IMPAC MORTGAGE HOLDINGS INC
Form 10-Q
August 09, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018

or

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

For the transition period from to

Commission File Number: 1-14100

IMPAC MORTGAGE HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Maryland	33-0675505
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

19500 Jamboree Road, Irvine, California 92612

(Address of principal executive offices)

(949) 475-3600

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

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

There were 21,047,589 shares of common stock outstanding as of August 3, 2018.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

FORM 10-Q QUARTERLY REPORT

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	June 30, 2018 (Unaudited)	December 31, 2017
ASSETS		
Cash and cash equivalents	$ 32,960	$ 33,223
Restricted cash	4,606	5,876
Mortgage loans held-for-sale	481,291	568,781
Finance receivables	37,215	41,777
Mortgage servicing rights	180,733	154,405
Securitized mortgage trust assets	3,409,477	3,670,550
Goodwill	29,925	104,587
Intangible assets, net	6,033	21,582
Loans eligible for repurchase from Ginnie Mae	60,488	47,697
Other assets	23,494	33,222
Total assets	$ 4,266,222	$ 4,681,700
LIABILITIES		
Warehouse borrowings	$ 482,546	$ 575,363
MSR financings	62,000	35,133
Convertible notes, net	24,979	24,974
Long-term debt	45,787	44,982
Securitized mortgage trust liabilities	3,393,721	3,653,265
Liability for loans eligible for repurchase from Ginnie Mae	60,488	47,697
Contingent consideration	—	554
Other liabilities	33,952	34,585
Total liabilities	4,103,473	4,416,553
Commitments and contingencies (See Note 11)		
STOCKHOLDERS' EQUITY		
Series A-1 junior participating preferred stock, $0.01 par value; 2,500,000 shares authorized; none issued or outstanding	—	—
Series B 9.375% redeemable preferred stock, $0.01 par value; liquidation value $30,290; 2,000,000 shares authorized, 665,592 noncumulative shares issued and outstanding as of June 30, 2018 and December 31, 2017 (See Note 12)	7	7
Series C 9.125% redeemable preferred stock, $0.01 par value; liquidation value $35,127; 5,500,000 shares authorized; 1,405,086 noncumulative shares issued and outstanding as of June 30, 2018 and December 31, 2017	14	14
	210	209

Common stock, $0.01 par value; 200,000,000 shares authorized; 21,026,392 and 20,949,679 shares issued and outstanding as of June 30, 2018 and December 31, 2017, respectively		
Additional paid-in capital	1,234,622	1,233,704
Accumulated other comprehensive earnings, net of tax	25,053	—
Net accumulated deficit:		
Cumulative dividends declared	(822,520)	(822,520)
Retained deficit	(274,637)	(146,267)
Net accumulated deficit	(1,097,157)	(968,787)
Total stockholders' equity	162,749	265,147
Total liabilities and stockholders' equity	$ 4,266,222	$ 4,681,700

See accompanying notes to unaudited consolidated financial statements

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) EARNINGS

(in thousands, except per share data)

(Unaudited)

