

PMC COMMERCIAL TRUST /TX

Form 10-Q

May 09, 2011

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10 - Q**

(Mark One);

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

For the quarterly period ended March 31, 2011

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 1-13610
PMC COMMERCIAL TRUST**

(Exact name of registrant as specified in its charter)

TEXAS

75-6446078

(State or other jurisdiction
of incorporation or organization)

(I.R.S. Employer Identification No.)

17950 Preston Road, Suite 600, Dallas, TX 75252

(972) 349-3200

(Address of principal executive offices)

(Registrant's telephone number)

Indicate by check mark whether the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. YES NO

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 (Section 232.405 of this chapter) 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, 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 Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a smaller
reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b-2). YES NO

As of May 3, 2011, the Registrant had outstanding 10,569,554 Common Shares of Beneficial Interest, par value \$.01 per share.

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PART I
Financial Information
ITEM 1.
Financial Statements

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

| | March 31, 2011 | December 31, 2010 |
|--|---------------------------|------------------------------|
| | <i>(Unaudited)</i> | |
| ASSETS | | |
| Loans receivable, net: | | |
| Commercial mortgage loans receivable, pledged to revolving credit facility | \$ 121,912 | \$ 122,581 |
| Commercial mortgage loans receivable, subject to structured notes payable | 38,804 | 40,421 |
| SBIC commercial mortgage loans receivable | 30,910 | 31,113 |
| SBA 7(a) loans receivable, subject to secured borrowings | 24,263 | 20,533 |
| SBA 7(a) loans receivable | 17,554 | 18,570 |
| | | |
| Loans receivable, net | 233,443 | 233,218 |
| Restricted cash and cash equivalents | 5,450 | 5,786 |
| Real estate owned | 3,494 | 3,477 |
| Cash and cash equivalents | 2,937 | 2,642 |
| Other assets | 6,256 | 7,004 |
| | | |
| Total assets | \$ 251,580 | \$ 252,127 |
| LIABILITIES AND EQUITY | | |
| Liabilities: | | |
| Debt: | | |
| Junior subordinated notes | \$ 27,070 | \$ 27,070 |
| Secured borrowings government guaranteed loans | 25,802 | 21,765 |
| Structured notes payable | 20,197 | 22,157 |
| Revolving credit facility | 12,200 | 13,800 |
| SBIC debentures payable | 8,178 | 8,177 |
| | | |
| Debt | 93,447 | 92,969 |
| Borrower advances | 3,700 | 3,462 |
| Accounts payable and accrued expenses | 2,118 | 2,678 |
| Dividends payable | 1,713 | 1,712 |
| Deferred gains on property sales | 683 | 685 |
| Other liabilities | 38 | 61 |
| | | |
| Total liabilities | 101,699 | 101,567 |
| <i>Commitments and contingencies</i> | | |
| Beneficiaries equity: | | |
| | 111 | 111 |

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Common shares of beneficial interest; authorized 100,000,000 shares of \$0.01 par value; 11,105,883 and 11,095,883 shares issued at March 31, 2011 and December 31, 2010, respectively; 10,569,554 and 10,559,554 shares outstanding at March 31, 2011 and December 31, 2010, respectively

| | | |
|---|------------|------------|
| Additional paid-in capital | 152,805 | 152,756 |
| Net unrealized appreciation of retained interests in transferred assets | 323 | 276 |
| Cumulative net income | 173,365 | 172,449 |
| Cumulative dividends | (172,722) | (171,031) |
| | 153,882 | 154,561 |
| Less: Treasury stock; at cost, 536,329 shares at March 31, 2011 and December 31, 2010 | (4,901) | (4,901) |
| Total beneficiaries equity | 148,981 | 149,660 |
| Noncontrolling interests cumulative preferred stock of subsidiary | 900 | 900 |
| Total equity | 149,881 | 150,560 |
| Total liabilities and equity | \$ 251,580 | \$ 252,127 |

The accompanying notes are an integral part of these consolidated financial statements.

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

| | Three Months Ended | |
|---|---------------------------|-----------------|
| | March 31, | |
| | 2011 | 2010 |
| | <i>(Unaudited)</i> | |
| Revenues: | | |
| Interest income | \$ 3,367 | \$ 3,217 |
| Other income | 689 | 238 |
| | | |
| Total revenues | 4,056 | 3,455 |
| | | |
| Expenses: | | |
| Salaries and related benefits | 1,117 | 941 |
| Interest | 973 | 989 |
| General and administrative | 504 | 568 |
| Provision for (reduction of) loan losses, net | 313 | (202) |
| | | |
| Total expenses | 2,907 | 2,296 |
| | | |
| Income before income tax benefit (provision) and discontinued operations | 1,149 | 1,159 |
| | | |
| Income tax benefit (provision) | (25) | 108 |
| | | |
| Income from continuing operations | 1,124 | 1,267 |
| | | |
| Discontinued operations | (208) | 11 |
| | | |
| Net income | \$ 916 | \$ 1,278 |
| | | |
| Weighted average shares outstanding: | | |
| Basic | 10,561 | 10,548 |
| | | |
| Diluted | 10,617 | 10,548 |
| | | |
| Basic and diluted earnings per share: | | |
| Income from continuing operations | \$ 0.11 | \$ 0.12 |
| Discontinued operations | (0.02) | |

Net income \$ 0.09 \$ 0.12

The accompanying notes are an integral part of these consolidated financial statements.

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2011 | 2010 |
| | <i>(Unaudited)</i> | |
| Net income | \$ 916 | \$ 1,278 |
| Change in unrealized appreciation of retained interests in transferred assets: | | |
| Net unrealized appreciation (depreciation) arising during period | 67 | (29) |
| Net realized gains included in net income | (20) | (3) |
| | 47 | (32) |
| Comprehensive income | \$ 963 | \$ 1,246 |

The accompanying notes are an integral part of these consolidated financial statements.

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY
(In thousands, except share and per share data)

Three Months Ended March 31, 2010

(Unaudited)

| Common Shares of Beneficial Interest Outstanding | Par Value | Paid-in Capital | Net Unrealized Appreciation of Retained Interests | | Net Income | Cumulative Dividends | Treasury Stock | Cumulative Preferred Stock of Subsidiary Equity | Total |
|--|--------------|--------------------|--|------------------|---------------|-------------------------|-------------------|--|------------|
| | | | Additional | in Cumulative | | | | | |
| Balances, January 1, 2010 | 10,548,354 | \$ 111 | \$ 152,611 | \$ 325 | \$ 167,686 | \$ (164,274) | \$ (4,901) | \$ 900 | \$ 152,458 |
| Cumulative effect adjustment | | | | \$ (265) | 466 | | | | 201 |
| Net unrealized depreciation | | | | (32) | | | | | (32) |
| Share-based compensation expense | | | 24 | | | | | | 24 |
| Dividends (\$0.16 per share) | | | | | | (1,688) | | | (1,688) |
| Net income | | | | | 1,278 | | | | 1,278 |
| Balances, March 31, 2010 | 10,548,354 | \$ 111 | \$ 152,635 | \$ 28 | \$ 169,430 | \$ (165,962) | \$ (4,901) | \$ 900 | \$ 152,241 |

Three Months Ended March 31, 2011

(Unaudited)

| Common Shares of Beneficial Interest | Par | Paid-in | Net Unrealized Appreciation of Retained Interests | | Net | Cumulative | Treasury | Cumulative Preferred Stock of | Total |
|---|-----|---------|--|------------------|-----|------------|----------|--|-------|
| | | | Additional | in Cumulative | | | | | |

| | Outstanding | Value | Capital | Assets | Income | Dividends | Stock | Subsidiary | Equity |
|--|-------------|--------|------------|--------|------------|--------------|------------|------------|------------|
| Balances, January 1, 2011 | 10,559,554 | \$ 111 | \$ 152,756 | \$ 276 | \$ 172,449 | \$ (171,031) | \$ (4,901) | \$ 900 | \$ 150,560 |
| Net unrealized appreciation | | | | 47 | | | | | 47 |
| Share-based compensation expense | 10,000 | | 49 | | | | | | 49 |
| Dividends (\$0.16 per share) | | | | | | (1,691) | | | (1,691) |
| Net income | | | | | 916 | | | | 916 |
| Balances, March 31, 2011 | 10,569,554 | \$ 111 | \$ 152,805 | \$ 323 | \$ 173,365 | \$ (172,722) | \$ (4,901) | \$ 900 | \$ 149,881 |

The accompanying notes are an integral part of these consolidated financial statements.

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

| | Three Months Ended | |
|---|---------------------------|----------------|
| | March 31, | |
| | 2011 | 2010 |
| | <i>(Unaudited)</i> | |
| Cash flows from operating activities: | | |
| Net income | \$ 916 | \$ 1,278 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation | 1 | 6 |
| Gains on sales of real estate | (2) | (76) |
| Deferred income taxes | (178) | (210) |
| Provision for (reduction of) loan losses, net | 313 | (202) |
| Unrealized premium adjustment | 397 | 190 |
| Amortization and accretion, net | 158 | (34) |
| Share-based compensation | 49 | 24 |
| Capitalized loan origination costs | (39) | (77) |
| Loans funded, held for sale | (6,809) | (9,401) |
| Proceeds from sale of guaranteed loans | 4,680 | |
| Principal collected on loans | 111 | 10 |
| Loan fees collected (remitted), net | (61) | 3 |
| Change in operating assets and liabilities: | | |
| Other assets | (509) | 25 |
| Borrower advances | 238 | 866 |
| Accounts payable and accrued expenses | (563) | (309) |
| Other liabilities | (16) | (13) |
| Net cash used in operating activities | (1,314) | (7,920) |
| Cash flows from investing activities: | | |
| Loans funded | (1,263) | (1,421) |
| Principal collected on loans | 2,750 | 5,013 |
| Principal collected on retained interests in transferred assets | 36 | 52 |
| Purchase of furniture, fixtures, and equipment | (31) | |
| Proceeds from sales of (investment in) real estate owned | (17) | 2,264 |
| Proceeds from unconsolidated subsidiary | 1,373 | |
| Release of (investment in) restricted cash and cash equivalents, net | 336 | (941) |
| Net cash provided by investing activities | 3,184 | 4,967 |
| Cash flows from financing activities: | | |
| Repayment of revolving credit facility, net | (1,600) | (800) |
| Payment of principal on structured notes payable | (1,960) | (772) |
| Proceeds from secured borrowings government guaranteed loans | 3,786 | 6,629 |
| Payment of principal on secured borrowings government guaranteed loans | (111) | (10) |

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| | | |
|---|-----------------|-----------------|
| Redemption of redeemable preferred stock of subsidiary | | (2,000) |
| Payment of dividends | (1,690) | (1,709) |
| Net cash provided by (used in) financing activities | (1,575) | 1,338 |
| Net increase (decrease) in cash and cash equivalents | 295 | (1,615) |
| Cash and cash equivalents, beginning of year | 2,642 | 7,838 |
| Cash and cash equivalents, end of period | \$ 2,937 | \$ 6,223 |

The accompanying notes are an integral part of these consolidated financial statements.

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Basis of Presentation:

The accompanying interim financial statements of PMC Commercial Trust (PMC Commercial or together with its wholly-owned subsidiaries, we, us or our) have not been audited by independent accountants. These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statement presentation. In the opinion of management, the financial statements reflect all adjustments necessary to present a fair statement of our financial position at March 31, 2011 and results of operations and cash flows for the three months ended March 31, 2011 and 2010. These adjustments are of a normal recurring nature. All material intercompany balances and transactions have been eliminated. The results for the three months ended March 31, 2011 are not necessarily indicative of future financial results. Therefore, these financial statements should be read in conjunction with the financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect (1) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and (2) the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. Our most sensitive estimates involve the valuation of our real estate owned and determination of loan loss reserves.

