PennyMac Mortgage Investment Trust
Form S-11/A
June 24, 2009

Use these links to rapidly review the document
TABLE OF CONTENTS
INDEX TO FINANCIAL STATEMENT

Table of Contents

As filed with the Securities and Exchange Commission on June 24, 2009

Registration Statement No. 333-159460

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 1
TO
FORM S-11

**FOR REGISTRATION UNDER THE SECURITIES ACT OF 1933
OF CERTAIN REAL ESTATE COMPANIES**

PENNYMAC MORTGAGE INVESTMENT TRUST

(Exact Name of Registrant as Specified in its Governing Instruments)

**27001 Agoura Road, Third Floor
Calabasas, California 91301
(818) 224-7442**

(Address, including Zip Code, and Telephone Number, including
Area Code, of Registrant's Principal Executive Offices)

**Jeff Grogin
Chief Legal Officer and Secretary
PNMAC Capital Management, LLC
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(Name, Address, including Zip Code, and Telephone Number,
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Approximate date of commencement of proposed sale to the public: As soon as practicable after the Registration Statement becomes effective.

If any of the Securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended, or Securities Act, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer" "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Securities Exchange Act of 1934, as amended, or the Exchange Act.

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

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to Completion
Preliminary Prospectus dated June 24, 2009

PROSPECTUS

Shares

PennyMac Mortgage Investment Trust

Common Shares

We are a newly-formed specialty finance company that will invest primarily in residential mortgage loans and mortgage-related assets. Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by investing in mortgage loans, a substantial portion of which may be distressed and acquired at discounts to their unpaid principal balances. We will then seek to maximize the value of the mortgage loans that we acquire through proprietary loan modification programs, special servicing and other initiatives focused on keeping borrowers in their homes. We will be externally managed by PNMAC Capital Management, LLC, or PCM, an investment adviser that specializes in, and focuses on, residential mortgage loans.

This is our initial public offering. We are offering of our common shares of beneficial interest, $0.01 par value per share, or common shares. We expect the initial public offering price of our common shares to be $15.00 per share. Prior to this offering, there has been no public market for our common shares. We have applied to have our common shares listed on the New York Stock Exchange, or NYSE, under the symbol "PMT."

Concurrently with this offering, we will sell to certain of our executive officers, an affiliate of BlackRock, Inc., or BlackRock, Highfields Capital Investments LLC, or Highfields Capital, and PNMAC (which is owned by certain of our executive officers, an affiliate of BlackRock and Highfields Capital), in a separate private placement, 5% of our outstanding common shares after giving effect to the common shares issued in this offering, excluding common shares that may be sold pursuant to the underwriters' overallotment option, and subject, in all cases, to a maximum purchase of $40 million of our common shares at a price per share equal to the initial public offering price per share in this offering.

In addition to the common shares being offered pursuant to the underwritten offering described in this prospectus, common shares are being offered by us pursuant to this prospectus directly to investors in the two private fund vehicles managed by PCM, which we refer to as the direct offering.

We intend to elect and qualify to be taxed as a real estate investment trust, or REIT, for U.S. federal income tax purposes. To assist us in qualifying as a REIT, among other reasons, ownership of our outstanding common shares by any person is limited to 9.8%, subject to certain exceptions. In addition, our declaration of trust contains various other restrictions on the ownership and transfer of our common shares. See "Description of Shares of Beneficial Interest Restrictions on Ownership and Transfer."

Investing in our common shares involves risks. You should read the section entitled "Risk Factors" beginning on page 23 of this prospectus for a discussion of the following and other risks that you should consider before investing in our common shares:

- We are dependent upon PCM, its affiliates and their key personnel and may not find suitable replacements if our agreements with PCM and its affiliates are terminated or such key personnel are no longer available to us.

- There are potential conflicts of interest in our relationship with PCM and its affiliates, which could result in decisions that are not in the best interests of our shareholders, such as conflicts in allocating investments that may also be suitable for entities or accounts managed by PCM or in allocating time of officers and other employees between us and other operations or funds

managed by PCM.

We are a new company with no operating history, and PCM's senior management team has limited experience operating a REIT. Accordingly, we may not operate successfully or generate sufficient operating cash flows to make or sustain distributions to our shareholders.

There is no assurance that we will be able to make investments from time to time on favorable terms, or at all, that satisfy our investment strategy or otherwise generate attractive risk-adjusted returns.

Our failure to qualify as a REIT would result in higher taxes and reduced cash available for distribution to our shareholders and may have significant adverse consequences on the market price of our common shares.

Continuing to qualify for an exclusion under the Investment Company Act of 1940, as amended, imposes limits on our business.

	Per Share	**Total[1]**
Public offering price	$	$
Underwriting discount	$	$
Proceeds, to us, before expenses	$	$

(1) Purchasers in the direct offering have agreed to purchase an aggregate of common shares in the direct offering at a price per share equal to the public offering price per share, and the underwriters will not be entitled to any underwriting discount with respect to such purchases.

The underwriters may also purchase up to an additional common shares from us at the public offering price, less the underwriting discount, within 30 days after the date of this prospectus to cover overallotments, if any.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The common shares will be ready for delivery on or about , 2009.

Merrill Lynch & Co. Credit Suisse Deutsche Bank Securities

The date of this prospectus is , 2009.

TABLE OF CONTENTS

	Page
Prospectus Summary	1
Risk Factors	23
Cautionary Statement Regarding Forward-Looking Statements	72
Use of Proceeds	74
Distribution Policy	75
Capitalization	77
Management's Discussion and Analysis of Financial Condition and Results of Operations	78
Business	88
Our Manager and the Management Agreement	111
Management	122
Principal Shareholders	128
Certain Relationships and Related Transactions	129
Description of Shares of Beneficial Interest	132
Certain Provisions of Maryland Law and of Our Declaration of Trust and Bylaws	137
Shares Eligible for Future Sale	143
Our Operating Partnership and the Partnership Agreement	145
U.S. Federal Income Tax Considerations	148
Underwriting	170
Legal Matters	176
Experts	176
Where You Can Find More Information	176
Index to Financial Statement	F-1

You should rely only on the information contained in this prospectus, any free writing prospectus prepared by us or information to which we have referred you. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate only as of the date on the front cover of this prospectus. Our business, financial condition, results of operations and prospects may have changed since that date.

Table of Contents

PROSPECTUS SUMMARY

This summary highlights some of the information in this prospectus. It is not complete and does not contain all of the information that you should consider before investing in our common shares. You should read carefully the more detailed information set forth under "Risk Factors" and the other information included in this prospectus. References to "company," "we," "us" and "our" refer to PennyMac Mortgage Investment Trust, a Maryland real estate investment trust, and PennyMac Operating Partnership, L.P., the subsidiary through which we will conduct our business and which we refer to as "our operating partnership," except where it is clear from the context that the term means only the issuer of the common shares, PennyMac Mortgage Investment Trust; references to "PCM" refer to PNMAC Capital Management, LLC, our manager; references to "PennyMac" refer to Private National Mortgage Acceptance Company, LLC, or PNMAC, and/or its wholly-owned subsidiaries, PCM and PennyMac Loan Services, LLC, or PLS; references to "common shares" refer to common shares of beneficial interest, $0.01 par value per share, in PennyMac Mortgage Investment Trust; and references to "this offering" refer to the underwritten offering of our common shares described in this prospectus, except where it is clear from the context that the term means both the underwritten offering and the direct offering (described below). Concurrently with this offering, we will sell to certain of our executive officers, an affiliate of BlackRock, Inc., or BlackRock, Highfields Capital Investments LLC, or Highfields Capital, and PNMAC (which is owned by certain of our executive officers, an affiliate of BlackRock and Highfields Capital), in a separate private placement, 5% of our outstanding common shares after giving effect to the common shares issued in this offering, excluding common shares that may be sold pursuant to the underwriters' overallotment option, and subject, in all cases, to a maximum purchase of $40 million of our common shares at a price per share equal to the initial public offering price per share in this offering, which we refer to in this prospectus as "our concurrent offering." In addition, investors in two private fund vehicles managed by PCM, or the PennyMac funds, may purchase our common shares directly from us, which we refer to as the "direct offering." Unless otherwise indicated, the information contained in this prospectus assumes (i) that the common shares to be sold in this offering are to be sold at $15.00 per share, (ii) that the underwriters' overallotment option to purchase an additional common shares is not exercised, (iii) that our concurrent offering has been completed and (iv) of our common shares are sold in the direct offering.

Our Company

We are a newly-formed specialty finance company that will invest primarily in residential mortgage loans and mortgage-related assets. Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by investing in mortgage loans, a substantial portion of which may be distressed and acquired at discounts to their unpaid principal balances. We will then seek to maximize the value of the mortgage loans that we acquire through proprietary loan modification programs, special servicing and other initiatives focused on keeping borrowers in their homes. We believe that by utilizing these methods, we can provide borrowers with long-term solutions that address their willingness and ability to pay their mortgage loans, which we expect to increase our portfolio of performing loans, reduce default rates and enhance the value of the loans in our portfolio. Once we have improved the credit quality of a portfolio, we intend to monetize the enhanced value through various disposition strategies.

We will be externally managed by PNMAC Capital Management, LLC, or PCM, an investment adviser registered with the Securities and Exchange Commission, or the SEC, that specializes in, and focuses on, residential mortgage loans. We will also enter into a loan servicing agreement with PennyMac Loan Services, LLC, or PLS, pursuant to which PLS will provide us with primary and special servicing. PCM and PLS are part of the PennyMac organization, which was designed specifically to

Table of Contents

address the opportunities created by the current dislocations in the markets for residential mortgage assets. PennyMac was developed from the ground up by its experienced senior management team, with the support of its strategic investors, BlackRock, Inc., or BlackRock, and Highfields Capital Investments LLC, or Highfields Capital. Concurrently with this offering, we will sell to certain of our executive officers, an affiliate of BlackRock, Highfields Capital and Private National Mortgage Acceptance Company, LLC, or PNMAC, in a separate private placement, 5% of our outstanding common shares after giving effect to the common shares issued in this offering, excluding common shares that may be sold pursuant to the underwriters' overallotment option, and subject, in all cases, to a maximum purchase of $40 million of our common shares at a price per share equal to the initial public offering price per share in this offering. We intend to elect and qualify to be taxed as a real estate investment trust, or REIT, for U.S. federal income tax purposes and to maintain our exclusion from regulation under the Investment Company Act of 1940, as amended, or the Investment Company Act. We have not yet made any investments.

Our Manager and Its Operating Platform

We will be externally managed and advised by PCM pursuant to a management agreement. PCM was established in March 2008 and is an SEC-registered investment adviser that specializes in, and focuses on, residential mortgage loans. PCM also serves as the investment manager to two private fund vehicles, which we refer to as the PennyMac funds, with investment objectives and policies that are substantially similar to ours and an aggregate of approximately $584 million in capital commitments as of May 31, 2009. Investors in the PennyMac funds may purchase our common shares directly from us, which we refer to as the direct offering, at a price per share equal to the initial public offering price per share. Such investors will be permitted to reduce their undrawn capital commitments to the PennyMac funds by the amount of their purchases in the direct offering. PCM and PLS are both wholly-owned subsidiaries of PNMAC.

PCM will be responsible for administering our business activities and day-to-day operations. Pursuant to the terms of the management agreement, PCM will provide us with our senior management team, including our officers, along with appropriate support personnel. PCM is subject to the supervision and oversight of our board of trustees and has only the functions and authority as are specified in the management agreement.

We will also enter into a loan servicing agreement with PLS, pursuant to which PLS will provide primary servicing and special servicing for our portfolio of residential mortgage loans. The workout-oriented servicing platform of PLS includes significant borrower contact, which we refer to as "high touch," and is designed to enable us to effectively implement programs that address borrower needs and maximize the value of our portfolio. PLS was established in February 2008 and also provides primary servicing and special servicing to the PennyMac funds and entities in which they have invested.

Mr. Stanford L. Kurland, our chairman and chief executive officer, leads PennyMac's senior management team of 14 members with extensive experience in the residential mortgage industry. This senior management team has expertise across each of the critical capabilities that PennyMac believes is required to successfully acquire and manage residential mortgage loans, including sourcing, valuation and acquisitions, due diligence, portfolio strategy, servicing (including modification and refinance fulfillment) and secondary marketing. PennyMac's senior management team is currently supported by a dedicated team of approximately 75 other employees.

Current Market Opportunities

We believe that there are unique, current market opportunities to acquire distressed mortgage loans and mortgage-related assets at significant discounts to their unpaid principal balances. Market prices of mortgage loans have declined significantly during the current economic downturn due, in large

Table of Contents

part, to increasing rates of borrower defaults and falling values of real estate collateral. Many depository institutions and other holders of portfolios of distressed mortgage loans in the U.S. are under financial duress and may be motivated to sell these loans directly or through recently announced government programs. In addition, government-related agencies acting as receivers, such as the Federal Deposit Insurance Corporation, or FDIC, have acquired and are expected to continue to acquire significant portfolios of troubled loans from failed depository institutions.

We believe that the size of the non-performing and sub-performing residential mortgage loan market has grown considerably and will likely continue to grow. According to the Federal Reserve's Flow of Funds report as of December 31, 2008, there were more than $4 trillion in residential mortgage whole loans outstanding, mostly held by depository institutions. We believe that more than $1 trillion of these loans are troubled or at significant risk of default in their present state.

We expect to benefit from PCM's analytical and portfolio management expertise and technology in evaluating these investment opportunities. Furthermore, we will seek to maximize the value of the mortgage loans we acquire using PCM's proprietary portfolio strategy techniques to identify the appropriate approach for each loan and, through the workout-oriented servicing platform of PLS, offer borrowers alternatives, including, where appropriate, the modification of the terms and conditions of loans in a manner that reflects the borrowers' financial condition and residential property values. Mortgage loans may become re-performing through effective modification, restructuring and other techniques, and the mortgage loans subsequently may be monetized through a variety of disposition strategies.

PCM will target initially the following sources of investment opportunities for us:

- liquidations by the FDIC of portfolios of mortgage loans of failed depository institutions; and

- direct acquisitions of pools of mortgage loans from institutions such as banks, mortgage companies and insurance companies.

To the extent available, we may also participate in programs established by the U.S. government, such as the Legacy Loans Program of the U.S. Treasury's Public-Private Investment Program.

FDIC Liquidations of Failed Depository Institution Assets. We believe that the FDIC will continue to provide attractive investment opportunities in mortgage loans through its liquidation of the assets of failed depository institutions for which it is appointed receiver. Forty depository institutions have failed in 2009 through June 19, 2009, with more than $22.7 billion in combined assets. As of May 31, 2009, we estimate that the FDIC held more than $ billion in residential mortgage loans from failed depository institutions. In addition, there were 305 depository institutions with a combined $220 billion of assets on the FDIC's Problem List as of March 31, 2009. "Problem" institutions, as defined by the FDIC, are those institutions with financial, operational or managerial weaknesses that threaten their continued financial viability. The FDIC has indicated that in conjunction with its liquidation of failed depository institution assets it may provide or guarantee debt financing to facilitate purchases. Based upon an announcement by the FDIC on June 3, 2009, we anticipate that the FDIC may provide guarantees on debt that are generally similar in structure and amount to the guarantees it proposed to make under the Legacy Loans Program in a test case sale of receivership assets for which it expects to solicit bids in July 2009. The amount of debt that the FDIC had proposed to guarantee under the Legacy Loans Programs was to be determined on a pool-by-pool basis, and would not exceed a debt-to-equity ratio of 6:1.

Direct Acquisitions. Many holders of residential mortgage loans, such as banks, mortgage companies and insurance companies, may be motivated to reduce their loan holdings, creating opportunities to acquire pools of loans at significant discounts. We believe that we are well positioned to leverage the relationships of PennyMac with a diverse group of financial intermediaries, ranging

Table of Contents

from primary dealers, major investment banks and brokerage firms to leading mortgage originators, specialty investment dealers and financial sponsors, to capitalize on these potential investment opportunities.

Government Programs. We may participate in programs established by the U.S. government. In March 2009, the U.S. Treasury announced certain details, which are subject to change, concerning its Public-Private Investment Program, including the Legacy Loans Program. The Legacy Loans Program would provide financing for loan purchases from U.S. depository institutions. Although the FDIC has announced the postponement of a pilot sale of assets under this program, the FDIC has indicated that it will continue its work on the Legacy Loans Program and will be prepared to offer the program in the future as "an important tool to cleanse bank balance sheets and bolster their ability to support the credit needs of the economy." We will continue to monitor developments concerning the Legacy Loans Program and we will seek to take advantage of attractive opportunities that may be presented by this or any other government programs.

Our Competitive Advantages

We believe that our competitive advantages include the following:

Investment and operational team with extensive experience in the residential mortgage business.

PennyMac's senior management team includes 14 individuals with extensive experience in the residential mortgage industry, and this team has been executing the investment and portfolio management strategy on behalf of the PennyMac funds since August 2008. Mr. Stanford L. Kurland, our and PennyMac's chairman and chief executive officer and former president and chief operating officer of Countrywide Financial Corporation, or Countrywide, is well recognized for his leadership in developing Countrywide's strategic direction, financial management, risk management activities and organizational and governance structure. Mr. Kurland helped grow Countrywide's loan origination and servicing capabilities. David A. Spector, Andrew S. Chang, Michael L. Muir and David M. Walker, who collectively have 71 years of experience in the residential mortgage business and related areas, lead the day-to-day operations of PCM. The day-to-day activities of PLS are led by Scott D. Anderson and John M. Lawrence, who together bring over 36 years of experience in building, managing and overseeing residential mortgage servicing and other mortgage operations platforms.

PennyMac's "high touch" borrower focus with regard to residential mortgage loans aligns our interests with those of the borrowers.

PennyMac's general strategy is to keep borrowers in their homes by offering alternatives that include modification of the terms and conditions of their loans to reflect both the borrowers' current financial condition and the value of their homes. By focusing on the borrowers and not simply on short-term collections on their mortgage loans, PennyMac works directly with individual borrowers to create long-term solutions designed to result in restructured and re-performing loans that will maximize the performance of our sub-performing and non-performing loans.

Customized operational platform designed to maximize the value of each loan.

PennyMac's senior management team, with the support of its strategic investors, BlackRock and Highfields Capital, organized PennyMac and assembled a team with the knowledge and experience to identify dislocations in the market for distressed residential mortgage loans and mortgage-related assets and enhance their value, primarily through customized solutions to assist borrowers in retaining their homes. It has developed a platform that is highly scalable and specifically designed for the current market opportunity. This platform includes the six dedicated functions that we believe are critical to maximizing the value of residential mortgage loans: sourcing, valuation and acquisitions, due diligence, portfolio strategy, servicing (including modification and refinance fulfillment) and secondary marketing.

PennyMac believes that many of these functions are proprietary. For example, its portfolio strategy uses proprietary loan-level analytics referred to as "LENE[SM]" (Loan Enhanced Normalization Engine) that is designed to determine the highest value approach for each borrower and loan. PennyMac's platform has been operating since August 2008 and, given the recent commencement of its activities, is not burdened by the financial and operational constraints faced by companies with existing "legacy" portfolios of distressed mortgage loans.

Access to investment opportunities.

PennyMac will use its extensive relationships with senior executives in the financial services and mortgage industries to source loans for acquisition. PCM has acquired four portfolios of residential mortgage loans on behalf of the PennyMac funds since their initial closings in August 2008. For example, in December 2008, the PennyMac funds completed the acquisition of a pool of performing and non-performing residential loans with an unpaid principal balance of approximately $558 million from the FDIC as the receiver for the First National Bank of Nevada.

Special servicing with an alignment of interests.

The senior management team of PLS has extensive special servicing expertise and experience in rehabilitating distressed mortgage loans into sustainable performing loans. We believe that PCM's affiliation with PLS provides a competitive advantage over third-party servicers because the interests of the investor, borrower and mortgage servicer are more closely aligned, which we believe allows us to better achieve our objectives. These special servicing skills are expected to help us achieve our investment philosophy of avoiding foreclosures, when possible and prudent, to keep the borrowers in their homes and restore their mortgage loans to performing status. A third-party mortgage servicer may be contractually compelled or have economic incentives to foreclose on a distressed mortgage loan rather than modify its terms. By contrast, PennyMac will seek to avoid foreclosures where appropriate by modifying mortgage loans to better reflect the borrowers' financial status and the underlying property values. We believe that this strategy will increase the quality and value of our acquired mortgage loans.

BlackRock and Highfields Capital are strategic investors in PNMAC.

PennyMac was founded with investment and organizational assistance from BlackRock and Highfields Capital in support of PennyMac's senior management team as they formulated PennyMac's strategy and developed its operational platform. BlackRock is an asset manager with approximately $1.28 trillion of assets under management and a demonstrated expertise in valuing and managing mortgage-related assets. Highfields Capital is a private investment firm with significant relationships and expertise in the financial services sector. An affiliate of BlackRock and Highfields Capital each holds an approximate 37% ownership interest in PNMAC, the company that owns 100% of PCM and PLS. Each of BlackRock and Highfields Capital has representation on the board of PNMAC, but neither is involved in its day-to-day operations.

Alignment of interests among PCM, our management and our investors.

Concurrently with this offering, we will sell to certain of our executive officers, an affiliate of BlackRock, Highfields Capital and PNMAC (which is owned by certain of our executive officers, an affiliate of BlackRock and Highfields Capital), in a separate private placement, 5% of our outstanding common shares after giving effect to the common shares issued in this offering, excluding common shares that may be sold pursuant to the underwriters' overallotment option, and subject, in all cases, to a maximum purchase of $40 million of our common shares at a price per share equal to the initial public offering price per share in this offering. We will enter into lockup agreements with the purchasers of our common shares in our concurrent offering pursuant to which such purchasers will

Table of Contents

agree, subject to the terms and conditions of the lockup agreements, not to sell the shares purchased in our concurrent offering for three years. Moreover, a portion of the fees that may be earned by PCM consists of incentive compensation that is based on the amount by which our earnings exceed a specified threshold. We believe that PCM's parent company's equity stake in our company, coupled with PCM's ability to earn incentive compensation, will align PCM's interests with our interests.

Our Investment Strategy

Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by investing in mortgage loans, a substantial portion of which may be distressed and acquired at discounts to their unpaid principal balances. We will then seek to maximize the value of the mortgage loans that we acquire through proprietary loan modification programs, special servicing and other initiatives focused on keeping borrowers in their homes. We also may invest in mortgage-related securities and other real estate and financial assets. It is anticipated that these securities and assets will not be rated by any rating agency.

The pools of loans that we acquire pursuant to the opportunities described above under " Current Market Opportunities" will consist primarily of U.S. residential mortgage loans. We expect that these loans will be performing, sub-performing and non-performing, of varying credit quality, including subprime, Alt-A and prime. PCM, in its sole discretion, will determine the size, loan type, credit quality and the composition of our portfolio of loans. We believe that the number and size of available residential mortgage loans will significantly exceed our capacity, allowing PCM to be selective in acquiring available mortgage loans.

We will rely on PennyMac's expertise in identifying pools of distressed mortgage loans and other assets for acquisition. PCM's sourcing and evaluation processes for potential acquisitions of residential mortgage loans and for mortgage-related assets are substantially similar. We expect that PCM will make investment decisions based on various factors, including expected cash yield, relative value, risk-adjusted returns, current and projected credit fundamentals, current and projected macroeconomic considerations, current and projected supply and demand, market risk, portfolio diversification, liquidity and availability and terms of financing, as well as maintaining our REIT qualification and our exclusion from registration under the Investment Company Act. The evaluation process with respect to residential mortgage-backed securities, or RMBS, and other mortgage-backed securities, or MBS, will also include relative value analyses based on yield, credit rating, average life, effective duration, option-adjusted spreads, prepayment assumptions and credit exceptions. In addition, PCM and its affiliates will evaluate new opportunities based on their relative expected returns compared to comparable assets held in our portfolio. Investment decisions with regard to the acquisition or disposition of any of our targeted assets are made by PCM's investment committee.

Our assets will not be subject to any geographic, diversification or concentration limitations except that we will be concentrated in residential mortgage-related investments. The maturity, duration or credit rating of our assets will not be limited.

Table of Contents

In addition to the opportunities described above under " Current Market Opportunities," we believe that the collapse of the independent mortgage company business model (*i.e.*, the origination by independent mortgage companies of mortgages not backed by a government sponsored entity, or GSE, followed by the funding of these mortgages through securitizations sponsored by Wall Street investment banks) and the weakened condition of other traditional mortgage lenders, has created additional opportunities. Such other opportunities include the purchase of newly originated mortgage loans from smaller mortgage lenders and the packaging of these new loans for resale to participating GSEs such as Federal Home Loan Mortgage Corporation, or Freddie Mac, and Federal National Mortgage Association, or Fannie Mae. We believe that there is currently a need, particularly among smaller lenders, to gain access to these GSEs and that we can utilize our expertise and capital to address this need. We believe that this strategy will also supplement PCM's continuing efforts to increase the number of relationships with other depository institutions originating or holding residential mortgage loans, which will benefit us.

Over time, we will reevaluate our investment strategy as market conditions change with a view toward maximizing the returns from our investment portfolio and identifying dislocations in the mortgage market, including continuing opportunities resulting from the collapse of the independent mortgage company business model, as described above. We believe this strategy, combined with the experience of PennyMac's senior management team and PCM's proprietary operational platform and tools, will benefit us during various interest rate and credit cycles and capital market conditions and provide attractive long-term returns to our investors.

Targeted Asset Classes

We will invest primarily in residential mortgage loans and mortgage-related assets. Based on current market conditions, our primary focus initially will be on distressed mortgage loans and, to a lesser extent, on other mortgage-related assets. As market conditions improve, our focus will expand to include other types of assets in our targeted asset classes. At all times, we will seek to take advantage of attractive investment opportunities that may arise in our targeted asset classes.

Our targeted asset classes and the principal investments we expect to make in each class are as follows:

Asset Class	Principal Investments
Residential Mortgage Loans	Performing, sub-performing and non-performing residential mortgage loans.
RMBS	Non-U.S. government agency RMBS, including investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes. U.S. government agency RMBS.
Other MBS and other assets	Commercial mortgage-backed securities, or CMBS. Mortgage-related derivatives, including, but not limited to, credit default swaps, options, futures and derivatives on MBS. Policies, instruments and agreements related to mortgage insurance or reinsurance risk. Hedging instruments that include U.S. Treasury securities, options and futures.

Prior to the full investment of the offering proceeds into our targeted asset classes, we may make investments in high grade, short-term securities, such as securities guaranteed by the Government

National Mortgage Association, or Ginnie Mae, securities issued and guaranteed by Freddie Mac or Fannie Mae, short-term money market funds, including BlackRock-sponsored money market funds, as well as cash equivalents for temporary cash management. For purposes of maintaining our exclusion from registration under the Investment Company Act, we may also acquire from time to time RMBS that represent the entire beneficial interest in the underlying pool of mortgage loans. We may incur leverage in connection with the acquisition of any of these assets through repurchase agreements or otherwise.

Our Financing and Hedging Strategy

We plan to finance our investments with leverage, the level of which may vary based upon the particular characteristics of our portfolio and on market conditions. However, in light of current market conditions, we anticipate initially utilizing limited leverage on our portfolio as part of our financing strategy. With regard to mortgage loans, we anticipate that leverage may be available to us in connection with our acquisitions, if any, of mortgage assets from the FDIC as receiver for failed depository institutions. Although the amount of any leverage for this type of acquisition would be determined on a case-by-case basis, we anticipate that leverage may be available which would provide for a debt-to-equity ratio for acquisitions in the range of 2:1 to 3:1, and would likely not exceed 6:1. Direct acquisitions of mortgage loans from financial institutions may include seller financing although the amount of potential leverage available, if any, would vary depending upon the seller. Our financing sources will include the net proceeds of this offering, our concurrent offering and the direct offering (if any) and, if and to the extent available at the relevant time, may include borrowings in the form of bank credit facilities (including term loans and revolving facilities), repurchase agreements, warehouse facilities, structured financing arrangements, public and private equity and debt issuances and derivative instruments, in addition to transaction or asset specific funding arrangements. We may also utilize leverage to the extent available through participation in the Legacy Loans Program, if the program is established. We do not currently intend to participate in the Legacy Securities Program of the Public-Private Investment Program. We intend to use leverage for the primary purpose of financing our portfolio and not for the purpose of speculating on changes in interest rates. We are not required to maintain any specific debt-to-equity ratio, and we believe the appropriate leverage for the particular assets we may finance depends on, among other things, the credit quality and risk of such assets. Our declaration of trust and bylaws do not limit the amount of indebtedness we can incur, and our board of trustees has discretion to deviate from or change our financing strategy at any time.

We expect to attempt to reduce interest rate risk on any outstanding debt and to minimize exposure to interest rate fluctuations thereon through the use of match funded financing structures, when appropriate, whereby we seek (i) to match the maturities of our debt with the maturities of the assets that we finance and (ii) to match the interest rates on our leveraged investments with like-kind debt (*i.e.*, floating rate assets are financed with floating rate debt and fixed-rate assets are financed with fixed-rate debt), directly or through the use of interest rate swaps, caps or other financial instruments, or through a combination of these strategies. We expect this approach will allow us to minimize the risk that we have to refinance our liabilities before the maturities of our assets and to reduce the impact of changing interest rates on our earnings.

Subject to maintaining our qualification as a REIT and exclusion from the Investment Company Act, we intend to utilize derivative financial instruments, or hedging instruments, including interest rate swap agreements and interest rate cap agreements, in an effort to hedge the interest rate risk associated with the financing of our portfolio. Specifically, we will seek to hedge our exposure to potential interest rate mismatches between the interest we earn on our investments and our borrowing costs caused by fluctuations in short-term interest rates. In utilizing leverage and interest rate hedges, our objectives will be to improve risk-adjusted returns and, where possible, to lock in, on a long-term basis, a spread between the yield on our assets and the cost of our financing.

Table of Contents

Summary Risk Factors

An investment in our common shares involves various risks. You should consider carefully the risks discussed below and under "Risk Factors" before purchasing our common shares.

- We are dependent upon PCM and its key personnel and may not find a suitable replacement if the management agreement with PCM is terminated or such key personnel are no longer available to us.

- PCM has a limited operating history and its investment track record may not be indicative of its or our future performance. PennyMac is undergoing significant growth and its integration of new operations may not be effective.

- There are potential conflicts of interest in our relationship with PCM and its affiliates, which could result in decisions that are not in the best interests of our shareholders, such as conflicts in allocating investments that may also be suitable for entities or accounts managed by PCM or in allocating time of officers and other employees between us and other operations or funds managed by PCM.

- The manner of determining the base management fee may not provide sufficient incentive to PCM to maximize risk-adjusted returns on our investment portfolio because it is based on our Shareholders' Equity (as defined herein) and not on our performance.

- The manner of determining the incentive fee may cause PCM to invest in more risky investments to increase our short-term net income and thereby increase the incentive fee it earns.

- Termination of our management agreement would be costly and, in certain cases, not permitted.

