,411,935	730,828	483,664
Carried Interest due from					
Investment Funds	8,552	70,906	69,926	67,298	61,142
Servicing advances	318,066	348,306	299,354	228,630	154,328
Other	1,822,784	914,203	622,875	332,046	354,337
Total assets	\$ 7,368,093	\$ 5,133,902	\$ 3,505,294	\$ 2,506,686	\$ 1,584,475

Liabilities and stockholders' equity

Assets sold under

agreements to repurchase	\$ 2,381,538	\$ 1,735,114	\$ 1,166,731	\$ 822,252	\$ 471,592
Mortgage loan participation and sale agreements	527,395	671,426	234,872	143,568	—
Notes payable	891,505	150,942	61,136	146,855	52,154
Excess servicing spread financing at fair value payable to PennyMac					
Mortgage Investment Trust	236,534	288,669	412,425	191,166	138,723
Other	1,611,447	888,395	567,780	395,579	292,802

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Total liabilities	5,648,419	3,734,546	2,442,944	1,699,420	955,271
Stockholders' equity	1,719,674	1,399,356	1,062,350	807,266	629,204
Total liabilities and stockholders' equity	\$ 7,368,093	\$ 5,133,902	\$ 3,505,294	\$ 2,506,686	\$ 1,584,475
Earnings Per Share:					
Basic	\$ 4.34	\$ 2.98	\$ 2.17	\$ 1.73	\$ 0.83
Diluted	\$ 4.03	\$ 2.94	\$ 2.17	\$ 1.73	\$ 0.82
Year end Per Share:					
Book value	\$ 19.95	\$ 15.49	\$ 12.32	\$ 9.92	\$ 8.04
Share price	\$ 22.35	\$ 16.65	\$ 15.36	\$ 17.30	\$ 17.55

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Critical Accounting Policies

Preparation of financial statements in compliance with accounting principles generally accepted in the United States ("GAAP") requires us to make estimates 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. Certain of these estimates significantly influence the portrayal of our financial condition and results, and they require us to make difficult, subjective or complex judgments. Our critical accounting policies primarily relate to our fair value estimates.

Fair Value

We group assets measured at or based on fair value in three levels based on the markets in which the assets are traded and the observability of the inputs used to determine fair value. These levels are:

Level/Description	December 31, 2017		
	Carrying value of assets measured (in thousands)	Percentage of Total assets	Total stockholders' equity
Level 1: Prices determined using quoted prices in active markets for identical assets or liabilities.	\$ 175,793	2%	10%
Level 2: Prices determined 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 us. These may include quoted prices for similar assets or liabilities, interest rates, prepayment speeds, credit risk and others.	2,326,762	32%	135%
Level 3: Prices determined using significant unobservable inputs. In situations where observable inputs are unavailable (for example, when there is little or no market activity for an asset or liability at the end of the year), unobservable inputs may be used. Unobservable inputs reflect our assumptions about the factors that market participants use in pricing an asset or liability, and are based on the best information available in the circumstances.	2,974,914	40%	173%

Total assets measured at or based on fair value (1)	\$ 5,477,469	74%	318%
Total assets	\$ 7,368,093		
Total stockholders' equity	\$ 1,719,674		

(1) Includes assets measured on both a recurring and nonrecurring basis based on the accounting principles applicable to the specific asset or liability and whether we have elected to carry the asset or liability at its fair value.

As shown above, our consolidated balance sheet is substantially comprised of assets and liabilities that are measured at or based on their fair values. At December 31, 2017, \$4.0 billion or 54% of our total assets were carried at fair value and \$1.5 billion or 20% of our total assets were carried based on their fair values (comprised of certain of our MSRs and real estate acquired in settlement of loans (“REO”) properties, which are carried at the lower of amortized cost or fair value). Of these assets carried at or based on fair value, \$3.0 billion or 40% are measured using “Level 3” fair value inputs – significant inputs that are difficult to observe due to the difficulty in observing the inputs used by market participants in establishing fair value. Changes in inputs to measurement of these assets can have a significant effect on the amounts reported for these items including their reported balances and their effects on our income.

