

PennyMac Mortgage Investment Trust

Fourth Quarter and Full-Year 2021 Earnings Transcript

February 3, 2022

Introduction

Good afternoon, and welcome to the fourth quarter and full year 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.

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

Speaker:

David Spector – Chairman and Chief Executive Officer

Thank you, Isaac.

For the fourth quarter 2021, PMT reported a net loss attributable to common shareholders of 27.3 million dollars, or 28 cents per common share, driven primarily by fair value declines in its interest rate sensitive strategies.

These impacts were partially offset by strong returns in our credit sensitive strategies, which consist of investments in GSE credit risk transfers and investments in non-Agency subordinate bonds.

During the quarter, we repurchased 2.2 million common shares of PMT common stock for 39 million dollars.

PMT paid a common dividend of 47 cents per share. Book value per share decreased to 19 dollars and 5 cents from 19 dollars and 79 cents at the end of the prior quarter.

Our high-quality loan production continues to organically generate assets for PMT and this quarter, 17.2 billion dollars in UPB of conventional correspondent production led to the creation of 239 million dollars in new, low-coupon mortgage servicing rights.

We continue to create new credit investments in the form of subordinate bonds from non-Agency investor loan securitizations, also sourced from PMT's production volumes. This quarter, PMT successfully completed two securitizations with an aggregate UPB of 713 million dollars. In total, the fair value of PMT's investments in investor loan securitizations, net of associated asset-backed financing, was approximately 87 million dollars at the end of the year.

The origination market is projected to decline substantially in 2022. Inside Mortgage Finance estimates the 2021 origination market was 4.8 trillion dollars and current forecasts for 2022 total 3.1 trillion dollars, a reduction of 35 percent year-over-year. However, purchase originations are expected to remain strong at 2 trillion dollars in 2022. The smaller origination market, combined with significant levels of competition for conventional loans in the correspondent channel, including from the GSEs, is expected to

result in headwinds for PMT's correspondent production business in the near term. Despite these headwinds, however, we believe PMT's scale and purchase market orientation positions it well over the long-term for continued organic asset creation.

PMT went public in July of 2009 and in our more than 12 year history we have delivered shareholder returns that have exceeded comparable REIT indices. Additionally, our book value over the same time period has remained relatively stable, with an average of 20 dollars per share. This performance can be attributed to PMT's organic business model, led by the deep and talented management at PFSI, with years of experience successfully navigating changing mortgage markets and the associated risks.

Organic asset creation remains a competitive advantage for PMT relative to other mortgage REITs. Combined with the platform and management team provided by PFSI, we believe PMT is uniquely positioned to capitalize on opportunities as they arise and evolve. An example of this is our recent success aggregating and securitizing investor loans while investing in the subordinate tranches of the resulting bonds. In fact, over the last several months we have invested in subordinate tranches of investor loan securitizations with a total UPB of over 1.5 billion dollars. Importantly, the two most recent transactions we completed in the quarter were securitized by PMT, and we expect to be a programmatic issuer of investor and second home securitizations throughout 2022.

As we look ahead, we see additional opportunities for private label securitizations and subsequent investments for PMT, bolstered by recent GSE fee increases on certain loans as mandated by the FHFA. Loan level price adjustments for second homes and certain high balance loans have provided incentives for originators to sell these loans through the correspondent channel for securitization, particularly to scaled aggregators like PMT, rather than directly to Fannie Mae or Freddie Mac.

Turning to CRT, PMT is a leader in lender risk share transactions, with nearly 120 billion dollars in UPB of loans sold to Fannie Mae from 2015 to 2020. While we are not currently delivering loans into CRT transactions, we are actively engaged in discussions with the GSEs regarding the potential resumption of lender risk share investments. We believe we are well-positioned to lead broadly on this effort given our history, platform and expertise. Because of the greater capital relief CRT provides the GSEs under the amended Enterprise Regulatory Capital Framework, and the additional private capital CRT provides to the housing ecosystem, we remain optimistic for the future of lender risk share. Most importantly, the alignment of interest as acquirer and servicer of the loans should be compelling for the GSEs, given we can work directly with our borrowers in times of hardship.

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 the quarterly run-rate return for PMT's strategies to average 37 cents per share or a 7.7 percent annualized return on equity.

This run-rate potential reflects performance expectations in the highly-competitive, transitioning mortgage market. In our credit sensitive strategies, CRT returns reflect credit spreads that have tightened over time. In addition, we expect to increase investments in non-Agency subordinate MBS at attractive returns through private label securitizations.

In the interest rate sensitive strategies, we expect more consistent returns as prepayment speeds stabilize.

In correspondent production, the expected returns reflect our view that significant levels of competition to acquire conventional loans will result in lower volumes and margins than we have experienced in recent quarters.

This analysis excludes potential contributions from opportunities under exploration, such as new investments in CRT or the introduction of new products other than investor loans.

It is also important to note our forecast for PMT's taxable income and liquidity continues to support the common dividend at its current level of 47 cents per share over this period.

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 fourth quarter investment performance.

Speaker:

Vandy Fartaj – Senior Managing Director and Chief Investment Officer

Thank you, David.

