

PMC COMMERCIAL TRUST /TX  
Form 10-Q  
May 10, 2012  
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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, 2012

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)

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**TEXAS**  
(State or other jurisdiction  
of incorporation or organization)

**75-6446078**  
(I.R.S. Employer  
Identification No.)

**17950 Preston Road, Suite 600, Dallas, TX 75252**  
(Address of principal executive offices)

**(972) 349-3200**  
(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  (Do not check if a smaller reporting company) 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, 2012, the Registrant had outstanding 10,584,554 Common Shares of Beneficial Interest, par value \$0.01 per share.

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**PMC COMMERCIAL TRUST AND SUBSIDIARIES**

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**PART I**

**Financial Information**

**ITEM 1.**

**Financial Statements**

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

|  | March 31,<br>2012  | December 31,<br>2011 |
|--|--------------------|----------------------|
|  | <i>(Unaudited)</i> |                      |
| <b>ASSETS</b>  |                    |                      |
| Loans receivable, net:   |                    |                      |
| Commercial mortgage loans receivable   | \$ 142,190         | \$ 133,327           |
| SBA 7(a) loans receivable, subject to secured borrowings   | 35,378             | 30,476               |
| SBIC commercial mortgage loans receivable  | 35,215             | 32,153               |
| SBA 7(a) loans receivable  | 22,961             | 22,997               |
| Commercial mortgage loans receivable, subject to structured notes payable  |                    | 15,474               |
| Loans receivable, net  | 235,744            | 234,427              |
| Cash and cash equivalents  | 3,254              | 6,502                |
| Real estate owned  | 1,241              | 1,259                |
| Restricted cash and cash equivalents   |                    | 2,233                |
| Other assets   | 7,059              | 6,826                |
| <b>Total assets</b>  | <b>\$ 247,298</b>  | <b>\$ 251,247</b>    |
| <b>LIABILITIES AND EQUITY</b>  |                    |                      |
| <b>Liabilities:</b>  |                    |                      |
| Debt:  |                    |                      |
| Secured borrowings - government guaranteed loans   | \$ 37,846          | \$ 32,546            |
| Junior subordinated notes  | 27,070             | 27,070               |
| Revolving credit facility  | 15,700             | 17,800               |
| SBIC debentures payable  | 13,183             | 13,181               |
| Structured notes payable   |                    | 5,264                |
| Debt   | 93,799             | 95,861               |
| Borrower advances  | 3,685              | 3,863                |
| Accounts payable and accrued expenses  | 2,216              | 2,095                |
| Dividends payable  | 1,716              | 1,692                |
| <b>Total liabilities</b>   | <b>101,416</b>     | <b>103,511</b>       |
| <i>Commitments and contingencies</i>   |                    |                      |
| <b>Beneficiaries equity:</b>   |                    |                      |
| Common shares of beneficial interest; authorized 100,000,000 shares of \$0.01 par value; 11,120,883 and 11,110,883 shares issued at March 31, 2012 and December 31, 2011, respectively; 10,584,554 and 10,574,554 shares outstanding at March 31, 2012 and December 31, 2011, respectively | 111                | 111                  |
| Additional paid-in capital   | 152,974            | 152,934              |
| Net unrealized appreciation of retained interests in transferred assets  | 349                | 394                  |
| Cumulative net income  | 175,941            | 176,096              |
| Cumulative dividends   | (179,492)          | (177,798)            |
| <b>Beneficiaries equity before treasury stock</b>  | <b>149,883</b>     | <b>151,737</b>       |
| Less: Treasury stock; at cost, 536,329 shares at March 31, 2012 and December 31, 2011  | (4,901)            | (4,901)              |

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|   |            |            |
|---|------------|------------|
| <b>Total beneficiaries equity</b>                                   | 144,982    | 146,836    |
| Noncontrolling interests - cumulative preferred stock of subsidiary | 900        | 900        |
| <b>Total equity</b>   | 145,882    | 147,736    |
| <b>Total liabilities and equity</b>                                 | \$ 247,298 | \$ 251,247 |