Note 2. Recently Issued Accounting Pronouncements:

ASC topic 310 Update 2011-02 (Update) was issued in April 2011. The Update clarified guidance on a creditor's evaluation of whether (1) it has granted a concession and (2) a debtor is experiencing financial difficulties. This Update is effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. Early adoption is permitted. We are currently evaluating the impact of this update on our financial statements; however, we anticipate that our loans identified as impaired loans will increase.

Note 3. Reclassifications:

Certain prior period amounts have been reclassified to conform with the current period presentation. These reclassifications had no effect on previously reported net income, cash flows or beneficiaries' equity.

Note 4. Loans Receivable, net:

Loans receivable, net, consisted of the following:

| | March 31, 2011 | December 31, 2010 |
|---|-----------------------|----------------------|
| | <i>(In thousands)</i> | |
| Commercial mortgage loans, pledged to revolving credit facility | \$ 123,525 | \$ 124,065 |
| Commercial mortgage loans, subject to structured notes payable | 38,948 | 40,514 |
| SBIC commercial mortgage loans | 31,157 | 31,289 |
| SBA 7(a) loans, subject to secured borrowings | 24,001 | 20,326 |
| SBA 7(a) loans | 17,704 | 18,673 |
| Total loans receivable | 235,335 | 234,867 |
| Less: | | |
| Deferred commitment fees, net | (5) | (40) |
| Loan loss reserves | (1,887) | (1,609) |
| Loans receivable, net | \$ 233,443 | \$ 233,218 |

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**PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

Commercial mortgage loans, pledged to revolving credit facility

Represents loans of PMC Commercial Trust which collateralize our \$30 million revolving credit facility.

Commercial mortgage loans, subject to structured notes payable

Represents loans contributed to special purpose entities in exchange for a subordinated financial interest in that entity. The collateral of the structured notes payable includes these loans.

SBIC commercial mortgage loans

Loans originated by our Small Business Investment Company (SBIC) subsidiaries.

SBA 7(a) loans, subject to secured borrowings

Represents the government guaranteed portion of loans which were sold with the proceeds received from the sale reflected as secured borrowings government guaranteed loans (a liability on our consolidated balance sheet). There is no credit risk associated with these loans since the SBA has guaranteed payment of the principal.

SBA 7(a) loans

Represents (1) the non-government guaranteed retained portion of loans originated under the SBA 7(a) program and (2) the government guaranteed portion of loans that have not yet been fully funded or legally sold. The balance is net of retained loan discounts of \$1.3 million at both March 31, 2011 and December 31, 2010.

Concentration Risks

We have certain concentrations of investments. Substantially all of our revenue is generated from loans collateralized by hospitality properties. At both March 31, 2011 and December 31, 2010, our loans were 94% concentrated in the hospitality industry. Any economic factors that negatively impact the hospitality industry, including recessions, depressed commercial real estate markets, travel restrictions, gasoline prices, bankruptcies or other political or geopolitical events, could have a material adverse effect on our financial condition and results of operations.

At both March 31, 2011 and December 31, 2010, 19% of our loans were collateralized by properties in Texas. No other state had a concentration of 10% or greater of our loans receivable at March 31, 2011. A decline in economic conditions in any state in which we have a concentration of investments could have a material adverse effect on our financial condition and results of operations.

We have not loaned more than 10% of our assets to any single borrower; however, we have an affiliated group of obligors representing greater than 5% of our loans receivable (approximately 6%) at both March 31, 2011 and December 31, 2010. Any decline in the financial status of this group could have a material adverse effect on our financial condition and results of operations.

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Aging

The following tables represent an aging of our loans receivable. These tables do not include our SBA 7(a) loans receivable, subject to secured borrowings since the SBA has guaranteed payment of the principal.

| Category | March 31, 2011 | | | | | |
|-----------------------------------|----------------|---------------------------------|------------------------|------------------------|------------------------|-------------------|
| | Totals | Commercial Mortgage Loans | | | | SBA 7(a) Loans |
| | | (Dollars in thousands) | (Dollars in thousands) | (Dollars in thousands) | (Dollars in thousands) | |
| Current (1) | \$ 200,962 | 95.1% | \$ 183,918 | 95.0% | \$ 17,044 | 96.3% |
| Between 30 and 59 days delinquent | 3,128 | 1.5% | 2,762 | 1.4% | 366 | 2.1% |
| Between 60 and 89 days delinquent | 476 | 0.2% | 358 | 0.2% | 118 | 0.7% |
| Over 89 days delinquent (2) | 6,768 | 3.2% | 6,592 | 3.4% | 176 | 1.0% |
| | \$ 211,334 | 100.0% | \$ 193,630 | 100.0% | \$ 17,704 | 100.0% |

(1) Includes \$6.8 million of loans which are current under agreements which provide for interest only payments during a short period of time.

(2) Includes \$5.9 million of loans on which the borrowers have filed for Chapter 11 Bankruptcy. We are classified as a secured creditor in the bankruptcy proceedings. In addition, the collateral underlying \$0.8 million of loans included in the over 89 days delinquent category was in the foreclosure process.

| Category | December 31, 2010 | | | | | |
|-----------------------------------|-------------------|---------------------------------|------------------------|------------------------|------------------------|-------------------|
| | Totals | Commercial Mortgage Loans | | | | SBA 7(a) Loans |
| | | (Dollars in thousands) | (Dollars in thousands) | (Dollars in thousands) | (Dollars in thousands) | |
| Current (1) | \$ 196,539 | 91.6% | \$ 178,592 | 91.2% | \$ 17,947 | 96.1% |
| Between 30 and 59 days delinquent | 4,877 | 2.3% | 4,664 | 2.4% | 213 | 1.1% |
| Between 60 and 89 days delinquent | 5,576 | 2.6% | 5,253 | 2.7% | 323 | 1.7% |
| Over 89 days delinquent (2) | 7,549 | 3.5% | 7,359 | 3.8% | 190 | 1.0% |
| | \$ 214,541 | 100.0% | \$ 195,868 | 100.0% | \$ 18,673 | 100.0% |

(1) Includes \$9.0 million of loans which are current under agreements which provide for interest only payments during a short period of time in exchange for additional collateral. Of this, \$7.2 million relates to an affiliated group of obligors described above.

- (2) *Includes \$6.3 million of loans on which the borrowers have filed for Chapter 11 Bankruptcy. We are classified as a secured creditor in the bankruptcy proceedings. In addition, the collateral underlying \$1.1 million of loans included in the over 89 days delinquent category was in the foreclosure process.*

Loan Loss Reserves

We have a quarterly review process to identify and evaluate potential exposure to loan losses. Loans that require specific identification review are identified based on one or more negative characteristics including, but not limited to, non-payment or lack of timely payment of interest and/or principal, non-payment or lack of timely payment of property taxes for an extended period of time, insurance defaults and/or franchise defaults. The specific identification evaluation begins with an estimation of underlying collateral values using appraisals, broker price opinions, tax assessed value and/or revenue analysis. Management uses appraisals as tools in conjunction with other determinants of collateral value to estimate collateral values, not as the sole determinant of value due to the current economic environment. The property valuation takes into consideration current information on property values in general and value changes in commercial real estate and/or hospitality properties. The probability of liquidation is then determined. These probability determinations include macroeconomic factors, the location of the property and economic environment where the property is located, industry specific factors relating primarily to the hospitality industry, our historical experience with similar borrowers and/or individual borrower or collateral characteristics, and in certain circumstances, the strength of the guarantors. The liquidation probability is then applied to the specifically identified exposure to loss to establish the specifically identified reserve for that loan.

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Management closely monitors our loans which require evaluation for loan loss reserves based on specific identification which are classified into three categories: Doubtful, Substandard and Other Assets Especially Mentioned (OAEM) (together Specific Identification Loans). Loans classified as Doubtful are generally loans which are not complying with their contractual terms, the collection of the balance of the principal is considered impaired and liquidation of the collateral securing the loan is probable. These loans are typically placed on non-accrual status and are generally in the foreclosure process. Loans classified as Substandard are generally those loans that are either not complying or had previously not complied with their contractual terms and have other credit weaknesses which may make payment default or principal exposure likely but not yet certain. Loans classified as OAEM are generally loans for which the credit quality of the borrowers has temporarily deteriorated. Typically the borrowers are current on their payments; however, they may be delinquent on their property taxes, insurance, or franchise fees or may be under agreements which provided for interest only payments during a short period of time. In addition, included in OAEM are loans for which the borrowers have filed for Chapter 11 Bankruptcy and we are classified as a secured creditor in the bankruptcy proceedings. Until bankruptcy plans are confirmed, the loans are typically delinquent. Management has classified our loans receivable (excluding our SBA 7(a) loans receivable, subject to secured borrowings since the SBA has guaranteed payment of the principal) as follows (balances represent our investment in the loans prior to loan loss reserves and deferred commitment fees):

| | March 31, 2011 | | | | | |
|--------------|-------------------------------|--------|---------------------------------|--------|-------------------|--------|
| | | | Commercial Mortgage Loans | | SBA 7(a) Loans | |
| | Totals | % | Loans | % | Loans | % |
| | <i>(Dollars in thousands)</i> | | | | | |
| Satisfactory | \$ 179,202 | 84.8% | \$ 162,721 | 84.0% | \$ 16,481 | 93.1% |
| OAEM | 23,438 | 11.1% | 23,426 | 12.1% | 12 | 0.1% |
| Substandard | 6,270 | 3.0% | 5,421 | 2.8% | 849 | 4.8% |
| Doubtful | 2,424 | 1.1% | 2,062 | 1.1% | 362 | 2.0% |
| | \$ 211,334 | 100.0% | \$ 193,630 | 100.0% | \$ 17,704 | 100.0% |
| | December 31, 2010 | | | | | |
| | | | Commercial Mortgage Loans | | SBA 7(a) Loans | |
| | Totals | % | Loans | % | Loans | % |
| | <i>(Dollars in thousands)</i> | | | | | |
| Satisfactory | \$ 187,630 | 87.5% | \$ 169,880 | 86.7% | \$ 17,750 | 95.1% |
| OAEM | 16,886 | 7.9% | 16,872 | 8.6% | 14 | 0.1% |
| Substandard | 9,113 | 4.2% | 8,469 | 4.3% | 644 | 3.4% |
| Doubtful | 912 | 0.4% | 647 | 0.3% | 265 | 1.4% |
| | \$ 214,541 | 100.0% | \$ 195,868 | 100.0% | \$ 18,673 | 100.0% |

At March 31, 2011 and December 31, 2010, we had loan loss reserves of \$1,887,000 and \$1,609,000, respectively, including general loan loss reserves of \$1,220,000 and \$1,100,000, respectively. Our total loan loss reserves and general loan loss reserves as a percentage of our outstanding portfolio (excluding SBA 7(a) loans receivable, subject to secured borrowings) were 90 basis points and 58 basis points, respectively, at March 31, 2011 and 55 basis points

and 35 basis points, respectively, at March 31, 2010. Our provision for loan losses (excluding reductions of loan losses) as a percentage of our weighted average outstanding loans receivable (excluding SBA 7(a) loans receivable, subject to secured borrowings) was 0.18% and 0.07% during the three months ended March 31, 2011 and 2010, respectively. To the extent one or several of our loans experience significant operating difficulties and we are forced to liquidate the loans, future losses may be substantial.