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

Total correspondent acquisition volume in the quarter was 32.8 billion dollars, down 25 percent from the prior quarter and down 42 percent from the fourth quarter of 2020. 52 percent of PMT's acquisition volumes were conventional loans, down from 65 percent in 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 nearly 770 correspondent sellers.

Conventional lock volume in the quarter was 14.7 billion dollars, down 50 percent from the prior quarter and down 63 percent year-over-year as we maintained our pricing discipline despite significant competition for conventional loans in a smaller origination market, including the GSE cash window.

PMT's correspondent production segment pretax income as a percentage of interest rate lock commitments was 3 basis points, down from 9 basis points in the prior quarter. The weighted average fulfillment fee rate in the fourth quarter was 12 basis points, down from 15 basis points in the prior quarter, reflecting discretionary reductions made by PFSI to facilitate successful loan acquisitions by PMT.

Acquisition volumes in January were 7.6 billion dollars in UPB, and locks were 7.5 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 investments at the end of the fourth quarter was 2.9 billion dollars, up slightly from 2.8 billion dollars at the end of the prior quarter. The increase reflects newly originated MSRs resulting from conventional production volumes that more than offset fair value declines and prepayments. Similarly, the UPB of loans underlying PMT's MSR investments totaled 216 billion dollars, up from 212 billion dollars.

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 December 31st was 30.8 billion dollars, down 13 percent quarter-over-quarter. Fair value of our CRT investments at the end of the quarter was 1.7 billion dollars, down from 1.9 billion dollars at September 30th due to declines in asset value that resulted from prepayments.

The 60-plus day delinquency rate underlying our CRT investments continued to improve and declined to 3.06 percent from 3.79 percent at September 30th.

And the outlook for our current investments in CRT remains favorable, with a current weighted average loan-to-value ratio of approximately 64 percent at year end, benefiting from the home price appreciation experienced in recent years.

PFSI's position as the manager and servicer of loans underlying PMT's CRT investments gives PMT a strategic advantage, since we can work directly with borrowers who have loans underlying PMT's investments that have experienced hardships. 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 11 million dollars. Through the end of the quarter, losses to date totaled 13 million dollars.

Moving on to L Street Securities 2017-PM1, which comprises 19 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 17 million dollars in net losses reversed in the fourth quarter, as 19 million dollars of losses reversed more than offset the 2 million dollars in additional realized losses.

We estimate that an additional 18 million dollars of these losses were eligible for reversal as of December 31st 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 17 million dollars of the 48 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 12 million dollars at the end of the quarter.

As David mentioned earlier, we continued to invest in securitizations collateralized by investor loans. During the quarter, we added 42 million dollars in fair value of new investor loan securitization investments and ended the year with 87 million dollars of such investments.

In total, this year we have successfully deployed the runoff from elevated prepayments on CRT investments and on slide 7 you can see 1.1 billion dollars of net new investments in long-term mortgage assets offset 1.1 billion dollars in runoff from prepayments on CRT assets. Additionally, we opportunistically deployed 56.9 million dollars to repurchase 3.1 million of PMT's common shares in 2021. Under our current program, capital remains available for repurchases at attractive price levels.

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 33.2 million dollars in pretax income; Interest Rate Sensitive Strategies, which contributed 43.2 million dollars in pretax loss; Correspondent Production, which contributed 4.6 million dollars in pretax income; and the Corporate segment, which had a pretax loss of 14 million dollars.

The contribution from PMT's CRT investments totaled 31.3 million dollars. This amount included 1.6 million dollars in market-driven value gains, reflecting the impact of slight 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 26.9 million dollars in realized gains and carry, 14.5 million dollars in net losses reversed, primarily related to L Street Securities 2017-PM1 which Vandy discussed earlier, 100 thousand dollars in interest income on cash deposits, 11.7 million dollars of financing expenses, and 200 thousand 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 43.2 million dollars in the quarter. MSR fair value decreased a total of 84 million dollars

during the quarter and included 49 million dollars in fair value declines due to changes in interest rates, primarily due to a significant flattening of the yield curve, and 35 million dollars of valuation decreases due to increases to short-term prepayment projections.

The fair value on Agency MBS and interest rate hedges also declined by 7 million dollars largely due to elevated hedge costs during the quarter.

PMT's Correspondent Production segment contributed 4.6 million dollars to pretax income for the quarter.

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 million dollars.

Finally, we recognized a tax benefit of 2.6 million dollars in the fourth 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.

As the market transitions to a higher rate environment, we believe the return volatility of our investments will stabilize and the competitive climate will improve as correspondent aggregators adjust capacity to the new market. Until that takes place, we expect headwinds for the return potential of PMT's strategies. However, there are significant investment opportunities we are pursuing in the form of private-label securitization and the potential to resume new CRT investments and we are encouraged by our continued active discussions with the GSEs and FHFA on that front.

As a public company in our 13th year of operations with a very seasoned management team, we have been disciplined through numerous mortgage cycles and have a strong track record of performance throughout our history. While we acknowledge the headwinds in this currently transitioning mortgage market, we are optimistic about PMT's ability to execute on opportunities and deliver attractive risk-adjusted returns to shareholders over the long-term.

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 fourth 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.