*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 (LOSS)**

*(In thousands, except per share data)*

|  | <b>Three Months Ended<br/>March 31,</b> |                |
|--|---|----------------|
|  | <b>2012</b>                             | <b>2011</b>    |
|  | <i>(Unaudited)</i>                      |                |
| <b>Revenues:</b>   |   |                |
| Interest income  | \$ 3,398                                | \$ 3,367       |
| Premium income   | 113                                     | 431            |
| Other income   | 276                                     | 258            |
| <b>Total revenues</b>  | <b>3,787</b>                            | <b>4,056</b>   |
| <b>Expenses:</b>   |   |                |
| Salaries and related benefits  | 1,144                                   | 1,117          |
| Interest   | 883                                     | 973            |
| Strategic alternatives   | 850                                     |                |
| Provision for loan losses, net   | 475                                     | 313            |
| General and administrative   | 460                                     | 504            |
| <b>Total expenses</b>  | <b>3,812</b>                            | <b>2,907</b>   |
| <b>Income (loss) before income tax benefit (provision) and discontinued operations</b> | <b>(25)</b>                             | <b>1,149</b>   |
| Income tax benefit (provision)   | 19                                      | (25)           |
| <b>Income (loss) from continuing operations</b>  | <b>(6)</b>                              | <b>1,124</b>   |
| Discontinued operations  | (149)                                   | (208)          |
| <b>Net income (loss)</b>   | <b>\$ (155)</b>                         | <b>\$ 916</b>  |
| <b>Weighted average shares outstanding:</b>  |   |                |
| Basic  | 10,576                                  | 10,561         |
| Diluted  | 10,576                                  | 10,617         |
| <b>Basic and diluted earnings (loss) per share:</b>                                    |   |                |
| Income (loss) from continuing operations   | \$                                      | \$ 0.11        |
| Discontinued operations  | (0.01)                                  | (0.02)         |
| <b>Net income (loss)</b>   | <b>\$ (0.01)</b>                        | <b>\$ 0.09</b> |

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

**Table of Contents****PMC COMMERCIAL TRUST AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)***(In thousands)*

|  | <b>Three Months Ended<br/>March 31,<br/>2012      2011<br/>(Unaudited)</b> |        |
|--|--|--------|
| <b>Net income (loss)</b>   | \$ (155)   | \$ 916 |
| Change in unrealized appreciation of retained interests in transferred assets: |  |        |
| Net unrealized appreciation (depreciation) arising during period               | (9)  | 67     |
| Net realized gains included in net income (loss)                               | (36)   | (20)   |
| Change in unrealized appreciation of retained interests in transferred assets  | (45)   | 47     |
| <b>Comprehensive income (loss)</b>   | \$ (200)   | \$ 963 |

*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, 2011                                       |           |                            |  |                       |                      |                |  |              |
|----------------------------------|---|-----------|----------------------------|--|-----------------------|----------------------|----------------|--|--------------|
|                                  | <i>(Unaudited)</i>  |           |                            |  |                       |                      |                |  |              |
|                                  | Net Unrealized Appreciation of Retained Interests in Transferred Assets |           |                            |  |                       |                      |                |  |              |
|                                  | Common Shares of Beneficial Interest Outstanding                        | Par Value | Additional Paid-in Capital | Retained Interests in Transferred Assets | Cumulative Net Income | Cumulative Dividends | Treasury Stock | Cumulative Preferred Stock of Subsidiary | Total Equity |
| <b>Balances, January 1, 2011</b> | 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          |
| <b>Balances, March 31, 2011</b>  | 10,569,554  | \$ 111    | \$ 152,805                 | \$ 323                                   | \$ 173,365            | \$ (172,722)         | \$ (4,901)     | \$ 900                                   | \$ 149,881   |