- We depend upon PLS to provide primary servicing and special servicing for our portfolio of residential mortgage loans; if the loan servicing agreement with PLS is terminated, we may not be able to timely replace those services on favorable terms, or at all, and subject to certain restrictions, PLS may provide servicing to other entities or accounts.

- Because PLS will be entitled to base servicing fees calculated as a percentage of the unpaid principal balance of mortgage loans that it services, its interests may not be aligned with ours with regard to modifications to our mortgage loans that would reduce their unpaid principal balances.

- BlackRock and Highfields Capital, PennyMac's strategic investors, are not obligated to provide us with any assistance and could compete with us and/or transfer their ownership interests in PNMAC to a third party.

- Our board of trustees has approved very broad investment policies for PCM and will not approve each investment decision made by PCM.

- As a result of difficult conditions in the financial markets and the economy in general, the risks to our business strategy are high and there are no assurances that we will be successful in implementing our business strategy.

- Current or future legislation or regulatory action designed to address the current economic crisis or for other purposes may adversely affect our business.

Our initial strategies include potential investment through the Legacy Loans Program which may not be established on the terms proposed or at all. The extent to which depository institutions will participate under the program is uncertain.

There is no assurance that we will be able to make investments from time to time on favorable terms, or at all, that satisfy our investment strategy or otherwise generate attractive risk-adjusted returns.

Changing market conditions and competition may limit the availability of attractive investments and result in reduced risk-adjusted returns; the supply of distressed residential mortgage loans will likely recede as the economy improves.

We may change our investment strategies and policies and targeted asset classes without shareholder consent, which could result in investments that are different, and possibly riskier, than those we describe in this prospectus.

We are a new company with no operating history, and PCM's senior management team has limited experience operating a REIT. Accordingly, we may not operate successfully or generate sufficient operating cash flows to make or sustain distributions to our shareholders.

Our current investment strategy focuses, in part, on distressed opportunities, thereby involving an increased risk of loss, and certain investments such as our sub-performing or non-performing assets may have a particularly high risk of loss, and we cannot assure you that we will be able to generate attractive risk-adjusted returns.

Our targeted asset classes involve residential mortgage loans and mortgage-related assets that are subject to various risks that can affect their value and performance.

Changes in prepayment rates could negatively affect the value of our investment portfolio.

The mortgage loans in which we invest and the mortgage loans underlying the mortgage securities in which we invest are subject to delinquency, foreclosure and loss, which could result in losses to us.

Our investment portfolio may be concentrated by geography, asset, property type and/or borrower, increasing our risk of loss if there are adverse developments or greater risks affecting the particular concentration.

Access to financing sources may not be available on favorable terms, or at all, especially in light of current market conditions, which could adversely affect our ability to maximize our returns.

We may incur significant debt in the future, which will subject us to restrictive covenants and increased risk of loss and may reduce the cash available for distributions to our shareholders.

Interest rate fluctuations could significantly decrease our results of operations and cash flows and the market value of our assets, and our ability to use derivative and hedging instruments may be limited by our qualification as a REIT.

Future issuances of equity securities by us or sales of common shares eligible for resale in the public market or otherwise after the completion of this offering, or the perception that such issuances or sales may occur, could depress the market price of our common shares.

Share ownership limits that are imposed by our declaration of trust may reduce the liquidity of our common shares and restrict business combination opportunities.

A significant portion of our business is expected to be conducted through, and a significant portion of our income may be earned in, one or more taxable REIT subsidiaries, or TRSs, that are subject to corporate income taxation.

The REIT distribution requirements will limit our ability to retain earnings and will therefore affect our liquidity and ability to finance growth from earnings.

Complying with the REIT requirements can be difficult and may cause us to forego otherwise attractive business opportunities.

Our failure to qualify as a REIT would result in higher taxes and reduced cash available for distribution to our shareholders and may have significant adverse consequences on the market price of our common shares.

Continuing to qualify for an exclusion under the Investment Company Act imposes limits on our business.

Table of Contents

Certain provisions of our organizational documents and Maryland law may delay or prevent a change in our control, which could have significant consequences on the market price of our common shares.

There may not be an active market for our common shares, which may cause our common shares to trade at a discount and make it difficult for purchasers in this offering to sell their shares.

Our Organizational Structure

We were formed as a Maryland real estate investment trust on May 18, 2009. We will be externally managed by PCM, which may be deemed to be our promoter with respect to this offering. A wholly-owned subsidiary of ours is the sole general partner of our operating partnership, and we intend to conduct substantially all of our operations, and make substantially all of our investments, through our operating partnership. Upon the completion of this offering, our concurrent offering and the direct offering (if any), we will contribute to our operating partnership the net proceeds of these offerings as our initial capital contribution in exchange for all of the limited partnership interests and, indirectly, the general partner interest in our operating partnership.

The following chart shows our structure after giving effect to this offering, our concurrent offering and the direct offering:

(1) Assumes of our common shares are sold in the direct offering.

Table of Contents

(2) Includes (i) common shares purchased in our concurrent offering, (ii) restricted common shares to be granted to our executive officers and other employees of PCM and/or PLS under our equity incentive plan upon the completion of this offering and (iii) 9,000 restricted common shares to be granted to our independent trustees under our equity incentive plan upon the completion of this offering. Does not include of our common shares available for future grant under our equity incentive plan. See "Management Equity Incentive Plan."

(3) It is anticipated that loan modifications and certain other activities may occur in the Subsidiary TRS. See "U.S. Federal Income Tax Considerations Taxation of Our Company Effect of Subsidiary Entities Taxable REIT Subsidiaries."

Our Relationship with Our Manager and Servicer

We will be externally managed and advised by PCM. We expect to benefit from the personnel, infrastructure, relationships and experience of PCM to enhance the growth of our business. All of our officers are employees of PCM or one of its affiliates. We will have no employees upon completion of this offering other than our officers.

The management agreement with PCM requires PCM to oversee our business affairs in conformity with the investment polices that are approved and monitored by our board of trustees. PCM is responsible for our day-to-day management and will perform such services and activities related to our assets and operations as may be appropriate.

The initial term of the management agreement expires on , 2012 and will be automatically renewed for a one year term each anniversary date thereafter unless previously terminated as described below. Our independent trustees will review PCM's performance and the management fees annually and, following the initial term, the management agreement may be terminated annually by us without cause upon the affirmative vote of at least two-thirds of our independent trustees or by a vote of the holders of at least two-thirds of our outstanding common shares (other than those common shares held by PCM or any affiliate), in each case based upon (i) unsatisfactory performance by PCM that is materially detrimental to us or (ii) our determination that the management fees payable to PCM are not fair, subject to PCM's right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds of our independent trustees. We must provide 180 days' prior notice of any such termination. Upon termination without cause, PCM will be paid a termination fee. We may also terminate the management agreement without payment of any termination fee to PCM, upon at least 30 days' prior written notice from our board of trustees, at any time for "cause" as defined in the management agreement. PCM may terminate the management agreement if we become required to register as an investment company under the Investment Company Act with termination deemed to occur immediately before such event, in which case we would not be required to pay a termination fee to PCM. Furthermore, PCM may decline to renew the management agreement by providing us with 180 days' written notice, in which case we would not be required to pay a termination fee to PCM. PCM may also terminate the management agreement upon at least 60 days' prior written notice if we default in the performance of any material term of the management agreement and the default continues for a period of 30 days after written notice to us, whereupon we would be required to pay to PCM the termination fee.

We will also enter into a loan servicing agreement with PLS, pursuant to which PLS will provide primary servicing and special servicing for our portfolio of residential mortgage loans. The loan servicing to be provided by PLS will include collecting principal, interest and escrow account payments, if any, with respect to mortgage loans, as well as managing loss mitigation, which may include, among other things, collection activities, loan workouts, modifications and refinancings, foreclosures and

Table of Contents

financings to facilitate sales of real estate owned properties, or REOs. The term of the loan servicing agreement is identical to the term of the management agreement, and is subject to early termination, without the payment of any termination fee, in the event the management agreement is terminated for any reason. PLS may retain sub-servicers in any jurisdictions where licensing is required and PLS has not obtained the necessary license or where PLS otherwise deems it advisable, and the fees of such sub-servicers will be paid by PLS out of its servicing fee.

PCM is entitled to receive a base management fee, an incentive fee based on certain performance criteria, a termination fee in certain cases and reimbursement of certain expenses as described in the management agreement. PLS is entitled to receive a servicing fee and reimbursement of certain expenses as described in the loan servicing agreement. The following summarizes the calculation of the fees payable to PCM and PLS pursuant to the management agreement and the loan servicing agreement, respectively, as well as the expenses to be reimbursed to PCM and PLS, respectively:

Fee	**Description and Method of Computation**
Base Management Fee to PCM	PCM will be entitled to a base management fee equal to 1.50% per annum, calculated and payable quarterly in arrears, of our Shareholders' Equity. For purposes of calculating the base management fee, our "Shareholders' Equity" means the sum of the net proceeds from any issuances of our equity securities since inception (allocated on a pro rata daily basis for such issuances during the fiscal quarter of any such issuance), plus our retained earnings at the end of such quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less any amount that we pay for repurchases of our common shares, excluding any unrealized gains, losses or other non-cash items that have impacted shareholders' equity as reported in our financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP"), regardless of whether such items are included in other comprehensive income or loss, or in net income, and excluding one-time events pursuant to changes in GAAP, and certain other non-cash charges after discussions between PCM and our independent trustees and after approval by a majority of our independent trustees.
Incentive Fee to PCM	PCM will be entitled to an incentive fee that is payable quarterly in arrears in an amount equal to 20% of the dollar amount by which Core Earnings, on a rolling four-quarter basis and before the incentive fee, exceeds the product of (1) the weighted average of the issue price per share of all of our public offerings multiplied by the weighted average number of common shares outstanding in such quarter and (2) 8.0%. For the initial four quarters following this offering, Core Earnings will be calculated on the basis of each of the previously completed quarters on an annualized basis. Core Earnings for the initial quarter will be calculated from the settlement date of this offering on an annualized basis. Core Earnings is a non-GAAP measure and is defined as GAAP net income (loss) excluding non-cash equity compensation expense, excluding any unrealized gains, losses or other non-cash items recorded in the period, regardless of whether such items are included in other comprehensive income or loss, or in net income. The amount will be adjusted to exclude one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between PCM and our independent trustees and after approval by a

majority of our independent trustees.

Table of Contents

Fee	Description and Method of Computation
	To the extent we have net loss in Core Earnings from a period prior to the rolling four-quarter period that has not been offset by Core Earnings in a subsequent period, such loss will continue to be included in the rolling four-quarter calculation until it has been fully offset.
Termination Fee to PCM	The termination fee, payable for (1) our termination of the management agreement without cause or (2) PCM's termination of the management agreement upon a default in the performance of any material term of the management agreement, will be equal to three times (a) the average annual base management fee and (b) the average annual (or, if the period is less than 24 months, annualized) incentive fee earned by PCM during the prior 24-month period before termination.
Loan Servicing Fee to PLS	PLS will be entitled to base servicing fees that are competitive with those charged by specialty servicers. Base servicing fees are calculated as a percentage of the unpaid principal balance of the mortgage loans, with the actual percentage being based on the risk characteristics of the loans in a particular pool. Such risk characteristics include market value of the underlying properties, creditworthiness of the borrowers, seasoning of the loans, degree of current and expected loan defaults, current loan-to-value ratios, borrowers' payment history and debt-to-income levels. The base servicing fees will range from 30 to 100 basis points per annum of the unpaid principal balance of such loans. The risk characteristics used in calculating the base servicing fee for a particular portfolio of loans will be consistent with the assumptions used by PCM in determining the bid for that portfolio. PLS will also be entitled to certain customary market-based fees and charges, including boarding and deboarding fees, disposition fees, assumption, modification and origination fees and late charges, as well as interest on funds on deposit in custodial or escrow accounts. In addition, to the extent we participate in the U.S. Treasury's Home Affordable Modification Program (or other similiar mortgage loan modification programs), or the HAMP, which established standard loan modification guidelines for "at risk" homeowners and provides incentive payments to certain participants, including loan servicers, for achieving modifications and successfully remaining in the program, PLS will retain any incentive payments made to it in connection with our participation therein.

Table of Contents

Fee	Description and Method of Computation
Expense Reimbursement to PCM and PLS	PCM will be entitled to reimbursement of organizational and operating expenses, including third party expenses, incurred on our behalf, as detailed in "Our Manager and the Management Agreement Management Fees and Incentive Compensation Reimbursement of Expenses." We will not have any employees. PCM and PLS are responsible for the compensation and other related expenses of all personnel who perform services for us pursuant to the management agreement and the loan servicing agreement, respectively. Under the management agreement, PCM may perform certain legal, accounting, due diligence, asset management, securitization, property management, brokerage, leasing and other services that outside professionals or outside consultants otherwise would perform on our behalf and is entitled to be reimbursed or paid for the cost of performing such tasks. PCM may retain third parties, including accountants, legal counsel, real estate underwriters, brokers or others on our behalf, and shall be reimbursed for the costs and expenses of such services. Under the loan servicing agreement, PLS is also entitled to reimbursement for all customary, reasonable and necessary out of pocket expenses incurred by PLS in connection with the performance of its servicing obligations as further described in the loan servicing agreement. In general, this right to reimbursement for out of pocket expenses is limited to proceeds (including liquidation proceeds and escrow deposits) received in respect of the mortgage loan for which the expense was incurred.

Historical Performance

PCM commenced operations in March 2008 and is the manager of the two PennyMac funds. The PennyMac funds commenced operations in August 2008. The PennyMac funds have investment periods that expire on December 31, 2011 (subject to earlier termination under certain circumstances), and they had aggregate capital commitments of approximately $584 million as of May 31, 2009, of which approximately $226 million was invested as of May 31, 2009. The PennyMac funds have substantially similar investment objectives and strategies as we do and their current portfolios are comprised of holdings of residential mortgage loans.

The tables under "Business Historical Performance" in this prospectus set forth certain historical investment performance about PCM and the PennyMac funds. This information is a reflection of the past performance of PCM and the PennyMac funds and is not a guarantee or prediction of the returns that we, PCM or the PennyMac funds may achieve in the future.

Concurrent Offering; Direct Offering

Concurrently with this offering, we will sell to certain of our executive officers, an affiliate of BlackRock, Highfields Capital and PNMAC (which is owned by certain of our executive officers, an affiliate of BlackRock and Highfields Capital), in a separate private placement, 5% of our outstanding

common shares after giving effect to the common shares issued in this offering, excluding common shares that may be sold pursuant to the underwriters' overallotment option, and subject, in all cases, to a maximum purchase of $40 million of our common shares at a price per share equal to the initial public offering price per share in this offering. We will enter into lockup agreements with the purchasers of our common shares in our concurrent offering pursuant to which such purchasers will agree, subject to the terms and conditions of the lockup agreements, not to sell the shares purchased in our concurrent offering for three years. We will enter into a registration rights agreement with the purchasers of our common shares in our concurrent offering. See "Shares Eligible for Future Sale Registration Rights." The closing of our concurrent offering is expected to occur on the same day as this offering, and is contingent upon the completion of this offering. This offering is not contingent upon the closing of our concurrent offering.

In addition, investors in the PennyMac funds may purchase our common shares directly from us, at a price per share equal to the initial public offering price. The closing of the direct offering is expected to occur on the same day as this offering, and is contingent upon the completion of this offering. This offering is not contingent upon the closing of the direct offering.

Conflicts of Interest

We are dependent on PCM for our day-to-day management and do not have any independent officers or other employees. Our officers and our non-independent trustees also serve as employees of PCM or its affiliates. As a result, our management agreement with PCM was negotiated between related parties and its terms, including fees payable, may not be as favorable to us as if our management agreement had been negotiated at arm's length with an unaffiliated third party. Our loan servicing agreement with PLS also was negotiated between related parties and its terms, including fees payable, may not be as favorable to us as if our loan servicing agreement had been negotiated at arm's length with an unaffiliated third party.

PCM has discretionary investment authority over the PennyMac funds, which have investment objectives and strategies substantially similar to ours, and it is possible in the future that PCM may manage other entities and accounts which may compete with us for investment opportunities.

Investment opportunities in pools of mortgage loans that are consistent with our investment objective, on the one hand, and the investment objectives of the PennyMac funds and other future entities or accounts managed by PCM, on the other hand, will be allocated among us and the PennyMac funds and the other entities or accounts generally *pro rata* based upon relative amounts of investment capital (including undrawn capital commitments) available for new investments by us, the PennyMac funds and any other relevant entities or accounts or by assigning opportunities among the relevant entities such that investments assigned among us, such funds, entities or accounts are fair and equitable over time; *provided* that PCM, in its sole discretion, may allocate investment opportunities in any other manner that it deems to be fair and equitable.

In the case of the assignment of investment opportunities, PCM will consider a number of factors. These factors include:

- investment objective or strategies for particular entities or accounts,
- tax considerations of an entity or account,
- risk or investment concentration parameters for an entity or account,
- supply or demand for an investment at a given price level,
- size of available investment,
- cash availability and liquidity requirements for an entity or account,

Table of Contents

- regulatory restrictions,
- minimum investment size of an entity or account,
- relative size or "buying power" of an entity or account,
- regulatory considerations, including the impact on an entity's status under the Investment Company Act and, in our case, our REIT status, and
- such other factors as may be relevant to a particular transaction.

In the case of *pro rata* purchases of pools of loans where the pool is allocated among us and other entities or accounts, PCM will, at the time of purchase, seek to allocate the hundreds, or potentially thousands, of individual mortgage loans in the pools among us and the other entities or accounts such that the overall allocation of acquired mortgage loans in the pools will target reasonable symmetry with reference to, among other factors, the following:

- unpaid principal balances,
- default status,
- discounts from purchase price,
- lien position,
- expected cash flows,
- geography, and
- such other factors as may be relevant to a particular transaction.

The ability of PennyMac and its officers and employees to engage in other business activities may reduce the time PCM spends managing us.

We have agreed to pay PCM a base management fee that is tied to our Shareholders' Equity and incentive compensation that is based on our Core Earnings. The base management fee component may not sufficiently incentivize PCM to generate attractive, risk-adjusted returns for us. The incentive compensation component may cause PCM to place undue emphasis on the maximization of net income at the expense of other criteria, such as preservation of capital, to achieve higher incentive compensation. This could result in increased risk to the value and long-term performance of our investment portfolio.

For its services under the loan servicing agreement, PLS will be entitled to base servicing fees calculated as a percentage of the unpaid principal balance of the mortgage loans held in our portfolio. Accordingly, PLS's interests may not be aligned with ours with regard to modifications on our mortgage loans that would reduce their unpaid principal balances.

PLS's refinancing of sub-performing and non-performing loans on our behalf can result in a new loan that is readily saleable in the secondary market with a value significantly in excess of the loan that was refinanced. In addition, PLS originates loans on our behalf as a form of seller financing to facilitate the disposition of real estate that we acquire through foreclosure. In order to provide PLS with an incentive to work with borrowers to refinance sub-performing and non-performing loans and to dispose of real estate that we acquire through foreclosure, we have agreed to pay PLS customary market-based origination fees in cases where PLS originates such loans on our behalf. The amount of any origination fees will be subject to review by our board of trustees from time to time. This may provide PLS with an incentive to refinance a greater proportion of our loans than it otherwise would and/or to refinance loans on our behalf instead of arranging the refinancings with a third party lender. It may also provide PLS with an incentive to provide financing to facilitate sales to third parties with regard to the disposition of real estate that we acquire through foreclosure.

Prior to the investment of the offering proceeds into our targeted asset classes, we may make investments in high grade, short-term securities, including BlackRock-sponsored money market funds.

We may enter into transactions with market participants with which BlackRock or Highfields Capital has business relationships, and such relationships could influence the decisions made by PCM with respect to the purchase or sale of assets. In addition, such third parties could have interests that may be contrary to our investment objective or which may conflict with our interests. Furthermore, BlackRock- or Highfields Capital-managed investment vehicles or separate accounts may, to the extent permitted by applicable law, purchase or sell assets from or to us. In addition, we may secure services from companies in which BlackRock- or Highfields Capital-managed investment vehicles or accounts may invest or, to the extent permitted by applicable law, from BlackRock or Highfields Capital. Neither BlackRock nor Highfields Capital is prohibited from purchasing or selling the assets of, or otherwise investing in or financing, either for its own account or for client accounts, issuers in which we may have an interest. Such activities could have an adverse effect on the value of the positions held by us, or may result in BlackRock and/or Highfields Capital having interests adverse to ours.

Operating and Regulatory Structure

REIT Qualification

In connection with this offering, we intend to elect to be treated as a REIT under Sections 856 through 859 of the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code, commencing with our taxable year ending on December 31, 2009. Our qualification as a REIT depends upon our ability to meet on a continuing basis, through actual investment and operating results, various complex requirements under the Internal Revenue Code relating to, among other things, the sources of our gross income, the composition and values of our assets, our distribution levels and the diversity of ownership of our shares. We believe that we will be organized in conformity with the requirements for qualification and taxation as a REIT under the Internal Revenue Code, and that our intended manner of operation will enable us to meet the requirements for qualification and taxation as a REIT.

As a REIT, we generally will not be subject to U.S. federal income tax on our REIT taxable income we distribute currently to our shareholders. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to U.S. federal income tax at regular corporate rates and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year during which we lost our REIT qualification. Accordingly, our failure to qualify as a REIT could have a material adverse impact on our results of operations and amounts available for distribution to our shareholders. Even if we qualify for taxation as a REIT, we may be subject to some U.S. federal, state and local taxes on our income or property. In addition, subject to maintaining our qualification as a REIT, a significant portion of our business is expected to be conducted through, and a significant portion of our income may be earned in, one or more TRSs that are subject to corporate income taxation.

Investment Company Act Exclusion

We intend to conduct our operations so that we are not required to register as an investment company under the Investment Company Act. Section 3(a)(1)(A) of the Investment Company Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Section 3(a)(1)(C) of the Investment Company Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. Excluded from the term "investment securities," among other things, are U.S. government securities and securities issued

Table of Contents

by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company set forth in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act. Because we are organized as a holding company that conducts our businesses primarily through our operating partnership and its wholly-owned subsidiaries, our status under the Investment Company Act is dependent upon the status of our operating partnership which, as a holding company, in turn, will have its status determined by the status of its subsidiaries. The securities issued to our operating partnership by these subsidiaries that are excepted from the definition of "investment company" in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act, together with any other investment securities it may own, may not have a value in excess of 40% of the value of our operating partnership's total assets on an unconsolidated basis. We will monitor our holdings to ensure continuing and ongoing compliance with this test. In addition, we believe our company will not be considered an investment company under Section 3(a)(1)(A) of the Investment Company Act because we will not engage primarily or hold ourselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through our wholly-owned subsidiaries, we are primarily engaged in the business of our subsidiaries. Further, we believe that we may also rely upon Section 3(c)(6) of the Investment Company Act, which excludes from the definition of "investment company" any company primarily engaged, directly or through majority-owned subsidiaries, in a business, among others, described in Section 3(c)(5)(C) of the Investment Company Act (from which not less than 25% of such company's gross income during its last fiscal year was derived) together with an additional business or additional businesses other than investing, reinvesting, owning, holding or trading in securities.

If the value of our operating partnership's investments in its subsidiaries that are excepted from the definition of "investment company" by Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act, together with any other investment securities it owns, exceeds 40% of its total assets on an unconsolidated basis, or if one or more of such subsidiaries fail to maintain their exceptions or exclusions from the Investment Company Act, we may have to register under the Investment Company Act and we could become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with affiliated persons (as defined in the Investment Company Act), portfolio composition, including restrictions with respect to diversification and industry concentration, and other matters.

In addition, certain of our operating partnership's subsidiaries intend to qualify for an exclusion from the definition of "investment company" under Section 3(c)(5)(C) (or Section 3(c)(6)) of the Investment Company Act which is available for entities "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." This exclusion generally means that at least 55% of such subsidiaries' portfolios must be comprised of qualifying assets and 80% of each of their portfolios must be comprised of qualifying assets and real estate-related assets under the Investment Company Act.

Distribution Policy

We generally need to distribute at least 90% of our taxable income each year (subject to certain adjustments) to our shareholders in order to qualify as a REIT under the Internal Revenue Code. We may, under certain circumstances, particularly when we are required to report taxable income in advance of the receipt of related cash, make a distribution only partly in cash and partly as a taxable distribution of our shares as part of a distribution in which shareholders may elect to receive shares or (subject to a limit measured as a percentage of the total distribution) cash, or in a form other than cash. Although we anticipate initially making quarterly distributions to our shareholders, the timing, form and amount of any distributions to our shareholders, if any, will be at the sole discretion of our board of trustees and will depend upon a number of factors, as to which no assurance can be given. Our ability to make distributions to our shareholders depends, in part, upon the performance of

our investment portfolio. For additional details, see "Distribution Policy." Distributions to our shareholders will be generally taxable to our shareholders as ordinary income, although a portion of our distributions may be designated by us as capital gain or qualified dividend income or may constitute a return of capital. See "U.S. Federal Income Tax Considerations Taxation of Shareholders."

Restrictions on Ownership and Transfer of Shares

Our declaration of trust, subject to certain exceptions, prohibits any person from directly or indirectly owning more than 9.8% by vote or value, whichever is more restrictive, of our outstanding common shares or more than 9.8% by vote or value, whichever is more restrictive, of our outstanding shares of beneficial interest, referred to in this prospectus collectively as the share ownership limits. Our declaration of trust also prohibits any person from directly or indirectly owning our shares of beneficial interest of any class if such ownership would result in us being "closely held" under Section 856(h) of the Internal Revenue Code or otherwise cause us to fail to qualify as a REIT.

Our declaration of trust generally provides that any shares of beneficial interest owned or transferred in violation of the foregoing restrictions will be deemed to be transferred to a charitable trust for the benefit of a charitable beneficiary, and the purported owner or transferee will acquire no rights in such shares. If the foregoing is ineffective for any reason to prevent a violation of these restrictions, then the transfer of such shares will be void *ab initio*.

No person may transfer our shares of beneficial interest or any interest in our shares if the transfer would result in our shares of beneficial interest being beneficially owned by fewer than 100 persons on or after January 29, 2010. Any attempt to transfer our shares of beneficial interest in violation of this minimum will be void *ab initio*.

Table of Contents

THE OFFERING

Common shares offered by us	common shares (plus up to an additional common shares that we may issue and sell upon the exercise of the underwriters' overallotment option).
Common shares to be outstanding after this offering	shares.[(1)(2)(3)]
Use of proceeds	We intend to use the net proceeds of this offering, our concurrent offering and the direct offering (if any) in accordance with our investment objective and strategies described in this prospectus. Prior to the full investment of the offering proceeds into our targeted asset classes, we may make investments in high grade, short-term securities, such as securities guaranteed by Ginnie Mae, securities issued and guaranteed by Freddie Mac or Fannie Mae, short-term money market funds, including BlackRock-sponsored money market funds, as well as cash equivalents for temporary cash management, consistent with our intention to qualify as a REIT. See "Use of Proceeds."
Proposed NYSE symbol	"PMT"
Ownership and transfer restrictions	Our declaration of trust, subject to certain exceptions, prohibits any person from directly or indirectly owning more than 9.8% by vote or value, whichever is more restrictive, of our outstanding common shares or more than 9.8% by vote or value, whichever is more restrictive, of our outstanding shares of beneficial interest. See "Description of Shares of Beneficial Interest Restrictions on Ownership and Transfer."
Risk factors	Investing in our common shares involves a high degree of risk. You should carefully read and consider the information set forth under "Risk Factors" and all other information in this prospectus before investing in our common shares.

(1) Assumes (i) the underwriters' overallotment option to purchase up to an additional of our common shares is not exercised and (ii) of our common shares are sold in the direct offering.

(2) Concurrently with this offering, we will sell to certain of our executive officers, an affiliate of BlackRock, Highfields Capital and PNMAC, in a separate private placement, 5% of our outstanding common shares after giving effect to the common shares issued in this offering, excluding common shares that may be sold pursuant to the underwriters' overallotment option, and subject, in all cases, to a maximum purchase of $40 million of our common shares at a price per share equal to the initial public offering price per share in this offering.

(3) Does not include (i) restricted common shares to be granted to our executive officers and other employees of PCM and/or PLS under our equity incentive plan upon the completion of this offering, (ii) 9,000 restricted common shares to be granted to our independent trustees under our equity incentive plan upon the completion of this offering or (iii) of our common shares available for future grant under our equity incentive plan. See "Management Equity Incentive Plan."

Table of Contents

Our Information

Our principal executive offices are located at 27001 Agoura Road, Third Floor, Calabasas, California 91301. Our telephone number is 1-818-224-7442. Our website is *http://www.PennyMacMortgageInvestmentTrust.com*. The contents of our website are not a part of this prospectus. We have included our website address only as an inactive textual reference and do not intend it to be an active link to our website.

Table of Contents

RISK FACTORS

An investment in our common shares involves a high degree of risk. You should carefully consider the risks described below, together with the other information contained in this prospectus, before making a decision to purchase our common shares in this offering. The occurrence of any of the following risks could materially and adversely affect our business, prospects, financial condition, cash flows, liquidity, results of operations, funds from operations, share price, ability to service our indebtedness and ability to make cash distributions to our shareholders and could cause you to lose all or a significant part of your investment in our common shares. In connection with the forward-looking statements that appear in this prospectus, you should also carefully review the cautionary statement referred to under "Cautionary Statement Regarding Forward-Looking Statements."

Risks Associated with Our Management and Relationship with Our Manager and Its Affiliates

We are dependent upon PCM, and its key personnel and may not find a suitable replacement if the management agreement with PCM is terminated or such key personnel are no longer available to us, which would materially and adversely affect us.

In accordance with our management agreement, we are externally advised by PCM, and all of our officers are employees of PCM or its affiliates. We have no separate facilities and will have no employees upon completion of this offering other than our officers. Pursuant to our management agreement, PCM will be obligated to supply us with our senior management team, and the members of that team will be required to devote such time to us as is necessary and appropriate, commensurate with the level of our activity, and may have conflicts in allocating their time and services between us and other entities or accounts managed by PCM now or in the future, including the PennyMac funds. We expect that all or substantially all of our investment, financing and risk management decisions will be made by PCM and not by us, and PCM also will have significant discretion as to the implementation of our operating policies and strategies. Furthermore, PCM has the sole discretion to hire and fire its employees, and our board of trustees and shareholders will not have any authority over the individual employees of PCM, although our board of trustees will have authority over our officers who are supplied by PCM. Accordingly, we are completely reliant upon, and our success depends exclusively on, PCM's personnel, services, resources, facilities, relationships and contacts. No assurance can be given that PCM will act in our best interests with respect to the allocation of personnel, services and resources to our business. In addition, the management agreement does not require PCM to dedicate specific personnel to us or to require personnel servicing our business to allocate a specific amount of time to us. The failure of any of PCM's key personnel to service our business with the requisite time and dedication, or the departure of such personnel from PCM, or the failure of PCM to attract and retain key personnel, would materially and adversely affect our ability to execute our business plan. Our management agreement only extends until , 2012, and may be terminated earlier under certain circumstances. Accordingly, we are also subject to the risk that no suitable replacement is found to manage us on a timely basis or at all. If the management agreement is terminated and a suitable replacement is not secured in a timely manner or at all, we would likely be unable to execute our business plan, which would materially and adversely affect us.