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The activity in our loan loss reserves was as follows:

| | Total | Three Months Ended March 31, 2011 | | 2010 |
|--|----------|--------------------------------------|-------------------|----------|
| | | Commercial Mortgage Loans | SBA 7(a) Loans | |
| | | <i>(In thousands)</i> | | |
| Balance, beginning of year | \$ 1,609 | \$ 1,303 | \$ 306 | \$ 1,257 |
| Provision for loan losses | 378 | 310 | 68 | 162 |
| Reduction of loan losses | (65) | (47) | (18) | (364) |
| Consolidation of the 2000 Joint Venture and the 1998 Partnership reserves | | | | 184 |
| Principal balances written-off | (35) | | (35) | |
| Balance, end of period | \$ 1,887 | \$ 1,566 | \$ 321 | \$ 1,239 |

Information on those loans considered to be impaired loans (loans for which it is probable that the lender will be unable to collect all amounts due according to the original contractual terms of the loan) was as follows:

| | Total | March 31, 2011 | |
|---|----------|---------------------------------|-------------------|
| | | Commercial Mortgage Loans | SBA 7(a) Loans |
| | | <i>(In thousands)</i> | |
| Impaired loans requiring reserves | \$ 1,768 | \$ 1,402 | \$ 366 |
| Impaired loans expected to be fully recoverable | 654 | 654 | |
| Total impaired loans | \$ 2,422 | \$ 2,056 | \$ 366 |

| | Total | December 31, 2010 | |
|---|--------|---------------------------------|-------------------|
| | | Commercial Mortgage Loans | SBA 7(a) Loans |
| | | <i>(In thousands)</i> | |
| Impaired loans requiring reserves | \$ 687 | \$ 419 | \$ 268 |
| Impaired loans expected to be fully recoverable | 228 | 228 | |
| Total impaired loans | \$ 915 | \$ 647 | \$ 268 |

Three Months Ended March 31,
2011
Commercial
Mortgage SBA 7(a)

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| | Total | Loans | Loans | 2010 |
|-----------------------------------|----------|-----------------------|--------|----------|
| | | <i>(In thousands)</i> | | |
| Average impaired loans | \$ 2,444 | \$ 2,053 | \$ 391 | \$ 4,322 |
| Interest income on impaired loans | \$ 2 | \$ | \$ 2 | \$ 13 |

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
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(Unaudited)

Our recorded investment in Non-Accrual Loans at March 31, 2011 of \$8,502,000 was comprised of \$302,000 of SBA 7(a) loans and \$8,200,000 of commercial mortgage loans. Our recorded investment in Non-Accrual Loans at December 31, 2010 of \$12,275,000 was comprised of \$519,000 of SBA 7(a) loans and \$11,756,000 of commercial mortgage loans. Our Non-Accrual Loans were primarily in bankruptcy proceedings or the collateral securing our Non-Accrual Loans was in the process of foreclosure at March 31, 2011 and December 31, 2010. We did not have any loans receivable past due 90 days or more which were accruing interest at March 31, 2011 or December 31, 2010.

Additional Credit Quality Indicator

We consider loan origination dates to be a credit quality indicator of our portfolio. Loans originated from 1991 to 1999 are heavily seasoned; thus typically representing a smaller risk in terms of loss upon liquidation due to paydowns of principal. For loans originated during 2005 to 2007, the businesses collateralizing these loans (within a short period of time following closing of the loans) were subject to extreme conditions including a recession and resulting decrease in property values and performance. Industry performance, while improving, has not yet reached pre-recession levels. The majority of our loans receivable which were over 89 days delinquent at March 31, 2011 and December 31, 2010 were originated from 2005 to 2007.

The years of origination for our loans receivable outstanding (excluding our SBA 7(a) loans receivable, subject to secured borrowings since the SBA has guaranteed payment of the principal) were as follows:

March 31, 2011

| Year of Origination | Totals | | Commercial Mortgage Loans | | SBA 7(a) Loans | |
|---------------------|------------|--------|---------------------------------|--------|-------------------|--------|
| | | | <i>(Dollars in thousands)</i> | | | |
| 1991 to 1999 | \$ 35,661 | 16.9% | \$ 34,339 | 17.7% | \$ 1,322 | 7.5% |
| 2000 to 2004 | 55,458 | 26.2% | 52,853 | 27.3% | 2,605 | 14.7% |
| 2005 to 2007 | 78,504 | 37.1% | 77,177 | 39.9% | 1,327 | 7.5% |
| 2008 to 2011 | 41,711 | 19.7% | 29,261 | 15.1% | 12,450 | 70.3% |
| | \$ 211,334 | 100.0% | \$ 193,630 | 100.0% | \$ 17,704 | 100.0% |

December 31, 2010

| Year of Origination | Totals | | Commercial Mortgage Loans | | SBA 7(a) Loans | |
|---------------------|------------|--------|---------------------------------|--------|-------------------|--------|
| | | | <i>(Dollars in thousands)</i> | | | |
| 1991 to 1999 | \$ 36,405 | 17.0% | \$ 35,057 | 17.9% | \$ 1,348 | 7.2% |
| 2000 to 2004 | 56,497 | 26.3% | 53,739 | 27.4% | 2,758 | 14.8% |
| 2005 to 2007 | 79,118 | 36.9% | 77,773 | 39.7% | 1,345 | 7.2% |
| 2008 to 2010 | 42,521 | 19.8% | 29,299 | 15.0% | 13,222 | 70.8% |
| | \$ 214,541 | 100.0% | \$ 195,868 | 100.0% | \$ 18,673 | 100.0% |

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
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(Unaudited)

Note 5. Other Assets:

Other assets consisted of the following:

| | March 31, 2011 | December 31, 2010 |
|--|-----------------------|----------------------|
| | <i>(In thousands)</i> | |
| Deferred tax asset, net | \$ 1,217 | \$ 1,039 |
| Retained interests in transferred assets | 1,021 | 1,010 |
| Deferred borrowing costs, net | 831 | 836 |
| Servicing asset, net | 830 | 758 |
| Investment in variable interest entities (1) | 820 | 2,183 |
| Interest receivable | 693 | 691 |
| Prepaid expenses and deposits | 409 | 286 |
| Other | 435 | 201 |
| | \$ 6,256 | \$ 7,004 |

(1) During January 2011, our lessee exercised the fixed purchase option related to one of our unconsolidated variable interest entities. No gain or loss was recorded on the transaction.

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(Unaudited)

Note 6. Debt:

Information on our debt was as follows:

| | Carrying Value (1) | | Weighted Average Coupon Rate at | | Weighted Average Interest Rate on Underlying Loans at |
|--|--|-------------------------|------------------------------------|-------------------------|---|
| | March 31, 2011 | December 31, 2010 | March 31, 2011 | December 31, 2010 | March 31, 2011 |
| | <i>(Dollars in thousands, except footnote)</i> | | | | |
| <i>Structured notes payable:</i> | | | | | |
| 2003 Joint Venture | \$ 6,316 | \$ 7,094 | 2.80% | 2.80% | 4.30% |
| 2000 Joint Venture | 10,644 | 11,724 | 7.28% | 7.28% | 9.52% |
| 1998 Partnership | 3,237 | 3,339 | 2.25% | 2.25% | 5.01% |
| | 20,197 | 22,157 | | | |
| Junior subordinated notes | 27,070 | 27,070 | 3.55% | 3.54% | NA |
| Revolving credit facility | 12,200 | 13,800 | 3.25% | 3.25% | NA |
| Debentures payable | 8,178 | 8,177 | 5.90% | 5.90% | NA |
| <i>Secured borrowings government guaranteed loans:</i> | | | | | |
| Loans sold for a premium and excess spread | 19,728 | 15,664 | 3.84% | 3.87% | 5.94% |
| Loans sold for excess spread | 6,074 | 6,101 | 1.58% | 1.58% | 5.96% |
| | 25,802 | 21,765 | | | |
| Debt | \$ 93,447 | \$ 92,969 | | | |

(1) *The face amount of debt as of March 31, 2011 and December 31, 2010 was \$93,459,000 and \$92,982,000, respectively.*

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
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Principal payments on our debt at March 31, 2011 were as follows:

| Years Ending March 31, | Total | Structured Notes and Secured Borrowings (1) <i>(In thousands)</i> | All Other Debt (2) |
|---------------------------|-----------|---|-----------------------|
| 2012 | \$ 16,239 | \$ 4,039 | \$ 12,200 |
| 2013 | 4,277 | 4,277 | |
| 2014 | 8,648 | 4,458 | 4,190 |
| 2015 | 8,620 | 4,620 | 4,000 |
| 2016 | 4,287 | 4,287 | |
| Thereafter | 51,388 | 24,318 | 27,070 |
| | \$ 93,459 | \$ 45,999 | \$ 47,460 |

(1) *Principal payments are generally dependent upon cash flows received from the underlying loans. Our estimate of their repayment is based on scheduled principal payments on the underlying loans. Our estimate will differ from actual amounts to the extent we experience prepayments and/or loan losses. No payment is due on the structured notes or secured borrowings unless payments are received from the borrowers on the loans underlying them.*

(2) *Represents the revolving credit facility, junior subordinated notes and debentures payable.*

Note 7. Share-Based Compensation Plans:

We issued an aggregate of 10,000 restricted shares to executive officers on March 13, 2011 at the then current market price of the shares of \$8.72. The restricted shares vest based on two years of continuous service with one-third of the shares vesting immediately upon issuance of the shares and one-third vesting at the end of each of the next two years. Restricted share awards provide for accelerated vesting if there is a change in control (as defined in the plan).

Compensation expense related to the restricted shares is being recognized over the vesting periods. We recorded compensation expense of \$49,000 and \$24,000 during the three months ended March 31, 2011 and 2010, respectively, related to restricted shares. As of March 31, 2011, there was \$84,000 of total unrecognized compensation expense related to restricted shares which will be recognized over the next two years.

Note 8. Earnings Per Share:

The computations of basic earnings per common share are based on our weighted average shares outstanding. For purposes of calculating diluted earnings per share, the weighted average shares outstanding were increased by 56,000 shares to reflect the dilutive effect of stock options during the three months ended March 31, 2011. During the three months ended March 31, 2010, no shares were added to the weighted average shares outstanding for purposes of calculating diluted earnings per share as options were anti-dilutive.

Not included in the computation of diluted earnings per share were outstanding options to purchase 35,000 and 90,000 common shares during the three months ended March 31, 2011 and 2010, respectively, because the options exercise prices were greater than the average market price of the shares.

Note 9. Dividends Declared:

The Board of Trust Managers declared a \$0.16 per common share quarterly dividend to common shareholders of record on March 31, 2011 which was paid on April 11, 2011.

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We have certain covenants within our revolving credit facility which limit our ability to pay out returns of capital as part of our dividends. These restrictions have not historically limited the amount of dividends we have paid and management does not believe that they will restrict future dividend payments.

Note 10. Income Taxes:

PMC Commercial has elected to be taxed as a real estate investment trust (REIT) under the Internal Revenue Code of 1986, as amended (the Code). To qualify as a REIT, PMC Commercial must meet a number of organizational and operational requirements, including a requirement that we distribute at least 90% of our REIT taxable income to our shareholders. As a REIT, PMC Commercial generally will not be subject to corporate level Federal income tax on net income that is currently distributed to shareholders.

PMC Commercial has wholly-owned taxable REIT subsidiaries (TRS s) which are subject to Federal income taxes. The income generated from the TRS s is taxed at normal corporate rates.

