

PennyMac Mortgage Investment Trust

First Quarter 2021 Earnings Transcript

May 6, 2021

Introduction

Good afternoon, and welcome to the first quarter 2021 earnings discussion for PennyMac Mortgage Investment Trust. The slides that accompany this discussion are available from PennyMac Mortgage Investment Trust's website at www.PennyMac-REIT.com. Before we begin, let me remind you that our discussion contains forward-looking statements that are subject to the risks identified on Slide 2 that could cause our actual results to differ materially. Thank you.

Now I'd like to introduce David Spector, PMT's Chairman and Chief Executive Officer who will discuss the Company's first quarter 2021 results.

Speaker:

David Spector – Chairman and Chief Executive Officer

Thank you, Isaac.

PMT produced another strong quarter of financial results with net income attributable to common shareholders of 65.4 million dollars, or diluted earnings per common share of 67 cents. These strong results were driven by strong correspondent production results and the continued improvement in the fair value of its GSE credit risk transfer investments. Additionally, PMT's CRT investments continued to benefit from the elevated prepayment speeds we are seeing across the industry.

MSR fair value gains were more than offset by fair value declines on Agency MBS and interest rate hedges due to significant prepayment activity and elevated hedge costs driven by market volatility. PMT paid a common dividend of 47 cents per share. Book value per share increased 3 percent to 20 dollars and 90 cents from 20 dollars and 30 cents at the end of the prior quarter, partially due to strong earnings and partially due to the issuance of senior exchangeable notes.

In the current and evolving market environment, PMT is uniquely positioned as the largest correspondent lender in the country to continue to create organic investments in MSRs sourced from the high quality conventional production of loans it delivers to the GSEs. In addition to benefitting from the historically large origination market we are currently in, PMT also benefits from the investments in technology and fulfillment capacity made by its manager and services provider, PennyMac Financial. Further, PMT's investments in MSR and CRT benefit from PFSI's expertise in managing credit risk utilizing a variety of loss mitigation strategies.

Our high quality loan production in the quarter resulted in the creation of more than 400 million dollars in new, low-rate mortgage servicing rights and PMT ended the quarter with approximately 2.4 billion dollars in fair value of MSRs, which we expect will perform well in a rising rate environment.

Also this quarter, we further strengthened PMT's balance sheet, issuing senior exchangeable notes and term asset-backed financing to replace less favorable short-term securities repurchase agreements.

We issued 659 million dollars of 3-year term notes associated with PMT's sixth CRT transaction and the entirety of PMT's CRT investments is now financed with term notes that do not contain margin call provisions, providing stable financing throughout much of the expected life of the asset.

We also issued 350 million dollars in five year Fannie Mae MSR term notes to support the growing MSR portfolio. This term financing also more closely aligns to the expected life of the asset.

And finally, we issued 345 million dollars of 5-year senior exchangeable notes, upsized from an initial 200 million dollars offered with strong support from institutional investors. This issuance with an initial conversion price of 21 dollars and 69 cents represents an attractive

premium to PMT's book value per share at issuance. In addition, the option value of the conversion premium contributed partially to the increase in PMT's book value during the quarter.

With that, I will now turn it over to Andy Chang, PMT's Senior Managing Director and Chief Operating Officer.

Speaker:

Andrew Chang – Senior Managing Director and Chief Operating Officer

Thank you, David. I will discuss the mortgage origination landscape and how we believe we have positioned PMT to continue delivering attractive risk-adjusted returns to our shareholders.

The origination market continues to be historically strong as mortgage rates remain near record lows despite the increases in the ten-year Treasury yield since the start of the year. Recent economic forecasts for 2021 originations range from 3.3 trillion to 4 trillion dollars, while

average forecasts for 2022 originations remain strong at 2.6 trillion dollars. It is worth noting that in each of 2021 and 2022, purchase originations are expected to total 1.7 trillion dollars, almost 40 percent higher than 2019 levels. So while refinance origination volumes are expected to decline significantly over time as a result of higher interest rates, we believe PMT is well positioned to continue organically creating investments – especially as we are one of the largest producers of purchase money loans in the U.S.

We believe favorable dynamics continue to drive significant opportunities for PMT in correspondent production. As the GSEs implement the latest amendments to their preferred stock purchase agreements, we expect these changes to favor scaled and well-capitalized market participants such as PMT. Additionally, we expect the 1.5 billion dollar annual limit per client on cash window deliveries into each of the GSEs to drive more volume into the correspondent channel. Finally, we expect limitations placed on the GSEs' ability to

guarantee certain types of loans to create a heightened need for private capital over time, providing opportunities for increased investment from companies like PMT that have established expertise in the mortgage capital markets and private label securitizations.

PMT's capital deployment is currently focused on the large opportunity in conventional correspondent production and the related high-quality mortgage servicing rights.