We are a newly formed company with no separate operating history, PCM's investment track record may not be indicative of its or our future performance and PCM has a limited operating history. PennyMac is undergoing significant growth and its integration of new operations may not be effective.

We have not yet commenced operations and do not have any historical financial statements with which you may evaluate us, the performance of the investments that we intend to make or the effectiveness of our investment and other strategies as a whole. We have presented in this prospectus certain information with respect to the PennyMac funds, which are managed by PCM. Such information is included, among other places, under "Business Historical Performance." When considering this

Table of Contents

information, you should bear in mind that the historical results of the PennyMac funds are not indicative of the future results that you should expect from an investment in our common shares.

PNMAC was organized in January 2008 and has only a limited operating history. PennyMac's success, which will be largely determinative of our own success, will depend on many factors, including the availability of attractive risk-adjusted investment opportunities that satisfy its targeted investment strategies and then identifying and consummating them on favorable terms, the level and volatility of interest rates, its ability to access on our behalf short-term and long-term financing on favorable terms and conditions in the financial markets, real estate market and the economy, as to which no assurance can be given. In addition, PennyMac will face substantial competition for attractive investment opportunities. We cannot assure you that PennyMac will be able to cause us to make investments with attractive risk-adjusted returns or will not seek on our behalf investments with greater risk to obtain the same level of returns or that the value of our investments in the future will not decline substantially.

In addition, since commencing operations in 2008, PennyMac has formed the PennyMac funds, which had aggregate capital commitments of approximately $584 million as of May 31, 2009, and its number of employees has grown to approximately 90 over that same period. PennyMac's significant growth has caused, and if it continues will continue to cause, significant demands on its operational, accounting and legal infrastructure, and increased expenses. In addition, PennyMac is required to continuously develop its systems and infrastructure in response to the increasing sophistication of the residential mortgage loan market and legal, accounting and regulatory developments.

Our success depends on the personnel, services, resources, relationships and contacts of PCM and PLS. The ability of PCM and PLS to provide us with the services we require to be successful depends, among other things, on the ability of PennyMac, including PCM and PLS, to maintain an operating platform and management system sufficient to address its growth and will require PennyMac to incur significant additional expenses and to commit additional senior management and operational resources. As a result, PennyMac faces significant challenges in (i) maintaining adequate financial and business controls, (ii) implementing new or updated information and financial systems and procedures and (iii) training, managing and appropriately sizing its work force and other components of its business on a timely and cost-effective basis. There can be no assurance that PennyMac will be able to effectively integrate its expanding operations or that PennyMac will be able to continue to grow. PennyMac's failure to do so could adversely affect the ability of PCM and PLS to manage us and service our mortgage loan portfolio, respectively, which would materially and adversely affect us.

The management agreement and the loan servicing agreement were not negotiated on an arm's length basis and the terms, including the fees payable to PCM and PLS, as the case may be, may not be as favorable to us than if those agreements were negotiated with unaffiliated third parties.

All of our officers are employees of PCM or its affiliates. The management agreement and the loan servicing agreement were each negotiated between related parties, and we did not have the benefit of arm's length negotiations of the type normally conducted with an unaffiliated third party and the terms, including the fees payable to PCM and PLS, as the case may be, may not be as favorable to us. We may choose not to enforce, or to enforce less vigorously, our rights under the management agreement or the loan servicing agreement because of our desire to maintain our ongoing relationship with PCM or PLS, as the case may be.

We expect that PCM will source all of our investments, and existing or future entities or accounts managed by PCM may compete with us for, or may participate in, some of those investments, which could result in conflicts of interest.

Although we and PCM have adopted an allocation policy to specifically address some of the conflicts relating to our investment opportunities, which are described under "Business Conflicts of Interest," there is no assurance that this policy will be adequate to address all of the conflicts that may

arise or will address such conflicts in a manner that results in the allocation of a particular investment opportunity to us or is otherwise favorable to us. We will be limited in our ability to acquire assets that are not "qualifying real estate assets" and/or real estate-related assets, as described under "Business Operating and Regulatory Structure Investment Company Act Exclusion," whereas the PennyMac funds and other entities or accounts that PCM may manage in the future will not be so limited. There is no limitation on the ability of PCM to manage additional entities or accounts, except that during the term of our management agreement, PCM may not act as the manager to, or otherwise provide investment advisory services to, any other entity the primary investment objective of which is to invest in distressed residential mortgage loans, excluding the PennyMac funds, any entity in which we are an investor and any government-related entity. The management agreement provides that PCM may act as manager to such an entity if we are not able to pursue additional investment in distressed residential mortgage loans due to limitations on available capital and we determine not to raise additional capital, so long as the independent members of our board of trustees do not determine that such activities would be detrimental to us. In addition, PCM and/or the PennyMac funds and the other entities or accounts managed by PCM now or in the future may participate in some of our investments. Our interests in such investments may also conflict with the interests of PCM in the event of a default or restructuring of the investment. Participating investments will not be the result of arm's length negotiations and will involve potential conflicts between our interests and those of PCM or such other entities or accounts in obtaining favorable terms. To the extent permitted under the Investment Advisers Act of 1940, as amended, or the Investment Advisers Act, the same personnel may determine the price and terms for the investments for both us and PCM or such other entities or accounts and there can be no assurance that any procedural protections, such as obtaining market prices or other reliable indicators of fair market value, will prevent the consideration we pay for these investments from exceeding their fair market value or ensure that we receive terms for a particular investment opportunity that are as favorable as those available from an independent third party.

PCM, in connection with activities other than on our behalf, may acquire material non-public information about an entity that may restrict PCM from trading securities of such entity for us at an opportune time or otherwise using such information for our benefit.

The manner of determining the base management fee may not provide sufficient incentive to PCM to maximize risk-adjusted returns on our investment portfolio because it is based on our Shareholders' Equity and not on our performance.

PCM is entitled to receive a base management fee that is based on our Shareholders' Equity at the end of each quarter. Accordingly, the possibility exists that significant base management fees could be payable to PCM for a given quarter despite the fact that we could experience a net loss during that quarter. PCM's entitlement to such significant non-performance-based compensation may not provide sufficient incentive to PCM to devote its time and effort to source and maximize risk-adjusted returns on our investment portfolio, which could, in turn, adversely affect our ability to make distributions to our shareholders and the market price of our common shares.

The manner of determining the incentive fee may cause PCM to invest in more risky investments to increase our short-term net income and thereby increase the incentive fee it earns.

PCM is entitled to receive incentive compensation based on our performance in each quarter. In evaluating investments and other management strategies, the opportunity to earn incentive compensation based on our Core Earnings may lead PCM to place undue emphasis on the maximization of short-term net income at the expense of other criteria, such as preservation of capital, maintaining sufficient liquidity and/or management of market risk, in order to achieve higher incentive compensation. Investments with higher yield potential are generally riskier and more speculative. In addition, PCM may have a conflict of interest in deciding upon whether to sell any investment at a gain, thereby recognizing additional incentive compensation, or to hold such investment based on its

long-term value. This could result in increased risk to the value and long-term performance of our portfolio.

Termination of our management agreement would be costly and, in certain cases, not permitted.

It is difficult and costly to terminate the management agreement we have entered into with PCM without cause. Our independent trustees will review PCM's performance and the management fees annually, and following the initial term ending , 2012, the management agreement provides that it may be terminated annually by us without cause upon the affirmative vote of at least two-thirds of our independent trustees or by a vote of the holders of at least two-thirds of our outstanding common shares, in each case based upon (i) PCM's unsatisfactory performance that is materially detrimental to us or (ii) our determination that the management fees payable to PCM are not fair, subject to PCM's right to prevent termination based on unfair fees by accepting a reduction of management fees agreed to by at least two-thirds of our independent trustees. PCM must be provided 180-days' prior notice of any such termination. Upon any such termination without cause, we will pay PCM a termination fee equal to three times the sum of (a) the average annual base management fee and (b) the average annual (or, if the period is less than 24 months, annualized) incentive compensation earned by PCM during the prior 24-month period before termination, calculated as of the end of the most recently completed fiscal quarter. These provisions may increase the effective cost to us of terminating the management agreement, thereby adversely affecting our interest or ability to terminate PCM without cause.

PCM may terminate the management agreement if we become required to register as an investment company under the Investment Company Act with termination deemed to occur immediately before such event, in which case we would not be required to pay a termination fee to PCM. Furthermore, PCM may decline to renew the management agreement by providing us with 180 days' written notice, in which case we would not be required to pay a termination fee to PCM. PCM may also terminate the management agreement upon at least 60 days' prior written notice if we default in the performance of any material term of the management agreement and the default continues for a period of 30 days after written notice to us, whereupon we would be required to pay to PCM the termination fee described above.

We depend upon PLS to provide primary servicing and special servicing for our portfolio of residential mortgage loans; if the loan servicing agreement with PLS is terminated, we may not be able to timely replace those services on favorable terms, or at all, and subject to certain restrictions, PLS may provide servicing to other entities or accounts.

Under the loan servicing agreement with PLS, PLS will agree to provide primary servicing and special servicing for our portfolio of residential mortgage loans, as described under "Certain Relationships and Related Transactions Loan Servicing Agreement," for an initial term through , 2012. For its services under the loan servicing agreement, PLS will be entitled to base servicing fees that are competitive with those charged by specialty servicers and are calculated as a percentage of the unpaid principal balance of the mortgage loans in our portfolio. Because the base servicing fees will be calculated on this basis, PLS's interests may not be aligned with ours with regard to modifications on our mortgage loans that would reduce their unpaid principal balances. PLS also will be entitled to certain customary market-based fees and charges, including boarding and deboarding fees, disposition fees, assumption, modification and origination fees and late charges, as well as interest on funds on deposit in custodial or escrow accounts. In addition, to the extent we participate in the HAMP (or other similar mortgage loan modification programs), PLS will be entitled to retain any incentive payments made to it in connection with our participation therein. The term of the loan servicing agreement is identical to the term of the management agreement, and is subject to early termination, without the payment of any termination fee, in the event the management agreement is terminated for any reason. PLS may retain sub-servicers in any jurisdiction where licensing is required

and PLS has not obtained the necessary license or where PLS otherwise deems it advisable, and the fees of such sub-servicers will be paid by PLS out of the servicing fee.

We will rely on PLS to provide these services for our portfolio and will have no in-house capability to handle these services independently of PLS. The costs of these services will increase our operating costs and may adversely affect our net income. If the loan servicing agreement is terminated, we will have to obtain the loan servicing from another servicer. We may not be able to replace these services in a timely manner or on favorable terms, including, without limitation, cost, or at all. In addition, PLS also provides primary and special servicing to the PennyMac funds and, subject to certain limitations contained in the loan servicing agreement as described below under "Certain Relationships and Related Transactions Loan Servicing Agreement," PLS may provide primary and special servicing to other entities or accounts in the future.

PLS's refinancing of sub-performing and non-performing loans on our behalf can result in a new loan that is readily saleable in the secondary market with a value significantly in excess of the loan that was refinanced. In addition, PLS originates loans on our behalf as a form of seller financing to facilitate the disposition of real estate that we acquire through foreclosure. In order to provide PLS with an incentive to work with borrowers to refinance sub-performing and non-performing loans and to dispose of real estate that we acquire through foreclosure, we have agreed to pay PLS customary market-based origination fees in cases where PLS originates such loans on our behalf. In the event PLS effects a refinancing of a loan on our behalf and not through a third party lender and the resulting loan is readily saleable, PLS will be entitled to receive from us an origination fee of $. Similarly, when PLS originates a loan to facilitate the disposition of real estate that we acquire through foreclosure, PLS will be entitled to a fee in the same amount. The amount of the origination fee is intended to reflect market rates and will be subject to review by our board of trustees from time to time. This may provide PLS with an incentive to refinance a greater proportion of our loans than it otherwise would and/or to refinance loans on our behalf instead of arranging the refinancings with a third party lender. It may also provide PLS with an incentive to provide financing to facilitate sales to third parties with regard to the disposition of real estate that we acquire through foreclosure.

PLS has no obligation to provide assistance to us other than as specified in the loan servicing agreement.

PCM's and PLS's respective liability is limited under the management agreement and the loan servicing agreement, and we have agreed to indemnify PCM and PLS against certain liabilities.

The management agreement and the loan servicing agreement provide that PCM (in the case of the management agreement) and PLS (in the case of the loan servicing agreement) will not assume any responsibility other than to provide the services specified in such agreements. The management agreement further provides that PCM will be responsible for any action of our board of trustees in following or declining to follow its advice or recommendations. In addition, each of PCM (in the case of the management agreement) and PLS (in the case of the loan servicing agreement) and their respective affiliates, managers, officers, trustees, directors, employees and members will be held harmless from, and indemnified by us against, certain liabilities on customary terms.

Publicity and media attention concerning litigation and investigations involving Countrywide and certain of its former officers could have an adverse impact on PennyMac and us.

There are several lawsuits pending against Countrywide and certain of its former officers. Countrywide's former chief executive officer and two other former executives have been charged in a civil suit by the SEC with securities fraud and insider trading. Certain of the officers of PennyMac who are former employees of Countrywide, including Stanford L. Kurland, our chairman and chief executive officer, who was chief operating officer of Countrywide until September 2006, have been named as defendants in lawsuits in which Countrywide and other employees and former employees of

Countrywide are defendants. Neither we nor PennyMac nor any of our officers in their capacity as officers of PennyMac or us are party to, nor do any such parties expect to become party in such capacities to, any current or future litigation relating to Countrywide. However, we cannot assure you that existing or future, if any, investigations or litigation will not generate publicity or media attention or adversely impact us or PCM's and PLS's ability to conduct their respective businesses.

BlackRock and Highfields Capital, PennyMac's strategic investors, are not obligated to provide us with any assistance and could compete with us.

BlackRock and Highfields Capital each holds an approximate 37% ownership interest in PNMAC and have representation on the board of PNMAC, the company that owns 100% of PCM and PLS. However, the officers and employees of PCM and PLS are responsible for the investment management operations of PCM and the loan servicing of PLS and no employees of BlackRock or Highfields Capital are employees of PCM or PLS. BlackRock and Highfields Capital are not involved in our day-to-day operations and are under no obligation to provide us with any financial or operational assistance.

BlackRock and Highfields Capital have no obligation to present opportunities to us for matters in which they may become involved. Affiliates of each of BlackRock and Highfields Capital currently manage investment vehicles and separate accounts in a variety of strategies, including strategies targeting investments in mortgage loans and mortgage-related securities, that may compete directly or indirectly with us. We may enter into transactions with market participants with which BlackRock or Highfields Capital has business relationships, and such relationships could influence the decisions made by PCM with respect to the purchase or sale of assets. In addition, such third parties could have interests that may be contrary to our investment objective or which may conflict with our interests. Furthermore, BlackRock- or Highfields Capital-managed investment vehicles or separate accounts may, to the extent permitted by applicable law, purchase or sell assets from or to us. In addition, we may secure services from companies in which BlackRock- or Highfields Capital-managed investment vehicles or accounts may invest or, to the extent permitted by applicable law, from BlackRock or Highfields Capital. Neither BlackRock nor Highfields Capital is prohibited from purchasing or selling the assets of, or otherwise investing in or financing, either for its own account or for client accounts, issuers in which we may have an interest. Such activities could have an adverse effect on the value of the positions held by us, or may result in BlackRock and/or Highfields Capital having interests adverse to ours.

Affiliates of Merrill Lynch, Pierce, Fenner & Smith Incorporated, one of the underwriters in this offering, own approximately 47.4% of the outstanding capital stock of BlackRock on a fully-diluted basis. See "Underwriting."

It is possible that the foregoing relationships and circumstances could require PCM to refrain from making all or a portion of any investment or a disposition in order for PCM to comply with its fiduciary duties, the Investment Company Act, the Investment Advisers Act or other applicable laws.

If ownership interests held by PennyMac's strategic investors were transferred to a third party, this could result in a change in our objectives and cause us material harm.

PCM, our manager, and PLS, our loan servicer, are each wholly-owned subsidiaries of PNMAC. PNMAC's strategic investors, BlackRock and Highfields Capital, each hold an approximate 37% ownership interest in PNMAC. If either or both of BlackRock and Highfields Capital were to sell their ownership interests in PNMAC to a third party, that party might, subject to certain limitations, attempt to cause us to amend our investment policies to include objectives and governing terms that differ completely from those currently contemplated by us. A new controlling shareholder in PNMAC could attempt to cause a sale or disposition of PCM and/or PLS to a third party without the approval of our shareholders. A new owner could also employ professionals who are less experienced or who

have a track record that is not as successful as that possessed by the professionals made available by PCM. In addition, any such change or exercise of control could mean a change in the composition of PCM's professionals, either through the appointment of new professionals or through the departure of dissatisfied professionals. Further, if the strategic investors transfer their interest in PNMAC, it could, under the provisions of the Investment Advisers Act, result in a termination of our management agreement with PCM unless the agreement is re-approved by our independent trustees. If any of the foregoing were to occur, we could experience difficulty in making new investments and the value of our existing investments, our business, our results of operations and our financial condition could suffer materially.

Additionally, we cannot predict with any certainty the effect that any transfer in the ownership of PNMAC would have on the trading price of our common shares or our ability to raise capital or make investments in the future because such matters would depend to a large extent on the identity of the new owner and the new owner's intentions with regard to our business and affairs. As a result, the future of our company would be uncertain and the value of our investments, our results of operations and our financial condition could suffer.

Risks Related to Our Business

We have no operating history and may not be able to successfully operate our business or generate sufficient operating cash flows to make or sustain distributions to our shareholders.

We were organized in May 2009 and have no operating history. We have no assets and will only commence operations upon completion of this offering. Our ability to make or sustain distributions to our shareholders will depend on many factors, including the availability of attractive risk-adjusted investment opportunities that satisfy our investment strategies and our success in identifying and consummating them on favorable terms, the level and volatility of interest rates, readily accessible short-term and long-term financing on favorable terms and conditions in the financial markets, real estate market and the economy, as to which no assurance can be given. In addition, we will face substantial competition in acquiring attractive investments. We cannot assure you that we will be able to make investments with attractive risk-adjusted returns or will not seek investments with greater risk to obtain the same level of returns or that the value of our investments in the future will not decline substantially. We also may not be able to operate successfully as a separate business or implement our operating policies and strategies successfully. Furthermore, there can be no assurance that we will be able to generate sufficient returns to pay our operating expenses and make distributions to our shareholders.

As a result of difficult conditions in the financial markets and the economy generally, the risks to our business strategies are high and there are no assurances that we will be successful in implementing our business strategies.

The implementation of our business strategies may be materially affected by current conditions in the mortgage market, the financial markets and the economy generally. Continuing concerns over inflation, energy costs, geopolitical issues, the availability and cost of credit, the mortgage market and a declining real estate market have contributed to increased volatility and diminished expectations for the economy and markets going forward. The residential mortgage market has been severely affected by changes in the lending landscape and there is no assurance that these conditions have stabilized or that they will not worsen. The severity of the liquidity limitation was largely unanticipated by the markets, and access to mortgages has been substantially limited. While the limitation on financing was initially in the subprime mortgage market, the liquidity issues have now also affected prime and Alt-A lending, with mortgage rates on certain types of loans remaining higher than previously available in recent periods and many product types being severely curtailed. This has an impact on new demand for homes, which will compress the home ownership rates and weigh heavily on future home price performance. There is a strong correlation between home price growth rates and mortgage loan delinquencies.

In addition to the foregoing, the residential mortgage market in the United States has experienced defaults, credit losses and significant liquidity concerns. Certain commercial banks, investment banks and insurance companies have announced extensive losses from exposure to the residential mortgage market. These losses have reduced financial industry capital, leading to reduced liquidity for many institutions. These factors have impacted investor perception of the risk associated with residential mortgage loans, RMBS, real estate-related securities and various other asset classes in which we intend to invest. As a result, values for residential mortgage loans, RMBS, real estate-related securities and various other asset classes in which we intend to invest have experienced substantial volatility. A continuation or increase in the volatility and deterioration in the broader residential mortgage and RMBS markets may adversely affect the performance and market value of our investments. Although we intend to purchase distressed mortgage loans at discounts to their unpaid principal balances, further deterioration in home prices or the value of our investments could require us to take charges which may be material.

Dramatic declines in the housing market, with falling home prices and increasing foreclosures and unemployment, have resulted in, and may result in further, significant asset write-downs by depository institutions, which, combined with other factors, have caused many depository institutions to seek additional capital, to merge with other institutions and, in some cases, to fail. Institutions from which we may seek to obtain financing may have owned or financed residential mortgage loans, real estate-related securities and real estate loans which have declined in value and caused them to suffer losses as a result of the recent downturn in the residential mortgage market. Many lenders and institutional investors have reduced and, in some cases, ceased to provide funding to borrowers, including other depository institutions. If these conditions persist, these institutions may become insolvent or tighten their lending standards, which could make it more difficult for us to obtain financing on favorable terms or at all. As a result, our ability to acquire assets and implement our business strategy may be hindered, and our results of operations may be negatively affected.

The actions of the U.S. government, the Federal Reserve and the U.S. Treasury, including the establishment of the TALF and the Public-Private Investment Program, may adversely affect our business.

The Term Asset-Backed Securities Loan Facility, or TALF, was first announced by the Federal Reserve in November 2008 and has since been expanded in size and scope. Under the TALF, the Federal Reserve Bank of New York makes loans (which, with certain exceptions, are non-recourse) to borrowers to fund their purchase of eligible assets, currently certain asset-backed securities. The nature of the eligible assets has been expanded several times. The Federal Reserve expanded the TALF in June 2009 to include certain CMBS as eligible assets. Currently, TALF loans have three-year terms, have interest due monthly, are exempt from mark to market rules and margin calls related to a decrease in the underlying collateral value, are pre-payable in whole or in part, and prohibit the substitution of any underlying collateral. Beginning in June 2009, borrowers have the option to select five-year loans for certain eligible assets, including CMBS. Payments of principal on the collateral underlying a TALF loan are required to be applied to reduce the loan's principal amount pro rata based upon the original loan-to-value ratio. The U.S. Treasury announced in March 2009 that through the expansion of the TALF, loans will be made available to investors to fund purchases of certain legacy securitization assets, including legacy RMBS. The eligibility criteria and terms of loans to purchase legacy securities have not yet been determined. Additionally, terms of the general TALF program may be modified by the Federal Reserve Bank of New York at any time. Accordingly, we may not be able to acquire assets through the TALF on favorable terms or at all.

In March 2009, the U.S. Treasury announced certain details, which are subject to change, concerning its Public-Private Investment Program, including the Legacy Loans Program. As proposed, the Legacy Loans Program would provide financing for loan purchases from financial institutions and

may stimulate financial institutions to strengthen their balance sheets by selling their troubled loans. In addition to the foregoing, the U.S. Congress and/or various states and local legislatures may enact additional legislation or regulatory action designed to address the current economic crisis or for other purposes that could have a material adverse effect on our ability to execute our business strategies.

The Legacy Loans Program has been delayed and it may not be established on the terms proposed or at all. Consequently, it is not possible to predict how the TALF, the Public-Private Investment Program or other recent U.S. government actions will impact the financial markets, including current significant levels of volatility, or our future investments. To the extent the market does not respond favorably to these initiatives or they do not function as intended, they may not provide our business the positive impact we anticipate. The Legacy Loans Program as currently proposed is subject to change and there can be no assurance as to its final terms or that we will be successful in winning a bid on any assets in the future. The extent to which depository institutions will participate if the program is established and its ultimate impact on the market for residential mortgage loans is uncertain. We can provide no assurance that we will be eligible to use these programs or, if eligible, will be able to utilize them successfully. Further, the incentives provided by these programs may increase competition for, and the pricing of, our targeted assets.

In addition, the U.S. government, the Federal Reserve, the U.S. Treasury and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. There can be no assurances that such actions will have a beneficial impact on the financial markets, including current extreme levels of volatility. Additionally, we cannot predict whether or when such actions may occur, and such actions could have a material adverse impact on our business, results of operations and financial condition.

Mortgage loan modification and refinance programs, future legislative action, changes in the requirements necessary to qualify for refinancing mortgage loans with Fannie Mae, Freddie Mac or Ginnie Mae and other actions and changes may adversely affect the value of, and the returns on, the assets in which we intend to invest.

During the second half of 2008 and in early 2009, the U.S. government, through the Federal Housing Administration, or FHA, the FDIC and the U.S. Treasury, commenced or proposed implementation of programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures. One of these programs, Hope for Homeowners, allows certain distressed borrowers to refinance their mortgages into FHA insured loans. In addition, certain mortgage lenders and servicers have voluntarily, or as part of settlements with law enforcement authorities, established loan modification programs relating to the mortgages they hold or service. Other government programs, including the HAMP and the Second Lien Program, involve, among other things, the modification of first-lien and/or second-lien mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans. These loan modification and refinance programs, future U.S. federal, state and/or local legislative or regulatory actions that result in the modification of outstanding mortgage loans, as well as changes in the requirements necessary to qualify for refinancing mortgage loans with Fannie Mae, Freddie Mac or Ginnie Mae, may adversely affect the value of, and the returns on, residential mortgage loans, RMBS, real estate-related securities and various other asset classes in which we intend to invest. In addition to the foregoing, the U.S. Congress and/or various states and local legislators may enact additional legislation or regulatory action designed to address the current economic crisis or for other purposes that could have a material adverse effect on our ability to execute our business strategies.

Table of Contents

The conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the U.S. federal government, may adversely affect our business.

Due to increased market concerns about Fannie Mae and Freddie Mac's ability to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the U.S. federal government, on July 30, 2008, the government passed the Housing and Economic Recovery Act of 2008, or the HERA. On September 7, 2008, the Federal Housing Finance Agency, or the FHFA, placed Fannie Mae and Freddie Mac into conservatorship and, together with the U.S. Treasury, established a program designed to boost investor confidence in Fannie Mae's and Freddie Mac's debt and MBS. As the conservator of Fannie Mae and Freddie Mac, the FHFA controls and directs the operations of Fannie Mae and Freddie Mac and may (i) take over the assets of and operate Fannie Mae and Freddie Mac with all the powers of the shareholders, the directors and the officers of Fannie Mae and Freddie Mac and conduct all business of Fannie Mae and Freddie Mac; (ii) collect all obligations and money due to Fannie Mae and Freddie Mac; (iii) perform all functions of Fannie Mae and Freddie Mac which are consistent with the conservator's appointment; (iv) preserve and conserve the assets and property of Fannie Mae and Freddie Mac; and (v) contract for assistance in fulfilling any function, activity, action or duty of the conservator. A primary focus of this new legislation is to increase the availability of mortgage financing by allowing Fannie Mae and Freddie Mac to continue to grow their guarantee business without limit, while limiting net purchases of RMBS to a modest amount through the end of 2009. It is currently planned for Fannie Mae and Freddie Mac to reduce gradually their RMBS portfolios beginning in 2010.

In addition to the FHFA becoming the conservator of Fannie Mae and Freddie Mac, the U.S. Treasury has taken three additional actions: (i) the U.S. Treasury and the FHFA have entered into preferred stock purchase agreements between the U.S. Treasury and Fannie Mae and Freddie Mac pursuant to which the U.S. Treasury will ensure that each of Fannie Mae and Freddie Mac maintains a positive net worth; (ii) the U.S. Treasury has established a new secured lending credit facility which will be available to Fannie Mae, Freddie Mac and the Federal Home Loan Banks, which is intended to serve as a liquidity backstop, which will be available until December 2009; and (iii) the U.S. Treasury has initiated a temporary program to purchase U.S. government agency RMBS issued by Fannie Mae and Freddie Mac.

Although the U.S. Treasury has committed capital to Fannie Mae and Freddie Mac, there can be no assurance that these actions will be adequate for their needs. If these actions are inadequate, Fannie Mae and Freddie Mac could continue to suffer losses and could fail to honor their guarantees and other obligations. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be considerably limited relative to historical measurements. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes a U.S. government agency RMBS and could have broad adverse market implications. Such market implications could negatively affect the performance and market value of our investments.

We are dependent on PCM and its senior management team, the members of which have limited experience operating a REIT.

Although PCM's experienced senior management team has been active in real estate operations and the management of residential mortgage loans for many years, they have limited experience operating a REIT and operating a business in compliance with the numerous technical restrictions and limitations set forth in the Internal Revenue Code or the Investment Company Act applicable to REITs. In addition, managing a portfolio of assets under Internal Revenue Code and Investment Company Act constraints may limit the types of investments we are able to make and thus hinder PCM's ability to achieve our investment objective.

Our access to financing sources, which may not be available on favorable terms, or at all, especially in light of current market conditions, may be limited and thus our ability to maximize our returns may be adversely affected.

We are generally required to distribute to our shareholders at least 90% of our taxable income each year for us to qualify as a REIT, which we currently intend to satisfy. As a result, our retained earnings available to execute our business strategies will be nominal. We plan to finance our investments with leverage, the level of which may vary based upon the particular characteristics of our portfolio and on market conditions. However, in light of current market conditions, we anticipate initially utilizing limited leverage on our portfolio as part of our financing strategy. Our financing sources will include the net proceeds of this offering, our concurrent offering and the direct offering (if any) and, if and to the extent available at the relevant time, may include borrowings in the form of bank credit facilities (including term loans and revolving facilities), repurchase agreements, warehouse facilities, structured financing arrangements, public and private equity and debt issuances and derivative instruments, in addition to transaction or asset specific funding arrangements. We also may utilize leverage to the extent available through participation in the Legacy Loans Program, if the program is established. As of the date of this prospectus, we have no contractual commitments for any financing arrangements, and we cannot assure you that we will secure any such arrangements in a timely manner in the future on favorable terms, or at all. Accordingly, our ability to execute our business strategies, and therefore our long-term growth, will depend in large part on our ability to secure financing arrangements on favorable terms.

The capital and credit markets have been experiencing extreme volatility and disruption for more than a year. The volatility and disruption have reached unprecedented levels. The markets have exerted downward pressure on stock prices and credit capacity for lenders. The current dislocation and weakness in the capital and credit markets could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing or to increase the costs of that financing. In addition, if regulatory capital requirements imposed on our lenders change, they may be required to limit, or increase the cost of, financing they provide to us. In general, this could potentially increase our financing costs and reduce our liquidity or require us to sell assets at an inopportune time or price. Under current market conditions, structured financing arrangements are generally unavailable, which has also limited borrowings under warehouse and repurchase agreements that are intended to be refinanced by such financings. Consequently, depending on market conditions at the relevant time, we may have to rely more heavily on additional equity issuances, which may be dilutive to our shareholders, or on less efficient forms of debt financing that require a larger portion of our cash flow from operations, thereby reducing funds available for our operations, future business opportunities, cash distributions to our shareholders and other purposes. We cannot assure you that we will have access to such equity or debt capital on favorable terms (including, without limitation, cost and term) at the desired times, or at all, which may cause us to curtail our asset acquisition activities and/or dispose of assets, which could negatively affect our results of operations.