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As a result of the difficulty in observing certain significant valuation inputs affecting our “Level 3” fair value assets and liabilities, we are 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 illiquidity of some of these assets, subsequent transactions may be at values significantly different from those reported.

Because the fair value of “Level 3” fair value assets and liabilities are difficult to estimate, our process includes performance of these items’ fair value estimation by specialized staff and significant senior management oversight. We have assigned the responsibility for estimating the fair values of non- interest rate lock commitment (“IRLC”) “Level 3” fair value assets and liabilities to our Financial Analysis and Valuation group (the “FAV group”), which is responsible for valuing and monitoring these items and maintenance of our valuation policies and procedures for non-IRLC assets and liabilities. The FAV group submits the results of its valuations to our senior management valuation committee, which oversees and approves the valuations. During 2017, our senior management valuation committee included the Company’s executive chairman, chief executive, chief financial, chief risk, chief enterprise operations and deputy chief financial officers.

The fair value of our IRLCs is developed by our Capital Markets Risk Management staff and is reviewed by our Capital Markets Operations group.

Following is a discussion of our approach to measuring the balance sheet items that are most affected by “Level 3” fair value estimates.

Mortgage Loans

We carry mortgage loans at their fair values. We recognize changes in the fair value of mortgage loans in current period income as a component of Net gains on mortgage loans held for sale at fair value. We estimate the fair value of mortgage loans based on whether the mortgage loans are saleable into active markets with observable fair value inputs.

- We categorize mortgage loans that are saleable into active markets as “Level 2” fair value assets. We estimate the fair value of such mortgage loans using their quoted market price or market price equivalent. At December 31, 2017, we held \$2.3 billion of such mortgage loans.
- We categorize mortgage loans that are not saleable into active markets as “Level 3” fair value assets. “Level 3” fair value mortgage loans arise primarily from two sources:

- We may purchase certain delinquent government guaranteed or insured mortgage loans from Ginnie Mae guaranteed pools in our mortgage loan servicing portfolio. Our right to purchase such mortgage loans arises as the result of the borrower's failure to make payments for three consecutive months preceding the month that we repurchase the mortgage loan and provides an alternative to our obligation to continue advancing principal and interest at the coupon rate of the related Ginnie Mae security. To the extent such mortgage loans ("early buyout loans" or "EBO") 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, we measure such mortgage loans using "Level 3" fair value inputs.
- Certain of our mortgage loans may become non-saleable into active markets due to our identification of one or more defects. Because such mortgage loans are generally not saleable into active mortgage markets, we classify them as "Level 3" fair value assets.

At December 31, 2017, we held \$782.2 million of "Level 3" fair value mortgage loans.

The significant unobservable inputs used in the fair value measurement of our "Level 3" fair value mortgage loans held for sale are discount rates, home price projections, voluntary prepayment speeds and default speeds.

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Significant changes in any of those inputs in isolation could result in a significant change to the mortgage loans' fair value measurement.

Interest Rate Lock Commitments

Our net gains on mortgage loans held for sale includes our estimates of the gains or losses we expect to realize upon the sale of mortgage loans we have contractually committed to fund or purchase but have not yet funded, purchased or sold. We recognize a substantial portion of our net gains on mortgage loans held for sale at fair value before we fund or purchase the mortgage loan as the result of these commitments. We call these commitments IRLCs. We recognize the fair value of IRLCs at the time we make the commitment to the correspondent seller or mortgage loan applicant and adjust the fair value of such IRLCs as the mortgage loan approaches the point of funding or purchase or the prospective transaction is canceled.

We carry IRLCs as either derivative assets or derivative liabilities on our consolidated balance sheet. The fair value of an IRLC is transferred to mortgage loans held for sale at fair value when the mortgage loan is funded or purchased.

An active, observable market for IRLCs does not exist. Therefore, we measure the fair value of IRLCs using methods we believe that market participants use in pricing IRLCs. We estimate the fair value of an IRLC based on observable Agency MBS prices, our estimates of the fair value of the MSR we expect to receive in the sale of the mortgage loans and the probability that we will fund or purchase the mortgage loan (the "pull-through rate").