	For the Three Months Ended June 30, 2018	2017	For the Six Months Ended June 30, 2018	2017
Revenues:				
Gain on sale of loans, net	$ 18,741	$ 36,806	$ 40,223	$ 74,126
Servicing fees, net	9,861	7,764	19,324	15,083
Gain (loss) on mortgage servicing rights, net	167	(6,669)	7,872	(7,646)
Real estate services fees, net	1,038	1,504	2,423	3,137
Other	116	228	207	275
Total revenues	29,923	39,633	70,049	84,975
Expenses:				
Personnel expense	16,678	21,373	34,421	46,291
Business promotion	9,000	10,110	18,730	20,341
General, administrative and other	10,846	8,324	19,122	16,348
Intangible asset impairment	13,450	—	13,450	—
Goodwill impairment	74,662	—	74,662	—
Accretion of contingent consideration	—	707	—	1,552
Change in fair value of contingent consideration	—	(6,793)	—	(6,254)
Total expenses	124,636	33,721	160,385	78,278
Operating (loss) income	(94,713)	5,912	(90,336)	6,697
Other income (expense):				
Interest income	49,064	60,573	99,215	122,157
Interest expense	(48,518)	(59,475)	(97,648)	(120,614)
Loss on extinguishment of debt	—	(1,265)	—	(1,265)
Change in fair value of long-term debt	258	(265)	1,481	(2,761)
Change in fair value of net trust assets, including trust REO gains	217	2,005	(1,921)	8,324
Total other income, net	1,021	1,573	1,127	5,841
(Loss) earnings before income taxes	(93,692)	7,485	(89,209)	12,538
Income tax expense	3,706	1,045	4,316	1,471
Net (loss) earnings	$ (97,398)	$ 6,440	$ (93,525)	$ 11,067
Other comprehensive (loss) earnings:				
Change in fair value of instrument specific credit risk	$ (526)	$ —	$ (1,965)	$ —
Total comprehensive (loss) earnings	$ (97,924)	$ 6,440	$ (95,490)	$ 11,067

(Loss) earnings per common share:

Basic	$ (4.65)	$ 0.33	$ (4.46)	$ 0.62
Diluted	(4.65)	0.32	(4.46)	0.62

See accompanying notes to unaudited consolidated financial statements

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(in thousands, except share amounts)

(Unaudited)

	Preferred Shares Outstanding	Preferred Stock	Common Shares Outstanding	Common Stock	Additional Paid-In Capital	Cumulative Dividends Declared	Retained Deficit	Accumulated Other Comprehensive Earnings	Tota Stoc Equi
er 31, 2017	2,070,678	$ 21	20,949,679	$ 209	$ 1,233,704	$ (822,520)	$ (146,267)	$ —	$ 26
and tax rom of stock	—	—	76,713	1	319	—	—	—	32
sed ation	—	—	—	—	599	—	—	—	59
fication adoption 2016-01	—	—	—	—	—	—	(27,018)	27,018	–
ent related on of ASU	—	—	—	—	—	—	(7,827)	—	(7
ensive loss	—	—	—	—	—	—	—	(1,965)	(1
	—	—	—	—	—	—	(93,525)	—	(9
2018	2,070,678	$ 21	21,026,392	$ 210	$ 1,234,622	$ (822,520)	$ (274,637)	$ 25,053	$ 16

See accompanying notes to unaudited consolidated financial statements

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the Six Months Ended June 30, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) earnings	$ (93,525)	$ 11,067
Loss on sale of mortgage servicing rights	—	82
Change in fair value of mortgage servicing rights	(9,572)	8,861
Loss on extinguishment of debt	—	1,265
Gain on sale of mortgage loans	(47,766)	(62,202)
Change in fair value of mortgage loans held-for-sale	5,282	(9,598)
Change in fair value of derivatives lending, net	419	(669)
Provision (recovery) for repurchases	1,594	(1,574)
Origination of mortgage loans held-for-sale	(2,354,373)	(3,373,606)
Sale and principal reduction on mortgage loans held-for-sale	2,467,591	3,217,330
Gains from REO	(603)	(5,751)
Change in fair value of net trust assets, excluding REO	2,524	(2,573)
Change in fair value of long-term debt	(1,481)	2,761
Accretion of interest income and expense	20,544	48,114
Amortization of intangible and other assets	2,385	2,384
Accretion of contingent consideration	—	1,552
Change in fair value of contingent consideration	—	(6,254)
Amortization of debt issuance costs and discount on note payable	41	124
Stock-based compensation	599	979
Impairment of deferred charge	—	520
Impairment of goodwill	74,662	—
Impairment of intangible assets	13,450	—
Excess tax benefit from share based compensation	—	12
Change in deferred tax assets, net	4,315	—
Net change in other assets	(1,743)	(2,170)
Net change in other liabilities	(2,890)	(11,966)
Net cash provided by (used in) operating activities	81,453	(181,312)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in securitized mortgage collateral	247,374	366,469
Proceeds from the sale of mortgage servicing rights	—	813
Purchase of mortgage servicing rights	—	(5,619)
Finance receivable advances to customers	(350,264)	(434,567)
Repayments of finance receivables	354,826	438,788
Net change in mortgages held-for-investment	—	1
Purchase of premises and equipment	(530)	(399)