We may incur significant debt in the future, which will subject us to increased risk of loss and may reduce cash available for distributions to our shareholders.

Subject to market conditions and availability, we may incur significant debt in the future through bank credit facilities (including term loans and revolving facilities), repurchase agreements, warehouse facilities and structured financing arrangements, public and private debt issuances and derivative instruments, in addition to transaction or asset specific funding arrangements. The percentage of leverage we employ will vary depending on our available capital, our ability to obtain and access financing arrangements with lenders and the lenders' and rating agencies' estimate of the stability of our investment portfolio's cash flow. Our governing documents contain no limitation on the amount of debt we may incur. In light of current market conditions, we anticipate initially utilizing

limited leverage. However, our board of trustees may establish and change our leverage policy at any time without shareholder approval. In addition, we may leverage individual assets at substantially higher levels. Incurring debt could subject us to many risks that, if realized, would materially and adversely affect us, including the risk that:

- our cash flow from operations may be insufficient to make required payments of principal of and interest on the debt or we may fail to comply with all of the other covenants contained in the debt, which is likely to result in (i) acceleration of such debt (and any other debt containing a cross-default or cross-acceleration provision) that we may be unable to repay from internal funds or to refinance on favorable terms, or at all, (ii) our inability to borrow unused amounts under our financing arrangements, even if we are current in payments on borrowings under those arrangements and/or (iii) the loss of some or all of our assets to foreclosure or sale;

- our debt may increase our vulnerability to adverse economic and industry conditions with no assurance that investment yields will increase with higher financing costs;

- we may be required to dedicate a substantial portion of our cash flow from operations to payments on our debt, thereby reducing funds available for operations, future business opportunities, shareholder distributions or other purposes; and

- we are not able to refinance debt that matures prior to the investment it was used to finance on favorable terms, or at all.

In the event non-recourse long-term financing structures become available to us in the future, such structures may expose us to risks which could result in losses to us.

Although under current market conditions we do not anticipate that non-recourse long-term financing for our investments will be available, we may utilize these financing structures if and when they become available. In such structures, our lenders typically would not have a general claim against us as an entity, as opposed to the assets themselves. We also may finance our investments on a long-term basis through issuances of equity and non-collateralized debt in the capital markets or otherwise, to the extent such financing is available. Prior to any such financing, we may seek to finance our investments with relatively short-term facilities until a sufficient portfolio is accumulated. As a result, we would be subject to the risk that we would not be able to acquire, during the period that any short-term facilities are available, sufficient eligible assets or securities to maximize the efficiency of a securitization. We also would bear the risk that we would not be able to obtain new short-term facilities or would not be able to renew any short-term facilities after they expire should we need more time to seek and acquire sufficient eligible assets or securities for a securitization. In addition, conditions in the capital markets, including the current unprecedented volatility and disruption in the capital and credit markets, may not permit a non-recourse securitization at any particular time or may make the issuance of any such securitization less attractive to us even when we do have sufficient eligible assets or securities. While we would intend to retain the unrated equity component of securitizations and, therefore, still have exposure to any investments included in such securitizations, our inability to enter into such securitizations would increase our overall exposure to risks associated with direct ownership of such investments, including the risk of default. Our inability to refinance any short-term facilities would also increase our risk because borrowings thereunder would likely be recourse to us as an entity. If we are unable to obtain and renew short-term facilities or to consummate securitizations to finance our investments on a long-term basis, we may be required to seek other forms of potentially less attractive financing or to liquidate assets at an inopportune time or price.

Interest rate fluctuations could significantly decrease our results of operations and cash flows and the market value of our investments.

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Interest rate fluctuations present a variety of risks to our operations. Our primary interest rate exposures will relate to the yield on our investments and the financing cost of our debt, as well as any interest rate swaps that we utilize for hedging purposes. Changes in interest rates will affect our net interest income, which is the difference between the interest income we earn on our interest-earning investments and the interest expense we incur in financing these investments. Interest rate fluctuations resulting in our interest expense exceeding interest income may result in operating losses for us. Changes in the level of interest rates also may affect our ability to invest in investments, the value of our investments and our ability to realize gains from the disposition of assets. Changes in interest rates may also affect borrower default rates and may impact the ability to refinance or modify loans and/or to sell REOs.

We expect that most of our financing costs will be determined by reference to floating rates, such as LIBOR or a Treasury index, plus a margin, the amount of which will depend on a number of factors, including, without limitation, (i) for collateralized debt, the value and liquidity of the collateral, and for non-collateralized debt, our credit, (ii) the level and movement of interest rates and (iii) general market conditions and liquidity. In a period of rising interest rates, our interest expense on floating rate debt would increase, while any additional interest income we earn on our floating rate investments may not compensate for such increase in interest expense, the interest income we earn on our fixed rate investments would not change, the duration and weighted average life of our fixed rate investments would increase and the market value of our fixed rate investments would decrease. Similarly, in a period of declining interest rates, our interest income on floating rate investments would decrease, while any decrease in the interest we are charged on our floating rate debt may not compensate for such decrease in interest income and interest we are charged on our fixed rate debt would not change. Any such scenario could materially and adversely affect us.

Our operating results may depend, in large part, on differences between the income earned on our investments, net of credit losses, and our financing costs. We anticipate that, in most cases, for any period during which our investments are not match-funded, the income earned on such investments will respond more slowly to interest rate fluctuations than the cost of our borrowings. Consequently, changes in interest rates, particularly short-term interest rates, may immediately and significantly decrease our results of operations and cash flows and the market value of our investments.

Any warehouse facilities that we may obtain in the future may limit our ability to acquire assets, and we may incur losses if the collateral is liquidated.

Although under current market conditions we do not anticipate that securitization financings will be available, in the event they become available, we may utilize, if available, warehouse facilities pursuant to which we would accumulate assets in anticipation of a securitization financing, which assets would be pledged as collateral for such facilities until the securitization transaction is consummated. In order to borrow funds to acquire assets under any future warehouse facilities, we expect that our lenders thereunder would have the right to review the potential assets for which we are seeking financing. We may be unable to obtain the consent of a lender to acquire assets that we believe would be beneficial to us and we may be unable to obtain alternate financing for such assets. In addition, no assurance can be given that a securitization structure would be consummated with respect to the assets being warehoused. If the securitization is not consummated, the lender could liquidate the warehoused collateral and we would then have to pay any amount by which the original purchase price of the collateral assets exceeds its sale price, subject to negotiated caps, if any, on our exposure. In addition, regardless of whether the securitization is consummated, if any of the warehoused collateral is sold

before the consummation, we would have to bear any resulting loss on the sale. Currently, we have no warehouse facilities in place, and no assurance can be given that we will be able to obtain one or more warehouse facilities on favorable terms, or at all.

Any repurchase agreements and bank credit facilities that we may use in the future to finance our assets may require us to provide additional collateral or pay down debt.

Although under current market conditions we do not anticipate that we will utilize repurchase agreements and bank credit facilities (including term loans and revolving facilities) to finance our assets (other than potentially as financing for certain RMBS acquired for purposes of maintaining our exclusion from registration under the Investment Company Act or to meet the requirements for qualification and taxation as a REIT), we may utilize such arrangements to finance our assets if they become available on acceptable terms. In the event we utilize such financing arrangements, they would involve the risk that the market value of the loans pledged or sold by us to the funding source may decline in value, in which case the lending institution may require us to provide additional collateral or to repay all or a portion of the funds advanced. We may not have the funds available to repay our debt at that time, which would likely result in defaults unless we are able to raise the funds from alternative sources, which we may not be able to achieve on favorable terms or at all. Posting additional collateral would reduce our liquidity and limit our ability to leverage our assets. If we cannot meet these requirements, a lending institution could accelerate our indebtedness, increase the interest rate on advanced funds and terminate our ability to borrow funds from them, which could materially and adversely affect our financial condition and ability to implement our business plan. In addition, in the event that the funding source files for bankruptcy or becomes insolvent, our loans may become subject to bankruptcy or insolvency proceedings, thus depriving us, at least temporarily, of the benefit of these assets. Such an event could restrict or eliminate our access to, and increase our cost of capital.

The providers of repurchase agreements and bank credit facilities may also require us to maintain a certain amount of cash invested or set aside unlevered assets sufficient to maintain a specified liquidity position that would allow us to satisfy our collateral obligations. As a result, we may not be able to leverage our assets as fully as we would choose, which could reduce our return on assets. In the event that we are unable to meet these collateral obligations, our financial condition and prospects could deteriorate rapidly.

Currently, we have no repurchase agreements or bank credit facilities in place, and there can be no assurance that we will be able to obtain one or more such facilities on favorable terms, or at all.

Lenders may require us to enter into restrictive covenants relating to our operations.

If or when we obtain debt financing, lenders (especially in the case of bank credit facilities (including term loans and revolving facilities)) may impose restrictions on us that would affect our ability to incur additional debt, make certain investments or acquisitions, reduce liquidity below certain levels, make distributions to our shareholders, redeem debt or equity securities and impact our flexibility to determine our operating policies and investment strategies. For example, our loan documents may contain negative covenants that limit, among other things, our ability to repurchase our common shares, distribute more than a certain amount of our net income or funds from operations to our shareholders, employ leverage beyond certain amounts, sell assets, engage in mergers or consolidations, grant liens, and enter into transactions with affiliates. If we fail to meet or satisfy any of these covenants, we would be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, terminate their commitments, require the posting of additional collateral and enforce their interests against existing collateral. We may also be subject to cross-default and acceleration rights and, with respect to collateralized debt, the posting of additional collateral and foreclosure rights upon default. Further, this

could also make it difficult for us to satisfy the qualification requirements necessary to maintain our status as a REIT for U.S. federal income tax purposes.

If PCM ceases to be our manager pursuant to the management agreement or one or more of PCM's key personnel are no longer servicing our business, depository institutions providing any financing arrangements that we may have may not provide future financing to us, which could materially and adversely affect us.

Depository institutions that we seek to finance our investments may require that PCM remain as our manager under the management agreement and that certain key personnel of PCM continue to service our business. If PCM ceases to be our manager or one or more of PCM's key personnel are no longer servicing our business, it may constitute an event of default and the depository institution providing the arrangement may have acceleration rights with respect to outstanding borrowings and termination rights with respect to our ability to finance our future investments with that institution. If we are unable to obtain financing for our accelerated borrowings and for our future investments under such circumstances, we may be required to curtail our asset acquisitions and/or dispose of assets at an inopportune time.

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

Subject to maintaining our qualification as a REIT and our exclusion under the Investment Company Act, we may enter into interest rate swap agreements or pursue hedging strategies to reduce our exposure to adverse changes in interest rates. Our hedging activity will vary in scope based on the level of interest rates, the type of investments held, and other changing market conditions. 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 amount of income that a REIT may earn from hedging transactions to offset interest rate losses is limited by U.S. federal tax provisions governing REITs;
- 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 poorer overall investment performance than if we had not engaged in any such hedging transactions. 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 seek to establish a perfect correlation between such hedging instruments

and the portfolio positions or liabilities being hedged. Any such imperfect correlation may prevent us from achieving the intended hedge and expose us to risk of loss.

Hedging instruments 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 involve risks and costs that could result in material losses.

The cost of using hedging instruments increases as the period covered by the instrument increases and during periods of rising and volatile interest rates. We may increase our hedging activity and thus increase our hedging costs during periods when interest rates are volatile or rising and hedging costs have increased. In addition, hedging instruments involve risk since 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. Consequently, there are no requirements with respect to record keeping, financial responsibility or segregation of customer funds and positions. Furthermore, the enforceability of agreements underlying derivative transactions may depend on compliance with applicable statutory, commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. The business failure of a hedging counterparty with whom we enter into a hedging transaction will most likely result in a default, which may, in turn, result in the loss of unrealized profits and force us to cover our resale commitments, if any, at the then current market price. Although generally we will seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty, and we may not be able to enter into an offsetting contract in order to cover our risk. No assurance can be given that a liquid secondary market will exist for derivative instruments purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in significant losses.

Competition may limit the availability of desirable investments and result in reduced risk-adjusted returns.

Our profitability depends, in part, on our ability to acquire our targeted investments at favorable prices. We will compete with other mortgage REITs, specialty finance companies, private funds, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, depository institutions, governmental bodies and other entities. A number of these competitors may be focused on acquiring distressed mortgage loans. These other entities will increase competition for the available supply of mortgage assets suitable for purchase. Many of our anticipated competitors are significantly larger than we are and have stronger balance sheets and access to greater capital and other resources than we have and may have other advantages over us. In addition, some of our competitors may have higher risk tolerances or different risk assessments and may not be subject to the operating restraints associated with REIT tax compliance or maintenance of an exclusion from the Investment Company Act, which could allow them to consider a wider variety of investments and establish more relationships than we can. Current market conditions and the high-profile nature of the Legacy Loans Program (if established) will likely attract more competitors, which would increase the competition for assets and sources of financing. Competition may result in fewer investments, higher prices, acceptance of greater risk, lower yields and a narrower spread of yields over our financing costs. In addition, competition for desirable investments could delay the investment of our capital, which could materially and adversely affect our results of operations and cash flows. As a result, there can be no assurance that we will be able to identify and finance investments that are consistent with our investment objective or to achieve positive investment results or investment results that allow any or a specified level of distributions to our shareholders, and our failure to accomplish any of the foregoing would materially and adversely affect us.

Table of Contents

We may change our investment and operational policies without shareholder consent, which may adversely affect the market value of our common shares and our ability to make distributions to our shareholders.

Our board of trustees determines our operational policies and may amend or revise such policies, including our policies with respect to our REIT qualification, acquisitions, dispositions, growth, operations, indebtedness and distributions, or approve transactions that deviate from these policies, without a vote of, or notice to, our shareholders. Operational policy changes could adversely affect the market value of our common shares and our ability to make distributions to our shareholders.

We may also change our investment strategies and policies and targeted asset classes at any time without the consent of our shareholders, which could result in our making investments that are different in type from, and possibly riskier than, the investments contemplated in this prospectus. A change in our investment strategies and policies and targeted asset classes may increase our exposure to interest rate risk, default risk and real estate market fluctuations, which could adversely affect the market value of our common shares and our ability to make distributions to our shareholders.

PCM's failure to make investments on favorable terms that satisfy our investment strategies and otherwise generate attractive risk-adjusted returns initially and consistently from time to time in the future would materially and adversely affect us.

Our ability to achieve our investment objective depends on our ability to grow, which depends, in turn, on PCM's personnel and their ability to make investments on favorable terms that satisfy our investment strategies and otherwise generate attractive risk-adjusted returns initially and consistently from time to time in the future. Accomplishing this result is also a function of PCM's ability to execute our financing strategies on favorable terms. Our ability to grow is also dependent upon PCM's business contacts and its ability to successfully hire, train, supervise and manage its personnel. We may not be able to achieve any growth at all or to manage any future growth effectively, which would materially and adversely affect us.

Our board of trustees has approved very broad investment policies for PCM and will not review or approve each investment decision made by PCM.

PCM is authorized to follow very broad investment policies and, therefore, has great latitude in determining the types of assets that are proper investments for us, as well as the individual investment decisions. In the future, PCM may make investments with lower rates of return than those anticipated under current market conditions and/or may make investments with greater risks to achieve those anticipated returns. Our board of trustees will periodically review our investment policies and our investment portfolio but will not review or approve each proposed investment by PCM unless it falls outside our investment policies or constitutes a related party transaction. In addition, in conducting periodic reviews, our board of trustees will rely primarily on information provided to it by PCM. Furthermore, PCM may use complex strategies, and transactions entered into by PCM may be costly, difficult or impossible to unwind by the time they are reviewed by our board of trustees.

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, investment consolidations and other aspects of our anticipated 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 shareholders 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.

We are highly dependent on information systems and systems failures could significantly disrupt our business, which could have a material adverse effect on our results of operations and cash flows.

Our business is highly dependent on the communications and information systems of PCM. Any failure or interruption of these systems could cause delays or other problems in our securities trading activities, which could have a material adverse effect on our results of operations and cash flows and negatively affect the market price of our common shares and ability to make distributions to our shareholders.

Terrorist attacks and other acts of violence or war may affect the real estate industry generally and our business, financial condition and results of operations.

The terrorist attacks on September 11, 2001 disrupted the U.S. financial markets, including the real estate capital markets, and negatively impacted the U.S. economy in general. Any future terrorist attacks, the anticipation of any such attacks, the consequences of any military or other response by the U.S. and its allies, and other armed conflicts could cause consumer confidence and spending to decrease or result in increased volatility in the U.S. and worldwide financial markets and economy. The economic impact of these events could also 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 shares 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 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.

If we fail to implement and 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 shareholders could lose confidence in our financial results, which could harm our business and the market value of our common shares.

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 will require us to evaluate and report on our internal controls over financial reporting and have our independent auditors annually attest to our evaluation, as well as issue their own opinion on our internal control over financial reporting. While we intend to undertake substantial work to prepare for compliance with Section 404, we cannot be certain that we will be successful in implementing or maintaining adequate control over our financial reporting and financial processes. Furthermore, as we rapidly grow our business, our internal controls will become more complex, and we will require significantly more resources to ensure our internal controls remain effective. If we or our independent auditors discover a material weakness, the disclosure of that fact, even if quickly remedied, could reduce the market value of our common shares. Additionally, the existence of any material weakness or significant deficiency would require management to devote significant time and incur significant expense to remediate any such material weaknesses or significant deficiencies and management may not be able to remediate any such material weaknesses or significant deficiencies in a timely manner.

We and/or PLS are required to have various state licenses in order to conduct our business and there is no assurance we and/or PLS will be able to obtain or maintain those licenses.

We and PLS are required to be licensed to conduct business in certain jurisdictions. We and PLS are currently evaluating the need for various licenses in order to conduct our most important business activities directly and the timing of the pursuit of these licenses. PLS is licensed, or is taking steps to become licensed, in those jurisdictions, and for those activities, where it believes it is cost effective and appropriate to become licensed. In jurisdictions in which licensing is required and PLS has not obtained the necessary license or where PLS otherwise deems it advisable, it will retain sub-servicers and other vendors. For example, PLS has entered into sub-servicing arrangements with regard to less than 11% of the unpaid principal balance of the loans that it services for the PennyMac funds. Our failure or the failure by PLS to obtain any necessary licenses promptly or our failure to satisfy the various requirements or to maintain them over time will restrict our direct business activities.

We may be subject to liability for potential violations of predatory lending laws, which could adversely impact our results of operations, financial condition and business.

Various U.S. federal, state and local laws have been enacted that are designed to discourage predatory lending practices. The U.S. federal Home Ownership and Equity Protection Act of 1994, or HOEPA, prohibits inclusion of certain provisions in residential mortgage loans that have mortgage rates or origination costs in excess of prescribed levels and requires that borrowers be given certain disclosures prior to origination. Some states have enacted, or may enact, similar laws or regulations, which in some cases impose restrictions and requirements greater than those in the HOEPA. In addition, under the anti-predatory lending laws of some states, the origination of certain residential mortgage loans, including loans that are not classified as "high cost" loans under applicable law, must satisfy a net tangible benefits test with respect to the related borrower. This test may be highly subjective and open to interpretation. As a result, a court may determine that a residential mortgage loan, for example, does not meet the test even if the related originator reasonably believed that the test was satisfied.

Failure of residential mortgage loan originators or servicers to comply with these laws, to the extent any of their residential mortgage loans become part of our assets, could subject us, as an assignee or purchaser to the related residential mortgage loans, to monetary penalties and could result in the borrowers rescinding the affected residential mortgage loans. Lawsuits have been brought in various states making claims against assignees or purchasers of high cost loans for violations of state law. Named defendants in these cases have included numerous participants within the secondary mortgage market. If any of our loans are found to have been originated in violation of predatory or abusive lending laws, we could incur losses, which could adversely impact our results of operations, financial condition and business.

The increasing number of proposed U.S. federal, state and local laws may affect certain mortgage-related assets in which we intend to invest and could increase our cost of doing business.

Legislation has been proposed which, among other provisions, could hinder the ability of the servicer to foreclose promptly on defaulted mortgage loans or would permit limited assignee liability for certain violations in the mortgage loan origination process, which could result in us being held responsible for violations in the mortgage loan origination process. We cannot predict whether or in what form the U.S. Congress or the various state and local legislatures may enact legislation affecting our business. We will evaluate the potential impact of any initiatives which, if enacted, could affect our practices and results of operations. We are unable to predict whether U.S. federal, state or local authorities will enact laws, rules or regulations that will require changes in our practices in the future, and any such changes could adversely affect our cost of doing business and profitability.

Risks Related to Our Investments

You will not be able to evaluate the economic merits of our investments before you make a decision to invest in our common shares. We may be unable to use the net proceeds of this offering, our concurrent offering and the direct offering (if any) to make attractive risk-adjusted investments that meet our investment strategies, or at all.

The net proceeds of this offering, our concurrent offering and the direct offering (if any) have not yet been targeted for use. As a result, investors will not be able to evaluate the economic merits of our investments prior to purchasing common shares in this offering. In addition, our investments will be selected by PCM, and our shareholders will not have input on our investment decisions. Both of these factors will increase the uncertainty and the risk of investing in our common shares.

Until we identify and consummate one or more transactions that are consistent with our investment objective, we intend to hold the net proceeds of this offering, our concurrent offering and the direct offering (if any) as cash or acquire high grade, short term securities, such as securities guaranteed by Ginnie Mae, securities issued and guaranteed by Freddie Mac or Fannie Mae, short-term money market funds, including BlackRock-sponsored money market funds, as well as cash equivalents for temporary cash management. For purposes of maintaining our exclusion from registration under the Investment Company Act, we may also acquire from time to time RMBS that represent the entire beneficial interest in the underlying pool of mortgage loans. We may incur leverage in connection with the acquisition of any of these assets through repurchase agreements or otherwise.

These securities are expected to provide a lower net return than we hope to achieve from our targeted assets. We cannot assure you that we will be able to identify assets that meet our investment objective, that we will be successful in consummating any investment opportunities we identify or that one or more investments we may make using the net proceeds of this offering, our concurrent offering and the direct offering (if any) will yield attractive risk-adjusted returns. Our inability to do any of the foregoing likely would materially and adversely affect our results of operations and cash flows and our ability to make distributions to our shareholders.

We anticipate that a significant portion of the residential mortgage loans that we acquire will be or may become sub-performing or non-performing loans, which increases our risk of loss of our investment. The supply of distressed residential mortgage loans will likely recede as the economy improves.

We anticipate that we will acquire distressed residential mortgage loans and mortgage-related assets where the borrower has failed to make timely payments of principal and/or interest. We may also acquire performing loans that subsequently become sub-performing or non-performing. Under current market conditions, it is likely that many of these loans will have current loan-to-value ratios in excess of 100%, meaning the amount owed on the loan exceeds the value of the underlying real estate. Further, the borrowers on such loans may be in economic distress and/or may have become unemployed, bankrupt or otherwise unable to make payments when due. If PLS as our primary and special servicer is not able to address the issues concerning these loans, we may incur significant losses. Any loss we incur may be significant and may reduce distributions to our shareholders and adversely affect the market value of our common shares. There are no limits on the percentage of sub-performing and non-performing assets we may hold.

We believe that there are unique, current market opportunities to acquire distressed residential mortgage loans and mortgage-related assets at significant discounts to their unpaid principal balances. However, when the current conditions in the mortgage market, the financial markets and the economy stabilize and/or improve, the availability of distressed residential mortgage loans that meet our investment objective and strategies will likely recede, which could prevent us from implementing our business strategies. At such time, we will reevaluate our investment strategies with a view of maximizing

Table of Contents

the returns from our investment portfolio and identifying dislocations in the mortgage market, but there can be no assurance that any of our strategies will be successful.

Declines in the market values of our investments may adversely affect periodic reported results and credit availability, which may reduce earnings and, in turn, cash available for distribution to our shareholders.

A substantial portion of our assets may be reported for accounting purposes at fair value. Changes in the market values of those assets will be directly charged or credited to earnings for the period. As a result, a decline in values may reduce the book value of our company.

A decline in the market value of our assets may adversely affect us, particularly in instances where we have borrowed money based on the market value of those assets. If the market value of those assets declines, the lender may require us to post additional collateral to support the loan. If we were unable to post the additional collateral, we would have to sell the assets at a time when we might not otherwise choose to do so. A reduction in credit available may reduce our earnings and, in turn, cash available for distribution to shareholders.

We may not realize gains or income from our investments.

We will seek to generate both current income and capital appreciation from our investments. It is anticipated that our investments will not be rated by any rating agency. Therefore, PCM's assessment of the value, and therefore pricing, of our investments will be very difficult and the accuracy of such assessment is inherently uncertain. Furthermore, our investments may not appreciate in value and, in fact, may decline in value. In addition, the obligors on our investments may default on, or be delayed in making, interest and/or principal payments, especially given that our current investment strategies focus, in part, on distressed opportunities, and that we may also acquire sub-performing and non-performing residential mortgage loans. Accordingly, we are subject to an increased risk of loss and may not be able to realize gains or income from our investments. Any gains that we do realize may not be sufficient to offset our losses and expenses.

We anticipate that a significant portion of our investments will be in the form of whole loan mortgages, including subprime residential mortgage loans and non-performing and sub-performing residential mortgage loans, which are subject to increased risks.

We anticipate that a significant portion of our investments will be in the form of whole loan mortgages, including subprime residential mortgage loans and non-performing and sub-performing residential mortgage loans which are subject to increased risks of loss. Unlike "credit enhanced" MBS, whole loan mortgages generally are not government guaranteed or privately insured, though in some cases they may benefit from private mortgage insurance. A whole loan mortgage is directly exposed to losses resulting from default and foreclosure. Therefore, the value of the underlying property, the creditworthiness and financial position of the borrower and the priority and enforceability of the lien will significantly impact the value of such mortgages. Whether or not PCM has participated in the negotiation of the terms of any such mortgages, there can be no assurance as to the adequacy of the protection of the terms of the loan, including the validity or enforceability of the loan and the maintenance of the anticipated priority and perfection of the applicable security interests. Furthermore, claims may be asserted that might interfere with enforcement of our rights. In the event of a foreclosure, we may assume direct ownership of the underlying real estate. The liquidation proceeds upon sale of such real estate may not be sufficient to recover our cost basis in the loan, resulting in a loss to us. Any costs or delays involved in the effectuation of a foreclosure of the loan or a liquidation of the underlying property will further reduce the proceeds and thus increase the loss.

Table of Contents

Whole loan mortgages are also subject to "special hazard" risk (property damage caused by hazards, such as earthquakes or environmental hazards, not covered by standard property insurance policies), and to bankruptcy risk (reduction in a borrower's mortgage debt by a bankruptcy court as described below). In addition, claims may be assessed against us on account of our position as mortgage holder or property owner, including responsibility for tax payments, environmental hazards and other liabilities.

Our investment in residential mortgage loans subjects us to the risks associated with residential real estate and residential real estate-related investments.

We will invest in performing, sub-performing and non-performing residential mortgage loans. This strategy subjects us to the risks of residential real estate and residential real estate-related investments, including, among others: (i) continued declines in the value of residential real estate; (ii) risks related to general and local economic conditions; (iii) possible lack of availability of mortgage funds for borrowers to refinance or sell their homes; (iv) overbuilding; (v) the general deterioration of the borrower's ability to keep a rehabilitated sub-performing or non-performing mortgage loan current; (vi) increases in property taxes and operating expenses; (vii) changes in zoning laws; (viii) costs resulting from the clean-up of, and liability to third parties for damages resulting from, environmental problems, such as indoor mold; (ix) casualty or condemnation losses; (x) uninsured damages from floods, earthquakes or other natural disasters; (xi) limitations on and variations in rents; (xii) fluctuations in interest rates; (xiii) fraud by borrowers, originators and/or sellers of mortgage loans; and (xiv) failure of the borrower to adequately maintain the property, particularly during times of financial difficulty. To the extent that assets underlying our investments are concentrated geographically, by property type or in certain other respects, we may be subject to certain of the foregoing risks to a greater extent. Additionally, we may be required to foreclose on a mortgage loan and such actions would subject us to greater concentration of the risks of the residential real estate markets and risks related to the ownership and management of real property.

The mortgage loans and loan portfolios acquired by us will generally have been originated by third parties. While PCM will conduct due diligence on these loans and loan portfolios, there is a risk that the underlying mortgage loan documentation and calculations of outstanding principal, interest, late fees and other amounts will be deficient and/or inaccurate and that PCM will not detect such deficiencies and inaccuracies prior to acquisition. Accordingly, our mortgage loan portfolio may be compromised, reducing the value of our assets.

The borrowers under sub-performing or non-performing mortgage loans may have a variety of rights to contest the enforceability of the mortgage loans and prevent or significantly delay and increase the cost of any foreclosure action, including, without limitation, allegations regarding fraud in the inducement by the original lender or broker, failure of the lender to produce the original documentation, improper recordation of the mortgage, various theories of lender liability, and relief through the U.S. Bankruptcy Code and similar state laws providing debtor relief.

A significant concern in the purchase of loans secured by real estate is the possibility of material misrepresentation or omission on the part of the borrower or seller. The actual home owner may not be responsible for such fraudulent residential mortgage loans. Such fraudulent mortgage loans may not be identified as such due to internal control weaknesses of a loan originator and failure of the loan originator or intermediary to be advised of such claims. Such mortgage loans could be acquired by us despite the exercise of prudent due diligence. Any inaccuracy or incompleteness on the part of the borrower or seller may adversely affect the valuation of the real estate underlying the loans or may adversely affect the ability of PCM to perfect or effectuate a lien on the real estate or other collateral securing the loan. Under certain circumstances, payments to us may be reclaimed if such payment or distribution is later determined to have been a fraudulent conveyance or a preferential payment.

Table of Contents

The failure of PLS or any other servicer to effectively service our portfolio of mortgage loans would materially and adversely affect us.

Most residential mortgage loans and securitizations of residential mortgage loans require a servicer to manage collections on each of the underlying loans. Pursuant to the loan servicing agreement, PLS will provide us with primary and special servicing. PLS's responsibilities will include providing delinquency notices when necessary, loan workouts and modifications, foreclosure proceedings, liquidations of REOs acquired as a result of foreclosures of mortgage loans, and reporting on the performance of the loans to PCM, and, to the extent loans are securitized and sold, then to the trustee of such pooled loans. PLS may retain sub-servicers in any jurisdictions where licensing is required and PLS has not obtained the necessary license or where PLS otherwise deems it advisable, and the fees of such sub-servicers will be paid by PLS out of its servicing fee. Both default frequency and default severity of loans may depend upon the quality of the servicer. If PLS or any sub-servicers are not vigilant in encouraging borrowers to make their monthly payments, the borrowers may be far less likely to make these payments, which could result in a higher frequency of default. If PLS or any sub-servicers take longer to liquidate non-performing assets, loss severities may tend to be higher than originally anticipated. Higher loss severity may also be caused by less competent dispositions of REO properties. The ability of PLS to effectively service our portfolio of mortgage loans is critical to our success, particularly given our strategy of maximizing the value of the mortgage loans that we acquire through proprietary loan modification programs, special servicing and other initiatives focused on keeping borrowers in their homes.