Pull-through rates and MSR fair values are based on our estimates as these inputs are difficult to observe in the mortgage marketplace. Our estimate of the probability that a mortgage loan will be funded and market interest rates are updated as the mortgage loans move through the funding or purchase process and as mortgage market interest rates change and may result in significant changes in our estimates of the fair value of the IRLCs. Such changes are reflected in the change in fair value of IRLCs which is a component of our Net gains on mortgage loans held for sale at fair value in the period of the change. The financial effects of changes in these inputs are generally inversely correlated. Increasing mortgage 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.

A shift in our assessment of an input to the valuation of IRLCs can have a significant effect on the amount of Net gains on sale of mortgage loans held for sale for the period. We believe that the most significant "Level 3" fair value input to the measurement of IRLCs is the pull-through rate. At December 31, 2017, we held \$58.3 million of net IRLC assets at fair value. Following is a quantitative summary of the effect of changes in the pull-through rate input on the fair value of IRLCs:

Shift in input (1)		Effect on fair value of IRLC of a change in pull-through rate (in thousands)
5	%	\$ 3,517
10	%	\$ 6,861
20	%	\$ 12,359
(5)	%	\$ (3,885)
(10)	%	\$ (7,768)
(20)	%	\$ (15,533)

(1) The upward shift in input amount on a per-loan basis is limited to the amount of shift required to reach a 100% pull-through rate.

The preceding analysis holds constant all of the other inputs to show an estimate of the effect on fair value of a change in the pull-through rate. We expect that in a market shock event, multiple inputs would be affected and the

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effects of these changes may compound or counteract each other. Therefore the preceding analysis is not a projection of the effects of a shock event or a change in our estimate of an input and should not be relied upon as an earnings projection.

Mortgage Servicing Rights and Mortgage Servicing Liabilities (“MSLs”)

MSRs and MSLs represent the value assigned to a contract that obligates us to service the mortgage loans on behalf of the owner of the mortgage loan in exchange for servicing fees and the right to collect certain ancillary income from the borrower. We initially recognize MSRs at our estimate of the fair value of the contract to service the loans. At December 31, 2017, we held \$2.1 billion of carrying value of MSRs net of MSLs.

As economic fundamentals influencing the underlying mortgage loans change, our estimate of the fair value of the related MSR or MSL we hold will also change. As a result, we will record changes in fair value for the MSRs and MSLs we carry at fair value, and we may recognize changes in the fair value of our MSRs carried at the lower of amortized cost or fair value depending on the existing relationship of the MSR’s fair value to its carrying value at the measurement date. These fair value changes will be recognized as a component of Amortization, impairment and change in fair value of mortgage servicing rights and mortgage servicing liabilities.

After the initial recognition of MSRs and MSLs, we account for MSRs based on the class of MSRs: originated MSRs backed by mortgage loans with initial interest rates of less than or equal to 4.5%; originated MSRs backed by mortgage loans with initial interest rates of more than 4.5%; and purchased MSRs. We account for originated MSRs backed by mortgage loans with initial interest rates of less than or equal to 4.5% using the amortization method. Originated MSRs backed by loans with initial interest rates of more than 4.5% and purchased MSRs are accounted for at fair value with changes in fair value recorded in current period income. MSLs are accounted for at fair value with changes in fair value recorded in current period income.

MSRs Accounted for Using the Amortization Method

We amortize MSRs accounted for using the amortization method. MSR amortization is determined by applying the ratio of the net MSR cash flows projected for the current period to the estimated total remaining net MSR cash flows. The estimated total net MSR cash flows are determined at the beginning of each month using prepayment inputs applicable at that time.

We also evaluate MSRs accounted for using the amortization method for impairment with reference to the assets’ fair values at the measurement date. Impairment occurs when the current fair value of the MSR falls below the asset’s

amortized cost. If MSR's are impaired, the impairment is recognized in current period income and the carrying value of the MSR's is adjusted through a valuation allowance. If the fair value of impaired MSR's subsequently increases, we recognize the increase in fair value in current period income and, through a reduction in the valuation allowance, adjust the carrying value of the MSR's to a level not in excess of amortized cost.