Proceeds from the sale of REO	11,207	15,924
Net cash provided by investing activities	262,613	381,410
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of common stock	—	55,454
Repayment of MSR financing	(40,133)	(25,000)
Borrowings under MSR financing	67,000	35,133
Repayment of warehouse borrowings	(2,355,268)	(3,073,584)
Borrowings under warehouse agreements	2,262,451	3,265,581
Repayment of term financing	—	(30,000)
Payment of acquisition related contingent consideration	(554)	(11,444)
Repayment of securitized mortgage borrowings	(279,196)	(425,930)
Principal payments on capital lease	(106)	(174)
Debt issuance costs	—	(100)
Tax payments on stock based compensation awards	(113)	(103)
Proceeds from exercise of stock options	320	296
Net cash used in financing activities	(345,599)	(209,871)
Net change in cash, cash equivalents and restricted cash	(1,533)	(9,773)
Cash, cash equivalents and restricted cash at beginning of period	39,099	46,067
Cash, cash equivalents and restricted cash at end of period	$ 37,566	$ 36,294
NON-CASH TRANSACTIONS:		
Transfer of securitized mortgage collateral to real estate owned	$ 10,502	$ 10,042
Mortgage servicing rights retained from loan sales and issuance of mortgage backed securities	16,756	24,873

See accompanying notes to unaudited consolidated financial statements

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except share and per share data or as otherwise indicated)

Note 1.—Summary of Business and Financial Statement Presentation

Business Summary

Impac Mortgage Holdings, Inc. (the Company or IMH) is a Maryland corporation incorporated in August 1995 and has the following direct and indirect wholly-owned subsidiaries: Integrated Real Estate Service Corporation (IRES), Impac Mortgage Corp. (IMC), IMH Assets Corp. (IMH Assets) and Impac Funding Corporation (IFC).

The Company's operations include the mortgage lending operations and real estate services conducted by IRES and IMC and the long-term mortgage portfolio (residual interests in securitizations reflected as net trust assets and liabilities in the consolidated balance sheets) conducted by IMH. IMC's mortgage lending operations include the activities of CashCall Mortgage (CCM).

Financial Statement Presentation

The accompanying unaudited consolidated financial statements of IMH and its subsidiaries (as defined above) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. Operating results for the six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. These interim period condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements, which are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the United States Securities and Exchange Commission (SEC).

All significant intercompany balances and transactions have been eliminated in consolidation. In addition, certain amounts in the prior periods' consolidated financial statements have been reclassified to conform to the current period presentation.

Management has made a number of material estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period to prepare these consolidated financial statements in conformity with GAAP. Additionally, other items affected by such estimates and assumptions include the valuation of trust assets and trust liabilities, contingencies, the estimated obligation of repurchase liabilities related to sold loans, the valuation of long-term debt, mortgage servicing rights, goodwill and intangible asset valuation and impairment, mortgage loans held-for-sale and derivative instruments, including interest rate lock commitments (IRLC). Actual results could differ from those estimates and assumptions.