As you can see on slide 7 of our presentation, during the first quarter runoff from prepayments on our CRT investments was more than offset by net new MSR investments. As David mentioned, PMT's position as an industry-leading producer of mortgage loans gives us a unique ability to create attractive, high-quality, organic investments in MSRs at low interest rates. Furthermore, PennyMac Financial's history in successfully executing loss mitigation strategies in its role as the

servicer of the loans underlying these investments creates a strong alignment of interests.

On slide 9, we illustrate the run-rate return potential from PMT's investment strategies, which represents the average annualized return and quarterly earnings potential that PMT expects over the next four quarters. In total, we expect a quarterly run-rate return for PMT's strategies of 50 cents per share or a 9.5 percent annualized return on equity.

This run-rate potential estimate is down slightly from what we showed last quarter. In our credit sensitive strategies, a slight reduction in our expected CRT returns reflects credit spreads that have tightened.

In contrast, the return potential for our interest rate sensitive strategies has improved modestly, driven by expectations for higher carry on Agency MBS.

The change in PMT's run-rate expected return is also driven by a shift in equity allocation towards the interest rate sensitive strategies from the correspondent production segment as a result of expectations for lower origination market volumes over the next year.

Now I'd like to turn the call over to Vandy Fartaj, PMT's Senior Managing Director and Chief Investment Officer, who will discuss the drivers of PMT's first quarter investment performance.

Speaker:

Vandy Fartaj – Senior Managing Director and Chief Investment Officer

Thank you, Andy.

Let's begin with highlights in our Correspondent Production segment.

Total correspondent acquisition volume in the quarter was 51.2 billion dollars in UPB, down 10 percent from the prior quarter and up 72

percent year-over-year. 66 percent of PMT's acquisition volumes were conventional loans, essentially unchanged from the prior quarter. We maintained our leadership position in the channel as a result of our consistency, competitive pricing, and the operational excellence we continue to provide to our correspondent partners. PMT ended the quarter with 727 correspondent seller relationships, up from 714 at December 31st.

Conventional lock volume in the quarter was 34 billion dollars in UPB, down 14 percent from the prior quarter and up 78 percent year-over-year.

Margins in the channel have normalized and PMT's correspondent production segment pretax income as a percentage of interest rate lock commitments was 10 basis points, down from 13 basis points in the prior quarter.

Acquisition volumes remained strong in April, with 18.5 billion dollars in UPB of total acquisitions, and 15.6 billion dollars in UPB of total locks.

PMT's Interest Rate Sensitive strategies consists of our investments in MSR sourced from our correspondent production, and investments in Agency MBS, non-Agency senior MBS and interest rate hedges with offsetting interest rate exposure.

The fair value of PMT's MSR asset at the end of the first quarter was 2.4 billion dollars, up from 1.8 billion dollars at the end of the prior quarter. The substantial increase in the fair value of our MSR investments reflects both new MSR investments and fair value gains that resulted from higher interest rates.

Notably, during the quarter PMT sold its remaining investment in ESS back to PFSI at fair value. The capital that resulted from the sale of this investment is expected to be redeployed into attractive MSR investments.

Now I would like to discuss the drivers of performance in PMT's Credit Sensitive Strategies, which primarily consist of investments in CRT.

The total UPB of loans underlying our CRT investments as of March 31st was 48 billion dollars, down significantly quarter-over-quarter as a result of elevated prepayments. Fair value of our CRT investments at the end of the quarter was 2.58 billion dollars, down slightly from 2.62 billion dollars at December 31st as fair value gains largely offset the decline in asset value that resulted from prepayments.

The 60-plus day delinquency rate underlying our CRT investments was essentially unchanged quarter over quarter as the overall number of delinquent loans declined roughly in proportion with prepayments.

PFSI's position as the manager and servicer of loans underlying PMT's CRT investments gives PMT a strategic advantage, given we can work directly with borrowers who have loans underlying PMT's investments and have experienced hardships related to COVID-19. PFSI uses a

variety of loss mitigation strategies to assist delinquent borrowers, and because the scheduled loss transactions, notably PMTT1-3 and L Street Securities 2017-PM1, trigger a loss if a borrower becomes 180 days or more delinquent, we have deployed additional loss mitigation resources and continue to assist those borrowers at risk.

With respect to PMTT1-3, which comprises 6 percent of the fair value of PMT's overall CRT investment, if all presently delinquent loans proceeded unmitigated to 180 days or more delinquent, additional losses would be approximately 34 million dollars. Through the end of the quarter, losses to date totaled 7 million dollars. As a reminder, mortgage obligations underlying PMTT1-3 become credit events at 180 days or more delinquent regardless of any grant of forbearance.