When evaluating MSR's for impairment, we stratify the assets by predominant fair value risk characteristic including mortgage loan type (fixed-rate or adjustable-rate) and note interest rate. We stratify fixed-rate mortgage loans into note interest rate pools of 50 basis points for note interest rates between 3.0% and 4.5% and a single pool for note interest rates of less than or equal to 3.0%. We evaluate adjustable-rate mortgage loans with initial interest rates of 4.5% or less in a single pool. Amortization and impairment of MSR's accounted for using the amortization method are included in current period income as a component of Net mortgage loan servicing fees. During the year ended December 31, 2017, we recognized \$6.9 million in impairment of MSR's accounted for using the amortization method.

We periodically review the various impairment strata to determine whether the fair value of the impaired MSR's in a given stratum is likely to recover. When we conclude that recovery of the fair value is unlikely in the foreseeable future, a write-down of the cost of the MSR's for that stratum to its estimated recoverable value is charged to the valuation allowance. We did not recognize such write-down of MSR's during the year ended December 31, 2017.

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MSRs and MSLs Accounted for at Fair Value

We include changes in fair value of MSRs and MSLs accounted for at fair value in current period income as a component of Amortization, impairment and change in fair value of mortgage servicing rights and mortgage servicing liabilities. During the year ended December 31, 2017, we recognized a \$67.9 million net reduction in fair value of MSRs and MSLs accounted for at fair value, of which \$11.3 million was due to changes in inputs used to estimate fair value and \$56.6 million was due to realization of cash flows underlying the fair value of MSR and MSL.

A shift in the market for MSRs and MSLs or a change in our assessment of an input to the valuation of MSRs and MSLs can have a significant effect on their fair value and in our income for the period. We believe the most significant “Level 3” fair value inputs to the valuation of MSRs and MSLs are the pricing spread (used to develop periodic discount rates), prepayment speed and annual per-loan cost of servicing.

Following is a summary of the effect on fair value of MSRs (which totaled \$2.1 billion at December 31, 2017) of various changes to these key inputs:

Shift in input		Effect on fair value of MSRs of a change in input value		
		Pricing spread (in thousands)	Prepayment speed	Servicing cost
5	%	\$ (38,460)	\$ (34,353)	\$ (17,463)
10	%	\$ (75,531)	\$ (67,523)	\$ (34,925)
20	%	\$ (145,785)	\$ (130,552)	\$ (69,850)
(5)	%	\$ 39,922	\$ 35,602	\$ 17,463
(10)	%	\$ 81,388	\$ 72,522	\$ 34,925
(20)	%	\$ 169,292	\$ 150,627	\$ 69,850

The preceding analyses hold constant all of the inputs other than the input that is being changed to show an estimate of the effect on fair value of a change in a specific input. We expect that in a market shock event, multiple inputs would be affected and the effects of these changes may compound or counteract each other. Furthermore, certain of our MSRs are accounted for using the amortization method and are carried at the lower of amortized cost or fair value. Such assets' carrying value may not be immediately affected as a result of a change in input values depending on the carrying value of the MSR asset before the change in input occurs and whether the input change causes our estimate of fair value to change to a level below the amortized cost of those MSRs. Therefore the preceding analyses are not projections of the effects of a shock event or a change in our estimate of an input and should not be relied upon as earnings projections.

Excess Servicing Spread

We finance a portion of the cost of Agency MSR's that we purchase from non-affiliate sellers through the sale to PMT of the servicing spread in excess of a specified level. We carry our ESS at fair value.

Because the ESS is a claim to a portion of the cash flows from MSR's, the valuation of the ESS is similar to that of MSR's. We use the same discounted cash flow approach to measure the ESS and the related MSR's except that certain inputs relating to the cost to service the mortgage loans underlying the MSR's and certain ancillary income are not included in the ESS valuation as these cash flows do not accrue to the holder of the ESS.

