

PennyMac Mortgage Investment Trust

Second Quarter 2021 Earnings Transcript

August 5, 2021

Introduction

Good afternoon, and welcome to the second quarter 2021 earnings discussion for PennyMac Mortgage Investment Trust. The slides that accompany this discussion are available on 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 second 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 31.9 million dollars, or diluted earnings per common share of 32 cents. These results were driven by strong correspondent production segment results and the performance of its GSE credit risk transfer investments.

PMT's MSR fair value declined due to lower mortgage rates which increase the refinance potential for loans in our portfolio. These losses were partially offset by fair value gains on interest rate hedges and Agency MBS. PMT paid a common dividend of 47 cents per share. Book

value per share decreased slightly to 20 dollars and 77 cents from 20 dollars and 90 cents at the end of the prior quarter.

In this dynamic mortgage market, PMT is uniquely positioned to capitalize on current and evolving investment opportunities given its scale and importance in the home ownership ecosystem. In addition to benefiting from the historically large origination market we are currently in, PMT also benefits from strong demographic and secular trends driving growth in purchase activity. With a new administration in the White House and changes at the FHFA, we are likely to see an increasingly focused regulatory environment. As the GSE footprint continues to change, we also expect additional demand for private capital in the mortgage markets and we believe that well-capitalized aggregators with expertise in the capital markets will be best-positioned for success. Large correspondent aggregators with scalable technology, flexibility and capital resources, like PMT, will become increasingly more important.

Our high-quality loan production in the quarter resulted in the creation of more than 400 million dollars in new, low-coupon mortgage servicing rights and PMT ended the quarter with approximately 2.6 billion dollars in fair value of MSRs.

At our investor day we discussed a potential new investment opportunity for PMT related to securitization of non-owner occupied loans. This quarter, we purchased 13 million dollars in face amount of a securitization of non-owner occupied loans totaling 248 million dollars in UPB, sourced organically from PMT's conventional correspondent production volumes. We believe this to be an important investment

going forward and Vandy Fartaj, PMT's Chief Investment Officer, will discuss this later on in the presentation.

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 strong on a historical basis as mortgage rates have recently returned to near-record lows. Additionally, we believe FHFA's elimination of the Adverse Market Refinance Fee has resulted in a larger population of loans that would benefit from a refinance at today's lower rates, further supporting the origination market.

Recent economic forecasts for 2021 originations range from 3.6 trillion to 4.2 trillion dollars, while average forecasts for 2022 originations remain strong at 2.7 trillion dollars. It is worth noting that purchase originations are expected to grow and are forecasted to be 1.7 trillion and 1.9 trillion dollars in 2021 and 2022, respectively.

So while refinance origination volumes are expected to decline significantly over the next several years as a result of higher interest rates, we believe PMT is well positioned to continue organically creating investments – especially as one of the largest producers of purchase money loans in the U.S.

PMT's capital deployment is primarily 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 second quarter runoff from prepayments on our CRT assets was mostly offset by net investments in MSR and from private label securitizations. 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. Furthermore, PennyMac Financial's history as a leading servicer of the loans underlying PMT's investments further enhances the risk-adjusted return profile of those investments.

On slide 8, 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 49 cents per share or a 9.3 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 to our expected CRT returns reflects credit spreads that have tightened.

The return potential for our interest rate sensitive strategies is roughly in line with the previous quarter.

In correspondent production, increased expectations for market volumes have driven an increased equity allocation to the strategy.

As I mentioned earlier, FHFA recently announced the elimination of a 50 basis point Adverse Market Refinance fee on Fannie Mae and Freddie Mac mortgage refinance transactions effective August 1st. The elimination of this fee will reduce the cost of refinancing a residential mortgage loan with a new conventional conforming loan and is expected to increase future prepayment rates on mortgage loans underlying our MSRs. Our run-rate estimate on slide 8 does not include the expected valuation impact to the MSR of this one-time event. Had FHFA reversed the Adverse Market Refinance Fee as of June 30th, we estimate that the MSRs would have experienced a one-time decrease of approximately 50 million dollars. This estimate is based on the composition of the MSRs we held as of June 30th, which may differ materially from the size and composition of the value of our MSRs as of September 30th, 2021. The amount of the adjustment that will be included in our results for the third quarter 2021 may differ significantly from the estimate based on the June 30th composition of the portfolio and will consider changes in market interest rates among other key valuation inputs at that time.

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 second 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 46.7 billion dollars in UPB, down 9 percent from the prior quarter and up 56 percent from the second quarter of 2020. 65 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 752 correspondent seller relationships, up from 727 at March 31st.

Conventional lock volume in the quarter was 30.3 billion dollars in UPB, down 11 percent from the prior quarter and up 22 percent year-over-year.

Margins in the channel decreased over the quarter and PMT's correspondent production segment pretax income as a percentage of interest rate lock commitments was 6 basis points, down from 10 basis points in the prior quarter.