## CONSOLIDATED STATEMENTS OF EQUITY

|                                  | Three Months Ended March 31, 2012                                       |           |                            |  |                       |                      |                |  |              |
|----------------------------------|---|-----------|----------------------------|--|-----------------------|----------------------|----------------|--|--------------|
|                                  | <i>(Unaudited)</i>  |           |                            |  |                       |                      |                |  |              |
|                                  | Net Unrealized Appreciation of Retained Interests in Transferred Assets |           |                            |  |                       |                      |                |  |              |
|                                  | Common Shares of Beneficial Interest Outstanding                        | Par Value | Additional Paid-in Capital | Retained Interests in Transferred Assets | Cumulative Net Income | Cumulative Dividends | Treasury Stock | Cumulative Preferred Stock of Subsidiary | Total Equity |
| <b>Balances, January 1, 2012</b> | 10,574,554  | \$ 111    | \$ 152,934                 | \$ 394                                   | \$ 176,096            | \$ (177,798)         | \$ (4,901)     | \$ 900                                   | \$ 147,736   |
| Net unrealized depreciation      |   |           |                            | (45)                                     |                       |                      |                |  | (45)         |
| Share-based compensation expense | 10,000  |           | 40                         |  |                       |                      |                |  | 40           |
| Dividends (\$0.16 per share)     |   |           |                            |  |                       | (1,694)              |                |  | (1,694)      |
| Net loss                         |   |           |                            |  | (155)                 |                      |                |  | (155)        |
| <b>Balances, March 31, 2012</b>  | 10,584,554  | \$ 111    | \$ 152,974                 | \$ 349                                   | \$ 175,941            | \$ (179,492)         | \$ (4,901)     | \$ 900                                   | \$ 145,882   |

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

**Table of Contents****PMC COMMERCIAL TRUST AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS***(In thousands)*

|  | <b>Three Months<br/>Ended March 31,<br/>2012      2011<br/>(Unaudited)</b> |                |
|--|--|----------------|
| <b>Cash flows from operating activities:</b>   |  |                |
| Net income (loss)  | \$ (155)   | \$ 916         |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: |  |                |
| Impairment losses  | 18   |                |
| Net gains on sales of real estate  |  | (2)            |
| Deferred income taxes  | (160)  | (178)          |
| Provision for loan losses, net   | 475  | 313            |
| Unrealized premium adjustment  | 544  | 397            |
| Amortization and accretion, net  | (31)   | 159            |
| Share-based compensation   | 40   | 49             |
| Capitalized loan origination costs   | (76)   | (39)           |
| Loans funded, held for sale  | (4,941)  | (6,809)        |
| Proceeds from sale of guaranteed loans   | 1,258  | 4,680          |
| Principal collected on loans   | 155  | 111            |
| Loan fees remitted, net  | (13)   | (61)           |
| Change in operating assets and liabilities:  |  |                |
| Other assets   | (146)  | (509)          |
| Borrower advances  | (178)  | 238            |
| Accounts payable and accrued expenses  | 70   | (563)          |
| Other liabilities  | 43   | (16)           |
| <b>Net cash used in operating activities</b>   | <b>(3,097)</b>   | <b>(1,314)</b> |
| <b>Cash flows from investing activities:</b>   |  |                |
| Loans funded   | (5,790)  | (1,263)        |
| Principal collected on loans   | 7,584  | 2,750          |
| Principal collected on retained interests in transferred assets                      | 29   | 36             |
| Purchase of furniture and equipment  | (7)  | (31)           |
| Investment in real estate owned  |  | (17)           |
| Proceeds from unconsolidated subsidiary  |  | 1,373          |
| Release of restricted cash and cash equivalents                                      | 2,233  | 336            |
| <b>Net cash provided by investing activities</b>                                     | <b>4,049</b>   | <b>3,184</b>   |
| <b>Cash flows from financing activities:</b>   |  |                |
| Repayment of revolving credit facility, net  | (2,100)  | (1,600)        |
| Payment of principal on structured notes payable                                     | (5,264)  | (1,960)        |
| Proceeds from secured borrowings - government guaranteed loans                       | 4,989  | 3,786          |
| Payment of principal on secured borrowings - government guaranteed loans             | (155)  | (111)          |
| Payment of dividends   | (1,670)  | (1,690)        |
| <b>Net cash used in financing activities</b>   | <b>(4,200)</b>   | <b>(1,575)</b> |
| <b>Net increase (decrease) in cash and cash equivalents</b>                          | <b>(3,248)</b>   | <b>295</b>     |

|  |          |          |
|--|----------|----------|
| Cash and cash equivalents, beginning of year | 6,502    | 2,642    |
| Cash and cash equivalents, end of period     | \$ 3,254 | \$ 2,937 |