Note 11. Discontinued Operations:

Our discontinued operations consisted of the following:

| | Three Months Ended March 31, | |
|-------------------------------|------------------------------|-------|
| | 2011 | 2010 |
| | <i>(In thousands)</i> | |
| Gains on sales of real estate | \$ 2 | \$ 76 |
| Net losses | (210) | (65) |
| Discontinued operations | \$ (208) | \$ 11 |

In January 2010, we sold an asset acquired through foreclosure for cash proceeds of \$2.5 million and recorded a gain of \$76,000.

In March 2010, we sold an asset acquired through foreclosure for \$2,275,000 and financed the sale (representing a non-cash reclassification from real estate owned to loans receivable). No gain or loss was recorded on the transaction.

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Note 12. Fair Value Measurements:

For impaired loans measured at fair value on a nonrecurring basis during the three months ended March 31, 2011 and 2010, the following table provides the carrying value of the related individual assets at quarter end. We used Level 3 inputs to determine the estimated fair value of our impaired loans.

| | Carrying Value at | | Provision for | |
|--------------------|-----------------------|----------|--------------------|-------|
| | March 31, | | Loan Losses | |
| | 2011 | 2010 | Three Months Ended | |
| | | | March 31, (2) | |
| | | | 2011 | 2010 |
| | <i>(In thousands)</i> | | | |
| Impaired loans (1) | \$ 2,174 | \$ 3,955 | \$ 18 | \$ 45 |

(1) *Carrying value represents our impaired loans net of loan loss reserves. Our carrying value is determined based on management's assessment of the fair value of the collateral based on numerous factors including operating statistics to the extent available, appraised value of the collateral, tax assessed value and market environment.*

(2) *Represents the net change in the provision for loan losses included in our consolidated statements of income related specifically to these loans during the periods presented.*

For real estate owned, our carrying value approximates the estimated fair value at the time of foreclosure and the lower of cost or fair value thereafter. We use Level 3 inputs to determine the estimated fair value of our real estate owned. The carrying value of our real estate owned is established at the time of foreclosure based upon management's assessment of its fair value based on numerous factors including operating statistics to the extent available, the appraised value, tax assessed value and market environment. At March 31, 2011 and December 31, 2010, the carrying value and estimated fair value of our real estate owned was \$3,494,000 and \$3,477,000, respectively. Included within our real estate owned is a full service hospitality property with a carrying value and estimated fair value of \$1,046,000 at March 31, 2010 which is owned by the 2003 Joint Venture.

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The estimated fair values of our financial and nonfinancial instruments were as follows:

| | March 31, 2011 | Estimated Fair Value | December 31, 2010 | Estimated Fair Value |
|--|-----------------------|----------------------------|----------------------|----------------------------|
| | Carrying Amount | Value | Carrying Amount | Value |
| | <i>(In thousands)</i> | | | |
| Assets: | | | | |
| Loans receivable, net | \$ 233,443 | \$ 231,570 | \$ 233,218 | \$ 228,821 |
| Retained interests in transferred assets | 1,021 | 1,021 | 1,010 | 1,010 |
| Cash and cash equivalents | 2,937 | 2,937 | 2,642 | 2,642 |
| Restricted cash and cash equivalents | 5,450 | 5,450 | 5,786 | 5,786 |
| Liabilities: | | | | |
| Structured notes and SBIC debentures payable | 28,375 | 28,777 | 30,334 | 30,781 |
| Secured borrowings government guaranteed loans | 25,802 | 25,802 | 21,765 | 21,765 |
| Revolving credit facility | 12,200 | 12,200 | 13,800 | 13,800 |
| Junior subordinated notes | 27,070 | 22,334 | 27,070 | 22,310 |

In general, estimates of fair value may differ from the carrying amounts of the financial assets and liabilities primarily as a result of the effects of discounting future cash flows. Considerable judgment is required to interpret market data and develop estimates of fair value. Accordingly, the estimates presented may not be indicative of the amounts we could realize in a current market exchange.

Loans receivable, net: Our loans receivable are recorded at cost and adjusted by net loan origination fees and discounts. In order to determine the estimated fair value of our loans receivable, we use a present value technique for the anticipated future cash flows using certain assumptions including a current discount rate, prepayment tendencies and potential loan losses. Reserves are established based on numerous factors including, but not limited to, the creditor's payment history, collateral value, guarantor support and other factors. In the absence of a readily ascertainable market value, the estimated value of our loans receivable may differ from the values that would be placed on the portfolio if a ready market for the loans receivable existed.

Retained interests in transferred assets: In order to determine the estimated fair value of our retained interests in transferred assets, we use a present value technique for the anticipated future cash flows using certain assumptions including a current discount rate and prepayment tendencies.

Cash and cash equivalents: The carrying amount is considered to be reasonable estimates of fair value due to the short maturity of these funds.

Restricted cash and cash equivalents: Restricted cash and cash equivalents represent our collection and reserve accounts of the securitizations. The carrying amount is considered to be a reasonable estimate of their fair value due to (1) the short maturity of the collection account, (2) the majority of our reserve accounts can be used at any time in conjunction with the exercise of our clean-up call options and (3) the reserve accounts providing collateral value at their current carrying amounts to the structured noteholders.

Structured notes payable, SBIC debentures payable and junior subordinated notes: The estimated fair value is based on a present value calculation based on prices of the same or similar instruments after considering market risks, current interest rates and remaining maturities.

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**PMC COMMERCIAL TRUST AND SUBSIDIARIES
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(Unaudited)

Secured borrowings – government guaranteed loans: The estimated fair value approximates cost as the value of the loans that were sold approximates the value we would be able to attain in similar current third-party transactions.

Revolving credit facility: The carrying amount is a reasonable estimation of fair value as the interest rate on this instrument is variable and the short duration to maturity.

Note 13. Commitments and Contingencies:

Loan Commitments

Commitments to extend credit are agreements to lend to a customer provided the terms established in the contract are met. Our outstanding loan commitments and approvals to fund loans were approximately \$12.5 million at March 31, 2011, the majority of which were for prime-based loans to be originated by First Western, the government guaranteed portion of which is intended to be sold. Commitments generally have fixed expiration dates. Since some commitments are expected to expire without being drawn upon, total commitment amounts do not necessarily represent future cash requirements.

Operating Lease

We lease office space in Dallas, Texas under a lease which expires in October 2011. During April 2011, we signed an amendment extending this lease to February 2015. Future minimum lease payments approximate \$709,000.

Employment Agreements

We have employment agreements with our executive officers for three-year terms expiring June 30, 2013. Under certain circumstances, as defined within the agreements, the agreements provide for (1) severance compensation or change in control payments to the executive officer in an amount equal to 2.99 times the average of the last three years annual compensation paid to the executive officer and (2) death and disability payments in an amount equal to two times and one time, respectively, the annual compensation paid to the executive officer.

Structured Loan Sale Transactions

The documents of the structured loan sale transactions contain provisions (the Credit Enhancement Provisions) that govern the assets and the inflow and outflow of funds of the entities originally formed as part of the structured loan sale transactions. The Credit Enhancement Provisions include specified increased reserve requirements. If, at any measurement date, the loans in structured loan transactions were delinquent in excess of specified limits or were considered charged-off loans in accordance with the transaction documents, the Credit Enhancement Provisions would require an increase in the level of credit enhancement (reserve fund). During the period in which the Credit Enhancement Provisions were in effect, excess cash flow from the entity, if any, which would otherwise be distributable to us, would be used to fund the increased credit enhancement levels until the specified reserve requirement was met and would delay or reduce our distribution. In general, there can be no assurance that amounts deferred under Credit Enhancement Provisions would be received in future periods or that future deferrals or losses would not occur. As a result of a delinquent loan in the 2003 Joint Venture, Credit Enhancement Provisions were triggered during the first quarter of 2009. As a consequence, cash flows related to this transaction otherwise distributable to us are being deferred and utilized to fund the increased credit enhancement requirement. Based on current cash flow assumptions, management anticipates that the funds will be received in future periods.

Litigation

We had significant outstanding claims against Arlington Hospitality, Inc. and its subsidiary, Arlington Inns, Inc. (together Arlington) bankruptcy estates. Arlington objected to our claims and initiated a complaint in the bankruptcy seeking, among other things, the return of payments Arlington made pursuant to the property leases and the master lease agreement. While confident that a substantial portion of our claims would have been allowed and the claims against us would have been disallowed, due to the exorbitant cost of defense coupled with the likelihood of reduced available assets in the debtors' estates to pay claims, we executed an agreement with Arlington to settle our claims against Arlington and Arlington's claims against us. The settlement provides that Arlington will dismiss its claims seeking the return of certain payments made pursuant to the property leases and master lease agreement and substantially reduces our claims against the Arlington estates. The settlement further provides for mutual releases

among the parties. The Bankruptcy Court approved the settlement. Accordingly, there are no remaining assets or liabilities recorded in the accompanying consolidated financial statements related to this matter. However, the settlement will only become final upon the Bankruptcy Court's approval of Arlington's liquidation plan which was filed during the third quarter of 2007. Due to the complexity of the bankruptcy, we cannot estimate when, or if, the liquidation plan will be approved.

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In the normal course of business we are periodically party to certain legal actions and proceedings involving matters that are generally incidental to our business (*i.e.*, collection of loans receivable). In management's opinion, the resolution of these legal actions and proceedings will not have a material adverse effect on our consolidated financial statements.

Other

If the SBA establishes that a loss on an SBA guaranteed loan is attributable to significant technical deficiencies in the manner in which the loan was originated, funded or serviced by us, the SBA may seek recovery of the principal loss related to the deficiency from us. With respect to the guaranteed portion of SBA loans that have been sold, the SBA will first honor its guarantee and then seek compensation from us in the event that a loss is deemed to be attributable to technical deficiencies. Based on historical experience, we do not expect that this contingency would be material to the financial statements if asserted.

Table of Contents**ITEM 2.****Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created thereby. Such forward-looking statements can be identified by the use of forward-looking terminology such as may, will, expect, intend, believe, anticipate, estimate, or continue, or the negative thereof or other variations or similar words or phrases. These statements include the plans and objectives of management for future operations, including, but not limited to, plans and objectives relating to future growth of the loan portfolio and availability of funds. The forward-looking statements included herein are based on current expectations and there can be no assurance that these expectations will be attained. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Form 10-Q will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. Readers are cautioned not to place undue reliance on forward-looking statements. Forward-looking statements speak only as of the date they are made. We do not undertake to update them to reflect changes that occur after the date they are made.

The following discussion of our financial condition at March 31, 2011 and results of operations for the three months ended March 31, 2011 and 2010 should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2010. For a more detailed description of the risks affecting our financial condition and results of operations, see Risk Factors in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010.

EXECUTIVE SUMMARY**General Economic Environment*****Commercial Real Estate and Lodging Industry***

Economic conditions have subjected our borrowers to financial stress. The operations of the limited service hospitality properties collateralizing our loans were negatively impacted by the recent recessionary economic environment. As a result, we are experiencing a significant number of issues related to our borrowers including payment delinquencies, slow pays, insufficient funds payments, non-payment or lack of timely payment of real estate taxes and franchise fees, requests for payment deferrals, lack of cash flow for franchise required improvements or maintenance issues jeopardizing continuation of franchises, terminating franchises, conversion to lesser franchises, deterioration of the physical property (our collateral) and declining property values. As such, our litigation and foreclosure activity and related costs have increased.

There has been an increase in mortgage defaults and foreclosures in the broader commercial real estate market and these defaults may continue. This increase is due in part to credit market turmoil and declining property cash flows and property values. In addition, when foreclosures on commercial real estate properties increase, the property values typically decline even further as supply exceeds demand. We have experienced an increase in litigation (including borrowers who have filed for bankruptcy reorganization) and foreclosure activity. In conjunction with this increase in foreclosure activity, we have experienced, and will likely continue to experience, an increase in expenses, including general and administrative, provision for loan losses and impairment losses. Further, our ability to sell our real estate owned (REO) and the prices we receive on sale are affected by many factors, including but not limited to, the number of potential buyers, the number of competing properties on the market and other market conditions. As a result of the challenging economic conditions, our holding periods for our REO have increased.