Servicer quality is of prime importance in the default performance of residential mortgage loans and MBS. Many servicers have gone out of business in recent years, requiring a transfer of servicing to another servicer. This transfer takes time and loans may become delinquent because of confusion or lack of attention. When servicing is transferred, servicing fees may increase which may have an adverse effect on the credit support of MBS held by us. In the case of pools of securitized loans, servicers may be required to advance interest on delinquent loans to the extent the servicer deems those advances recoverable. In the event the servicer does not advance, interest may be interrupted even on more senior securities. Servicers may also advance more than is in fact recoverable once a defaulted loan is disposed, and the loss to the trust may be greater than the outstanding principal balance of that loan (greater than 100% loss severity).

A decline in the value of the real estate underlying our mortgage loans may result in reduced risk-adjusted returns.

The value of the real estate which underlies mortgage loans is subject to market conditions. Changes in the real estate market may adversely affect the value of the collateral and thereby lower the value to be derived from a liquidation. In addition, adverse changes in the real estate market increase the probability of default, as the incentive of the borrower to retain and protect equity in the property declines. Furthermore, many of the properties which will secure loans underwritten or invested in by us may be suffering varying degrees of financial distress or may be located in economically distressed areas. There has been a substantial decline in the value of housing in most markets in the U.S. over the past two years, which has continued in 2009. It is possible that real estate values will continue to decline for a substantial period. Loans purchased or underwritten by us may become non-performing for a wide variety of reasons, including, without limitation, because the mortgaged property is too highly leveraged (and, therefore, the borrower is unable to meet debt service payments), the borrower falls upon financial distress (such as from job loss or income reduction, or the reset of interest rates on the mortgage itself, which reduces the borrower's ability to pay) or the property is in a market which has suffered a decline in home prices (and therefore, a borrower has a reduced willingness to pay). Such non-performing loans may require a substantial amount of workout negotiations and/or restructuring, which may entail, among other things, a substantial reduction in the interest rate,

capitalization of interest payments and a substantial write-down of the principal of the loan. However, even if such restructuring were successfully accomplished, a risk exists that the borrower will not be able or willing to maintain the restructured payments or refinance the restructured mortgage upon maturity.

It is possible that we may find it necessary or desirable to foreclose on some, if not many, of the loans we acquire. The foreclosure process may be lengthy and expensive. Borrowers may resist mortgage foreclosure actions by asserting numerous claims, counterclaims and defenses against us including, without limitation, numerous lender liability claims and defenses, even when such assertions may have no basis in fact, in an effort to prolong the foreclosure action and force the lender into a modification of the loan or a favorable buy-out of the borrower's position. In some states, foreclosure actions can sometimes take several years or more to litigate. At any time prior to or during the foreclosure proceedings, the borrower may file for bankruptcy, which would have the effect of staying the foreclosure actions and further delaying the foreclosure process. Foreclosure may create a negative public perception of the related mortgaged property, resulting in a diminution of its value. Additionally, proposed legislation would, if enacted, empower bankruptcy courts to reduce the principal balance of certain residential mortgage loans secured by property of the related debtors. Any such reductions would adversely affect the value of residential mortgage loans, RMBS, real estate-related securities and various other asset classes in which we intend to invest.

We may invest in RMBS and CMBS, each of which is subject to significant risks.

RMBS. RMBS are subject to the risk of prepayment on the loans underlying such securities (including voluntary prepayments by the obligors and liquidations due to default and foreclosures). Generally, prepayment rates increase when interest rates fall and decrease when interest rates rise. Prepayment rates are also affected by other factors, including economic, demographic, tax, social and legal factors. To the extent that prepayment rates are different than anticipated, the average yield of investments in RMBS may be adversely affected. The interest rate sensitivity of any particular pool of loans depends upon the allocation of cash flow from the underlying mortgage loans. Certain types of RMBS contain complex interest rate and cash flow provisions and may be highly volatile with respect to market value, yield and total return to maturity.

The underlying mortgages that collateralize the RMBS in which we may invest will frequently have caps and floors which limit the maximum amount by which the loan rate to the residential borrower may change up or down (1) per reset or adjustment interval and (2) over the life of the loan. Some residential mortgage loans restrict periodic adjustments by limiting changes in the borrower's monthly principal and interest payments rather than limiting interest rate changes. These payment caps may result in negative amortization. In addition, because of the pass-through of prepayments of principal on the underlying loans, MBS are often subject to more rapid prepayment of principal than their stated maturity would indicate.

The market value of mortgage securities will generally vary inversely with changes in market interest rates, declining when interest rates rise and rising when interest rates decline. However, mortgage securities, while having comparable risk of decline during periods of rising rates, usually have less potential for capital appreciation than other investments of comparable maturities due to the likelihood of increased prepayments of mortgages as interest rates decline. In addition, to the extent such mortgage securities are purchased at a premium, mortgage foreclosures and unscheduled principal prepayments generally will result in some loss of the holders' principal to the extent of the premium paid. MBS are subject to whole loan risk, special residential mortgage loan risks and credit risk that the underlying receivables will not be paid by debtors or by credit insurers or guarantors of such instruments.

Table of Contents

CMBS. Mortgage loans on properties underlying CMBS often are structured so that a substantial portion of the loan principal is not amortized over the loan term but is payable at maturity and thus repayment of the loan principal often depends upon the future availability of real estate financing from the existing or an alternative lender and/or upon the current value and salability of the real estate. Therefore, the unavailability of real estate financing may lead to default. Most commercial mortgage loans underlying CMBS are effectively nonrecourse obligations of the borrower, meaning that there is no recourse against the borrower's assets other than the collateral. If borrowers are not able or willing to refinance or dispose of encumbered property to pay the principal and interest owed on such mortgage loans, payments on the subordinated classes of the related CMBS are likely to be adversely affected. The ultimate extent of the loss, if any, to the subordinated classes of CMBS may only be determined after a negotiated discounted settlement, restructuring or sale of the mortgage note, or the foreclosure (or deed in lieu of foreclosure) of the mortgage encumbering the property and subsequent liquidation of the property. Foreclosure can be costly and delayed by litigation and/or bankruptcy. Factors such as the property's location, the legal status of title to the property, its physical condition and financial performance, environmental risks, and governmental disclosure requirements with respect to the condition of the property may make a third party unwilling to purchase the property at a foreclosure sale or to pay a price sufficient to satisfy the obligations with respect to the related CMBS. Revenues from the assets underlying CMBS may be retained by the borrower and the return on investment may be used to make payments to others, maintain insurance coverage, pay taxes or pay maintenance costs. Such diverted revenue is generally not recoverable without a court-appointed receiver to control collateral cash flow.

Changes in prepayment rates could negatively affect the value of our investment portfolio, which could result in reduced earnings or losses and negatively affect the cash available for distribution to our shareholders.

The value of our investment portfolio may be affected by prepayment rates on mortgage loans. Many loans do not contain any restrictions on borrowers' abilities to prepay their residential mortgage loans. Prepayment rates on loans are influenced by changes in market interest rates and a variety of economic, geographic and other factors beyond our control. Consequently, we cannot predict with certainty such prepayment rates, and no strategy can completely insulate us from prepayment or other such risks. Homeowners tend to prepay mortgage loans faster when interest rates decline. Consequently, owners of the loans have to reinvest the money received from the prepayments at the lower prevailing interest rates. Conversely, homeowners tend not to prepay mortgage loans when interest rates increase. Consequently, owners of the loans are unable to reinvest money that would have otherwise been received from prepayments at the higher prevailing interest rates. This volatility in prepayment rates may affect our ability to maintain targeted amounts of leverage on our portfolio and may result in reduced earnings or losses for us and negatively affect the cash available for distribution to our shareholders.

The mortgage loans in which we will invest and the mortgage loans underlying the MBS in which we will invest are subject to delinquency, foreclosure and loss, which could result in losses to us.

Residential mortgage loans are typically secured by single-family residential property and are subject to risks of delinquency and foreclosure and risks of loss. These risks are greater for sub-performing and non-performing loans. The ability of a borrower to repay a loan secured by a residential property is dependent upon the income or assets of the borrower. A number of factors, including a general economic downturn (such as the current economic downturn), acts of God, terrorism, social unrest and civil disturbances, may impair borrowers' abilities to repay their loans. In addition, we intend to invest in RMBS that are not guaranteed by federally chartered entities such as Fannie Mae and Freddie Mac and, in the case of Ginnie Mae, the U.S. government. The ability of a

borrower to repay these loans or other financial assets is dependent upon the income or assets of these borrowers.

Commercial mortgage loans are secured by multifamily or commercial property and are subject to risks of delinquency and foreclosure, and risks of loss that are greater than similar risks associated with loans made on the security of single-family residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income producing property can be affected by, among other things, tenant mix, success of tenant businesses, property management decisions, property location and condition, competition from comparable types of properties, changes in laws that increase operating expense or limit rents that may be charged, any need to address environmental contamination at the property, the occurrence of any uninsured casualty at the property, changes in national, regional or local economic conditions or specific industry segments, declines in regional or local real estate values, declines in regional or local rental or occupancy rates, increases in interest rates, real estate tax rates and other operating expenses, changes in governmental rules, regulations and fiscal policies, including environmental legislation, acts of God, terrorism, social unrest and civil disturbances.

In the event of any default under a mortgage loan held directly by us, we will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the price we paid for the loan and any accrued interest of the mortgage loan, which could have a material adverse effect on our cash flow from operations. In the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law. Additionally, proposed legislation would, if enacted, empower bankruptcy courts to modify the terms of certain residential mortgage loans secured by property of the related debtors.

Foreclosure of a mortgage loan can be an expensive and lengthy process which could have a substantial negative effect on our anticipated return on the foreclosed mortgage loan. RMBS evidence interests in or are secured by pools of residential mortgage loans and CMBS evidence interests in or are secured by a single commercial mortgage loan or a pool of commercial mortgage loans. Accordingly, the RMBS and CMBS in which we intend to invest are subject to all of the risks of the respective underlying mortgage loans.

Many of our investments may be illiquid and we may not be able to vary our portfolio in response to changes in economic and other conditions.

Our investments in mortgage loans will be illiquid. We expect generally that any securities we purchase will be in connection with privately negotiated transactions that will not be registered under the relevant securities laws, resulting in a prohibition against their transfer, sale, pledge or other disposition except in a transaction that is exempt from the registration requirements of, or is otherwise in accordance with, those laws. Generally, we will not be able to sell these securities publicly without the expense and time required to register the securities under the Securities Act of 1933, as amended, or the Securities Act, if the obligors agree to do so, or will be able to sell the securities only under Rule 144 or other rules under the Securities Act which permit only limited sales under specified conditions. Moreover, turbulent market conditions, such as those currently in effect, could significantly and negatively impact the liquidity of our assets. It may be difficult or impossible to obtain or validate third party pricing on the investments we purchase. Illiquid investments typically experience greater price volatility, as a ready market does not exist, and can be more difficult to value. The illiquidity of our investments may make it difficult for us to sell such investments if the need or desire arises. In

addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value maintained for it in our records. Furthermore, we may face other restrictions on our ability to liquidate an investment in an entity to the extent that we have or could be attributed with material non-public information regarding such entity.

Investments in subordinated loans and subordinated MBS could subject us to increased risk of losses.

We may invest in subordinated loans and subordinated MBS. In the event a borrower defaults on a loan and lacks sufficient assets to satisfy such loan, we may lose all or a significant part of our investment. In the event a borrower becomes subject to bankruptcy proceedings, we will not have any recourse to the assets, if any, of the borrower that are not pledged to secure our loan, and the unpledged assets of the borrower may not be sufficient to satisfy our loan. If a borrower defaults on our loan or on its senior debt (i.e., a first-lien loan, in the case of a residential mortgage loan, or a contractually or structurally senior loan, in the case of a commercial mortgage loan), or in the event of a borrower bankruptcy, our loan will be satisfied only after all senior debt is paid in full. In the case of commercial mortgage loans, where senior debt exists, the presence of intercreditor arrangements may limit our ability to amend our loan documents, assign our loan, accept prepayments, exercise our remedies and control decisions made in bankruptcy proceedings relating to borrowers.

In general, losses on mortgage loans included in a securitization will be borne first by holders of the "first loss" subordinated security and then, in turn, by the holders of more senior securities, beginning with the most subordinated. In addition, losses on the property securing a commercial mortgage loan included in a securitization will be borne first by the equity holder of the property, then by a cash reserve fund or letter of credit provided by the borrower, if any, and then by subordinated security holders, as described in the preceding sentence. In the event of default of a mortgage loan we own (and, if the loan is a commercial mortgage loan, the exhaustion of any equity support, reserve fund or letter of credit) and, in the case of RMBS and CMBS in which we invest, the exhaustion of any credit support provided by any classes of securities junior to such RMBS and CMBS, we may not recover all or even a significant part of our investment, which could result in repayment losses. In addition, if the underlying mortgage portfolio has been overvalued by the originator, or if the values subsequently decline and, as a result, less collateral is available to satisfy interest and principal payments due on the related MBS, the securities in which we invest may suffer significant losses.

The prices of lower credit quality investments are generally more sensitive to adverse actual or perceived economic downturns or individual issuer developments than more highly rated investments. An economic downturn or a projection of an economic downturn, for example, could cause a decline in the price of lower credit quality investments because the ability of obligors to make principal and interest payments or to refinance may be impaired. In such event, existing credit support in the securitization structure may be insufficient to protect us against loss.

We may invest in subprime residential mortgage loans or RMBS collateralized by subprime mortgage loans, which are subject to increased risks.

We may invest in subprime residential mortgage loans or RMBS backed by collateral pools of subprime residential mortgage loans. "Subprime" mortgage loans refer to mortgage loans that have been originated using underwriting standards that are less restrictive than the underwriting requirements used as standards for other first and junior lien mortgage loan purchase programs, such as the programs of Fannie Mae and Freddie Mac. These lower standards include mortgage loans made to borrowers having imperfect or impaired credit histories (including outstanding judgments or prior bankruptcies), mortgage loans where the amount of the loan at origination is 80% or more of the value of the mortgage property, mortgage loans made to borrowers with low credit scores, mortgage loans made to borrowers who have other debt that represents a large portion of their income and mortgage loans made to borrowers whose income may not have been disclosed or verified. Due to economic

conditions, including increased interest rates and lower home prices, as well as aggressive lending practices, subprime mortgage loans have in recent periods experienced increased rates of delinquency, foreclosure, bankruptcy and loss, and they are likely to continue to experience delinquency, foreclosure, bankruptcy and loss rates that are higher, and that may be substantially higher, than those experienced by mortgage loans underwritten in a more traditional manner. Thus, because of the higher delinquency rates and losses associated with subprime mortgage loans, the performance of subprime mortgage loans or RMBS backed by subprime mortgage loans in which we may invest could be correspondingly adversely affected, which could adversely impact our results of operations, financial condition and business.

Our investments in loans to and debt securities of real estate companies will be subject to the specific risks relating to the particular borrower or issuer of the securities and to the general risks of investing in real estate-related loans and securities, which may result in significant losses.

We may, subject to maintaining our qualification as a REIT and exclusion from the Investment Company Act, invest in loans to and debt securities of real estate companies, including REITs. Our investments in loans to and debt securities of real estate companies will involve special risks relating to the particular borrower or issuer of the securities, including the financial condition, liquidity, results of operations, business and prospects of the borrower or issuer. Real estate companies often invest, and REITs generally are required to invest substantially, in real estate or real estate-related assets and are subject to the risks inherent with the real estate-related investments referred to in this prospectus.

These loans and debt securities are often non-collateralized and may also be subordinated to other obligations of the borrower or issuer. We are likely to invest primarily in loans to and debt securities of real estate companies that are not rated or are rated non-investment grade by one or more rating agencies. Investments that are not rated or are rated non-investment grade have a higher risk of default than investment grade rated assets and therefore may result in losses to us. We have not adopted any limit on such investments.

Investments in loans to and debt securities of real estate companies will also subject us to the risks inherent with real estate-related investments referred to in this prospectus, including the risks described with respect to mortgage loans and similar risks, including:

- risks of delinquency and foreclosure, and risks of loss in the event thereof;
- the dependence upon the successful operation of, and net income from, real property;
- risks generally incident to interests in real property; and
- risks specific to the type and use of a particular property.

Investments in REIT debt securities are also subject to risks of:

- transfer restrictions imposed on securities issued in SEC exempt private placements by the relevant securities laws and limited liquidity in the secondary trading market;
- substantial market price volatility resulting from changes in prevailing interest rates;
- in the case of subordinated investments, the seniority of claims of banks and other senior lenders to the issuer;
- the operation of mandatory sinking fund or redemption provisions during periods of declining interest rates that could cause us to reinvest redemption proceeds in comparable assets at lower yields or in riskier assets to maintain the current yield;

the possibility that the liquidity and performance of the issuer may be insufficient to meet its debt service and dividend obligations; and

the declining creditworthiness and potential for insolvency of the issuer during periods of rising interest rates, economic downturn and other adverse developments.

Table of Contents

These risks may adversely affect the value of our loans to and debt securities of real estate companies and the ability of the issuers thereof to make principal and interest payments in a timely manner, or at all, and could result in significant losses.

We may utilize derivative instruments, including credit default swaps, which could subject us to risk of loss.

The prices of derivative instruments, including futures and options, are highly volatile. Payments made pursuant to swap agreements may also be highly volatile. Price movements of futures and options contracts and payments pursuant to swap agreements are influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments, and national and international political and economic events and policies. The value of futures, options and swap agreements also depends upon the value of the assets underlying them. In addition, our assets are also subject to the risk of the failure of any of the exchanges on which our positions trade or of our clearinghouses or counterparties.

We may utilize credit default swaps, or CDS. A CDS is a contract between two parties which transfers the risk of loss if a borrower fails to pay principal or interest on time or files for bankruptcy. CDS can be used to hedge a portion of the default risk on a single corporate debt or a portfolio of loans. The CDS market in high yield securities is comparatively new and rapidly evolving compared to the CDS market for more seasoned and liquid investment grade securities. Swap transactions dependent upon credit events are priced incorporating many variables, including the pricing and volatility of the common shares and potential loss upon default, among other factors. As such, there are many factors upon which market participants may have divergent views.

Although we intend to utilize these instruments for hedging purposes, the derivative instruments that we utilize may fail to effectively hedge our positions. The cost of utilizing derivatives may also reduce our income that would otherwise be available for distribution to shareholders or for other purposes. We are also subject to credit risk with regard to the counterparty involved in the derivative transaction.

Participating interests may not be available and, even if obtained, may not be realized.

In connection with the origination or acquisition of certain structured finance assets, subject to maintaining our qualification as a REIT, we may obtain participating interests, or equity "kickers," in the owner of the property that entitle us to payments based upon a development's cash flow or profits or any increase in the value of the property that would be realized upon a refinancing or sale thereof. Competition for participating interests is dependent to a large degree upon market conditions. Participating interests are more difficult to obtain when real estate financing is available at relatively low interest rates. Participating interests are not insured or guaranteed by any governmental entity and are therefore subject to the general risks inherent in real estate investments. Therefore, even if we are successful in making investments that provide for participating interests, there can be no assurance that such interests will result in additional payments to us.

Any credit ratings assigned to our investments will be subject to ongoing evaluations and revisions and we cannot assure you that those ratings will not be downgraded.

Some of our investments may be rated by Moody's Investors Service, Fitch Ratings or Standard & Poor's. Any credit ratings on our investments are subject to ongoing evaluation by credit rating agencies, and we cannot assure you that any such ratings will not be changed or withdrawn by a rating agency in the future if, in its judgment, circumstances warrant. If rating agencies assign a lower-than-expected rating or reduce or withdraw, or indicate that they may reduce or withdraw, their ratings of our investments in the future, the value of these investments could significantly decline,

which would adversely affect the value of our investment portfolio and could result in losses upon disposition or the failure of borrowers to satisfy their debt service obligations to us.

Insurance on mortgage loans and real estate securities collateral may not cover all losses.

There are certain types of losses, generally of a catastrophic nature, such as earthquakes, floods, hurricanes, terrorism or acts of war, that may be uninsurable or not economically insurable. Inflation, changes in building codes and ordinances, environmental considerations and other factors, including terrorism or acts of war, also might make the insurance proceeds insufficient to repair or replace a property if it is damaged or destroyed. Under these circumstances, the insurance proceeds received might not be adequate to restore our economic position with respect to the affected real property. Any uninsured loss could result in the loss of cash flow from, and the asset value of, the affected property.

PCM's due diligence of potential investments may not reveal all of the liabilities associated with such investments and may not reveal other weaknesses in such investments, which could lead to investment losses.

Before making an investment, PCM will assess the strengths and weaknesses of the originators, borrowers, and the underlying property values, as well as other factors and characteristics that are material to the performance of the investment. In making the assessment and otherwise conducting customary due diligence, PCM will rely on resources available to it and, in some cases, an investigation by third parties. There can be no assurance that PCM's due diligence process will uncover all relevant facts or that any investment will be successful.

We may be adversely affected by risks affecting borrowers or the asset or property types in which our investments may be concentrated at any given time, as well as from unfavorable changes in the related geographic regions.

Our assets will not be subject to any geographic, diversification or concentration limitations except that we will be concentrated in residential mortgage-related investments. Accordingly, our investment portfolio may be concentrated by geography, asset, property type and/or borrower, increasing the risk of loss to us if the particular concentration in our portfolio is subject to greater risks or undergoing adverse developments. In addition, adverse conditions in the areas where the properties securing or otherwise underlying our investments are located (including business layoffs or downsizing, industry slowdowns, changing demographics and other factors) and local real estate conditions (such as oversupply or reduced demand) may have an adverse effect on the value of our investments. A material decline in the demand for real estate in these areas may materially and adversely affect us. Lack of diversification can increase the correlation of non-performance and foreclosure risks among our investments.

A prolonged economic slowdown, recession or declining real estate values could materially and adversely affect us.

We believe the risks associated with our investments will be more acute during periods of economic slowdown or recession (such as the current period marked by dislocation and weakness in the capital and credit markets), especially if these periods are accompanied by declining real estate values. Declining real estate values will likely reduce our level of new investments since borrowers often use increases in the value of their existing properties to support the purchase of or investment in additional properties. Furthermore, a weakening economy and declining real estate values significantly increase the likelihood that borrowers will default on their debt service obligations to us and that we will incur losses on our investments with them in the event of a default on a particular investment because the value of any collateral we foreclose upon may be insufficient to cover the full amount of such investment or may require a significant amount of time to realize. A weakening economy and declining

real estate values may increase the likelihood of re-default rates even after we have completed loan modifications aimed at keeping borrowers in their homes. Our exposure will increase to the extent of the subordination, if applicable, of our investment. In addition, under such conditions, our access to capital will generally be more limited, if available at all, and more expensive. Any period of increased payment delinquencies, foreclosures or losses could adversely affect the net interest income generated from our portfolio and our ability to make and finance future investments, which would materially and adversely affect our revenues, results of operations, financial condition, business prospects, and our ability to make distributions to our shareholders.

If we fail to develop, enhance, and implement strategies to adapt to changing conditions in the mortgage industry and capital markets, our financial condition and earnings may be adversely affected.

The manner in which we compete and the products for which we compete are affected by changing conditions, which can take the form of trends or sudden changes in our industry, regulatory environment, changes in the role of government-sponsored entities, changes in the role of credit rating agencies or their rating criteria or process, or the U.S. economy more generally. If we do not effectively respond to these changes, or if our strategies to respond to these changes are not successful, our financial condition and earnings may be adversely affected.

Our investments will generally be recorded at fair value, and quoted prices or observable inputs may not be available to determine such value, resulting in the use of significant unobservable inputs to determine value.

We expect that the values of some of our investments may not be readily determinable. We will measure the fair value of these investments quarterly, in accordance with guidance set forth in Financial Accounting Standards Board, or FASB, Statement of Financial Accounting Standards, or SFAS, No. 157, "Fair Value Measurements," or SFAS No. 157. The fair value at which our assets may be recorded may not be an indication of their realizable value. Ultimate realization of the value of an asset depends to a great extent on economic and other conditions that are beyond the control of PCM, our company or our board of trustees. Further, fair value is only an estimate based on good faith judgment of the price at which an investment can be sold since market prices of investments can only be determined by negotiation between a willing buyer and seller. If we were to liquidate a particular asset, the realized value may be more than or less than the amount at which such asset is valued. Accordingly, the value of our common shares could be adversely affected by our determinations regarding the fair value of our investments, whether in the applicable period or in the future. Additionally, such valuations may fluctuate over short periods of time.

In certain cases, PCM's determination of the fair value of our investments will include inputs provided by third-party dealers and pricing services. Valuations of certain securities in which we may invest are often difficult to obtain or unreliable. In general, dealers and pricing services heavily disclaim their valuations. Dealers may claim to furnish valuations only as an accommodation and without special compensation, and so they may disclaim any and all liability for any direct, incidental, or consequential damages arising out of any inaccuracy or incompleteness in valuations, including any act of negligence or breach of any warranty. Depending on the complexity and illiquidity of a security, valuations of the same security can vary substantially from one dealer or pricing service to another. Therefore, our results of operations for a given period could be adversely affected if our determinations regarding the fair market value of these investments are materially higher than the values that we ultimately realize upon their disposal. The valuation process has been particularly challenging recently as market events have made valuations of certain assets more difficult, unpredictable and volatile.

Table of Contents

PCM will utilize analytical models and data in connection with the valuation of our investments, and any incorrect, misleading or incomplete information used in connection therewith would subject us to potential risks.

Given the complexity of our investments and strategies, PCM must rely heavily on analytical models (both proprietary models developed by PCM and those supplied by third parties) and information and data supplied by third parties, or Models and Data. Models and Data will be used to value investments or potential investments and also in connection with hedging our investments. When Models and Data prove to be incorrect, misleading or incomplete, any decisions made in reliance thereon expose us to potential risks. For example, by relying on Models and Data, especially valuation models, PCM may be induced to buy certain investments at prices that are too high, to sell certain other investments at prices that are too low or to miss favorable opportunities altogether. Similarly, any hedging based on faulty Models and Data may prove to be unsuccessful. Furthermore, any valuations of our investments that are based on valuation models may prove to be incorrect.

Some of the risks of relying on analytical models and third-party data are particular to analyzing tranches from securitizations, such as MBS. These risks include, but are not limited to, the following: (i) collateral cash flows and/or liability structures may be incorrectly modeled in all or only certain scenarios, or may be modeled based on simplifying assumptions that lead to errors; (ii) information about collateral may be incorrect, incomplete, or misleading; (iii) collateral or bond historical performance (such as historical prepayments, defaults, cash flows, etc.) may be incorrectly reported, or subject to interpretation (*e.g.*, different issuers may report delinquency statistics based on different definitions of what constitutes a delinquent loan); or (iv) collateral or bond information may be outdated, in which case the models may contain incorrect assumptions as to what has occurred since the date information was last updated.

Some of the analytical models used by PCM, such as mortgage prepayment models or mortgage default models, are predictive in nature. The use of predictive models has inherent risks. For example, such models may incorrectly forecast future behavior, leading to potential losses on a cash flow and/or a mark-to-market basis. In addition, the predictive models used by PCM may differ substantially from those models used by other market participants, with the result that valuations based on these predictive models may be substantially higher or lower for certain investments than actual market prices. Furthermore, since predictive models are usually constructed based on historical data supplied by third parties, the success of relying on such models may depend heavily on the accuracy and reliability of the supplied historical data and the ability of these historical models to accurately reflect future periods.

All valuation models rely on correct market data inputs. If incorrect market data is entered into even a well-founded valuation model, the resulting valuations will be incorrect. However, even if market data is inputted correctly, "model prices" will often differ substantially from market prices, especially for securities with complex characteristics, such as derivative securities.

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 knew of, or was responsible for, the release of such hazardous substances.

The presence of hazardous substances may adversely affect an owner's ability to sell real estate or borrow using real estate as collateral. To the extent that an owner of a property underlying one of our debt investments becomes liable for removal costs, the ability of the owner to make debt payments to us may be reduced, which in turn may adversely affect the value of the relevant mortgage asset held by us and our ability to make distributions to our shareholders.

If we take title to a property, the presence of hazardous substances on the property may adversely affect our ability to sell the property, and we may become liable to a governmental entity or to third parties for property damage, personal injury, investigation, remediation costs, or we may be required to investigate or clean up hazardous or toxic substances. Such liabilities would harm our business, financial condition, liquidity, results of operation and our ability to make distributions to our shareholders.

We may be required to repurchase mortgage loans or indemnify investors if we breach representations and warranties, which could harm our earnings.

If we sell loans, we would be required to make customary representations and warranties about such loans to the loan purchaser. Our residential mortgage loan sale agreements may require us to repurchase or substitute loans in the event we breach a representation or warranty given to the loan purchaser. In addition, we may be required to repurchase loans as a result of borrower fraud or in the event of early payment default on a mortgage loan. Likewise, we may be required to repurchase or substitute loans if we breach a representation or warranty in connection with our securitizations. The remedies available to a purchaser of mortgage loans are generally broader than those available to us against the originating broker or correspondent. Further, if a purchaser enforces its remedies against us, we may not be able to enforce the remedies we have against the sellers. The repurchased loans typically can only be financed at a steep discount to their repurchase price, if at all. They are also typically sold at a significant discount to the unpaid principal balance. Significant repurchase activity could harm our cash flow, results of operations, financial condition and business prospects.

Risks Related to Our Organization and Structure

Certain provisions of Maryland law could inhibit a change in our control.

Certain provisions of the Maryland General Corporation Law, or the MGCL, applicable to a Maryland real estate investment trust may have the effect of inhibiting a third party from making a proposal to acquire us or of impeding a change in our control under circumstances that otherwise could provide the holders of our common shares with the opportunity to realize a premium over the then prevailing market price of such shares. We are subject to the "business combination" provisions of the MGCL that, subject to limitations, prohibit certain business combinations between us and an "interested shareholder" (defined generally as any person who beneficially owns 10% or more of our then outstanding voting shares or an affiliate or associate of ours who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of our then outstanding voting shares) or an affiliate thereof for five years after the most recent date on which the shareholder becomes an interested shareholder and, thereafter, imposes special appraisal rights and special shareholder voting requirements on these combinations. These provisions of the MGCL do not apply, however, to business combinations that are approved or exempted by the board of trustees of a real estate investment trust prior to the time that the interested shareholder becomes an interested shareholder. Pursuant to the statute, our board of trustees has by resolution exempted business combinations between us and any other person, provided that the business combination is first approved by our board of trustees. This resolution, however, may be altered or repealed in whole or in part at any time. If this resolution is repealed, or our board of trustees does not otherwise approve a business combination, this statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer. See "Certain Provisions of Maryland Law and of Our Declaration of Trust and Bylaws Business Combinations."