Recent Accounting Pronouncements

Accounting Standards Update (ASU) No. 2014-09, 2015-04, 2016-08, 2016-10, 2016-12, 2016-20, 2017-13 and 2017-14, collectively implemented as Financial Accounting Standards Board (FASB) Accounting Standards

Codification (ASC), “Revenue from Contracts with Customers (Topic 606)”, provides guidance for revenue recognition. This ASC’s core principle requires a company to recognize revenue when it transfers promised goods or services to customers in an amount that reflects consideration to which the company expects to be entitled in exchange for those goods or services. The standard also clarifies the principal versus agent considerations, providing the evaluation must focus on whether the entity has control of the goods or services before they are transferred to the customer. The new standard permits the use of either the modified retrospective or full retrospective transition method. The Company's revenue is primarily generated from loan originations, loan servicing and real estate services. Origination revenue is comprised of fee income earned at origination of a loan, interest income earned for the period the loans are held and gain on sale on loans upon disposition of the loan. Servicing revenue is comprised of servicing fees and other ancillary fees in connection with our servicing

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activities. Real estate services revenue is comprised of income earned from various real estate services and support such as loss mitigation, loan modification, surveillance and disposition and monitoring services. The Company performed a review of the guidance as compared to current accounting policies and have evaluated all services rendered to customers as well as underlying contracts to determine the impact of this standard to the Company's revenue recognition process. The majority of services rendered by the Company in connection with loan originations, loan servicing and the long-term mortgage portfolio are not within the scope of FASB ASC 606. However, the Company identified real estate services revenues that were within the scope of FASB ASC 606 and the impact upon adoption was not materially different from the previous revenue recognition processes. The Company adopted this guidance on January 1, 2018, and the adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in ASU 2016-01, among other things, requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables); requires separate presentation in other comprehensive income for the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments and eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The update is effective for interim and annual reporting periods beginning after December 15, 2017 on a modified retrospective basis, using a cumulative-effect adjustment to the balance sheet as of the beginning of the year adopted. The Company adopted this guidance on January 1, 2018, which resulted in a $27.0 million reclass, net of tax, between opening retained earnings and other comprehensive earnings (loss) within stockholders' equity.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments." The update amends the guidance in Accounting Standards Codification 230, Statement of Cash Flows, and clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows with the objective of reducing the existing diversity in practice related to eight specific cash flow issues. In addition, in November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230), Restricted Cash (ASU 2016-18). This ASU clarifies certain existing principles in FASB ASC 230, including providing additional guidance related to transfers between cash and restricted cash and how entities present, in their statement of cash flows, the cash receipts and cash payments that directly affect the restricted cash accounts. These ASUs were effective for the Company's fiscal year beginning after December 15, 2017 and subsequent interim periods. The Company adopted this guidance retrospectively on January 1, 2018. The adoption of this ASU did not have a material impact on the consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory." This ASU requires entities to recognize at the transaction date the income tax consequences of intercompany asset transfers other than inventory. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. The adoption of this standard was applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company adopted this guidance on January 1, 2018, which resulted in a $7.8 million cumulative effect adjustment to opening retained earnings.

In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment. ASU 2017-04 amends Topic 350 to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. This update requires the performance of an annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value. However, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The guidance is effective for annual periods beginning after December 15, 2019, including interim periods within those periods, with early adoption permitted. The Company early adopted this guidance prospectively on June 30, 2018. See Note 4.—Goodwill and Intangible Assets for further discussion on goodwill impairment testing.