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Historically, we have not experienced significant losses on real estate secured loans due to our borrowers' equity in their properties, the value of the underlying collateral, the cash flows from operations of the businesses and other factors, such as having recourse to the guarantors. However, if the economy or the commercial real estate market does not continue to improve, we could experience an increase in credit losses. In addition, due to the prolonged economic downturn and the current economic environment, we believe that in general, our borrowers' equity in their properties has been eroded and may further erode which may result in an increase in foreclosure activity and credit losses. Additional changes to the facts and circumstances of the individual borrowers, the limited service hospitality industry and the economy may require the establishment of significant additional loan loss reserves and the effect on our results of operations and financial condition may be material.

Liquidity

Our revolving credit facility matures on December 31, 2011. The total amount available under the revolving credit facility is \$30 million. We are currently in the process of finalizing an agreement with our current lender that would, among other things, extend the facility until December 31, 2013. There can be no assurance that we will be able to finalize this agreement.

We currently are targeting 2011 loan origination volume of between \$40 million and \$50 million. We anticipate net funding needs from our revolving credit facility for these originations to be between \$6 million and \$11 million during 2011 after sale of the guaranteed portion of the SBA 7(a) loans.

At this time, we are uncertain as to how long we will continue to be impacted by the current lack of long-term liquidity and what shape the economy will take in the future. As a result of the prolonged downturn in the real estate markets, the availability of capital for providers of real estate financing was severely restricted. As a result, capital providers (including banks and insurance companies) substantially reduced the availability and increased the cost of debt capital for many companies originating commercial mortgages. These challenges continue to impact our ability to fully utilize our lending platform and have reduced yields on our assets as interest rates declined and remained at low levels.

A major part of our business plan was to originate loans and then sell those loans through privately-placed structured loan transactions while retaining residual interests in the loans sold by retaining a subordinate financial interest. While we believe that a portion of our retained portfolio of loans could be used as collateral for a securitization, a market for our type of securitization may not be available at terms which are acceptable to us in the future.

Strategic Alternatives

The current credit and capital market environment remains unstable for commercial real estate lenders. While we continue to explore and evaluate strategic opportunities, our primary focus is on maximizing the value of our current investment portfolio and business strategy and exploring opportunities for alternative liquidity sources.

Secondary Market Loan Sales

We continue to focus on the origination of SBA 7(a) loans which require less capital due to the ability to sell the government guaranteed portion of such loans. We utilize the SBA 7(a) program to originate small business loans, primarily secured by real estate, and then sell the government guaranteed portion to investors.

During the first three months of 2011, we sold \$8.5 million of the guaranteed portion of SBA 7(a) loans for (1) cash premiums and 100 basis points (1%) (the minimum spread required to be retained pursuant to SBA regulations) as the servicing spread on the sold portion of the loan or (2) future servicing spreads averaging 187 basis points (including the 100 basis points required to be retained) and cash premiums of 10% (*i.e.*, hybrid loan sales). For hybrid loan sales, gains are not recognized at the time of sale due to accounting rules.

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Loans originated and principal repayments on our Retained Portfolio were as follows:

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2011 | 2010 |
| | <i>(In thousands)</i> | |
| Loans Originated: | | |
| Loans Funded: | | |
| SBA 7(a) loans | \$ 7,866 | \$ 10,782 |
| Commercial mortgage loans | 206 | 40 |
| Total loans funded | 8,072 | 10,822 |
| Other Loan Transactions: | | |
| 2000 Joint Venture (1) | | 22,912 |
| 1998 Partnership (1) | | 5,024 |
| Loans originated to facilitate sales of real estate owned | | 2,275 |
| Total loans originated | \$ 8,072 | \$ 41,033 |
| Principal Reductions: | | |
| Scheduled principal payments | \$ 2,699 | \$ 2,806 |
| Prepayments | 162 | 2,217 |
| Proceeds from sale of SBA 7(a) guaranteed loans | 4,680 | |
| Total principal reductions | \$ 7,541 | \$ 5,023 |

(1) The 2000 Joint Venture and the 1998 Partnership were consolidated effective January 1, 2010 due to a change in accounting rules.

Interest Rate Information

The LIBOR and the prime rate used in determining interest rates to be charged to our borrowers during the first quarter of 2011 (set on January 1, 2011) was 0.30% and 3.25%, respectively, while the LIBOR and prime rate charged during the fourth quarter of 2010 (set on October 1, 2010) was 0.29% and 3.25%, respectively. To the extent LIBOR or the prime rate changes, we will have changes in interest income from our variable-rate loans.

Retained Portfolio Breakdown

Our Retained Portfolio was comprised of the following:

| | March 31, 2011 | | | December 31, 2010 | | |
|---------------------|-------------------------------|-------|--------------------------------|--------------------|-------|--------------------------------|
| | Retained Portfolio | | Weighted Average Interest Rate | Retained Portfolio | | Weighted Average Interest Rate |
| | Amount | % | Rate | Amount | % | Rate |
| | <i>(Dollars in thousands)</i> | | | | | |
| Variable-rate LIBOR | \$ 135,569 | 58.1% | 4.2% | \$ 125,606 | 53.9% | 4.2% |
| Fixed-rate | 50,926 | 21.8% | 9.2% | 63,263 | 27.1% | 9.1% |
| Variable-rate prime | 46,948 | 20.1% | 5.7% | 44,349 | 19.0% | 5.7% |

| | | | | | |
|------------|--------|------|------------|--------|------|
| \$ 233,443 | 100.0% | 5.6% | \$ 233,218 | 100.0% | 5.8% |
|------------|--------|------|------------|--------|------|

Table of Contents**Portfolio Quality**

At March 31, 2011 and December 31, 2010, we had loan loss reserves of \$1,887,000 and \$1,609,000, respectively, including general reserves of \$1,220,000 and \$1,100,000, respectively. Our provision for loan losses (excluding reductions of loan losses) as a percentage of our weighted average outstanding loans receivable (excluding our SBA 7(a) loans receivable, subject to secured borrowings) was 0.18% and 0.07% during the three months ended March 31, 2011 and 2010, respectively. To the extent one or several of our loans experience significant operating difficulties and we are forced to liquidate the loans, future losses may be substantial.

Management closely monitors our loans which require evaluation for loan loss reserves based on specific identification which are classified into three categories: Doubtful, Substandard and Other Assets Especially Mentioned (OAEM) (together Specific Identification Loans). Loans classified as Doubtful are generally loans which are not complying with their contractual terms, the collection of the balance of the principal is considered impaired and liquidation of the collateral securing the loan is probable. These loans are typically placed on non-accrual status and are generally in the foreclosure process. Loans classified as Substandard are generally those loans that are either not complying or had previously not complied with their contractual terms and have other credit weaknesses which may make payment default or principal exposure likely but not yet certain. Loans classified as OAEM are generally loans for which the credit quality of the borrowers has temporarily deteriorated. Typically the borrowers are current on their payments; however, they may be delinquent on their property taxes, insurance, or franchise fees or may be under agreements which provided for interest only payments during a short period of time. In addition, included in OAEM are loans for which the borrowers have filed for Chapter 11 Bankruptcy and we are classified as a secured creditor in the bankruptcy proceedings. Until bankruptcy plans are confirmed, the loans are typically delinquent.

Management has classified our loans receivable (excluding our SBA 7(a) loans receivable, subject to secured borrowings since the SBA has guaranteed payment of the principal) as follows (balances represent our investment in the loans prior to loan loss reserves and deferred commitment fees):

| | March 31, 2011 | | | | | |
|--------------|-------------------------------|--------|---------------------------------|--------|-------------------|--------|
| | Totals | % | Commercial Mortgage Loans | % | SBA 7(a) Loans | % |
| | <i>(Dollars in thousands)</i> | | | | | |
| Satisfactory | \$ 179,202 | 84.8% | \$ 162,721 | 84.0% | \$ 16,481 | 93.1% |
| OAEM | 23,438 | 11.1% | 23,426 | 12.1% | 12 | 0.1% |
| Substandard | 6,270 | 3.0% | 5,421 | 2.8% | 849 | 4.8% |
| Doubtful | 2,424 | 1.1% | 2,062 | 1.1% | 362 | 2.0% |
| | \$ 211,334 | 100.0% | \$ 193,630 | 100.0% | \$ 17,704 | 100.0% |

| | December 31, 2010 | | | | | |
|--------------|-------------------------------|--------|---------------------------------|--------|-------------------|--------|
| | Totals | % | Commercial Mortgage Loans | % | SBA 7(a) Loans | % |
| | <i>(Dollars in thousands)</i> | | | | | |
| Satisfactory | \$ 187,630 | 87.5% | \$ 169,880 | 86.7% | \$ 17,750 | 95.1% |
| OAEM | 16,886 | 7.9% | 16,872 | 8.6% | 14 | 0.1% |
| Substandard | 9,113 | 4.2% | 8,469 | 4.3% | 644 | 3.4% |
| Doubtful | 912 | 0.4% | 647 | 0.3% | 265 | 1.4% |
| | \$ 214,541 | 100.0% | \$ 195,868 | 100.0% | \$ 18,673 | 100.0% |

We begin foreclosure and liquidation proceedings when we determine the pursuit of these remedies is the most appropriate course of action. Foreclosure and bankruptcy are complex and sometimes lengthy processes that are subject to Federal and state laws and regulations.

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We are currently in the process of foreclosure proceedings on several properties collateralizing our loans. Historically, subsequent to commencement of the foreclosure process, many borrowers brought their loans current; thus, we stopped the foreclosure process. However, in general, we believe that our borrowers' equity in their properties has eroded and may further erode which may result in an increase in foreclosure activity and credit losses. Borrowers have the option of seeking Federal bankruptcy protection which could delay the foreclosure process. In conjunction with bankruptcy process, the terms of the loan agreement may be modified. Typically, delays in the foreclosure process will have a negative impact on our results of operations and/or financial condition due to direct and indirect costs incurred and possible deterioration of the collateral. It is difficult to determine what impact the market disruptions will have on our borrowers whose collateral is in the process of foreclosure and the borrowers' ability to become current on their loans.

Properties being foreclosed upon typically have deteriorated both physically (requiring certain repairs and maintenance and discretionary capital spending) and in their market (*i.e.*, issues with the properties' vendors and reputation requiring rebuilding of its customer and vendor base). To the extent properties are acquired through foreclosure, we will incur holding costs including, but not limited to, taxes, legal fees and insurance. In many cases, (1) cash flows have been reduced such that expenses exceed revenues and (2) franchise issues must be addressed (*i.e.*, quality and brand standards and non-payment of franchise fees). Notwithstanding the foregoing, we believe that in most cases it is prudent to continue to have the business operate until the property can be sold because of a property's increased marketability as an operating entity compared to non-operating (demonstrated historically through our sales efforts and from information received from third-party brokers). We will hire third-party management companies to operate the properties until they are sold.