Acquisition volumes in July were 15 billion dollars in UPB, and locks were 12.8 billion dollars in UPB.

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

The fair value of PMT's MSR asset at the end of the second quarter was 2.6 billion dollars, up from 2.4 billion dollars at the end of the prior quarter. The increase reflects new MSR investments that more than offset fair value losses and prepayments.

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

The total UPB of loans underlying our CRT investments as of June 30th was 41 billion dollars, down 15 percent quarter-over-quarter. Notably, PMT's L Street Securities Trust 2020-PMT1 recognized increased runoff during the quarter, as prepayments surpassed a contractual threshold, thereby accelerating prepayments to PMT's investment in the subordinate bonds. Fair value of our CRT investments at the end of the quarter was 2.2 billion dollars, down from 2.6 billion dollars at March 31st due to the decline in asset value that resulted from prepayments.

The 60-plus day delinquency rate underlying our CRT investments declined from March 31st. Though the UPB of CRT investments declined from the prior quarter due to prepayments, the overall number of delinquent loans declined even more sharply.

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 that 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 22 million dollars. Through the end of the quarter, losses to date totaled 8 million dollars.

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 21 million dollars in net losses reversed in the second quarter, as 33 million dollars of losses reversed more than offset the 12 million dollars in additional realized losses. We estimate that an additional 24 million dollars of these losses were eligible for reversal as of June 30th subject to review by Fannie Mae and we expect this amount to continue to increase as additional borrowers exit forbearance and reperform. We estimate that only 8 million dollars of the 82 million dollars in losses-to-date 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 37 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 program 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.

As David and Andy mentioned earlier, and as we highlighted in our investor day presentation, favorable dynamics in the mortgage landscape are presenting opportunities for investments related to private-label securitizations given recent GSE limits on second homes and investment properties. This investment opportunity is similar to PMT's investment in CRT bonds. Since we underwrite the loans and continue to service them, we have a solid understanding of the underlying loans' credit profiles. PFSI will fulfill and service the non-owner-occupied loans sourced from PMT's correspondent channel, with PMT investing in the credit sensitive, higher-yielding tranches of these securitizations, enabling PFSI to influence performance of the investments through effective servicing. These opportunities are enhanced by PMT's scale and the capital markets expertise of its manager, which can provide the opportunity for better execution than delivery to the GSEs. PMT's first investment in this area involved 248 million dollars in underlying UPB of non-owner occupied loans acquired through PMT's correspondent channel. PMT purchased 13 million dollars in face amount of a

securitization of non-owner occupied loans on June 30th, or approximately 5 percent of the underlying UPB. In total, we expect PMT to earn a return on equity in the low teens for its investments related to non-owner occupied loan securitizations.

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 78.5 million dollars in pretax income; Interest Rate Sensitive Strategies, which contributed 65.4 million dollars in pretax loss; Correspondent Production, which contributed 19 million dollars in pretax income; and the Corporate segment, which had a pretax loss of 18.3 million dollars.

The contribution from PMT's CRT investments totaled 80.9 million dollars. This amount included 38.7 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. Net gain on CRT investments also included 39.1 million dollars in realized gains and carry, 20.2 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, 15.5 million dollars of financing expenses, and 1.8 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 65.4 million dollars in the quarter. MSR fair value decreased 230 million dollars during the quarter. 195 million dollars of valuation losses were due to increased expectations for prepayment activity in the future due to lower mortgage rates and a flatter yield curve, and 35 million dollars in additional valuation losses were primarily driven by elevated levels of prepayment activity. The MSR fair value declines were partially offset by gains of 121 million dollars on Agency MBS and interest rate hedges.

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.

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

PMT's Correspondent Production segment contributed 19 million dollars to pretax income for the quarter, down from 35.6 million dollars in the prior quarter as a result of lower volumes and lower gain-on-sale margins.

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 18.3 million dollars.

Finally, we recognized a tax benefit of 24.3 million dollars in the second quarter driven by fair value declines in MSRs held in PMT's taxable subsidiary.

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.

PMT continues to take advantage of its position as the largest correspondent aggregator in the U.S. and its synergistic relationship with PFSI. The infrastructure we have in place for PMT to source investments organically has proven to be a unique competitive advantage unmatched in the industry. PMT demonstrated this by successfully completing its first purchase of subordinate bonds related to a private label securitization of non-owner occupied loans acquired in PMT's correspondent production business. Additionally, we believe these new investments offer compelling, long-term returns and benefit from PFSI's industry-leading fulfillment process and position as the servicer of the underlying loans. While the recent decline in interest rates combined

with FHFA's elimination of the Adverse Market Refinance Fee is expected to have a mark-to-market impact on PMT's MSR value, these factors have meaningfully increased the population of loans that would benefit from a refinance. So given a continuation of the vibrant origination market, combined with PMT's high-quality interest rate sensitive and credit investments, we remain confident in PMT's ability to continue delivering strong risk-adjusted returns to its shareholders.

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 second 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.