In May 2017, the FASB issued ASU 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting." The update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. This ASU is effective for annual reporting periods beginning after December 15, 2017. The Company adopted this guidance on January 1, 2018, and the adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This ASU allows a reclassification from accumulated other comprehensive earnings (AOCE) to retained earnings for the stranded tax effects caused by the revaluation of deferred taxes resulting from the newly enacted corporate tax rate in the Tax Cuts and Jobs Act. The ASU is effective in years beginning after December 15, 2018, but permits early adoption in a period for which financial statements have not yet been issued. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In February 2018, the FASB ASU 2018-03, "Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." This amendment clarifies certain aspects of the new guidance (ASU 2016-01) on recognizing and measuring financial instruments and presentation requirements for certain fair value option liabilities. ASU 2018-03 is effective for interim periods beginning after June 15, 2018 and will be effective for our 2018 third quarter and annual reporting period. The standard requires entities to record a cumulative-effect adjustment to the statement of financial position at the beginning of the fiscal year in which the amendments are adopted. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In March 2018, the FASB issued ASU 2018-05, "Income Taxes (Topic 740) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118." This ASU codifies existing SEC guidance contained in SEC Staff Accounting Bulletin No. 118 (SAB 118), which expresses the view of the staff regarding application of existing guidance for the accounting for income taxes as it relates to the enactment of the Tax Cuts and Jobs Act (the TCJA) which was signed into law in the fourth quarter of 2017. In accordance with ASU 2018-05, the Company has recorded provisional estimates for the accounting impacts of the TCJA, deferred tax remeasurements, and other items, due to the uncertainty regarding how these provisions are to be implemented and additional anticipated forthcoming guidance. As management completes the analysis of the impacts of the TCJA, the Company may refine its current estimate and make adjustments, which will be recognized through income in the period such adjustments are identified, as required by ASU 2018-05.

In June 2018, the FASB issued ASU 2018-07, "Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting", which expands the scope of Topic 718 to include all share-based payment transactions for acquiring goods and services from nonemployees. This ASU specifies that Topic 718 apply to all share-based payment transactions in which the grantor acquires goods and services to be used or consumed in its own operations by issuing share-based payment awards. ASU 2018-07 also clarifies that Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under ASC 606. ASU 2018-07 is effective for public business entities for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

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Note 2.—Mortgage Loans Held-for-Sale

A summary of the unpaid principal balance (UPB) of mortgage loans held-for-sale by type is presented below:

	June 30, 2018	December 31, 2017
Government (1)	$ 209,133	$ 263,512
Conventional (2)	98,172	193,055
Other (3)	160,066	93,012
Fair value adjustment (4)	13,920	19,202
Total mortgage loans held for sale	$ 481,291	$ 568,781

(1) Includes all government-insured loans including Federal Housing Administration (FHA), Veterans Affairs (VA) and United States Department of Agriculture (USDA).
(2) Includes loans eligible for sale to Federal National Mortgage Association (Fannie Mae or FNMA) and Federal Home Loan Mortgage Corporation (Freddie Mac or FHLMC).
(3) Includes non-qualified mortgages (NonQM) and jumbo loans.
(4) Changes in fair value are included in gain on sale of loans, net in the accompanying consolidated statements of operations.

Gain on mortgage loans held-for-sale (LHFS), included in gain on sale of loans, net in the consolidated statements of operations, is comprised of the following the three and six months ended June 30, 2018 and 2017:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Gain on sale of mortgage loans	$ 28,641	$ 49,282	$ 57,979	$ 87,522
Premium from servicing retained loan sales	6,273	12,807	16,756	24,873
Unrealized gains (losses) from derivative financial instruments	1,435	1,896	(665)	751
Realized (losses) gains from derivative financial instruments	(227)	(6,167)	11,818	(5,042)
Mark to market (loss) gain on LHFS	(391)	4,394	(5,282)	9,598
Direct origination expenses, net	(15,773)	(25,314)	(38,789)	(45,150)
(Provision) recovery for repurchases	(1,217)	(92)	(1,594)	1,574
Total gain on sale of loans, net	$ 18,741	$ 36,806	$ 40,223	$ 74,126

Note 3.—Mortgage Servicing Rights

The Company retains mortgage servicing rights (MSRs) from its sales and securitization of certain mortgage loans or as a result of purchase transactions. MSRs are reported at fair value based on the income derived from the net projected cash flows associated with the servicing contracts. The Company receives servicing fees, less subservicing costs, on the UPB of the loans. The servicing fees are collected from the monthly payments made by the mortgagors or when the underlying real estate is foreclosed upon and liquidated. The Company may receive other remuneration from rights to various mortgagor-contracted fees, such as late charges, collateral reconveyance charges and nonsufficient fund fees, and the Company is generally entitled to retain the interest earned on funds held pending remittance (or float) related to its collection of mortgagor principal, interest, tax and insurance payments.