RESULTS OF OPERATIONS**Three Months Ended March 31, 2011 Compared to the Three Months Ended March 31, 2010****Overview**

| | Three Months Ended March | | Change | |
|-----------------------------------|-------------------------------|----------|----------|---------|
| | 2011 | 31, 2010 | \$ | % |
| | <i>(Dollars in thousands)</i> | | | |
| Total revenues | \$ 4,056 | \$ 3,455 | \$ 601 | 17.4% |
| Total expenses | \$ 2,907 | \$ 2,296 | \$ 611 | 26.6% |
| Income from continuing operations | \$ 1,124 | \$ 1,267 | \$ (143) | (11.3%) |
| Net income | \$ 916 | \$ 1,278 | \$ (362) | (28.3%) |

Revenues increased primarily due to an increase in premium income. Expenses increased primarily due to a change in provision for (reduction) of loan losses, net which was a provision of \$313,000 during the three months ended March 31, 2011 compared to a reduction of \$202,000 during the three months ended March 31, 2010.

The primary cause of the reduction in net income from 2010 to 2011 was a \$219,000 change in discontinued operations which generated a loss of \$208,000 during the three months ended March 31, 2011 compared to income of \$11,000 during the three months ended March 31, 2010. During 2011, we are generating significant operating losses from our REO primarily related to those properties we acquired through foreclosure subsequent to the first quarter of 2010.

More detailed information on the composition of and changes in our revenues and expenses is provided below.

Revenues

We had an increase in interest income of \$150,000 which was primarily attributable to an increase in our weighted average loans receivable outstanding to \$233.3 million from \$226.8 million during the three months ended March 31, 2010. At March 31, 2011, approximately 78% of our loans had variable interest rates. The base LIBOR charged to our borrowers increased slightly from 0.25% during the three months ended March 31, 2010 to 0.30% during the three months ended March 31, 2011.

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Other income consisted of the following:

| | Three Months Ended March 31, | |
|--|---------------------------------|--------|
| | 2011 | 2010 |
| | <i>(In thousands)</i> | |
| Premium income | \$ 431 | \$ |
| Servicing income | 97 | 78 |
| Retained interests in transferred assets | 53 | 41 |
| Loan related income other | 46 | 58 |
| Equity in earnings | 17 | 19 |
| Prepayment fees | | 42 |
| Other | 45 | |
| | \$ 689 | \$ 238 |

Premium income results from the sale of the government guaranteed portion of SBA 7(a) loans into the secondary market. Beginning January 1, 2010, due to a change in accounting rules, premium income to be recognized was deferred for a period of at least 90 days until any potential contingency period for having to refund these premiums was satisfied. Therefore, no premium income was recorded during the first quarter of 2010. However, contingency periods were eliminated during the first quarter of 2011; therefore, we recorded premium income for those sales for solely cash premiums and the required 1% servicing spread. We sold \$8.5 million and \$6.6 million of the government guaranteed portion of SBA 7(a) loans during the three months ended March 31, 2011 and 2010, respectively. Cash premiums collected during the three months ended March 31, 2011 and 2010 were \$828,000 and \$190,000, respectively. Premium income will not equal collected cash premiums (1) because premium income represents the difference between the relative fair value attributable to the sale of the government guaranteed portion of the loan and the principal balance (cost) of the loan adjusted by costs of origination and (2) due to a change in accounting rules which does not allow immediate recognition to premium income of cash premiums collected on hybrid loan sales (instead they are amortized as a reduction of interest expense over the life of the loan) and the prior year contingency period discussed above.

Interest Expense

Interest expense consisted of the following:

| | Three Months Ended March 31, | |
|---------------------------|---------------------------------|--------|
| | 2011 | 2010 |
| | <i>(In thousands)</i> | |
| Structured notes payable | \$ 273 | \$ 346 |
| Junior subordinated notes | 243 | 239 |
| Secured borrowings | 186 | 19 |
| Revolver | 127 | 200 |
| Debentures payable | 122 | 123 |
| Other | 22 | 62 |
| | \$ 973 | \$ 989 |

The weighted average cost of our funds was 4.0% during the three months ended March 31, 2011 compared to 3.9% during the three months ended March 31, 2010.

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Effective January 1, 2010, we record interest expense on secured borrowings relating to sales of the government guaranteed portion of our SBA 7(a) loans. Our weighted average secured borrowings increased to \$23.8 million during the three months ended March 31, 2011 compared to \$3.4 million during the three months ended March 31, 2010. This expense will continue to increase as we sell loans as hybrids or solely for servicing spread.

The weighted average balance outstanding on our revolving credit facility decreased to \$12.7 million during the three months ended March 31, 2011 compared to \$22.2 million during the three months ended March 31, 2010 while the interest rate remained constant.

Other Expenses

General and administrative expense decreased \$64,000 during the three months ended March 31, 2011 compared to the three months ended March 31, 2010. General and administrative expenses are comprised of (1) corporate overhead including legal and other professional expenses, sales and marketing expenses, public company and regulatory costs and (2) expenses related to assets currently in the process of foreclosure. Our corporate overhead increased to \$428,000 during the three months ended March 31, 2011 compared to \$380,000 during the three months ended March 31, 2010 primarily due to increased professional fees. Expenses related to assets currently in the process of foreclosure totaled \$188,000 during the three months ended March 31, 2010 compared to \$76,000 during the three months ended March 31, 2011. We expect to continue to incur general and administrative expenses related to collateral dependent loans until the foreclosure processes are completed; however, these expenses are difficult to estimate and may be material.

We had a provision for loan losses, net, of \$313,000 during the three months ended March 31, 2011 compared to a reduction of loan losses, net, of \$202,000 during the three months ended March 31, 2010. The increase during the three months ended March 31, 2011 was comprised of \$120,000 related to an increase in general reserves and \$193,000 in specific identification reserves. The increase in our specific identification reserves is primarily due to establishment of a reserve on a limited service hospitality loan. The reduction of loan losses during the three months ended March 31, 2010 was related to specific identification reserves primarily related to positive changes in (1) the financial condition of certain borrowers and (2) collateral valuation on a limited service hospitality loan.

We had a provision for income taxes of \$25,000 during the three months ended March 31, 2011 compared to an income tax benefit of \$108,000 during the three months ended March 31, 2010. The primary cause of the change in income taxes is the combined net income of our taxable REIT subsidiaries which was a loss of \$233,000 during the first quarter of 2010 compared to income of \$28,000 during the first quarter of 2011. See REIT Taxable Income.

Discontinued Operations

We recorded a gain on the sale of an asset acquired through foreclosure of \$76,000 during the three months ended March 31, 2010. As of March 31, 2011, previously deferred gains of \$683,000 remain from property sales we financed. Based on expected principal reductions during the second quarter of 2011, we anticipate recognition of a significant amount of these gains during the second quarter of 2011.

Our net losses from discontinued operations were \$210,000 and \$65,000 during the three months ended March 31, 2011 and 2010, respectively, arising from the operations and holding costs of our REO. The estimated fair value of our REO at March 31, 2011 was \$3,494,000. We expect these costs to continue at their current rate or possibly increase during the second quarter assuming no properties are sold. Our ability to sell our REO and the prices we receive on sale are affected by many factors, including but not limited to, the number of potential buyers, the number of competing properties on the market and other market conditions. As a result of the challenging economic conditions, our holding periods for our REO have increased.

Table of Contents**LIQUIDITY AND CAPITAL RESOURCES****Cash Flow Analysis**

Information on our cash flow was as follows:

| | Three Months Ended March 31, | | Change |
|---|---------------------------------|------------|----------|
| | 2011 | 2010 | |
| | <i>(In thousands)</i> | | |
| Cash used in operating activities | \$ (1,314) | \$ (7,920) | \$ 6,606 |
| Cash provided by investing activities | 3,184 | 4,967 | (1,783) |
| Cash provided by (used in) financing activities | (1,575) | 1,338 | (2,913) |
| Net cash flow | \$ 295 | \$ (1,615) | \$ 1,910 |

Operating Activities

As a REIT, our earnings are typically used to fund our dividends. Since operating cash flows also include lending activities, it is necessary to adjust our cash flow from operating activities for our lending activities to determine coverage of our dividends from operations. Therefore, we adjust net cash provided by operating activities to Modified Cash. Management believes that our modified cash available for dividend distributions (Modified Cash) is a more appropriate indicator of operating cash coverage of our dividend payments than cash flow provided by (used in) operating activities. Modified Cash is calculated by adjusting our cash provided by (used in) operating activities by (1) the change in operating assets and liabilities and (2) loans funded, held for sale, net of proceeds from sale of guaranteed loans and principal collected on loans (Operating Loan Activity). Modified Cash is one of the measurements used by our Board of Trust Managers (the Board) in its determination of dividends and their timing. In respect to our dividend policy, we believe that the disclosure of Modified Cash adds additional transparency to our dividend calculation and intentions. However, Modified Cash may differ significantly from dividends paid due to timing differences between book income and taxable income and timing of payment of dividends to eliminate or reduce Federal income taxes or excise taxes at the REIT level.

The following reconciles net cash used in operating activities to Modified Cash:

| | Three Months Ended March 31, | |
|--|---------------------------------|------------|
| | 2011 | 2010 |
| | <i>(In thousands)</i> | |
| Net cash used in operating activities | \$ (1,314) | \$ (7,920) |
| Change in operating assets and liabilities | 850 | (569) |
| Operating Loan Activity | 2,129 | 9,401 |
| Modified Cash | \$ 1,665 | \$ 912 |

The primary reason for the increase in Modified Cash was cash premiums collected on secondary market loan sales which increased to \$828,000 during the first quarter of 2011 compared to \$190,000 during the first quarter of 2010.

To the extent Modified Cash does not cover the current dividend distribution rate or if additional cash is needed based on our working capital needs, the Board may choose to modify its current dividend policy. During the three months ended March 31, 2011 and 2010, dividend distributions were greater than our Modified Cash by \$25,000 and \$797,000, respectively. To the extent we need working capital to fund any shortfall in operating cash flows to cover our dividend distribution, we would need to borrow the funds from our revolving credit facility or use funds from the repayment of principal on loans receivable.

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Investing Activities

Our primary investing activity is the origination of loans and collections on our investment portfolio. During the three months ended March 31, 2011 and 2010, the primary source of funds was principal collected on loans, net of loans funded of \$1,487,000 and \$3,592,000, respectively. We expect that this will continue to be our primary source of funds from investing activities. During the three months ended March 31, 2011, we also received cash proceeds from our unconsolidated subsidiary of \$1,373,000 when our lessee exercised their fixed purchase option. In addition, during the three months ended March 31, 2010, we sold an asset included in REO and collected cash proceeds of \$2,264,000.

Financing Activities

We used funds from financing activities during the three months ended March 31, 2011 and 2010 primarily (1) to pay dividends of \$1,690,000 and \$1,709,000, respectively, and (2) for net repayment on our revolving credit facility of \$1,600,000 and \$800,000, respectively. Proceeds from Secondary Market Loans Sales recorded as secured borrowings during the three months ended March 31, 2011 and 2010 were \$3,786,000 and \$6,629,000, respectively. In addition, during the three months ended March 31, 2010, we redeemed \$2,000,000 of redeemable preferred stock of subsidiary due in May 2010 using cash on hand of one of our SBIC subsidiaries.

Sources and Uses of Funds

Liquidity Summary

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund loans and other investments, pay dividends, fund debt service and for other general corporate purposes. Our primary sources of funds to meet our short-term liquidity needs, including working capital dividends, debt service and additional investments, if any, consist of (1) Secondary Market Loan Sales, (2) proceeds from principal and interest payments, including prepayments, and (3) borrowings under any credit facilities. We believe these sources of funds will be sufficient to meet our liquidity requirements in the short-term.

Our revolving credit facility (the Revolver) matures on December 31, 2011. The total amount available under the Revolver is \$30 million. We are currently in the process of finalizing an agreement with our current lender that would, among other things, extend the facility until December 31, 2013. There can no assurance that we will be able to finalize this agreement.