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

**Table of Contents****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 ( U.S. GAAP ) 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 U.S. GAAP for complete financial statement presentation. In the opinion of management, the financial statements include all normal recurring adjustments necessary for a fair statement of the results for the interim period. All material intercompany balances and transactions have been eliminated. The results for the three months ended March 31, 2012 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, 2011.

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:**

Accounting Standards Update ( ASU ) 2011-04, Fair Value Measurement (Topic 820); Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP was issued in May 2011. This ASU provides additional guidance on fair value measurements and requires additional fair value disclosures including quantitative and qualitative information for recurring Level 3 fair value measurements. In addition, entities must report the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed. This ASU was effective for interim and annual periods beginning on or after December 15, 2011.

**Note 3. Loans Receivable, net:**

Loans receivable, net, consisted of the following:

|  | March 31,<br>2012     | December 31,<br>2011 |
|--|-----------------------|----------------------|
|  | <i>(In thousands)</i> |                      |
| Commercial mortgage loans  | \$ 144,098            | \$ 134,835           |
| SBIC commercial mortgage loans                                     | 35,501                | 32,416               |
| SBA 7(a) loans, subject to secured borrowings                      | 34,986                | 30,151               |
| SBA 7(a) loans   | 23,235                | 23,238               |
| Commercial mortgage loans, subject to structured notes payable (1) |                       | 15,474               |
| <b>Total loans receivable</b>                                      | <b>237,820</b>        | <b>236,114</b>       |
| <b>Adjusted by:</b>  |                       |                      |
| Deferred capitalized costs, net                                    | 196                   | 125                  |
| Loan loss reserves   | (2,272)               | (1,812)              |
| <b>Loans receivable, net</b>                                       | <b>\$ 235,744</b>     | <b>\$ 234,427</b>    |

(1) We repaid the 2003 Joint Venture structured notes on February 15, 2012.

*Commercial mortgage loans*

Represents the loans held by our parent company, PMC Commercial Trust.

*SBIC commercial mortgage loans*

Represents loans of our licensed Small Business Investment Company ( SBIC ) subsidiaries.

**Table of Contents****PMC COMMERCIAL TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Unaudited)**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 the non-government guaranteed retained portion of loans originated under the SBA 7(a) program and the government guaranteed portion of loans that have not yet been fully funded or sold. The balance is net of retained loan discounts of \$1.6 million at both March 31, 2012 and December 31, 2011.

*Commercial mortgage loans, subject to structured notes payable*

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

*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, 2012 and December 31, 2011, our loans were 93% 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, 2012 and December 31, 2011, 18% 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, 2012. 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 5% of our loans receivable at both March 31, 2012 and December 31, 2011. Any decline in the financial status of this group could have a material adverse effect on our financial condition and results of operations.

*Aging*

The following tables represent an aging of our Loans Receivable Subject to Credit Risk (loans receivable less SBA 7(a) loans, subject to secured borrowings as the SBA has guaranteed payment of the principal). Balances are prior to loan loss reserves and deferred capitalized costs, net.

| Category                          | March 31, 2012                |       |                                 |       |                   |       |
|-----------------------------------|-------------------------------|-------|---------------------------------|-------|-------------------|-------|
|                                   | Totals                        |       | Commercial<br>Mortgage<br>Loans |       | SBA 7(a)<br>Loans |       |
|                                   | <i>(Dollars in thousands)</i> |       |                                 |       |                   |       |
| Current (1)                       | \$ 195,567                    | 96.4% | \$ 172,992                      | 96.3% | \$ 22,575         | 97.2% |
| Between 30 and 59 days delinquent | 5,450                         | 2.7%  | 5,163                           | 2.9%  | 287               | 1.2%  |
| Between 60 and 89 days delinquent |                               |       |                                 |       |                   |       |