The "control share" provisions of the MGCL provide that "control shares" of a Maryland real estate investment trust (defined as shares which, when aggregated with all other shares controlled by the shareholder, entitle the shareholder to exercise one of three increasing ranges of voting power in the election of trustees) acquired in a "control share acquisition" (defined as the acquisition of "control

Table of Contents

shares," subject to certain exceptions) have no voting rights except to the extent approved by our shareholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding votes entitled to be cast by the acquirer of control shares, our officers and our trustees who are also our employees. Our bylaws contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of our shares. There can be no assurance that this provision will not be amended or eliminated at any time in the future. See "Certain Provisions of Maryland Law and of Our Declaration of Trust and Bylaws Control Share Acquisitions."

The "unsolicited takeover" provisions of the MGCL permit our board of trustees, without shareholder approval and regardless of what is currently provided in our declaration of trust or bylaws, to implement certain provisions if we have a class of equity securities registered under the Securities Exchange Act of 1934, as amended, or the Exchange Act (which we will have upon the completion of this offering), and at least three independent trustees. These provisions may have the effect of inhibiting a third party from making an acquisition proposal for us or of delaying, deferring or preventing a change in our control under circumstances that otherwise could provide the holders of our common shares with the opportunity to realize a premium over the then current market price. Our declaration of trust contains a provision whereby we elect to be subject to the provisions of Title 3, Subtitle 8 of the MGCL relating to the filling of vacancies on our board of trustees as soon as we become eligible to do so. See "Certain Provisions of Maryland Law and of Our Declaration of Trust and Bylaws Subtitle 8."

Upon the completion of this offering, our board of trustees will be divided into three classes of trustees. The terms of the trustees will expire in 2010, 2011 and 2012, respectively. Trustees of each class will be elected for three-year terms upon the expiration of their current terms, and each year one class of trustees will be elected by our shareholders. The staggered terms of our trustees may reduce the possibility of a tender offer or an attempt at a change in control, even though a tender offer or change in control might be in the best interests of our shareholders.

Our authorized but unissued common and preferred shares may prevent a change in our control.

Our declaration of trust authorizes us to issue additional authorized but unissued common shares and preferred shares. In addition, our board of trustees may, without shareholder approval, increase the aggregate number of our authorized shares or the number of shares of any class or series that we have authority to issue and classify or reclassify any unissued common shares or preferred shares and may set the preferences, rights and other terms of the classified or reclassified shares. As a result, among other things, our board may establish a class or series of common shares or preferred shares that could delay or prevent a transaction or a change in our control that might involve a premium price for our common shares or otherwise be in the best interests of our shareholders.

Compliance with our Investment Company Act exclusion imposes limits on our operations.

We intend to conduct our operations so that we are not required to register as an investment company under the Investment Company Act. Section 3(a)(1)(A) of the Investment Company Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Section 3(a)(1)(C) of the Investment Company Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. Excluded from the term "investment securities," among other things, are U.S. government securities and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company set forth in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act. Because we are organized as a holding company that conducts its

businesses primarily through our operating partnership and its wholly-owned subsidiaries, our status under the Investment Company Act is dependent upon the status of our operating partnership which, as a holding company, in turn, will have its status determined by the status of its subsidiaries. The securities issued to our operating partnership by these subsidiaries that are excepted from the definition of "investment company" in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act, together with any other investment securities it may own, may not have a value in excess of 40% of the value of our operating partnership's total assets on an unconsolidated basis. We will monitor our holdings to ensure continuing and ongoing compliance with this test. In addition, we believe our company will not be considered an investment company under Section 3(a)(1)(A) of the Investment Company Act because we will not engage primarily or hold ourselves out as being engaged primarily in the business of investing, reinvesting or trading in securities. Rather, through our wholly-owned subsidiaries, we are primarily engaged in the business of our subsidiaries. Further, we believe that we may also rely upon Section 3(c)(6) of the Investment Company Act, which excludes from the definition of "investment company" any company primarily engaged, directly or through majority-owned subsidiaries, in a business, among others, described in Section 3(c)(5)(C) of the Investment Company Act (from which not less than 25% of such company's gross income during its last fiscal year was derived) together with an additional business or additional businesses other than investing, reinvesting, owning, holding or trading in securities.

If the value of our operating partnership's investments in its subsidiaries that are excepted from the definition of "investment company" by Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act, together with any other investment securities it owns, exceeds 40% of its total assets on an unconsolidated basis, or if one or more of such subsidiaries fail to maintain their exceptions or exclusions from the Investment Company Act, we may have to register under the Investment Company Act and we could become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with affiliated persons (as defined in the Investment Company Act), portfolio composition, including restrictions with respect to diversification and industry concentration, and other matters.

In addition, certain of our operating partnership's subsidiaries intend to qualify for an exclusion from the definition of "investment company" under Section 3(c)(5)(C) (or Section 3(c)(6)) of the Investment Company Act which is available for entities "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." This exclusion generally means that at least 55% of such subsidiaries' portfolios must be comprised of qualifying assets and 80% of each of their portfolios must be comprised of qualifying assets and real estate-related assets under the Investment Company Act.

Failure to maintain our exclusion from registration under the Investment Company Act could negatively affect the value of our common shares, the sustainability of our business model and our ability to make distributions to shareholders.

If we fail to qualify for the foregoing exclusion in the future, we could be required to restructure our activities in a manner that, or at a time when, we would not otherwise choose to do so, which could negatively affect the value of our common shares, the sustainability of our business model, and our ability to make distributions. For example, if the market value of our subsidiaries' investments in securities were to increase by an amount that resulted in less than 55% of their assets being invested in mortgage loans or RMBS that represent the entire ownership in a pool of mortgage loans or less than 80% of their assets being invested in real estate-related assets, they may have to sell securities to qualify for exclusion under the Investment Company Act. The sale could occur during adverse market conditions, and they could be forced to accept a price below that which they believe is acceptable. In addition, there can be no assurance that the laws and regulations governing REITs, including the Division of Investment Management of the SEC providing more specific or different guidance

regarding the treatment of assets as qualifying real estate assets or real estate-related assets, will not change in a manner that adversely affects our operations.

A loss of our Investment Company Act exclusion would allow PCM to terminate the management agreement with us, without the payment of a termination fee. The loan servicing agreement with PLS is subject to early termination, without the payment of any termination fee, in the event the management agreement is terminated for any reason. In addition, because affiliate transactions generally are prohibited under the Investment Company Act, we would not be able to enter into transactions with any of our affiliates if we fail to maintain our exclusion and may be required to terminate any other agreements with affiliates. The termination of any of these agreements would have a material adverse effect on our ability to execute our business strategy. If any of these agreements is terminated, we will have to obtain the services on our own. We may not be able to replace these services in a timely manner or on favorable terms, or at all.

Rapid changes in the values of our residential mortgage loans and other real estate-related assets may make it more difficult for us to maintain our qualification as a REIT or exclusion from the Investment Company Act.

If the market value or income potential of our residential mortgage loans and other real estate-related assets declines as a result of increased interest rates, prepayment rates or other factors, we may need to increase certain real estate investments and income and/or liquidate our non-qualifying assets in order to maintain our REIT qualification or exclusion from the Investment Company Act. If the decline in real estate asset values and/or income occurs quickly, this may be especially difficult to accomplish. This difficulty may be exacerbated by the illiquid nature of our investments. We may have to make investment decisions that we otherwise would not make absent our REIT and Investment Company Act considerations.

Our rights and the rights of our shareholders to take action against our trustees and officers are limited, which could limit your recourse in the event of actions not in your best interest.

Our declaration of trust limits the liability of our present and former trustees and officers to us and our shareholders for money damages to the maximum extent permitted under Maryland law. Under current Maryland law, our present and former trustees and officers will not have any liability to us or our shareholders for money damages other than liability resulting from:

- actual receipt of an improper benefit or profit in money, property or services; or

- active and deliberate dishonesty by the trustee or officer that was established by a final judgment and is material to the cause of action.

Our declaration of trust authorizes us to indemnify our present and former trustees and officers for actions taken by them in those capacities to the maximum extent permitted by Maryland law. Our bylaws require us to indemnify each present and former trustee or officer, to the maximum extent permitted by Maryland law, in the defense of any proceeding to which he or she is made, or threatened to be made, a party by reason of his or her service to us. In addition, we may be obligated to pay or reimburse the expenses incurred by our present and former trustees and officers without requiring a preliminary determination of their ultimate entitlement to indemnification. As a result, we and our shareholders may have more limited rights against our present and former trustees and officers than might otherwise exist absent the current provisions in our declaration of trust and bylaws or that might exist with other companies, which could limit your recourse in the event of actions not in your best interest.

Our declaration of trust contains provisions that make removal of our trustees difficult, which could make it difficult for our shareholders to effect changes to our management.

Our declaration of trust provides that, subject to the rights of holders of any series of preferred shares, a trustee may be removed only for "cause" (as defined in our declaration of trust), and then only by the affirmative vote of at least two-thirds of the votes entitled to be cast generally in the election of trustees. Vacancies generally may be filled only by a majority of the remaining trustees in office, even if less than a quorum, for the full term of the class of trustees in which the vacancy occurred. These requirements make it more difficult to change our management by removing and replacing trustees and may prevent a change in our control that is in the best interests of our shareholders.

Our declaration of trust generally does not permit ownership in excess of 9.8% of our common shares or 9.8% of our shares of beneficial interest and attempts to acquire our shares in excess of the share ownership limits will be ineffective unless an exemption is granted by our board of trustees.

Our declaration of trust generally prohibits beneficial or constructive ownership by any person of more than 9.8% by vote or value, whichever is more restrictive, of our outstanding common shares or more than 9.8% by vote or value, whichever is more restrictive, of our outstanding shares of beneficial interest. Our board of trustees, in its sole discretion, may grant an exemption to these prohibitions, subject to certain conditions and receipt by our board of certain representations and undertakings. Our board of trustees may from time to time increase certain of these limits for one or more persons and may increase or decrease such limits for all other persons. Any decrease in the share ownership limits generally applicable to all shareholders will not be effective for any person whose percentage ownership of our shares is in excess of such decreased limits until such time as such person's percentage ownership of our shares equals or falls below such decreased limits, but any further acquisition of our shares in excess of such person's percentage ownership of our shares will be in violation of the applicable limits. Our board of trustees may not increase these limits (whether for one person or all shareholders) if such increase would allow five or fewer persons to beneficially own more than 49.9% in value of our outstanding shares or otherwise cause us to fail to qualify as a REIT.

Our declaration of trust's constructive ownership rules are complex and may cause the outstanding shares owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than these percentages of the outstanding shares by an individual or entity could cause that individual or entity to own constructively in excess of these percentages of the outstanding shares and thus violate the share ownership limits. Any attempt to own or transfer our common shares or preferred shares (if and when issued) in excess of the share ownership limits without the consent of our board of trustees or in a manner that would cause us to be "closely held" under Section 856(h) of the Internal Revenue Code (without regard to whether the shares are held during the last half of a taxable year) will result in the shares being deemed to be transferred to a trustee for a charitable trust or, if the transfer to the charitable trust is not automatically effective to prevent a violation of the share ownership limits or the restrictions on ownership and transfer of our shares, any such transfer of our shares will be void *ab initio*. Further, any transfer of our shares that would result in our shares being beneficially owned by fewer than 100 persons on or after January 29, 2010 will be void *ab initio*.

We may use a portion of the net proceeds from our offerings to make quarterly distributions, which would, among other things, reduce our cash available for investing.

Prior to the time we have fully invested the net proceeds of this offering, our concurrent offering and the direct offering (if any), we may fund our quarterly distributions out of such net proceeds, which would reduce the amount of cash we have available for investing and other purposes.

Table of Contents

The use of our net proceeds for distributions could be dilutive to our financial results. In addition, funding our distributions from our net proceeds may constitute a return of capital to our investors, which would have the effect of reducing each shareholder's basis in its common shares.

Risks Related to Taxation

Our failure to qualify as a REIT would result in higher taxes and reduced cash available for distribution to our shareholders.

We are organized and intend to operate in a manner so as to qualify as a REIT for U.S. federal income tax purposes. Although we do not intend to request a ruling from the Internal Revenue Service, or the IRS, as to our REIT qualification, we have received the opinion of Sidley Austin LLP with respect to our qualification as a REIT. This opinion has been issued in connection with this offering of common shares. Investors should be aware, however, that opinions of counsel are not binding on the IRS or any court. The opinion of Sidley Austin LLP represents only the view of our counsel based on our counsel's review and analysis of existing law and on certain representations as to factual matters and covenants made by us, including representations relating to the values of our assets and the sources of our income. The opinion is expressed as of the date issued. Counsel has no obligation to advise us or the holders of our common shares of any subsequent change in the matters stated, represented or assumed, or of any subsequent change in applicable law. Furthermore, both the validity of the opinion of Sidley Austin LLP and our continued qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, shareholder ownership and other requirements on a continuing basis, the results of which will not be monitored by Sidley Austin LLP. Our ability to satisfy the asset tests depends upon our analysis of the fair market values of our assets, some of which are not susceptible to a precise determination, and for which we will not obtain independent appraisals. Our compliance with the REIT income and quarterly asset requirements also depends upon our ability to successfully manage the composition of our income and assets on an ongoing basis. Moreover, the proper classification of an instrument as debt or equity for U.S. federal income tax purposes and the tax treatment of participation interests that we hold in mortgage loans may be uncertain in some circumstances, which could affect the application of the REIT qualification requirements as described below. Accordingly, there can be no assurance that the IRS will not contend that our interests in subsidiaries or other issuers will not cause a violation of the REIT requirements. If we were to fail to qualify as a REIT in any taxable year, we would be subject to U.S. federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates, and distributions to our shareholders would not be deductible by us in computing our taxable income. Any such corporate tax liability could be substantial and would reduce the amount of cash available for distribution to our shareholders, which in turn would have an adverse impact on the value of our common shares. Unless we were entitled to relief under certain Internal Revenue Code provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year during which we ceased to qualify as a REIT.

The percentage of our assets represented by TRSs and the amount of our income that we can receive in the form of TRS dividends are subject to statutory limitations that could jeopardize our REIT status.

A REIT may own up to 100% of the stock of one or more TRSs. A TRS may earn income that would not be qualifying income if earned directly by the parent REIT. Both the subsidiary and the REIT must jointly elect to treat the subsidiary as a TRS. A significant portion of our activities will likely be conducted through one or more TRSs, and we expect that such TRSs may from time to time hold significant assets.

Table of Contents

Overall, no more than 25% of the value of a REIT's assets may consist of stock or securities of one or more TRSs (at the end of each quarter). While we intend to manage our affairs so as to satisfy this requirement, there can be no assurance that we will be able to do so in all market circumstances.

A TRS will be subject to U.S. federal, state and local income tax on its taxable income, and its after-tax net income will be available for distribution to us. We will receive distributions from TRSs which will be classified as dividend income to the extent of the earnings and profits of the distributing corporation. We may from time to time need to make such distributions in order to keep the value of our TRSs below 25% of our total assets. However, TRS dividends will generally not constitute "good" income for purposes of one of the tests we must satisfy to qualify as a REIT, namely, that at least 75% of our gross income must in each taxable year generally be from real estate assets. While we will be monitoring our compliance with both this income test and the limitation on the percentage of our assets represented by TRS securities, and intend to conduct our affairs so as to comply with both, the two may at times be in conflict with one another. That is, it is possible that we may wish to distribute a dividend from a TRS in order to reduce the value of our TRSs below 25% of our assets, but be unable to do so without violating the requirement that 75% of our gross income in the taxable year be derived from real estate assets. Although there are other measures we can take in such circumstances in order to remain in compliance, there can be no assurance that we will be able to comply with both of these tests in all market conditions.

Despite our qualification as a REIT, a significant portion of our income may be earned through TRSs that are subject to U.S. federal income taxation

Despite our qualification as a REIT, we may be subject to a significant amount of U.S. federal income taxes. We intend to hold a significant amount of our assets from time to time in one or more TRSs, subject to the limitation that securities in TRSs may not represent more than 25% of our assets in order for us to remain qualified as a REIT. In general, we intend that loans that we originate or buy with an intention of selling in a manner that might expose us to the 100% tax on "prohibited transactions" will be originated or sold by a TRS. In addition, loans that are to be modified will in general be held by a TRS on the date of their modification and for a period of time thereafter. Finally, some or all of the real estate properties that we may from time to time acquire by foreclosure or other procedure will likely be held in one or more TRSs. All taxable income and gains derived from the assets held from time to time in our TRSs will be subject to regular corporate income taxation.

Dividends payable by REITs do not generally qualify for the reduced tax rates applicable to certain corporate dividends.

The maximum tax rate for dividends paid by corporations to domestic shareholders that are individuals, trusts and estates is generally 15% through taxable years beginning on or before December 31, 2010. Dividends paid by REITs, however, are generally not eligible for the reduced rates. However, to the extent such dividends are attributable to certain dividends that we receive from a TRS, such dividends generally will be eligible for the preferential tax rates that apply to qualified dividend income. Although this does not adversely affect the taxation of REITs or dividends paid by REITs, the more favorable rates applicable to regular corporate dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our common shares.

Table of Contents

The REIT distribution requirements could adversely affect our ability to execute our business strategies.

We generally must distribute annually at least 90% of our net taxable income, excluding any net capital gain, in order for corporate income tax not to apply to earnings that we distribute. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to U.S. federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a 4% nondeductible excise tax if the actual amount that we pay out to our shareholders in a calendar year is less than a minimum amount specified under U.S. federal income tax laws. We intend to make distributions to our shareholders to comply with the requirements of the Internal Revenue Code and to avoid paying corporate tax on undistributed income. However, differences in timing between the recognition of taxable income and the actual receipt of cash could require us to sell assets or borrow funds on a short-term or long-term basis to meet the distribution requirements of the Internal Revenue Code.

We may find it difficult or impossible to meet distribution requirements in certain circumstances. Due to the nature of the assets in which we will invest, we may be required to recognize taxable income from those assets in advance of our receipt of cash flow on or proceeds from disposition of such assets. For example, we may be required to accrue interest and discount income on mortgage loans, mortgage backed securities, and other types of debt securities or interests in debt securities before we receive any payments of interest or principal on such assets. We may also acquire distressed debt investments that are subsequently modified by agreement with the borrower either directly or pursuant to our involvement in the Legacy Loans Program (if established) or other similar programs that may be established by the federal government. If the amendments to the outstanding debt are "significant modifications" under the applicable Treasury regulations, the modified debt may be considered to have been reissued to us at a gain in a debt-for-debt exchange with the borrower, with gain recognized by us to the extent that the principal amount of the modified debt exceeds our cost of purchasing it prior to modification. Finally, we may be required under the terms of indebtedness that we incur to use cash received from interest payments to make principal payments on that indebtedness, with the effect of recognizing income but not having a corresponding amount of cash available for distribution to our shareholders.

As a result, to the extent such income is not recognized within a TRS, the requirement to distribute a substantial portion of our net taxable income could cause us to: (i) sell assets in adverse market conditions, (ii) borrow on unfavorable terms, (iii) distribute amounts that would otherwise be invested in future acquisitions, capital expenditures or repayment of debt or (iv) make a taxable distribution of our shares as part of a distribution in which shareholders may elect to receive shares or (subject to a limit measured as a percentage of the total distribution) cash, in order to comply with REIT requirements. Moreover, if our only feasible alternative were to make a taxable distribution of our shares to comply with the REIT distribution requirements for any taxable year and the value of our shares was not sufficient at such time to make a distribution to our shareholders in an amount at least equal to the minimum amount required to comply with such REIT distribution requirements, we would generally fail to qualify as a REIT for such taxable year and would be precluded from being taxed as a REIT for the four taxable years following the year during which we ceased to qualify as a REIT.

We may be required to report taxable income early in our holding period for certain investments in excess of the economic income we ultimately realize from them.

We expect to acquire debt instruments in the secondary market for less than their face amount. The discount at which such debt instruments are acquired may reflect doubts about their ultimate collectibility rather than current market interest rates. The amount of such discount will nevertheless generally be treated as "market discount" for U.S. federal income tax purposes. Market discount on a debt instrument accrues on the basis of the constant yield to maturity of the debt instrument based

generally on the assumption that all future payments on the debt instrument will be made. Accrued market discount is reported as income when, and to the extent that, any payment of principal of the debt instrument is made. Payments on residential mortgage loans are ordinarily made monthly, and consequently accrued market discount may have to be included in income each month as if the debt instrument were assured of ultimately being collected in full. If that turned out not to be the case, and we eventually collected less on the debt instrument than the amount we paid for it plus the market discount we had previously reported as income, there would generally be a bad debt deduction available to us at that time, but our ability to benefit from that bad debt deduction would depend on our having taxable income in that later taxable year.

Similarly, many of the MBS that we buy will likely have been issued with original issue discount, which discount might reflect doubt as to whether the entire principal amount of such MBS will ultimately prove to be collectible. We will be required to report such original issue discount based on a constant yield method and income will be accrued and currently taxable based on the assumption that all future projected payments due on such MBS will be made. If such MBS turns out not to be fully collectible, a bad debt deduction will become available only in the later year that uncollectibility is provable.

Finally, in the event that any debt instruments or MBS acquired by us are delinquent as to mandatory principal and interest payments, or in the event a borrower with respect to a particular debt instrument acquired by us encounters financial difficulty rendering it unable to pay stated interest as due, we may nonetheless be required to continue to recognize the unpaid interest as taxable income as it accrues, despite doubt as to its ultimate collectibility. Similarly, we may be required to accrue interest income with respect to subordinate MBS at its stated rate regardless of whether corresponding cash payments are received or are ultimately collectible. In each case, while we would in general ultimately have a bad debt deduction available to us when such interest was determined to be uncollectible, the utility of that deduction would depend on our having taxable income in that later year or thereafter.

REITs may not carry back net operating losses to prior taxable years, but may only carry net operating losses over to future years. Amounts corresponding to the amounts of the types of income described in this prospectus would generally have been distributed and taxed to our shareholders as a dividend when we were required to report such income. If we had no taxable income in the later year that the bad debt deduction became available, we and our shareholders would derive no tax benefit from that deduction. This possible "income early, losses later" phenomenon could, accordingly, adversely affect us and our shareholders if it were persistent and in significant amounts.

If we were to make a taxable distribution of our shares as part of a distribution in which shareholders may elect to receive shares or (subject to a limit measured as a percentage of the total distribution) cash, shareholders may be required to sell such shares or sell other assets owned by them in order to pay any tax imposed on such distribution.

If we were to make a taxable distribution of our shares, shareholders would be required to include the amount of such distribution into income even though they did not receive sufficient cash to satisfy any tax imposed on such distribution. Accordingly, shareholders receiving a distribution of our shares may be required to sell shares received in such distribution or may be required to sell other stock or assets owned by them, at a time that may be disadvantageous, in order to satisfy any tax imposed on such distribution. Moreover, in the case of a taxable distribution of our shares with respect to which any withholding tax is imposed on a shareholder, we may have to withhold or dispose of part of the shares in such distribution and use such withheld shares or the proceeds of such disposition to satisfy the withholding tax imposed.

The share ownership limits applicable to us that are imposed by the Internal Revenue Code for REITs and our declaration of trust may restrict our business combination opportunities.

In order for us to maintain our qualification as a REIT under the Internal Revenue Code, not more than 50% in value of our outstanding shares may be owned, directly or indirectly, by five or fewer individuals (as defined in the Internal Revenue Code to include certain entities) at any time during the last half of each taxable year after our first taxable year. Our declaration of trust, with certain exceptions, authorizes our board of trustees to take the actions that are necessary and desirable to preserve our qualification as a REIT. Under our declaration of trust, no person may own more than 9.8% by vote or value, whichever is more restrictive, of our outstanding common shares or more than 9.8% by vote or value, whichever is more restrictive, of our outstanding shares of beneficial interest. However, our board of trustees may, in its sole discretion, grant an exemption to the share ownership limits (prospectively or retrospectively), subject to certain conditions and the receipt by our board of certain representations and undertakings. In addition, our board of trustees may change the share ownership limits as described under "Description of Shares of Beneficial Interest Restrictions on Ownership and Transfer." Our declaration of trust also prohibits any person from (a) beneficially or constructively owning, as determined by applying certain attribution rules of the Internal Revenue Code, our shares that would result in us being "closely held" under Section 856(h) of the Internal Revenue Code or that would otherwise cause us to fail to qualify as a REIT or (b) transferring shares if such transfer would result in our shares being beneficially owned by fewer than 100 persons on or after January 29, 2010. The share ownership limits applicable to us that are imposed by the tax law are based upon direct or indirect ownership by "individuals," which term includes certain entities. Ownership limitations are common in the organizational documents of REITs and are intended, among other purposes, to provide added assurance of compliance with the tax law requirements and to minimize administrative burdens. However, our share ownership limits might also delay or prevent a transaction or a change in our control that might involve a premium price for our common shares or otherwise be in the best interests of our shareholders.

Even if we qualify as a REIT, we will face tax liabilities that reduce our cash flow.

Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, property and transfer taxes, such as mortgage recording taxes. See "U.S. Federal Income Tax Considerations Taxation of Our Company Taxation of REITs in General." Any of these taxes would decrease cash available for distribution to our shareholders. In addition, in order to meet the REIT qualification requirements, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we will hold a significant portion of our assets through, and derive a significant portion of our taxable income and gains in, TRSs. Such subsidiaries will be subject to corporate level income tax at regular rates.

Complying with the REIT requirements can be difficult and may cause us to forego otherwise attractive opportunities.

To qualify as a REIT for U.S. federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our shareholders and the ownership of our shares. We may be required to make distributions to our shareholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with the REIT requirements may hinder our ability to make certain attractive investments.

Complying with the REIT requirements may force us to liquidate otherwise attractive investments.

To qualify as a REIT, we must ensure that, at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified REIT real estate assets, including certain mortgage loans and MBS. The remainder of our investments in securities (other than government securities and qualified real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our total assets (other than government securities, securities issued by a TRS and qualified real estate assets) can consist of the securities of any one issuer, and no more than 25% of the value of our total securities can be represented by securities of one or more TRSs. See "U.S. Federal Income Tax Considerations Taxation of Our Company Asset Tests." After meeting these requirements at the close of a calendar quarter, if we fail to comply with these requirements at the end of any subsequent calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate from our portfolio otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our shareholders.

Liquidation of assets may jeopardize our REIT qualification.

To continue to qualify as a REIT, we must comply with requirements regarding our assets and our sources of income. If we are compelled to liquidate our investments to repay obligations to our lenders, we may be unable to comply with these requirements, ultimately jeopardizing our qualification as a REIT, or we may be subject to a 100% tax on any resultant gain if we sell assets that are treated as dealer property or inventory.

Complying with the REIT requirements may limit our ability to hedge effectively.

The REIT provisions of the Internal Revenue Code may limit our ability to hedge our assets and operations. Under current law, any income that we generate from transactions intended to hedge our interest rate, inflation and/or currency risks will be excluded from gross income for purposes of the REIT 75% and 95% gross income tests described below if the instrument hedges (i) interest rate risk on liabilities incurred to carry or acquire real estate or (ii) risk of currency fluctuations with respect to any item of income or gain that would be qualifying income under the REIT 75% or 95% gross income tests, and such instrument is properly identified under applicable Treasury Regulations. Income from hedging transactions that do not meet these requirements will generally constitute nonqualifying income for purposes of both the REIT 75% and 95% gross income tests. As a result of these rules, we may have to limit our use of hedging techniques that might otherwise be advantageous, which could result in greater risks associated with interest rate or other changes than we would otherwise be subject to.

If our operating partnership failed to qualify as a partnership for U.S. federal income tax purposes, we could fail to qualify as a REIT and suffer other adverse consequences.

We believe that our operating partnership is organized and will be operated in a manner so as to be treated as a partnership, and not an association or publicly traded partnership taxable as a corporation, for U.S. federal income tax purposes. As a partnership, it will not be subject to U.S. federal income tax on its income. Instead, each of its partners, including us, will be allocated its share of our operating partnership's income. No assurance can be provided, however, that the Internal Revenue Service will not challenge its status as a partnership for U.S. federal income tax purposes, or that a court would not sustain such a challenge. If the Internal Revenue Service were successful in treating our operating partnership as an association or publicly traded partnership taxable as a

corporation for U.S. federal income tax purposes, we could fail to meet the gross income tests and certain of the asset tests applicable to REITs and, accordingly, could cease to qualify as a REIT. Also, the failure of our operating partnership to qualify as a partnership would cause it to become subject to federal corporate income tax, which would reduce significantly the amount of its cash available for debt service and for distribution to its partners, including us. See "U.S. Federal Income Tax Considerations Taxation of Our Company Effect of Subsidiary Entities" for more information.

The taxable mortgage pool, or TMP, rules may increase the taxes that we or our shareholders may incur, and may limit the manner in which we effect future securitizations.

Certain of our securitizations in the future, if any, will likely be considered to result in the creation of TMPs for U.S. federal income tax purposes. A TMP is always classified as a corporation for U.S. federal income tax purposes. However, as long as a REIT owns 100% of a TMP, such classification generally does not result in the imposition of corporate income tax, because the TMP is a "qualified REIT subsidiary." The requirement that a TMP be wholly owned by a REIT to be a qualified REIT subsidiary means that we would be precluded from holding equity interests in such a TMP through our operating partnership if the TMP were a U.S. entity that would be subject to taxation as a domestic corporation, unless our operating partnership itself formed another subsidiary REIT to own the TMP.

In the case of such wholly REIT owned TMPs, certain categories of our shareholders, such as foreign shareholders otherwise eligible for treaty benefits, shareholders with net operating losses, and tax exempt shareholders that are subject to unrelated business income tax, could be subject to increased taxes on a portion of their dividend income received from us that is attributable to the TMP or "excess inclusion income." In addition, to the extent that our shares are owned in record name by tax exempt "disqualified organizations," such as certain government related entities that are not subject to tax on unrelated business income, we may incur a corporate level tax on our allocable portion of excess inclusion income from such a wholly REIT owned TMP. In that case and to the extent feasible, we may reduce the amount of our distributions to any disqualified organization whose share ownership gave rise to the tax, or we may bear such tax as a general corporate expense. To the extent that our shares owned by disqualified organizations are held in record name by a broker/dealer or other nominee, the broker/dealer or other nominee would be liable for the corporate level tax on the portion of our excess inclusion income allocable to the shares held by the broker/dealer or other nominee on behalf of disqualified organizations. While we intend to attempt to minimize the portion of our distributions that is subject to these rules, the law is unclear concerning computation of excess inclusion income, and its amount could be significant. See "U.S. Federal Income Tax Considerations Taxation of Our Company Taxable Mortgage Pools and Excess Inclusion Income" and "U.S. Federal Income Tax Considerations Taxation of Shareholders Taxation of Tax Exempt Shareholders."

In the case of any TMP that would be taxable as a domestic corporation if it were not wholly REIT owned, we would be precluded from selling equity interests in these securitizations to outside investors, or selling any debt securities issued in connection with these securitizations that might be considered to be equity interests for tax purposes. This marketing limitation may prevent us from selling more junior or non investment grade debt securities in such securitizations and maximizing our proceeds realized in those offerings.