Currently we believe that access to debt capital through new warehouse lines or securitization issuances is not available to us or, to the extent available, with terms that would be unacceptable to us. In the event we are not able to extend or refinance our Revolver upon its maturity in December 2011 or successfully secure alternative financing, we will rely on Modified Cash, principal payments (including prepayments), and (if necessary) proceeds from asset and loan sales to satisfy our liquidity requirements.

If we are unable to make required payments under our borrowings, breach any representation or warranty of our borrowings or violate any covenant, our lenders may accelerate the maturity of our debt or require us to liquidate pledged collateral or force us to take other actions. In connection with an event of default under our Revolver, the lender is permitted to accelerate repayment of all amounts due, terminate commitments thereunder, and liquidate the mortgage loan collateral held as security for the Revolver to satisfy any balance outstanding and due pursuant to the Revolver. Any such event may have a material adverse effect on our liquidity, the value of our common shares and the ability to pay dividends to our shareholders.

Sources of Funds

In general, we need liquidity to originate new loans and repay principal on our debt. Our operating revenues are typically utilized to pay our operating expenses, interest and dividends. We have been utilizing principal collections on loans receivable, proceeds from Secondary Market Loan Sales and borrowings under our Revolver as our primary sources of funds.

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In addition, historically we utilized a combination of the following sources, among others, to generate funds:

- Issuance of SBIC debentures;
- Issuance of junior subordinated notes; or
- Structured loan financings or sales.

At March 31, 2011, these sources were not available to us and there can be no assurance that they will be available in the future. However, during 2010, we requested commitments from the SBA for debentures of \$15 million which would be used to fund loans within our SBICs. Initially, approval for these commitments was denied but we are in discussions with the SBA and have provided additional requested documentation to attempt to obtain these additional commitments. Since 2004, our working capital has primarily been provided through credit facilities, the issuance of junior subordinated notes and principal payments (including prepayments) on loans receivable. Prior to 2004, our primary source of long-term funds was structured loan sale transactions. At the current time, there is a limited market for commercial loan asset-backed securitizations. We cannot anticipate when, or if, this market will be available to us in the future. Until this market becomes more readily available, our ability to grow is limited.

The relatively limited amount of capital available to originate new loans has caused us to restrict non-SBA 7(a) loan origination activity. A reduction in the availability of the above sources of funds could have a material adverse effect on our financial condition and results of operations. If these sources are not available in the future, we may have to originate loans at further reduced levels or sell assets, potentially on unfavorable terms.

Our Revolver, which has aggregate availability of \$30 million, matures December 31, 2011. We are currently in the process of finalizing an agreement with our current lender that would, among other things, extend the facility until December 31, 2013. There can be no assurance that we will be able to finalize this agreement. To the extent we need additional capital for unanticipated items, there can be no assurance that we would be able to increase the amount available under any credit facilities or identify other sources of funds at an acceptable cost, if at all.

We rely on Secondary Market Loan Sales to create availability and/or repay principal due on our Revolver. Once fully funded, we typically sell the government guaranteed portion of our SBA 7(a) program loans. The market demand for Secondary Market Loan Sales may decline or be temporarily suspended. To the extent we are unable to execute Secondary Market Loan Sales in the normal course of business, our financial condition and results of operations could be adversely affected.

As a REIT, we must distribute to our shareholders at least 90% of our REIT taxable income to maintain our tax status under the Code. Accordingly, to the extent the sources above represent taxable income, such amounts have historically been distributed to our shareholders. In general, should we receive less cash from our portfolio of investments, we can lower the dividend so as not to cause any material cash shortfall. During 2011, we anticipate that our Modified Cash will be utilized to fund our expected 2011 dividend distributions and generally will not be available to fund portfolio growth or for the repayment of principal due on our debt.

The Revolver requires us to meet certain covenants. At March 31, 2011, we were in compliance with the covenants of this facility. While we anticipate maintaining compliance with these covenants, there can be no assurance that we will be able to do so. Our most significant covenants were as follows at March 31, 2011:

| Covenant | Requirement or Maximum | Actual |
|---------------------------|---------------------------|----------------|
| Minimum net worth | \$ 145,000,000 | \$ 149,881,000 |
| Maximum leverage ratio | 2.00 | 0.68 |
| Non-performing loan ratio | 15% | 10% |

Table of Contents***Uses of Funds***

Currently, the primary use of our funds is to originate loans and for repayment of principal and interest on our debt. Our outstanding commitments to fund new loans were \$12.5 million at March 31, 2011, the majority of which were for prime-rate based loans to be originated by First Western, the government guaranteed portion of which is intended to be sold pursuant to Secondary Market Loan Sales. Our net working capital outlay would be approximately \$3.0 million related to these loans; however, the guaranteed portion of the First Western loans cannot be sold until they are fully funded. Commitments have fixed expiration dates. Since some commitments expire without the proposed loan closing, total committed amounts do not necessarily represent future cash requirements. During 2011, we anticipate loan fundings will range from \$40 million to \$50 million. In addition, we use funds for operating deficits and holding costs of our REO and properties in the process of foreclosure.

There may be several months between when the initial balance of an SBA 7(a) loan is funded and it is fully funded and can be sold. In these instances, our liquidity would be affected in the short-term.

Upon approval from our lender, we may repurchase loans from the securitizations which have become charged-off as defined in the transaction documents either through delinquency or initiation of foreclosure or we may repurchase all of the loans from a securitization once clean-up call options have been achieved. We have achieved clean-up call options on our 2003 Joint Venture and 1998 Partnership. Once approved, if we choose to repurchase a loan from a securitization or exercise our clean-up call option and repurchase all of the loans from a securitization using our Revolver, the balance due on our structured notes payable would decrease and the balance due under our Revolver would increase. We may also be required to use restricted cash collateralizing one of our securitizations to repay to the structured noteholders a loan within such securitization if it is deemed charged-off per the transaction documents.

We may pay dividends in excess of our Modified Cash to maintain our REIT status or as approved by our Board. During the three months ended March 31, 2011, our source of funds for our dividend distributions of \$1.7 million was Modified Cash.

DIVIDENDS

Our shareholders are entitled to receive dividends when and as declared by the Board. In determining dividend policy, the Board considers many factors including, but not limited to, actual and anticipated Modified Cash, expectations for future earnings, REIT taxable income and maintenance of REIT status, TRS taxable income, the economic environment, our ability to obtain leverage and our loan portfolio performance. In order to maintain REIT status, PMC Commercial is required to pay out 90% of REIT taxable income. Consequently, the dividend rate on a quarterly basis will not necessarily correlate directly to any individual factor.

We have certain covenants within our debt facilities that limit our ability to pay out returns of capital as part of our dividends. These restrictions have not historically limited the amount of dividends we have paid and management does not believe that they will restrict future dividend payments.

REIT TAXABLE INCOME

REIT taxable income is a financial measure that is presented quarterly to assist investors in analyzing our performance and is one of the factors utilized by our Board in determining the level of dividends to be paid to our shareholders. Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied and are not audited. These non-GAAP measures have limitations as analytical tools and should not be considered in isolation, or as a substitute for analyses of results as reported under GAAP.

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The following reconciles net income to REIT taxable income:

| | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2011 | 2010 |
| | <i>(In thousands)</i> | |
| Net income | \$ 916 | \$ 1,278 |
| Book/tax difference on gains related to real estate | 448 | 389 |
| Book/tax difference on amortization and accretion | (16) | (26) |
| Loan valuation | 188 | (197) |
| Other book/tax differences, net | 30 | (54) |
| Subtotal | 1,566 | 1,390 |
| Adjustment for TRS net loss (income), net of tax | (28) | 233 |
| REIT taxable income | \$ 1,538 | \$ 1,623 |
| Distributions declared | \$ 1,691 | \$ 1,688 |
| Weighted average common shares outstanding | 10,561 | 10,548 |

As a REIT, PMC Commercial generally will not be subject to corporate level Federal income tax on net income that is currently distributed to shareholders provided the distribution exceeds 90% of REIT taxable income. We may make an election under the Code to treat a portion of distributions declared in the current year as distributions of the prior year's taxable income. Upon election, the Code provides that, in certain circumstances, a dividend declared subsequent to the close of an entity's taxable year and prior to the extended due date of the entity's tax return may be considered as having been made in the prior tax year in satisfaction of income distribution requirements.

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Primarily as a result of the timing differences for gain recognition on Secondary Market Loan Sales, our combined REIT taxable income and TRS s taxable income (net of income tax expense) is materially different than our net income. The following table reconciles our net income to our Adjusted Taxable Income, Net of Current Tax Expense:

| | Three Months Ended March 31, 2011 | | |
|---|---|----------|--------|
| | Combined | REIT | TRS s |
| | <i>(In thousands, except footnotes)</i> | | |
| Net income | \$ 916 | \$ 888 | \$ 28 |
| Book vs. tax timing differences | 1,220 | 650 | 570(1) |
| Taxable income | 2,136 | 1,538 | 598 |
| Special item (2) | (448) | (448) | |
| Taxable Income, adjusted for special item | 1,688 | 1,090 | 598 |
| Current income tax expense | (203) | | (203) |
| Adjusted Taxable Income, Net of Current Tax Expense | \$ 1,485 | \$ 1,090 | \$ 395 |

| | Three Months Ended March 31, 2010 | | |
|---|---|----------|----------|
| | Combined | REIT | TRS s |
| | <i>(In thousands, except footnotes)</i> | | |
| Net income (loss) | \$ 1,278 | \$ 1,511 | \$ (233) |
| Book vs. tax timing differences | 642 | 112 | 530(1) |
| Taxable income | 1,920 | 1,623 | 297 |
| Current income tax expense | (102) | | (102) |
| Adjusted Taxable Income, Net of Current Tax Expense | \$ 1,818 | \$ 1,623 | \$ 195 |

(1) Includes \$468,000 and \$701,000 of timing differences during 2011 and 2010, respectively, related primarily to Secondary Market Loan Sales.

(2) Recognition of deferred gain for tax purposes on the property previously owned by our off-balance sheet variable interest entity.

Adjusted Taxable Income, Net of Current Tax Expense is defined as reported net income, adjusted for book versus tax timing differences and special items. Special items may include, but are not limited to, unusual and infrequent non-operating items. We use Adjusted Taxable Income, Net of Current Tax Expense to measure and evaluate our operations. We believe that the results provide a useful analysis of ongoing operating trends.

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ITEM 3.

Quantitative and Qualitative Disclosures About Market Risk

Market risk is the exposure to loss resulting from changes in various market metrics. We are subject to market risk including liquidity risk, real estate risk and interest rate risk as described below. Although management believes that the quantitative analysis on interest rate risk below is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of our balance sheet and other business developments that could affect our financial position and net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by these estimates.

Liquidity Risk

Liquidity risk is the potential that we would be unable to meet our obligations as they come due because of an inability to liquidate assets or obtain funding. We are subject to changes in the debt and collateralized mortgage markets. These markets are experiencing disruptions, which could continue to have an adverse impact on our earnings and financial condition.

Current conditions in the debt markets include reduced liquidity and increased risk adjusted premiums. These conditions have increased the cost and reduced the availability of financing sources. The market for trading and issuance in asset-backed securities continues to experience disruptions resulting from reduced investor demand for these securities and increased investor yield requirements. In light of these market conditions, we expect to finance our loan portfolio in the short-term with our current capital and any available credit facilities.