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The following table summarizes the activity of MSRs for the six months ended June 30, 2018 and year ended December 31, 2017:

	June 30, 2018	December 31, 2017
Balance at beginning of period	$ 154,405	$ 131,537
Additions from servicing retained loan sales	16,756	56,049
Addition from purchases	—	5,618
Reductions from bulk sales (1)	—	(895)
Changes in fair value (2)	9,572	(37,904)
Fair value of MSRs at end of period	$ 180,733	$ 154,405

(1) In the first quarter of 2017, the Company sold substantially all of its NonQM MSRs.
(2) Changes in fair value are included within gain (loss) on MSRs, net in the accompanying consolidated statements of operations.

At June 30, 2018 and December 31, 2017, the outstanding principal balance of the mortgage servicing portfolio was comprised of the following:

	June 30, 2018	December 31, 2017
Government insured	$ 3,606,688	$ 2,834,680
Conventional (1)	13,177,521	13,493,463
NonQM	1,937	1,957
Total loans serviced	$ 16,786,146	$ 16,330,100

(1) At June 30, 2018 and December 31, 2017, $13.2 billion and $13.5 billion, respectively, of Fannie Mae and Freddie Mac servicing was pledged as collateral as part of the MSR Financing (See Note 5.—Debt– MSR Financings). Pledged collateral was approximately 77% and 81% of the fair value of MSRs in the consolidated balance sheets at June 30, 2018 and December 31, 2017, respectively.

The table below illustrates hypothetical changes in fair values of MSRs, caused by assumed immediate changes to key assumptions that are used to determine fair value. See Note 7.—Fair Value of Financial Instruments for a description of the key assumptions used to determine the fair value of MSRs.

Mortgage Servicing Rights Sensitivity Analysis	June 30, 2018	December 31, 2017
Fair value of MSRs	$ 180,733	$ 154,405
Prepayment Speed:		
Decrease in fair value from 10% adverse change	(3,464)	(5,643)
Decrease in fair value from 20% adverse change	(7,178)	(11,275)
Decrease in fair value from 30% adverse change	(11,101)	(16,807)
Discount Rate:		

Decrease in fair value from 10% adverse change	(6,759)	(5,461)
Decrease in fair value from 20% adverse change	(13,046)	(10,555)
Decrease in fair value from 30% adverse change	(18,905)	(15,316)

Sensitivities are hypothetical changes in fair value and cannot be extrapolated because the relationship of changes in assumptions to changes in fair value may not be linear. Also, the effect of a variation in a particular assumption is calculated without changing any other assumption, whereas a change in one factor may result in changes to another. Accordingly, no assurance can be given that actual results would be consistent with the results of these estimates. As a result, actual future changes in MSR values may differ significantly from those displayed above.

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Gain (loss) on mortgage servicing rights, net is comprised of the following for the three and six months ended June 30, 2018 and 2017:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Change in fair value of mortgage servicing rights	$ 393	$ (7,739)	$ 9,572	$ (8,861)
Gain (loss) on sale of mortgage servicing rights	—	331	—	(82)
Realized and unrealized (losses) gains from hedging instruments	(226)	739	(1,700)	1,297
Gain (loss) on mortgage servicing rights, net	$ 167	$ (6,669)	$ 7,872	$ (7,646)

Servicing fees, net is comprised of the following for the three and six months ended June 30, 2018 and 2017:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Contractual servicing fees	$ 11,326	$ 9,011	$ 22,864	$ 17,377
Late and ancillary fees	167	73	318	