The tax on prohibited transactions will limit our ability to engage in transactions, including certain methods of securitizing mortgage loans, that would be treated as sales for U.S. federal income tax purposes.

A REIT's net income from prohibited transactions is subject to a 100% tax. In general, prohibited transactions are sales or other dispositions of property, other than foreclosure property, but

including mortgage loans, held primarily for sale to customers in the ordinary course of business. We might be subject to this tax if we were to dispose of or securitize loans in a manner that was treated as a sale of the loans for U.S. federal income tax purposes. Therefore, in order to avoid the prohibited transactions tax, we may choose to engage in certain sales of loans through a TRS and not at the REIT level, and may limit the structures we utilize for our securitization transactions, even though the sales or structures might otherwise be beneficial to us. We may hold a substantial amount of assets in one or more TRSs that are subject to corporate income tax on its earnings, which may reduce the cash flow generated by us and our subsidiaries in the aggregate, and our ability to make distributions to our shareholders.

New legislation or administrative or judicial action, in each instance potentially with retroactive effect, could make it more difficult or impossible for us to qualify as a REIT.

The present U.S. federal income tax treatment of REITs may be modified, possibly with retroactive effect, by legislative, judicial or administrative action at any time, which could affect the U.S. federal income tax treatment of an investment in our common shares. The U.S. federal tax rules that affect REITs constantly are under review by persons involved in the legislative process, the Internal Revenue Service and the U.S. Treasury Department, which results in statutory changes as well as frequent revisions to Treasury regulations and interpretations. Revisions in U.S. federal tax laws and interpretations thereof could cause us to change our investments and commitments, which could also affect the tax considerations of an investment in our common shares.

Risks Related to this Offering

There may not be an active market for our common shares, which may cause our common shares to trade at a discount and make it difficult for purchasers in this offering to sell their shares.

Prior to this offering, there has been no public market for our common shares. The initial public offering price for our common shares will be determined by negotiations between the underwriters and us. We cannot assure you that the initial public offering price will correspond to the price at which our common shares will trade in the public market subsequent to this offering or that the price of our shares available in the public market will reflect our actual financial performance.

We have applied to have our common shares listed on the NYSE, under the symbol "PMT." Listing on the NYSE would not ensure that an actual market will develop for our common shares. Accordingly, no assurance can be given as to:

- the likelihood that an active trading market for our common shares will develop or, if one develops, be maintained;
- the liquidity of any market for our common shares;
- the ability of our shareholders to sell our common shares when desired, or at all; or
- the price that a shareholder may obtain for such shareholder's common shares.

Even if an active market develops for our common shares, the market price for our common shares may be highly volatile and subject to wide fluctuations. Some of the factors that could negatively affect our share price include:

- actual or projected results of operations;
- actual or projected financial condition, cash flows and liquidity;
- actual or anticipated changes in business strategies or prospects;

67

Table of Contents

- actual or perceived conflicts of interest with PCM and its affiliated entities and individuals, including our officers;
- equity issuances by us, or share resales by our shareholders, or the perception that such issuances or resales may occur;
- actual or anticipated accounting problems;
- publication of research reports about us or the real estate finance industry;
- our failure to meet, or the lowering of, our earnings' estimates or those of any securities analysts;
- increases in market interest rates, which may lead investors to demand a higher distribution yield for our common shares, if we have begun to make distributions to our shareholders, and would result in increased interest expenses on our debt;
- changes in market valuations of similar companies;
- adverse market reaction to the level of leverage we employ;
- failure to maintain our REIT qualification or exclusion from the Investment Company Act;
- additions or departures of PCM's key personnel, including our officers, or a change in control of PCM;
- actions by significant shareholders;
- speculation in the press or investment community;
- price and volume fluctuations in the stock market generally;
- general market and economic conditions, including the current state of the credit and capital markets;
- changes in current or proposed legislation;
- increased competition in the residential real estate mortgage business; and
- other events or circumstances which undermine confidence in the financial markets or otherwise have a broad impact on financial markets, such as the sudden instability or collapse of large depository institutions or other significant corporations, terrorist attacks, natural or man-made disasters, or threatened or actual armed conflicts.

No assurance can be given that the market price of our common shares will not fluctuate or decline significantly in the future or that holders of our common shares will be able to sell their shares when desired on favorable terms, or at all.

Future issuances of debt securities, which would rank senior to our common shares upon our liquidation, and future issuances of equity securities, which would dilute the holdings of our existing shareholders and may be senior to our common shares for the purposes of making distributions, including liquidating distributions, may adversely affect the market price of our common shares.

In the future, we may issue debt or equity securities or make other borrowings. Upon liquidation, holders of our debt securities and other loans and preferred shares will receive a distribution of our available assets before holders of our common shares. We are not required to offer any such additional debt or equity securities to existing shareholders on a preemptive basis. Therefore, additional common share issuances, directly or through convertible or exchangeable securities, warrants

or options, will generally dilute the holdings of our existing shareholders and may reduce the market price of our common shares. Our preferred shares, if issued, would likely have a preference on distribution payments, including liquidating distributions, which could limit our ability to make distributions, including liquidating distributions, to holders of our common shares. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, holders of our common shares bear the risk that our future issuances of debt or equity securities or other borrowings will reduce the market price of our common shares and dilute their ownership in us.

Future issuances and sales of our common shares may depress the market price of our common shares. You should not rely upon lockup agreements in connection with this offering to limit the amount of common shares sold into the market.

Subject to applicable law, our board of trustees has the authority, without further shareholder approval, to issue additional common shares and preferred shares on the terms and for the consideration it deems appropriate. We cannot predict the effect, if any, of future issuances of our common shares or the prospect of such issuances on the market price of our common shares. Issuances of a substantial amount of our common shares, or the perception that such issuances might occur, could depress the market price of our common shares.

Upon the completion of this offering, we will have common shares outstanding, on a fully diluted basis, assuming common shares are sold in the direct offering and including an aggregate of (i) restricted common shares to be granted to our executive officers and other employees of PCM and/or PLS under our equity incentive plan and (ii) 9,000 restricted common shares to be granted to our independent trustees under our equity incentive plan, or common shares if the underwriters' overallotment option is exercised in full.

Concurrently with this offering, we will sell to certain of our executive officers, an affiliate of BlackRock, Highfields Capital and PNMAC, in a separate private placement, 5% of our outstanding common shares after giving effect to the common shares issued in this offering, excluding common shares that may be sold pursuant to the underwriters' overallotment option, and subject, in all cases, to a maximum purchase of $40 million of our common shares at a price per share equal to the initial public offering price per share in this offering. In addition, investors in the PennyMac funds may purchase our common shares in the direct offering, at a price per share equal to the initial public offering price per share.

We, and each of our executive officers, our trustees and our trustee nominees have agreed with the underwriters not to offer, sell or otherwise dispose of any common shares or any securities convertible into or exercisable or exchangeable for common shares or any rights to acquire common shares for a period of 180 days after the date of this prospectus, without the prior written consent of the representatives, subject to specific limited exceptions. Purchasers of our common shares in our concurrent offering (including certain of our executive officers, an affiliate of BlackRock, Highfields Capital and PNMAC) have also agreed with the underwriters not to sell or otherwise dispose of the common shares that they purchase in our concurrent offering for a period of three years after the date of this prospectus. The representatives may, in their sole discretion, at any time from time to time and without notice, waive the terms and conditions of the lockup agreements to which it is a party. Assuming no exercise of the underwriters' overallotment option to purchase additional shares, approximately % of our common shares are subject to lockup agreements. When the lockup periods expire, these common shares will become eligible for sale, in some cases subject to the requirements of Rule 144 under the Securities Act, which are described under "Shares Eligible for Future Sale Rule 144."

Table of Contents

We will enter into a registration rights agreement with the purchasers of our common shares in our concurrent offering pursuant to which we will agree to register the resale of such common shares. We will also grant such purchasers the right to include these shares in any registration statements we may file in connection with any future public offerings, subject to the terms of the lockup arrangements described herein and subject to the right of the underwriters of those offerings to reduce the total number of secondary shares included in those offerings (with such reductions to be proportionately allocated among the selling shareholders participating in those offerings). Following the completion of this offering, we intend to file a registration statement on Form S-8 to register the total number of common shares that may be issued under our equity incentive plan, including the restricted common shares to be granted to our executive officers, other employees of PCM and/or PLS and our independent trustees. In addition, in the event that we issue any common shares under our equity incentive plan to PCM, PLS or any other entity that provides services to us, we will agree to register the resale of such common shares. See "Shares Eligible for Future Sale Registration Rights." Upon registration, these common shares will be eligible for sale without restriction.

After the closing of this offering, we may issue additional common shares and securities convertible into, or exchangeable or exercisable for, common shares under our equity incentive plan.

We also may issue from time to time additional common shares in connection with property, portfolio or business acquisitions and may grant demand or piggyback registration rights in connection with such issuances.

We have not established a minimum distribution payment level and we may be unable to generate sufficient cash flows from our operations to make distributions to our shareholders at any time in the future.

We are generally required to distribute to our shareholders at least 90% of our taxable income each year for us to qualify as a REIT under the Internal Revenue Code, which requirement we currently intend to satisfy. To the extent we satisfy the 90% distribution requirement but distribute less than 100% of our taxable income, we will be subject to U.S. federal corporate income tax on our undistributed taxable income. We have not established a minimum distribution payment level, and our ability to make distributions to our shareholders may be adversely affected by the risk factors described in this prospectus. Although we anticipate initially making quarterly distributions to our shareholders, our board of trustees has the sole discretion to determine the timing, form and amount of any distributions to our shareholders, and such determination will depend upon, among other factors, our historical and projected results of operations, financial condition, cash flows and liquidity, maintenance of our REIT qualification and other tax considerations, capital expenditure and other expense obligations, debt covenants, contractual prohibitions or other limitations and applicable law and such other matters as our board of trustees may deem relevant from time to time.

Among the factors that could impair our ability to make distributions to our shareholders are:

- our inability to invest the proceeds of this offering, our concurrent offering and the direct offering (if any);
- our inability to make attractive risk-adjusted returns on our future investments;
- unanticipated expenses that reduce our cash flow or non-cash earnings;
- defaults in our investment portfolio or decreases in its value; and
- the fact that anticipated operating expense levels may not prove accurate, as actual results may vary from estimates.

Table of Contents

As a result, no assurance can be given that we will be able to make distributions to our shareholders at any time in the future or that the level of any distributions we do make to our shareholders will achieve a market yield or increase or even be maintained over time, any of which could materially and adversely affect the market price of our common shares.

In addition, distributions that we make to our shareholders will generally be taxable to our shareholders as ordinary income. However, a portion of our distributions may be designated by us as long-term capital gains to the extent that they are attributable to capital gain income recognized by us or may constitute a return of capital to the extent that they exceed our earnings and profits as determined for tax purposes. A return of capital is not taxable, but has the effect of reducing the basis of a shareholder's investment in our common shares.

Investing in our common shares may involve a high degree of risk.

The investments we make in accordance with our investment objective may result in a high amount of risk when compared to alternative investment options and volatility or loss of principal. Our investments may be highly speculative and aggressive, and therefore an investment in our common shares may not be suitable for someone with lower risk tolerance.

Broad market fluctuations could negatively impact the market price of our common shares.

The stock market has experienced extreme price and volume fluctuations that have affected the market price of many companies in industries similar or related to ours and that have been unrelated to these companies' operating performances. These broad market fluctuations could reduce the market price of our common shares. Furthermore, our operating results and prospects may be below the expectations of public market analysts and investors or may be lower than those of companies with comparable market capitalizations, which could lead to a material decline in the market price of our common shares.

Table of Contents

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This prospectus 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," "project," "predict," "continue," "plan" or other similar words or expressions. Forward-looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain financial and operating projections or state other forward-looking information. 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. Factors that could have a material adverse effect on our business, financial condition, cash flows, liquidity, results of operations and prospects include, but are not limited to:

- the factors referenced in this prospectus, including those set forth under the section captioned "Risk Factors";
- expectations regarding the timing of generating any revenues;
- changes in our investment objective or investment or operational strategy;
- volatility in our industry, interest rates and spreads, the debt or equity markets, the general economy or the residential finance and real estate markets specifically, whether the result of market events or otherwise;
- events or circumstances which undermine confidence in the financial markets or otherwise have a broad impact on financial markets, such as the sudden instability or collapse of large depository institutions or other significant corporations, terrorist attacks, natural or man-made disasters, or threatened or actual armed conflicts;
- continued declines in residential real estate;
- the availability of attractive risk-adjusted investment opportunities in residential mortgage loans and mortgage-related assets that satisfy our investment objective and investment strategies;
- the concentration of credit risks to which we are exposed;
- changes to the proposed structure of the Legacy Loans Program, the implementation of which has been delayed and which may not be established at all, the extent to which depository institutions will participate in the program, its ultimate impact on the market for residential mortgage loans and our ability to win a bid on any assets being sold in connection with the Legacy Loans Program;
- the degree and nature of our competition;
- the availability, terms and deployment of short-term and long-term capital;

the adequacy of our cash reserves and working capital;

our dependence on PCM and potential conflicts of interest with PCM and its affiliated entities;

changes in personnel and lack of availability of qualified personnel;

our ability to match the interest rates and maturities of our assets with our financing;

the timing of cash flows, if any, from our investments;

- our ability to obtain financing or the use of proceeds from this offering, our concurrent offering and the direct offering (if any);
- unanticipated increases in financing and other costs, including a rise in interest rates;
- the performance, financial condition and liquidity of borrowers;
- increased rates of default and/or decreased recovery rates on our investments;
- increased prepayments of the mortgage and other loans underlying our MBS and other investments;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- our failure to maintain appropriate internal controls over financial reporting;
- estimates relating to our ability to make distributions to our shareholders in the future;
- changes in governmental regulations, accounting treatment, tax rates and similar matters;
- legislative and regulatory changes (including changes to laws governing the taxation of REITs or the exclusions from registration as an investment company); and
- limitations imposed on our business and our ability to satisfy complex rules in order for us to qualify as a REIT for U.S. federal income tax purposes and qualify for an exclusion from the Investment Company Act and the ability of certain of our subsidiaries to qualify as REITs and certain of our subsidiaries to qualify as TRSs for U.S. federal income tax purposes, and our ability and the ability of our subsidiaries to operate effectively within the limitations imposed by these rules.

When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this prospectus. Readers are cautioned not to place undue reliance on any of these forward-looking statements, which reflect our views as of the date of this prospectus. The matters summarized under "Summary," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Business" and elsewhere in this prospectus could cause our actual results and performance to differ significantly from those contained in our forward-looking statements. Accordingly, we cannot guarantee future results or performance. Furthermore, except as required by law, we are under no duty to, and we do not intend to, update any of our forward-looking statements after the date of this prospectus, whether as a result of new information, future events or otherwise.

Table of Contents

USE OF PROCEEDS

We estimate that the net proceeds we will receive from this offering will be approximately $ million (or approximately $ million if the underwriters exercise their overallotment option in full), in each case assuming an initial public offering price of $15.00 per share and after deducting underwriting discounts of approximately $ (or approximately $ if the underwriters exercise their overallotment option in full), and estimated organization and offering expenses of approximately $ million payable by us.

Concurrently with this offering, we will sell to certain of our executive officers, an affiliate of BlackRock, Highfields Capital and PNMAC, in a separate private placement, 5% of our outstanding common shares after giving effect to the common shares issued in this offering, excluding common shares that may be sold pursuant to the underwriters' overallotment option, and subject, in all cases, to a maximum purchase of $40 million of our common shares at a price per share equal to the initial public offering price per share in this offering. In addition, investors in the PennyMac funds may purchase our common shares in the direct offering, at a price per share equal to the initial public offering price per share. Assuming of our common shares are sold in the direct offering, we will receive proceeds of $ million. No underwriting discounts will be payable in connection with these other offerings.

We intend to use the net proceeds of this offering, our concurrent offering and the direct offering (if any) in accordance with our investment objective and strategies pursuant to which we will invest primarily in residential mortgage loans and mortgage-related assets. Based on current market conditions, our primary focus initially will be on distressed mortgage loans and, to a lesser extent, on other mortgage-related assets. As market conditions improve, our focus will expand to include other types of assets in our targeted asset classes. At all times, we will seek to take advantage of attractive investment opportunities that may arise in our targeted asset classes. Prior to the full investment of the offering proceeds into our targeted asset classes, we may make investments in high grade, short-term securities, such as securities guaranteed by Ginnie Mae, securities issued and guaranteed by Freddie Mac or Fannie Mae, short-term money market funds, including BlackRock-sponsored money market funds, as well as cash equivalents for temporary cash management, consistent with our intention to qualify as a REIT. These investments are expected to provide a lower rate of return than we will seek from the implementation of our investment strategies. Prior to the time we have fully invested the net proceeds of this offering, our concurrent offering and the direct offering (if any), we may fund quarterly distributions out of such net proceeds. To the extent we raise more proceeds in such offerings, we will make more investments. To the extent we raise less proceeds in such offerings, we will make fewer investments.

Table of Contents

DISTRIBUTION POLICY

To qualify as a REIT so that U.S. federal income tax generally does not apply to our earnings to the extent distributed to shareholders, we must, in addition to meeting other requirements, annually distribute to our shareholders an amount at least equal to (i) 90% of our REIT taxable income (determined before the deduction for dividends paid and excluding any net capital gain), plus (ii) 90% of the excess of our net income from foreclosure property (as defined in the Internal Revenue Code) over the tax imposed on such income by the Internal Revenue Code, less (iii) any excess non-cash income (as determined under the Internal Revenue Code). We are subject to income tax on income that is not distributed to our shareholders, and to an excise tax to the extent that certain percentages of our income are not distributed to our shareholders by specified dates.

To the extent that, in respect of any calendar year, cash available for distribution is less than our REIT taxable income, we could be required to sell assets or borrow funds to make cash distributions or make a portion of the required distribution in the form of a taxable share distribution or distribution of debt securities. In addition, prior to the time we have fully invested the net proceeds of this offering, our concurrent offering and the direct offering (if any) we may fund our quarterly distributions out of such net proceeds. The use of our net proceeds for distributions could be dilutive to our financial results. In addition, funding our distributions from our net proceeds may constitute a return of capital to our investors, which would have the effect of reducing each shareholder's basis in its common shares. We will generally not be required to make distributions with respect to activities conducted through any domestic TRS that we form following the completion of this offering. See "U.S. Federal Income Tax Considerations Taxation of Our Company Annual Distribution Requirements." Income as computed for purposes of the foregoing tax rules will not necessarily correspond to our income as determined for financial reporting purposes.

Although we anticipate initially making quarterly distributions to our shareholders, the timing, form and amount of any distributions to our shareholders will be at the sole discretion of our board of trustees and will depend upon a number of factors, including, but not limited to:

- our actual and projected results of operations;
- our actual and projected financial condition, cash flows and liquidity;
- our business and prospects;
- our operating expenses;
- our capital expenditure requirements;
- our debt service requirements;
- borrowings under temporary programs established by the U.S. government, such as the Public-Private Investment Program;
- restrictive covenants in our financing or other contractual arrangements;
- restrictions under Maryland law;
- the timing of the investment of our capital;

our taxable income;

the annual distribution requirements under the REIT provisions of the Internal Revenue Code; and

such other factors as our board of trustees deems relevant.

Subject to the distribution requirements referred to in the immediately preceding paragraph, we intend, to the extent practicable, to invest substantially all of the proceeds from repayments, sales and refinancings of our assets in accordance with our investment objective and strategies. We may, however, in the sole discretion of our board of trustees, make a distribution of capital or of assets or a taxable distribution of our shares (as part of a distribution in which shareholders may elect to receive shares or (subject to a limit measured as a percentage of the total distribution) cash). We intend to make distributions in cash to the extent that cash is available for such purpose.

We anticipate that distributions generally will be taxable as ordinary income to our non-exempt shareholders, although a portion of such distributions may be designated by us as long-term capital gain or qualified dividend income or may constitute a return of capital. To the extent that we decide to make distributions in excess of taxable income, such excess distributions generally will be considered a return of capital. In addition, if we own a securitization financing that is treated as a TMP, a portion of our distributions may constitute "excess inclusions." We will furnish annually to each of our shareholders a statement setting forth the distributions paid during the preceding year and their U.S. federal income tax status. For a discussion of the U.S. federal income tax treatment of distributions by us, see "U.S. Federal Income Tax Considerations Taxation of Our Company Taxation of REITs in General," "U.S. Federal Income Tax Considerations Taxation of Our Company Annual Distribution Requirements," "U.S. Federal Income Tax Considerations Taxation of Our Company Taxable Mortgage Pools and Excess Inclusion Income" and "U.S. Federal Income Tax Considerations Taxation of Shareholders."

Table of Contents

CAPITALIZATION

The following table sets forth (1) our actual capitalization at May 19, 2009 and (2) our capitalization as adjusted to reflect the effects of the sale of our common shares in this offering at an assumed initial public offering price of $15.00 per share after deducting the underwriting discounts and estimated organizational and offering expenses payable by us, the sale of common shares in the direct offering at a price per share equal to the assumed initial public offering price of $15.00 per share and the sale of common shares in our concurrent offering at a price per share equal to the initial public offering price per share in this offering. You should read this table together with "Use of Proceeds" included elsewhere in this prospectus.

	As of May 19, 2009	
	Actual	As Adjusted(1)(2)(3)
Shareholders' equity:		
Common shares, par value $0.01 per share; 5,000,000 shares authorized, 1,000 shares outstanding, actual and 500,000,000 common shares authorized and common shares outstanding, as adjusted	$ 10	$
Additional paid-in capital	990	
Total shareholders' equity	$1,000	$

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(1) Assumes shares will be sold in this offering at an initial public offering price of $15.00 per share for net proceeds of approximately $ million after deducting the underwriting discounts and estimated organizational and offering expenses of approximately $ million, the sale of common shares in the direct offering at a price per share equal to the assumed initial public offering price of $15.00 per share and the sale of common shares in our concurrent offering. The common shares sold in the direct offering and our concurrent offering will be sold without payment of any underwriting discounts. See "Use of Proceeds."

(2) Does not include the underwriters' option to purchase up to additional common shares.

(3) Does not include (i) restricted common shares to be granted to our executive officers and other employees of PCM and/or PLS under our equity incentive plan upon the completion of this offering, (ii) 9,000 restricted common shares to be granted to our independent trustees under our equity incentive plan upon the completion of this offering or (iii) of our common shares available for future grant under our equity incentive plan. See "Management Equity Incentive Plan."

Table of Contents

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are a newly-formed specialty finance company that will invest primarily in residential mortgage loans and mortgage-related assets. Our objective is to provide attractive risk-adjusted returns to our investors over the long-term, primarily through dividends and secondarily through capital appreciation. We intend to achieve this objective by investing in mortgage loans, a substantial portion of which may be distressed and acquired at discounts to their unpaid principal balances. We will then seek to maximize the value of the mortgage loans that we acquire through proprietary loan modification programs, special servicing and other initiatives focused on keeping borrowers in their homes. We also may invest in mortgage-related securities and other real estate and financial assets. It is anticipated that these securities and assets will not be rated by any rating agency. We will be externally managed by PCM, an SEC-registered investment adviser that specializes in, and focuses on, residential mortgage loans.

We will rely on PennyMac's expertise in identifying pools of distressed mortgage loans and other assets for acquisition. PCM's sourcing and evaluation processes for potential acquisitions of residential mortgage loans and for mortgage-related assets are substantially similar. We expect that PCM will make investment decisions based on various factors, including expected cash yield, relative value, risk-adjusted returns, current and projected credit fundamentals, current and projected macroeconomic considerations, current and projected supply and demand, market risk, portfolio diversification, liquidity and availability and terms of financing, as well as maintaining our REIT qualification and our exclusion from registration under the Investment Company Act. We have not yet made any investments. The evaluation process with respect to RMBS and MBS will also include relative value analyses based on yield, credit rating, average life, effective duration, option-adjusted spreads, prepayment assumptions and credit exceptions. In addition, PCM and its affiliates will evaluate new opportunities based on their relative expected returns compared to comparable assets held in our portfolio. Investment decisions with regard to the acquisition or disposition of any of our targeted assets are made by PCM's investment committee.

Over time, we will reevaluate our investment strategy as market conditions change with a view toward maximizing the returns from our investment portfolio and identifying dislocations in the mortgage market, including continuing opportunities resulting from the collapse of the independent mortgage company business model, as described in "Business Our Investment Strategy." We believe this strategy, combined with the experience of PennyMac's senior management team and PCM's proprietary operational platform and tools, will benefit us during various interest rate and credit cycles and capital market conditions and provide attractive long-term returns to our investors.

We are organized as a Maryland real estate investment trust. A wholly-owned subsidiary of ours is the sole general partner of our operating partnership, and we intend to conduct substantially all of our operations, and make substantially all of our investments, through our operating partnership. Upon the completion of this offering, our concurrent offering and the direct offering (if any), we will contribute to our operating partnership the net proceeds of these offerings as our initial capital contribution in exchange for all of the limited partnership interests and, indirectly, the general partner interest in our operating partnership.

Income Taxation

In connection with this offering, we intend to elect to be treated as a REIT under Sections 856 through 859 of the Internal Revenue Code commencing with our taxable year ending on December 31, 2009. Our qualification as a REIT depends upon our ability to meet on a continuing basis, through

Table of Contents

actual investment and operating results, various complex requirements under the Internal Revenue Code relating to, among other things, the sources of our gross income, the composition and values of our assets, our distribution levels and the diversity of ownership of our shares. We believe that we will be organized in conformity with the requirements for qualification and taxation as a REIT under the Internal Revenue Code, and that our intended manner of operation will enable us to meet the requirements for qualification and taxation as a REIT.

As a REIT, we generally will not be subject to U.S. federal income tax on our REIT taxable income we distribute currently to our shareholders. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to U.S. federal income tax at regular corporate rates and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year during which we lost our REIT qualification. Even if we qualify for taxation as a REIT, we may be subject to some U.S. federal, state and local taxes on our income or property. In addition, subject to maintaining our qualification as a REIT, a significant portion of our business is expected to be conducted through, and a portion of our income may be earned in, one or more TRSs that are subject to corporate income taxation. Changes in the market values of mortgage loans and other assets that may be held by our TRSs may result in gain (or loss) and, accordingly, increases (or decreases) in the amount of corporate income taxes paid.

Reporting Metrics

Income. We expect our primary sources of income will be:

- net interest income;
- realized gain or loss on the sale of mortgage loans or securities; and
- unrealized appreciation or depreciation on loans and trading securities.

We expect our results of operations to be affected by various factors, many of which are beyond our control. Generally, we expect that our mortgage loan portfolio may grow at an uneven pace, as opportunities to acquire distressed mortgage loans may be irregularly timed and may involve large portfolios of loans, and the timing and extent of our success in acquiring such loans cannot be predicted. This factor may cause our income to be depressed while our capital is being fully deployed.

In addition, following the acquisition of a mortgage loan portfolio, our income may be negatively affected by our loan modifications to the extent that the loan modifications reduce the principal amount or stated interest rates on loans and thereby reduce interest income; by our foreclosures on loans where PennyMac is unable to modify the loans on acceptable terms; and by other losses on defaulted loans. We expect that these activities will primarily commence in the first periods after we acquire a portfolio.

Net Interest Income. Interest income represents interest earned on our residential mortgage loans and mortgage-related assets. We anticipate that the primary contributing elements of our interest income will be the size of our mortgage loan portfolio, the timing of purchases of such loans, the level and changes of interest rates, prepayment speeds and the payment performance of borrowers.

We expect that interest expense will be driven by the size of our mortgage loan portfolio, the leverage employed and borrowing rates. Borrowing rates in turn will be dependent on market conditions, which are beyond our control, as well as the specific debt vehicle employed and the terms we are able to negotiate. Currently, we anticipate utilizing limited leverage on our portfolio and, accordingly, do not expect interest expense to materially affect our results of operations.

Realized Gain or Loss on Sale. When we sell our mortgage loans or securities, we will record a gain or loss which will be determined by the nature and terms of the disposition transaction. We

expect that we will not be in a position to dispose of our mortgage loans following modification until adequate time has passed to establish a satisfactory payment history. As a result, our ability to realize gain on our modified loans will be correspondingly deferred and we do not expect that our initial period of operations will include material levels of disposition transactions with regard to modified loans. In addition, as a result of our fair value accounting, in the event of a loan modification, we will incur realized gain (or loss) to the extent that the fair value of the modified loan exceeded (or was less than) the fair value of the loan prior to modification.

Unrealized Appreciation or Depreciation. Many of our assets, including our mortgage loans, will be carried at fair value. Accordingly, changes in the fair value will impact the results of our operations for the period in which such change in value occurs, and these changes may be material. The expectation of changes in home prices is a major determinant of the value of residential mortgage loans. This factor is beyond our control.

Expenses. We expect to incur management and incentive fees payable to PCM that will be determined based upon our equity and profitability, among other factors. We also expect to incur loan servicing, origination and other fees payable to PLS that will be determined by the size of our mortgage loan portfolio, the characteristics of our loans and the volumes of loan modifications and refinancing, among other factors. The expenses we incur that are payable to PCM and PLS will be computed in accordance with the agreements entered into with PCM and PLS and described under "Our Manager and the Management Agreement Management Agreement" and "Certain Relationships and Related Transactions Loan Servicing Agreement." We will also incur ongoing operating and administrative expenses necessary to conduct our business. In connection with investigating portfolios for acquisition, we anticipate that we will be obligated to reimburse PCM's upfront expenses related to due diligence, credit and collateral evaluation and the costs to board the loans onto PCM's and PLS's systems. In some cases, these costs may not be reimbursable by the selling party if PCM's bidding efforts are not successful.

Other Factors Impacting Our Results

Fair Value of Our Assets. Many of our assets, including our mortgage loans, will be carried at fair value. Accordingly, changes in the fair value will impact the results of our operations for the period in which such change in value occurs. The expectation of changes in home prices is a major determinant of the value of residential mortgage loans. This factor is beyond our control.

Prepayment Speeds. Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, vary according to interest rates, the type of investment, conditions in the financial markets, competition and other factors, none of which can be predicted with any certainty. In general, when interest rates rise, it is relatively less attractive for borrowers to refinance their mortgage loans and, as a result, prepayment speeds tend to decrease. This can extend the period over which we earn interest income. When interest rates fall, prepayment speeds tend to increase, thereby decreasing the period over which we earn interest income.

Rising Interest Rate Environment. Rising interest rates increase our financing costs which may result in a net negative impact on our net interest income. With respect to our future floating rate investments, such interest rate increases should result in increases in our net interest income because our floating rate assets will likely be greater in amount than the related floating rate liabilities. Similarly, such an increase in interest rates should generally result in an increase in our net interest income on future fixed-rate investments made by us because our fixed-rate assets would be greater in amount than our fixed-rate liabilities. We expect, however, that our fixed-rate assets would decline in value in a rising interest rate environment and that our net interest spreads on fixed rate assets could

decline in a rising interest rate environment to the extent such assets are financed with floating rate debt.