A shift in the market for, or a change in our assessment of an input to the valuation of, ESS can have a significant effect on the fair value of ESS and in our income for the period. However, we believe that this change will be offset to a great extent by a change in the fair value of the MSR's that the ESS is financing. We record changes in the fair value of ESS in Amortization, impairment and change in fair value of mortgage servicing rights and mortgage servicing liabilities. During the year ended December 31, 2017, we recorded \$19.4 million of net reduction in fair value of ESS.

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We believe that the most significant “Level 3” fair value inputs to the valuation of ESS are the pricing spread (used to develop periodic discount rates) and prepayment speed. At December 31, 2017, we carried \$236.5 million of ESS at fair value. Following is a summary of the effect on fair value of various changes to these inputs:

Shift in input		Effect on excess servicing spread of a change in input value	
		Pricing spread (in thousands)	Prepayment speed
5	%	\$ (1,997)	\$ (5,359)
10	%	\$ (3,962)	\$ (10,500)
20	%	\$ (7,798)	\$ (20,177)
(5)	%	\$ 2,031	\$ 5,590
(10)	%	\$ 4,096	\$ 11,427
(20)	%	\$ 8,330	\$ 23,901

The preceding analyses hold constant all of the inputs other than the input that is being changed to show an estimate of the effect on fair value of a change in that specific input. We expect that in a market shock event, multiple inputs would be affected and the effects of these changes may compound or counteract each other. Therefore the preceding analyses are not projections of the effects of a shock event or a change in our estimate of an input and should not be relied upon as earnings projections.

Critical Accounting Policy Not Based on Fair Value- Liability for Losses Under Representations and Warranties

We record a provision for losses relating to our representations and warranties as part of our mortgage loan sale transactions. The method we use to estimate the liability for representations and warranties is a function of the representations and warranties given and considers a combination of factors, including, but not limited to, estimated future default and mortgage loan repurchase rates, the potential severity of loss in the event of default and, if applicable, the probability of reimbursement by the correspondent mortgage loan seller. We establish a liability at the time loans are sold and periodically update our liability estimate. We recorded \$5.9 million in provision for losses relating to current year mortgage loan sales during the year in Net gain on mortgage loans held for sale at fair value during the year ended December 31, 2017. At December 31, 2017, the balance of our liability for losses under representations and warranties totaled \$20.1 million.

The level of the liability for losses under representations and warranties is difficult to estimate and requires considerable judgment. The level of mortgage loan repurchase losses is dependent on economic factors, purchaser or insurer loss mitigation strategies, and other external conditions that may change over the lives of the underlying mortgage loans. Our estimate of the liability for representations and warranties is developed by our credit

administration staff. The liability estimate is reviewed and approved by our senior management credit committee which includes the senior executives of the Company and of the loan production, loan servicing and credit risk management areas.

As economic fundamentals change, as purchaser and insurer evaluations of their loss mitigation strategies (including claims under representations and warranties) change and as the mortgage market and general economic conditions affect our correspondent sellers, the level of repurchase activity and ensuing losses will change. As a result of these changes, we may be required to adjust the estimate of our liability for representations and warranties. Such an adjustment may be material to our financial condition and income. During the year ended December 31, 2017, we recorded reductions to our previously recorded representations and warranties liability amounts totaling \$4.3 million in Net gain on mortgage loans held for sale at fair value.

Accounting Developments

Refer to Note 28 – Recently Issued Accounting Pronouncements to our consolidated financial statements for a discussion of recent accounting developments and the expected effect on the Company.

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Results of Operations

Our results of operations are summarized below:

	Year ended December 31,		
	2017	2016	2015
	(in thousands)		
Revenues:			
Net gains on mortgage loans held for sale at fair value	\$ 391,804	\$ 531,780	\$ 320,715
Mortgage loan origination fees	119,202	125,534	91,520
Fulfillment fees from PennyMac Mortgage Investment Trust	80,359	86,465	58,607
Net mortgage loan servicing fees	306,059	185,466	229,543
Management fees & Carried Interest	22,545	23,726	30,865