Moving on to L Street Securities 2017-PM1, which comprises 18 percent of the total fair value of PMT's CRT investment, such losses will become reversed credit events if the payment status is reported as current after

a forbearance period due to COVID-19. PMT recorded 14 million dollars in net losses reversed in the first quarter, as 43 million dollars of losses reversed more than offset the 29 million dollars in additional realized losses. We believe the majority of the remaining losses have the potential to reverse if the payment status of the related loan is reported as current after the conclusion of the CARES Act forbearance. We estimate that an additional 32 million dollars of these losses were eligible for reversal as of March 31st subject to review by Fannie Mae and we expect this amount to increase as additional borrowers exit forbearance and reperform. We estimate that only 6 million dollars of the losses outstanding had no potential for reversal. This market expectation of significant future loss reversals resulted in the fair value of L Street Securities 2017-PM1 exceeding its face amount by 46 million dollars at the end of the quarter.

The most common method for borrowers to exit forbearance to date has been a COVID-19 payment deferral. This allows the borrower to

defer the amount owed of the payment deferral to the end of the loan term and the loan is deemed current after the borrower makes a specified number of monthly mortgage payments.

Now I would like to turn the call over to Dan Perotti, our Senior Managing Director and Chief Financial Officer, who will review our quarterly financial results.

Speaker:

Daniel Perotti – Senior Managing Director and Chief Financial Officer

Thank you Vandy.

PMT reports results through four segments: Credit Sensitive Strategies, which contributed 134.3 million dollars in pretax income; Interest Rate Sensitive Strategies, which contributed 64.6 million dollars in pretax loss; Correspondent Production, which contributed 35.6 million dollars

in pretax income; and the Corporate segment, which had a pretax loss of 14.2 million dollars.

The contribution from PMT's CRT investments totaled 135.7 million dollars. This amount included 98.1 million dollars in market-driven value gains, reflecting the impact of credit spread tightening and elevated prepayment speeds. As a reminder, faster prepayment speeds benefit PMT's CRT investments as payoffs of the associated loans reduce potential for realized losses and return principal at par for investments currently held at a discount. Net gain on CRT investments also included 42.7 million dollars in realized gains and carry, 13.3 million dollars in net losses reversed, primarily related to L Street Securities 2017-PM1 which Vandy discussed earlier, 200 thousand dollars in interest income on cash deposits, 15.9 million dollars of financing expenses, and 2.5 million dollars of expenses to assist certain borrowers in mitigating loan delinquencies they incurred as a result of dislocations arising from the COVID-19 pandemic.

PMT's interest rate sensitive strategies contributed a loss of 64.6 million dollars in the quarter. MSR fair value increased 338 million dollars during the quarter. 380 million dollars in fair value gains as a result of lower expectations for prepayment activity in the future driven by higher mortgage rates was partially offset by 42 million dollars in other valuation losses primarily driven by elevated levels of prepayment activity. Fair value declines on Agency MBS and interest rate hedges totaled 448 million dollars and included 29 million dollars in hedge costs driven by market volatility that also impacted hedge effectiveness in the quarter.

Valuation related losses in the quarter were somewhat offset by income excluding market-driven value changes, as servicing fees increased from the prior quarter primarily due to a larger servicing portfolio, and as PMT continues to benefit from increasing recapture income from PFSI.

We believe over time, our results have demonstrated successful hedging of mortgage servicing rights in volatile markets.

PMT's Correspondent Production segment contributed 35.6 million dollars to pretax income for the quarter, down from 52.7 million dollars in the prior quarter as gain on sale margins normalized.

PMT's Corporate segment includes interest income from cash and short-term investments, management fees and corporate expenses. The segment's contribution for the quarter was a pretax loss of 14.2 million dollars.

Finally, we recognized a provision for tax expense of 19.4 million dollars in the first quarter compared to a tax benefit of 9 million dollars in the prior quarter.

And with that, I'll turn the discussion back over to David for some closing remarks.

Speaker:

David Spector – Chairman and Chief Executive Officer

Thank you, Dan.

As we look at the evolving mortgage landscape, we believe PMT remains uniquely positioned to capitalize on the current environment characterized by elevated production volumes. Additionally, we expect changes to the GSE preferred stock purchase agreements limiting cash window deliveries to make the role of well-capitalized correspondent lenders like PMT increasingly important to a healthy mortgage market. Finally, we look forward to further discussing our outlook for the business at our upcoming investor day for PennyMac Mortgage Investment Trust and PennyMac Financial.

We encourage investors with any questions to reach out to our Investor Relations team by email or phone.

Thank you.

Operator:

This concludes PennyMac Mortgage Investment Trust's first quarter earnings discussion. For any questions, please visit our website at www.PennyMac-REIT.com, or call our Investor Relations department at 818-224-7028. Thank you.