Risk Management Effectiveness Credit Risk. We are subject to the risk of potential credit losses on all of the residential mortgage loans we hold in our portfolio, particularly those that are sub-performing or non-performing. Additionally, we may purchase all classes of certain RMBS securities for the purpose of maintaining our exclusion from the Investment Company Act, and thereby will have the credit exposure on all of the loans underlying these RMBS. Prior to the purchase of these securities, we intend to conduct due diligence that allows us to identify loans that do not meet our credit standards based on loan-to-value ratios, borrowers' credit scores, income and asset documentation and other criteria that we believe to be important indications of credit risk. In the event that we identify such loans, we intend to either price the securities to our expectation of value or decline purchase of the RMBS.

Risk Management Effectiveness Interest Rate Risk. Since changes in interest rates may significantly affect our activities, our operating results will depend, in large part, upon our ability to effectively manage interest rate risk and prepayment risks while maintaining our status as a REIT and our exclusion from the Investment Company Act.

Size of Investment Portfolio. The size of our investment portfolio, as measured by the aggregate unpaid principal balance of our mortgage loans and aggregate principal balance of our mortgage-related securities and the other assets we own will also be a key revenue driver. Generally, as the size of our investment portfolio grows, the amount of interest income we receive will increase. The larger investment portfolio, however, will drive increased expenses to the extent that we incur additional interest expense to finance the purchase of our assets.

Critical Accounting Policies

Our financial statements will be prepared in accordance with GAAP. These accounting principles may require us to make some complex and subjective decisions and assessments. Our most critical accounting policies will involve decisions and assessments that could affect our reported assets and liabilities, as well as our reported revenues and expenses. We believe that all of the decisions and assessments upon which our financial statements will be based will be reasonable at the time made and based upon information available to us at that time. Some of our investments will be recorded at fair value, as determined by PCM, subject to oversight of our board of trustees, and in accordance with SFAS No. 157, "Fair Value Measurements," or SFAS No. 157, and FASB Staff Position No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active." We have identified what we believe will be our most critical accounting policies to be the following:

Valuation of Financial Instruments

SFAS No. 157 establishes a hierarchy that prioritizes the inputs to valuation techniques giving the highest priority to readily available unadjusted quoted prices in active markets for identical assets (Level I measurements) and the lowest priority to unobservable inputs (Level III measurements) when market prices are not readily available or reliable. The three levels of the hierarchy under SFAS No. 157 are described below:

Level I Quoted prices in active markets for identical assets or liabilities.

Level II Prices determined using other significant observable inputs. Observable inputs are inputs that other market participants would use in pricing a security. These may include quoted prices for similar securities, interest rates, prepayment speeds, credit risk and others.

Level III Prices determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable (for example, when there is little or no market activity for an investment at the end of the period), unobservable inputs may be used. Unobservable inputs reflect our own assumptions about the factors that market participants would use in pricing an asset or liability, and would be based on the best information available. We anticipate that a significant portion of our assets will be with a Level III.

Mortgage Loans

Mortgage loans that are not committed to be sold will be recorded at fair value, which will be approximated using a discounted cash flow valuation model. Inputs to the model will be classified into directly and non-directly observable inputs. Directly observable inputs are inputs that can be taken directly from observable data or market sources such as current interest rates, loan amount, payment status and property type. Non-directly observable inputs are inputs that cannot be taken directly from observable data or market sources such as forecasts of future interest rates, home prices, prepayment speeds, defaults and loss severities. Loans which are committed to be sold will be valued at their quoted market price or market price equivalent.

Residential Mortgage-Backed Securities

Our investments in RMBS will be carried at fair value. Realized gains and losses on sales of RMBS will be recorded in earnings at the time of disposition. How the change in fair value of RMBS is recognized is dependent on the accounting classification of the assets. Changes in the fair value of RMBS accounted for as trading securities will be recognized in current period earnings.

With respect to RMBS accounted for as available-for-sale securities, unrealized gains or losses, net of applicable deferred income taxes, will be excluded from earnings and reported as a component of accumulated other comprehensive income, which is included in shareholders' equity. Other-than-temporary impairment will be recorded when the fair value of an RMBS accounted for as an available-for-sale security has declined below its cost basis and is not expected to recover in value. If we do not intend to sell such RMBS and it is more likely than not that we will not have to sell it before recovery of its cost basis, any credit component of an other-than temporary impairment is recognized in earnings and the remaining portion is recognized in other comprehensive income. Credit losses will be measured using cash flow projections including expected prepayments. The determination of other-than-temporary impairment will be made at least quarterly. If we determine an impairment to be other-than-temporary, we will realize a loss which will negatively impact current income.

Mortgage Loan Sales and Securitizations

We will periodically enter into transactions in which we sell financial assets, such as residential mortgage loans, RMBS and other assets. Upon a transfer of financial assets, we will sometimes retain or acquire senior or subordinated interests in the related assets. Gains and losses on such transactions will be recognized using the guidance in SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," or SFAS No. 140, which is based on a financial components approach that focuses on control. Under this approach, after a transfer of financial assets that meets the criteria for treatment as a sale legal isolation, ability of transferee to pledge or exchange the transferred assets without constraint, and transferred control an entity recognizes the financial and servicing assets it acquired or retained and the liabilities it has incurred, derecognizes financial assets it has sold, and derecognizes liabilities when extinguished.

We will determine the gain or loss on sale of mortgage loans by allocating the carrying value of the underlying mortgage between securities or loans sold and the interests retained based on their fair

values. The gain or loss on sale is the difference between the cash proceeds from the sale and the amount allocated to the securities or loans sold.

From time to time, we may securitize mortgage loans we hold if such financing is available. These transactions will be recorded in accordance with SFAS No. 140 and will be accounted for as either a "sale" and the loans will be removed from our balance sheet or as a "financing" and will be classified as "securitized loans" on our balance sheet, depending upon the structure of the securitization transaction.

Investment Consolidation

For each investment we make, we will evaluate the underlying entity that issued the securities we acquired or to which we make a loan to determine the appropriate accounting. A similar analysis will be performed for each entity with which we enter into an agreement for management, servicing or related services. In performing our analysis, we will refer to guidance in SFAS No. 140 and FASB Interpretation No., or FIN, 46R, "Consolidation of Variable Interest Entities," or FIN 46R. FIN 46R addresses the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which voting rights are not effective in identifying an investor with a controlling financial interest. In variable interest entities, or VIEs, an entity is subject to consolidation under FIN 46R if the investors either do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support, are unable to direct the entity's activities or are not exposed to the entity's losses or entitled to its residual returns. VIEs within the scope of FIN 46R are required to be consolidated by their primary beneficiary. The primary beneficiary of a VIE is determined to be the party that absorbs a majority of the entity's expected losses, its expected returns, or both. This determination can sometimes involve complex and subjective analyses.

Interest Income Recognition

Interest income on loans will be recognized over the life of the investment using the nominal interest rate. Income recognition will be suspended for loans when, in our opinion, a full recovery of income and principal becomes doubtful. Income recognition will be resumed when the loan becomes contractually current and performance is demonstrated to be resumed. Interest income on RMBS will be recognized over the life of the investment using the effective interest rate method. We will estimate, at the time of purchase, the future expected cash flows and will determine the effective interest rate based on these estimated cash flows and our purchase price. In estimating these cash flows, there will be a number of assumptions that will be subject to uncertainties and contingencies. These will include the rate and timing of principal payments (including prepayments, repurchases, defaults and liquidations), the pass-through or coupon rate and interest rate fluctuations. In addition, interest payment shortfalls due to delinquencies on the underlying mortgage loans, the likelihood of modification and the timing of the magnitude of credit losses on the mortgage loans underlying the securities will have to be judgmentally estimated. These uncertainties and contingencies will be difficult to predict and will be subject to future events that may impact our estimates and interest income.

Mortgage Loan Modifications

We will account for loan modifications by measuring the difference between the fair values of the original loan and the modified loan. Any difference between these amounts will be recorded in realized gain or loss in the period of the modification.

Table of Contents

Accounting For Derivative Financial Instruments

We may enter into derivative contracts, including interest rate swaps and interest rate caps, as a means of mitigating our interest rate risk. We will use interest rate derivative instruments to mitigate interest rate risk rather than to enhance returns.

We will account for derivative financial instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended and interpreted, or SFAS No. 133. SFAS No. 133 requires an entity to recognize all derivatives as either assets or liabilities in the balance sheet and to measure those instruments at fair value. Additionally, the fair value adjustments will affect either other comprehensive income in shareholders' equity until the hedged item is recognized in earnings or net income depending on whether the derivative instrument qualifies as a hedge for accounting purposes and, if so, the nature of the hedging activity.

In the normal course of business, we may use a

In February 2008, the Company granted 25,000 shares of restricted stock and options to purchase 150,000 shares of common stock to the Company s Chief Executive Officer, which is included in the 175,000 options and restricted stock authorized in the above table. The option award vests evenly over a three-year period. The 25,000 shares of restricted stock vest entirely on the earlier of the third anniversary date from the date of grant or upon involuntary termination.

The weighted-average grant date fair value of options granted during the years ended December 31, 2008, 2007 and 2006 was $2.76, $3.01 and $3.01, respectively. There were no options exercised during the year ended December 31, 2008. For the years ended December 31, 2007 and 2006, the total intrinsic value of options exercised was $13,600 and $10,000, respectively. As of December 31, 2008, there was $1.0 million of unrecognized compensation cost related to non-vested options that is expected to be recognized over a weighted average period of 1.09 years. The total fair value of options and restricted stock vested during the years ended December 31, 2008 and 2007 was $912,000 and $783,000, respectively. The total fair value of options vested during the year ended December 31, 2008 that were issued prior to adoption of SFAS 123R was $99,000. The aggregate intrinsic value of options fully vested at December 31, 2008 was $0. The aggregate intrinsic value of options outstanding at December 31, 2008 and expected to vest was $1,000.

The Company consistently used the binomial model for estimating the fair value of options granted in the years ended December 31, 2008, 2007 and 2006. The Company used historical data to estimate the option exercise and employee departure behavior used in the binomial valuation model. Forfeitures are estimated on the date of grant and shares vest on a graded schedule, with shares being earned per day under the accrual method. The expected term of options granted is derived from the output of the option pricing model and represents the period of time that options granted are expected to be outstanding. The risk-free rates for periods within the contractual term of the options are based on the U.S. Treasury stripped coupon interest in effect at the end of the quarter. Because the binomial valuation model accommodates multiple input values, the risk free interest rates and expected term rates used in calculating the fair value of the options, are expressed in ranges. Expected volatility is based on historical volatility of the Company s stock.

Table of Contents

Following are the weighted-average and range assumptions, where applicable, used for each respective period:

		Twelve Months Ended	
	December 31, 2008	December 31, 2007 (Binomial)	December 31, 2006
Expected dividend yield	0.0%	0.0%	0.0%
Risk-free interest rate	0.81 to 4.34%	3.03 to 5.12%	4.46 to 5.19%
Weighted-average expected volatility	100.75%	62.5%	61.5%
Expected term	1.8 to 9.5 years	1.8 to 9.4 years	3.1 to 8.9 years
Forfeiture rate	0.14 to 41.76%	0.18 to 41.76%	0.29 to 17.51%
Respective service period	3 to 5 years	3 to 5 years	3 to 5 years

Restricted Stock Awards

In fiscal year 2006, the Company granted unvested common stock awards (restricted stock) to certain key employees pursuant to the 2004 Stock Compensation Plan. The shares vest ratably over five years. The restricted stock awards granted in 2006 were accounted for using the measurement and recognition principles of SFAS 123R. Compensation for restricted stock awards is measured at fair value on the date of grant based on the number of shares expected to vest and the quoted market price of the Company s common stock. Compensation cost for all awards will be recognized in earnings, net of estimated forfeitures, on a straight-line basis over the requisite service period.

The Company recorded $107,000, $76,000 and $126,000 in compensation expense related to the restricted stock that vested during the years ended December 31, 2008, 2007 and 2006, respectively. As of December 31, 2008, there was $229,000 of total unrecognized compensation cost related to restricted stock awards granted under the Plan. Unrecognized compensation cost of $150,000 related to the 2004 Stock Compensation Plan is expected to be recognized over a period of two years, while unrecognized compensation cost of $78,000 related to the option grant to the Company s Chief Executive Officer is expected to be recognized over a period of 2.25 years.

NOTE K EARNINGS (LOSS) PER SHARE

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	Years ended December 31,		
	2008	2007	2006
	(in 000 s except per share data)		
Basic			
Numerator:			
Loss available for common shareholders	$ (2,556)	$ (3,193)	$ (1,953)
Denominator:			
Weighted average shares outstanding	6,434	6,399	6,338
Loss per common share basic	$ (0.40)	$ (0.50)	$ (0.31)
Diluted			
Numerator:			
Net loss	$ (2,556)	$ (3,193)	$ (1,953)
Denominator:			
Weighted average shares outstanding	6,434	6,399	6,338
Effect of dilutive securities:			
Employee stock options			

Weighted average shares outstanding Diluted	6,434	6,399	6,338
Loss per common share diluted	$ (0.40)	$ (0.50)	$ (0.31)

Options to purchase 1,046,569, 820,675 and 359,100 shares of common stock for the years ended December 31, 2008, 2007 and 2006, respectively, were not included in the computation of diluted earnings per common share, because the assumed proceeds per share were greater than the average market price, and therefore, were antidilutive. The dilutive effect of 44,185 options with assumed proceeds per share less than the average market price, were not included for the year ended December 31, 2007, because the effect would be anti-dilutive due to the Company s net loss for the period.

NOTE L LEASE AGREEMENT

Effective March 1, 2007, the Company entered into an agreement to lease to a third party a portion of its corporate headquarters under the terms of a non-cancelable operating lease. The lease calls for an initial term of five (5) years with a tenant option to renew for one extension period of five years. The lease agreement provides for escalating rental payments over its term. Under the agreement, the tenant pays an allocated share of the increase over the base year of certain costs, including utilities, maintenance costs and property taxes.

Future minimum lease payments expected to be received as of December 31, 2008 are as follows (in 000 s):

Year ending December 31	
2009	$ 364
2010	375
2011	387
2012	97
	$ 1,223

Rental income, which is included in other income in the statements of operations, was approximately $361,000 and $305,000 for the years ended December 31, 2008 and 2007, respectively.

NOTE M SRI 401(k) PLAN

The Company sponsors the SRI/Surgical Express, Inc. 401(k) Plan (the Plan), a defined contribution plan established under Section 401(k) of the U.S. Internal Revenue Code. Employees are eligible to contribute voluntarily to the Plan after six months of continued service, satisfying 1,000 hours of service and attaining age 21. In addition to the employees contributions, at its discretion, the Company may contribute 50% of the first 4% of the employee s contribution. The Plan allows for employee elective contributions up to an amount equivalent to 15% of salary. Employees are always vested in their contributed balance and vest ratably in the Company s contribution over three years. For the years ended December 31, 2008, 2007, and 2006, the Company s expense related to the Plan was approximately $269,000, $228,000, and $220,000, respectively.

NOTE N RELATED PARTY TRANSACTIONS

The Company had a procurement agreement with Standard Textile under which the Company agreed to purchase 90% of its reusable surgical products from Standard Textile through August 2008. The Company is currently working with Standard Textile on a month-to-month basis until a new agreement can be reached. Standard Textile is a shareholder of the Company. During the years ended December 31, 2008, 2007, and 2006, the Company purchased products in the amounts of $5.6 million, $3.0 million, and $2.8 million, respectively, from Standard Textile.

During the years ended December 31, 2008, 2007 and 2006, the Company paid approximately $4,500, $13,500, and $18,300, respectively, to a company to design and supply the components for water reclamation systems for Company facilities. A shareholder of the Company owns the business providing these services.

Table of Contents

During the years ended December 31, 2008 and 2007, the Company paid approximately $258,000 and $243,000, respectively, in consulting fees to a director and shareholder of the Company for assistance with managing the facilities operations while the Company searches for a new operations leader.

NOTE O SELECTED QUARTERLY FINANCIAL DATA

The following selected unaudited quarterly information is being disclosed in accordance with Regulation S-K (Item 302):

	Quarters Ended			
	Mar. 31, 2008	Jun. 30, 2008	Sep. 30, 2008	Dec. 31, 2008
	(In thousands, except per share data)			
Revenues	$ 23,968	$ 25,113	$ 23,959	$ 23,988
Gross profit	$ 5,043	$ 5,847	$ 5,318	$ 5,221
Net loss	$ (1,294)	$ (390)	$ (173)	$ (699)
Basic loss per share	$ (0.20)	$ (0.06)	$ (0.03)	$ (0.11)
Diluted loss per share	$ (0.20)	$ (0.06)	$ (0.03)	$ (0.11)

	Quarters Ended			
	Mar. 31, 2007	Jun. 30, 2007	Sep. 30, 2007	Dec. 31, 2007
	(In thousands, except per share data)			
Revenues	$ 23,377	$ 23,717	$ 23,151	$ 23,956
Gross profit	$ 5,369	$ 5,600	$ 4,545	$ 4,740
Net loss	$ (589)	$ (342)	$ (645)	$ (1,617)
Basic loss per share	$ (0.09)	$ (0.05)	$ (0.10)	$ (0.26)
Diluted loss per share	$ (0.09)	$ (0.05)	$ (0.10)	$ (0.26)

Table of Contents

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

SRI/SURGICAL EXPRESS, INC.

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Write-offs / Reductions	Balance at end of Period
Allowance for doubtful accounts:				
Year ended December 31, 2006 (1)	$ 441,000	$ 192,000	$ (159,000)	$ 474,000
Year ended December 31, 2007	474,000	791,000	(400,000)	865,000
Year ended December 31, 2008	865,000		(759,000)	106,000
Reserve for shrinkage, obsolescence, and scrap: reusable surgical products				
Year ended December 31, 2006	$ 1,488,000	$ 1,321,000	$ (1,255,000)	$ 1,554,000
Year ended December 31, 2007	1,554,000	994,000	(1,337,000)	1,211,000
Year ended December 31, 2008	1,211,000	1,275,000	(1,099,000)	1,387,000
Reserve for shrinkage and obsolescence: disposable products				
Year ended December 31, 2006	$ 323,000	$ 155,000	$ (78,000)	$ 400,000
Year ended December 31, 2007	400,000	501,000	(376,000)	525,000
Year ended December 31, 2008	525,000		(211,000)	314,000

(1) Includes allowance for a note receivable at December 31, 2006 totaling $239,000.

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
None.

Item 9A(T). Controls and Procedures
Evaluation of Disclosure Controls and Procedures

In accordance with Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act), we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and principal financial officer (our Executives), of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report. Based on this evaluation, our Executives concluded that our disclosure controls and procedures were effective as of December 31, 2008 to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and (ii) accumulated and communicated to the our management, including the Executives, as appropriate, to allow timely decisions regarding required disclosure.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a and 15(f)). Our internal control over financial reporting process was designed to provide reasonable assurance to our management and our Board of Directors regarding the reliability of financial reporting and the preparation of our financial statements in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree or compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2008, based upon the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*. Based on this assessment under the framework in *Internal Control Integrated Framework* issued by COSO*,* our management concluded that our internal control over financial reporting was effective as of December 31, 2008.

This Annual Report does not include an attestation report of the Company s registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by the Company s registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management s report in this Annual Report.

Item 9B. Other Information
None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item concerning our executive officers and directors is incorporated by reference to the information set forth under the captions Proposal No. 1: Election of Directors, Executive Officer Compensation, Security Ownership of Directors, Officers and Principal Shareholders and Corporate Governance in our Definitive Proxy Statement for the 2009 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2008.

Item 11. Executive Compensation

The information required by this item is incorporated by reference to the information set forth under the caption Executive Officer Compensation and Director Compensation in our Definitive Proxy Statement for the 2009 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2008.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item is incorporated by reference to the information set forth under the caption Security Ownership of Directors, Officers and Principal Shareholders and Executive Officer Compensation in our Definitive Proxy Statement for the 2009 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2008.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is incorporated by reference to the information set forth under the caption Certain Relationships and Related Transactions and Corporate Governance in our Definitive Proxy Statement for the 2009 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2008.

Item 14. Principal Accountant Fees and Services

The information required by this item is incorporated by reference to the information set forth under the caption Ratification of Appointment of Independent Auditors Fees Paid to Independent Auditors in our Definitive Proxy Statement for the 2009 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2008.

Table of Contents

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) 1. The following Financial Statements of the Registrant are included in Part II, Item 8, Page 18:

Report of Independent Registered Public Accounting Firm	24
Balance Sheets at December 31, 2008 and 2007	25
Statements of Operations for Years Ended December 31, 2008, 2007 and 2006	26
Statements of Shareholders Equity for Years Ended December 31, 2008, 2007 and 2006	27
Statements of Cash Flows for Years Ended December 31, 2008, 2007 and 2006	28
Notes to Financial Statements	29

2. Financial Statement Schedules of the Registrant: See (c) below.

(b) Exhibits: See Exhibit Index

(c) Financial Statements Schedule: The valuation and qualifying accounts schedule is provided and all other financial statement schedules are omitted because of the absence of conditions requiring them.

EXHIBIT INDEX

Exhibit Number	Exhibit Description
3.1	Restated Articles of Incorporation of the Company (incorporated herein by reference to Exhibit 3.1 to the Registration Statement on Form S-1 filed by the Registrant on May 15, 1996).
3.2	First Amendment to Restated Articles of Incorporation dated as of August 31, 1998, of the Company (for Series A Preferred Stock) (incorporated herein by reference to Exhibit 4.4 to the Current Report on Form 8-K dated August 31, 1998 filed by the Registrant on September 9, 1998).
3.3	Amended and Restated Bylaws of the Company (incorporated herein by reference to Exhibit 3.3 to the Annual Report on Form 10-K for the 2006 year filed by the Registrant on March 23, 2007).
4.1	Trust Indenture dated as of February 1, 1999, between First Union National Bank and the Industrial Development Board of Hamilton County, Tennessee (incorporated herein by reference to Exhibit 4.2 to the Annual Report on Form 10-K for the 1998 year filed by the Registrant on March 23, 1999).
4.2	Trust Indenture dated as of June 1, 1999, between First Union National Bank and First Security Bank, National Association (incorporated herein by reference to Exhibit 4.3 to the Quarterly Report on Form 10-Q for the 1999 third quarter filed by the Registrant on November 12, 1999).
10.1	1995 Stock Option Plan, as amended, of the Company (incorporated herein by reference to Exhibit 10.1 to the Registration Statement on Form S-1 filed by the Registrant on May 15, 1996).
10.2	Form of Stock Option Agreement between the Company and participants under the 1995 Stock Option Plan (incorporated herein by reference to Exhibit 10.2 to the Registration Statement on Form S-1 filed by the Registrant on May 15, 1996).
10.3	Texas Industrial Net Lease dated March 19, 1992, between the Trustees of the Estate of James Campbell, Deceased, and Amsco SRI/Surgical Express, Inc., as assigned to the Company (incorporated herein by reference to Exhibit 10.18 to the Registration Statement on Form S-1 filed by the Registrant on May 15, 1996).
10.4	

Lease dated March 30, 1992, between Walter D Aloisio and Amsco SRI/Surgical Express, Inc., as assigned to the Company (incorporated herein by reference to Exhibit 10.19 to the Registration Statement on Form S-1 filed by the Registrant on May 15, 1996).

Exhibit Number	Exhibit Description
10.5	Standard Industrial Lease Multi-Tenant (American Industrial Real Estate Association) dated February 24, 1992, between Borstein Enterprises and Amsco SRI/Surgical Express, Inc., as assigned to the Company (incorporated herein by reference to Exhibit 10.20 to the Registration Statement on Form S-1 filed by the Registrant on May 15, 1996).
10.6	Carolina Central Industrial Center Lease dated April 22, 1992, between Industrial Development Associates and Amsco SRI/Surgical Express, Inc., as assigned to the Company (incorporated herein by reference to Exhibit 10.21 to the Registration Statement on Form S-1 filed by the Registrant on May 15, 1996).
10.7	Lease Agreement dated September 2, 1993, between Price Pioneer Company, Ltd., and Amsco SRI/Surgical Express, Inc., as assigned to the Company (incorporated herein by reference to Exhibit 10.22 to the Registration Statement on Form S-1 filed by the Registrant on May 15, 1996).
10.8	Service Center Lease dated December 4, 1991, between QP One Corporation and Amsco SRI/Surgical Express, Inc., as assigned to the Company (incorporated herein by reference to Exhibit 10.23 to the Registration Statement on Form S-1 filed by the Registrant on May 15, 1996).
10.9	1996 Non-Employee Director Stock Option Plan of the Company (incorporated herein by reference to Exhibit 10.29 to the Registration Statement on Form S-1 filed by the Registrant on May 15, 1996).
10.10	Amendments No. 2 and 3 to the 1995 Stock Option Plan of the Company (incorporated herein by reference to Exhibit 10.24 to the Annual Report on Form 10-K for the 1996 year filed by the Registrant on March 24, 1997).
10.11	Corporate Service Agreement dated October 21, 1997, between Standard Textile Co., Inc. and the Company (incorporated herein by reference to Exhibit 10.26 to the Annual Report on Form 10-K for the 1997 year filed by the Registrant on March 30, 1998).
10.12	1998 Stock Option Plan of the Company (incorporated herein by reference to Exhibit 10.28 to the Annual Report on Form 10-K for the 1997 year filed by the Registrant on March 30, 1998).
10.13	Lease Agreement dated as of June 15, 1999, between the Company and ProLogis Limited Partnership IV (incorporated herein by reference to Exhibit 10.32 to the Quarterly Report on Form 10-Q for the 1999 third quarter filed by the Registrant on November 12, 1999).
10.14	Lease Agreement dated as of June 10, 1999, between the Company and Riggs & Company, a division of Riggs Bank, N.A., as Trustee of the Multi-Employer Property Trust, a trust organized under 12 C.F.R. Section 9.18 (incorporated by reference to the Annual Report on Form 10-K for the 1999 year-filed by the Registrant on March 30, 2000).
10.15	Purchasing Agreement dated as of May 1, 2001, between the Company and HealthTrust Purchasing Group, L.P. (incorporated herein by reference to Exhibit 10.46 to the Quarterly Report on Form 10-Q for the 2001 second quarter filed by the Registrant on July 26, 2001).
10.16	Form of stock option agreement between the Company and non-employee directors (incorporated herein by reference to Exhibit 10.47 to the Annual Report on Form 10-K for the 2001 year filed by the Registrant on April 1, 2002).
10.17	Joint Marketing Agreement dated as of March 1, 2003 between the Company and Aesculap, Inc. (incorporated herein by reference to Exhibit 10.54 to the Quarterly Report on Form 10-Q for the 2003 first quarter filed by the Registrant on May 14, 2003).
10.18	2004 Stock Compensation Plan of the Company (incorporated herein by reference to Exhibit 4.1 to the Registration Statement on Form S-8 filed by the Registrant on March 28, 2005).
10.19	Employment Agreement dated as of July 1, 2005, between Wallace D. Ruiz and the Company (incorporated herein by reference to Exhibit 99.4 to the Current Report on Form 8-K filed by the Registrant on June 24, 2005).

Table of Contents

Exhibit Number	Exhibit Description
10.20	Notice of Restricted Stock Grant and Stock Restriction Agreement (incorporated herein by reference to Exhibit 99.1 to the Current Report on Form 8-K filed by the Registrant on February 3, 2006).
10.21	Amendment No. 1 to 1998 Stock Option Plan of the Company (as Amended and Restated as of June 17, 2005) (incorporated herein by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the 2006 first quarter filed by the Registrant on May 9, 2006).
10.22	Amendment No. 1 to 2004 Stock Compensation Plan of the Company (incorporated herein by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q for the 2006 first quarter filed by the Registrant on May 9, 2006).
10.23	Letter Agreement dated as of March 22, 2006, between Wayne R. Peterson and the Company (incorporated herein by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q for the 2006 first quarter filed by the Registrant on May 9, 2006).
10.24	Retention Agreement dated as of February 2, 2005, between D. Jon McGuire and the Company (incorporated herein by reference to Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on February 5, 2007).
10.25	Employment Agreement dated as of December 31, 2007, between Gerald Woodard and the Company (incorporated herein by reference to Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on January 7, 2008).
10.26	Restricted Stock Grant Agreement dated as of February 6, 2008, between Gerald Woodard and the Company (incorporated herein by reference to Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on February 7, 2008).
10.27	Stock Option Agreement dated as of February 6, 2008, between Gerald Woodard and the Company (incorporated herein by reference to Exhibit 10.2 to the Current Report on Form 8-K filed by the Registrant on February 7, 2008).
10.28	First Amendment to Retention Agreement dated November 4, 2008 between D. Jon McGuire and the Company (incorporated herein by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the 2008 third quarter filed by the Registrant on November 4, 2008).
10.29	First Amendment to Retention Agreement dated December 23, 2008 between Gerald Woodard and the Company.
10.30	First Amendment to Retention Agreement dated December 24, 2008 between Wallace D. Ruiz and the Company.
10.31	Supply and Co-Marketing Agreement dated November 26, 2008 between Cardinal Health 200, Inc. and the Company. *
23.1	Consent of Grant Thornton LLP.
31	Certifications by the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) of the Company under Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification by the CEO and CFO of the Company under Section 906 of the Sarbanes-Oxley Act of 2002. (Not deemed to be filed with the Securities and Exchange Commission.)

* Certain parts of this exhibit have not been disclosed and have been filed separately with the Secretary of the Securities and Exchange Commission, and are subject to a confidential treatment request pursuant to Rule 24b-2 of the Securities Exchange Act of 1934.

Table of Contents

SIGNATURES

PURSUANT TO THE REQUIREMENTS OF SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934, THE REGISTRANT HAS DULY CAUSED THIS REPORT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED, THEREUNTO DULY AUTHORIZED.

SRI/SURGICAL EXPRESS, INC.

BY:	/s/ GERALD WOODARD	BY:	/s/ WALLACE D. RUIZ
	Gerald Woodard,		**Wallace D. Ruiz,**
	Chief Executive Officer		**Sr. Vice President & Chief Financial Officer**

Dated: March 10, 2009

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES AND EXCHANGE ACT OF 1934, THIS REPORT HAS BEEN SIGNED BELOW BY THE FOLLOWING PERSONS ON BEHALF OF THE REGISTRANT AND IN THE CAPACITIES AND ON THE DATES INDICATED.

Signature	Title	Date
/s/ CHARLES W. FEDERICO **Charles W. Federico**	Chairman and Director	March 10, 2009
/s/ GERALD WOODARD **Gerald Woodard**	Chief Executive Officer and Director	March 10, 2009
/s/ WALLACE D. RUIZ **Wallace D. Ruiz**	Sr. Vice President & Chief Financial Officer	March 10, 2009
/s/ JAMES T. BOOSALES **James T. Boosales**	Director	March 10, 2009
/s/ JAMES M. EMANUEL **James M. Emanuel**	Director	March 10, 2009
/s/ CHARLES T. ORSATTI **Charles T. Orsatti**	Director	March 10, 2009
/s/ WAYNE R. PETERSON **Wayne R. Peterson**	Director	March 10, 2009