Real Estate Risk

The value of our commercial mortgage loans and our ability to sell such loans, if necessary, are impacted by market conditions that affect the properties that are the primary collateral for our loans. Property values and operating income from the properties may be affected adversely by a number of factors, including, but not limited to:

national, regional and local economic conditions;

rises in gasoline prices if there is a concurrent decrease in business and leisure travel;

local real estate conditions (including an oversupply of commercial real estate);

natural disasters including hurricanes and earthquakes, acts of war and/or terrorism and other events that may cause performance declines and/or losses to the owners and operators of the real estate securing our loans;

changes or continued weakness in the underlying value of limited service hospitality properties;

construction quality, construction cost, age and design;

demographic factors;

uninsured losses;

environmental, zoning and other governmental laws and regulations;

increases in operating expenses (such as energy costs) for the owners of the properties; and

limitations in the availability and cost of leverage.

In the event property cash flows decrease, a borrower may have difficulty repaying our loan, which could result in losses to us. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to borrowers to repay our loans, which could also cause us to suffer losses. Decreases in property values could reduce the value of our REO which could cause us to suffer losses.

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The following analysis of our provision for loan losses quantifies the negative impact to our net income from increased losses on our Retained Portfolio:

| | Three Months Ended March 31, 2011 | Year Ended December 31, 2010 | Three Months Ended March 31, 2010 |
|---|---|---------------------------------------|--|
| Provision for loan losses | | | |
| | | <i>(In thousands)</i> | |
| As reported (1) | \$ 378 | \$ 1,019 | \$ 162 |
| Annual loan losses increase by 50 basis points (2) | 641 | 2,117 | 446 |
| Annual loan losses increase by 100 basis points (2) | 904 | 3,214 | 729 |

(1) Excludes reductions of loan losses

(2) Represents provision for loan losses based on increases in losses as a percentage of our weighted average loans receivable for the periods indicated

Interest Rate Risk

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors.

Since our loans are predominantly variable-rate, based on LIBOR or the prime rate, our operating results will depend in large part on LIBOR or the prime rate. One of the determinants of our operating results is differences between the income from our loans and our borrowing costs. Most of our borrowings are also based on LIBOR or the prime rate. The objective of this strategy is to minimize the impact of interest rate changes on our net interest income.

VALUATION OF LOANS

Our loans are recorded at cost and adjusted by net loan origination fees and discounts (which are recognized as adjustments of yield over the life of the loan) and loan loss reserves. In order to determine the estimated fair value of our loans, we use a present value technique for the anticipated future cash flows using certain assumptions including a current market discount rate, potential prepayment risks and loan losses. If we were required to sell our loans at a time we would not otherwise do so, there can be no assurance that management's estimates of fair values would be obtained and losses could be incurred.

At March 31, 2011, our loans are 78% variable-rate at spreads over LIBOR or the prime rate. Increases or decreases in interest rates will generally not have a material impact on the fair value of our variable-rate loans. We had \$182.5 million of variable-rate loans at March 31, 2011. The estimated fair value of our variable-rate loans (\$179.4 million at March 31, 2011) is dependent upon several factors including changes in interest rates and the market for the type of loans we have originated.

We had \$50.9 million and \$63.2 million of fixed-rate loans at March 31, 2011 and December 31, 2010, respectively. The estimated fair value of these fixed-rate loans approximates their cost and is dependent upon several factors including changes in interest rates and the market for the types of loans that we have originated. Since changes in market interest rates do not affect the interest rates on our fixed-rate loans, any changes in these rates do not have an immediate impact on our interest income. Our interest rate risk on our fixed-rate loans is primarily related to loan prepayments and maturities.

The average maturity of our loan portfolio is less than its average contractual terms because of prepayments. Assuming market liquidity, the average life of mortgage loans tends to increase when the current mortgage rates are substantially higher than rates on existing mortgage loans and, conversely, decrease when the current mortgage rates are substantially lower than rates on existing mortgage loans (due to refinancing of fixed-rate loans).

Table of Contents**INTEREST RATE SENSITIVITY**

At March 31, 2011 and December 31, 2010, we had \$182.5 million and \$170.0 million of variable-rate loans, respectively, and \$74.6 million and \$73.1 million of variable-rate debt, respectively. On the difference between our variable-rate loans and our variable-rate debt (\$107.9 million and \$96.9 million at March 31, 2011 and December 31, 2010, respectively) we have interest rate risk. To the extent variable rates decrease, our interest income net of interest expense would decrease.

The sensitivity of our variable-rate loans and debt to changes in interest rates is regularly monitored and analyzed by measuring the characteristics of our assets and liabilities. We assess interest rate risk in terms of the potential effect on interest income net of interest expense in an effort to ensure that we are insulated from any significant adverse effects from changes in interest rates. As a result of our predominately variable-rate portfolio, our earnings are susceptible to being reduced during periods of lower interest rates. Based on a sensitivity analysis of interest income and interest expense at March 31, 2011 and December 31, 2010, if the consolidated balance sheet were to remain constant and no actions were taken to alter the existing interest rate sensitivity, each hypothetical 25 basis point reduction in interest rates would reduce net income by approximately \$270,000 and \$242,000, respectively, on an annual basis. Since LIBOR has already been reduced to historically low levels, further significant negative impacts from lower LIBOR interest rates are not anticipated. In addition, as a REIT, the use of hedging interest rate risk is typically only provided on debt instruments due to potential negative REIT compliance to the extent the hedging strategy was based on our investments. Benefits derived from hedging strategies not based on debt instruments (*i.e.*, investments) may be deemed bad income for REIT qualification purposes. The use of a hedge strategy (on our debt instruments) would only be beneficial to fix our cost of funds and hedge against rising interest rates.

DEBT

Our debt is comprised of SBA debentures, junior subordinated notes, the Revolver, structured notes and secured borrowings government guaranteed loans. At March 31, 2011 and December 31, 2010, approximately \$18.8 million and \$19.9 million, respectively, of our debt had fixed rates of interest and was therefore not affected by changes in interest rates. Our variable-rate debt is based on LIBOR or the prime rate and thus subject to adverse changes in market interest rates. Assuming there were no increases or decreases in the balance outstanding under our variable-rate debt at March 31, 2011, each hypothetical 100 basis points increase in interest rates would increase interest expense and decrease net income by approximately \$746,000.

Our fixed-rate debt at March 31, 2011 was comprised of SBA debentures and structured notes of the 2000 Joint Venture.

The following tables present the principal amounts by year of expected maturity, weighted average interest rates and estimated fair values to evaluate the expected cash flows and sensitivity to interest rate changes of our outstanding debt at March 31, 2011 and December 31, 2010:

| | Twelve Month Periods Ending March 31, | | | | | | Carrying Value | Fair Value (1) |
|--|---------------------------------------|----------|----------|----------|----------|------------|----------------|----------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | Thereafter | | |
| | <i>(Dollars in thousands)</i> | | | | | | | |
| Fixed-rate debt (2) | \$ 1,602 | \$ 1,760 | \$ 6,051 | \$ 5,936 | \$ 2,126 | \$ 1,347 | \$ 18,822 | \$ 19,378 |
| Variable-rate debt (LIBOR and prime based) (3) (4) | 14,637 | 2,517 | 2,585 | 2,684 | 2,161 | 50,041 | 74,625 | 69,735 |
| Totals | \$ 16,239 | \$ 4,277 | \$ 8,636 | \$ 8,620 | \$ 4,287 | \$ 51,388 | \$ 93,447 | \$ 89,113 |

(1) The estimated fair value is based on a present value calculation based on prices of the same or similar instruments after considering risk, current interest rates and remaining maturities.

- (2) *The weighted average interest rate of our fixed-rate debt at March 31, 2011 was 6.7%.*
- (3) *Principal payments on the structured notes and secured borrowings are dependent upon cash flows received from the underlying loans. Our estimate of their repayment is based upon scheduled principal payments on the underlying loans. Our estimate will differ from actual amounts to the extent we experience prepayments and/or loan losses.*
- (4) *The weighted average interest rate of our variable-rate debt at March 31, 2011 was 3.3%.*

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| | 2011 | Years Ending December 31, | | | | | Carrying | Fair |
|---|-----------|---------------------------|----------|-------------------------------|----------|------------|-----------|-----------|
| | | 2012 | 2013 | 2014 | 2015 | Thereafter | Value | Value (1) |
| | | | | <i>(Dollars in thousands)</i> | | | | |
| Fixed-rate debt (2) | \$ 1,652 | \$ 1,815 | \$ 6,155 | \$ 2,008 | \$ 6,205 | \$ 2,066 | \$ 19,901 | \$ 20,514 |
| Variable-rate debt (LIBOR and prime rate based) (3) (4) | 16,123 | 2,414 | 2,463 | 2,570 | 2,534 | 46,964 | 73,068 | 68,142 |
| Totals | \$ 17,775 | \$ 4,229 | \$ 8,618 | \$ 4,578 | \$ 8,739 | \$ 49,030 | \$ 92,969 | \$ 88,656 |

- (1) *The estimated fair value is based on a present value calculation based on prices of the same or similar instruments after considering risk, current interest rates and remaining maturities.*
- (2) *The weighted average interest rate of our fixed-rate debt at December 31, 2010 was 6.7%.*
- (3) *Principal payments on the structured notes and secured borrowings are dependent upon cash flows received from the underlying loans. Our estimate of their repayment is based upon scheduled principal payments on the underlying loans. Our estimate will differ from actual amounts to the extent we experience prepayments and/or loan losses.*
- (4) *The weighted average interest rate of our variable-rate debt at December 31, 2010 was 3.3%.*

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ITEM 4.

Controls and Procedures

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, management has evaluated the effectiveness of our disclosure controls and procedures (as defined under rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of March 31, 2011. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have been no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II
Other Information**

ITEM 1. Legal Proceedings

In the normal course of business we are periodically party to certain legal actions and proceedings involving matters that are generally incidental to our business (*i.e.*, collection of loans receivable). In management's opinion, the resolution of these legal actions and proceedings will not have a material adverse effect on our consolidated financial statements.

ITEM 1A. Risk Factors

There have been no material changes to the factors disclosed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

ITEM 3. Defaults upon Senior Securities

None.

ITEM 4. Reserved

ITEM 5. Other Information

None.

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ITEM 6. Exhibits

A. Exhibits

- 3.1 Declaration of Trust (incorporated by reference to the exhibits to the Registrant's Registration Statement on Form S-11 filed with the Securities and Exchange Commission (SEC) on June 25, 1993, as amended (Registration No. 33-65910)).
- 3.1(a) Amendment No. 1 to Declaration of Trust (incorporated by reference to the Registrant's Registration Statement on Form S-11 filed with the SEC on June 25, 1993, as amended (Registration No. 33-65910)).
- 3.1(b) Amendment No. 2 to Declaration of Trust (incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1993).
- 3.1(c) Amendment No. 3 to Declaration of Trust (incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003).
- 3.2 Bylaws (incorporated by reference to the exhibits to the Registrant's Registration Statement on Form S-11 filed with the SEC on June 25, 1993, as amended (Registration No. 33-65910)).
- 3.3 Amendment No. 1 to Bylaws (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on April 16, 2009).
- *31.1 Section 302 Officer Certification Chief Executive Officer
- *31.2 Section 302 Officer Certification Chief Financial Officer
- **32.1 Section 906 Officer Certification Chief Executive Officer
- **32.2 Section 906 Officer Certification Chief Financial Officer

* Filed herewith.

** Submitted herewith

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PMC Commercial Trust

Date: 05/09/11

/s/ Lance B. Rosemore
Lance B. Rosemore
President and Chief Executive Officer

Date: 05/09/11

/s/ Barry N. Berlin
Barry N. Berlin
Executive Vice President and
Chief Financial Officer
(Principal Accounting Officer)