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|                             |            |        |            |        |           |        |
|-----------------------------|------------|--------|------------|--------|-----------|--------|
| Over 89 days delinquent (2) | 1,817      | 0.9%   | 1,444      | 0.8%   | 373       | 1.6%   |
|                             | \$ 202,834 | 100.0% | \$ 179,599 | 100.0% | \$ 23,235 | 100.0% |

- (1) *Includes \$6.3 million of loans classified as troubled debt restructurings which are current based on revised note terms. Of these loans, \$5.6 million are paying interest only.*
- (2) *Includes a \$1.4 million loan on which the borrower has filed for Chapter 11 Bankruptcy. We are classified as a secured creditor in the bankruptcy proceeding.*

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## PMC COMMERCIAL TRUST AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

December 31, 2011

| Category                          | Totals     |        | Commercial        |        |                   |        |
|-----------------------------------|------------|--------|-------------------|--------|-------------------|--------|
|                                   |            |        | Mortgage<br>Loans |        | SBA 7(a)<br>Loans |        |
| <i>(Dollars in thousands)</i>     |            |        |                   |        |                   |        |
| Current (1)                       | \$ 202,217 | 98.2%  | \$ 179,497        | 98.2%  | \$ 22,720         | 97.7%  |
| Between 30 and 59 days delinquent | 1,224      | 0.6%   | 1,090             | 0.6%   | 134               | 0.6%   |
| Between 60 and 89 days delinquent | 696        | 0.3%   | 696               | 0.4%   |                   |        |
| Over 89 days delinquent (2)       | 1,826      | 0.9%   | 1,442             | 0.8%   | 384               | 1.7%   |
|                                   | \$ 205,963 | 100.0% | \$ 182,725        | 100.0% | \$ 23,238         | 100.0% |

(1) Includes \$6.3 million of loans classified as troubled debt restructurings which are current based on revised note terms. Of these loans, \$5.6 million are paying interest only.

(2) Includes a \$1.4 million loan on which the borrower has filed for Chapter 11 Bankruptcy. We are classified as a secured creditor in the bankruptcy proceeding.

*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 evaluation of the estimated fair value of the loan. In determining estimated fair value, management utilizes the present value of the expected future cash flows discounted at the loan's effective interest rate and/or 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. 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, our historical experience with similar borrowers and/or individual borrower or collateral characteristics, and in certain circumstances, the financial strength of the guarantors. The liquidation probability is then applied to the identified loss exposure to determine the general or specific reserve for that loan and the ultimate determination as to whether it is considered impaired.

Management closely monitors our loans which require evaluation for loan loss reserves based on specific criteria which classify the loans 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 these borrowers, whose loans are classified as OAEM, 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.





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## PMC COMMERCIAL TRUST AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(Unaudited)*

Management has classified our Loans Receivable Subject to Credit Risk as follows (balances represent our investment in the loans prior to loan loss reserves and deferred capitalized costs):

|              | March 31, 2012                |        |                           |        |                |        |
|--------------|-------------------------------|--------|---------------------------|--------|----------------|--------|
|              | Totals                        |        | Commercial Mortgage Loans |        | SBA 7(a) Loans |        |
|              |                               | %      |                           | %      |                | %      |
|              | <i>(Dollars in thousands)</i> |        |                           |        |                |        |
| Satisfactory | \$ 186,801                    | 92.1%  | \$ 164,466                | 91.6%  | \$ 22,335      | 96.1%  |
| OAEM         | 2,082                         | 1.0%   | 1,950                     | 1.1%   | 132            | 0.6%   |
| Substandard  | 11,958                        | 5.9%   | 11,739                    | 6.5%   | 219            | 0.9%   |
| Doubtful     | 1,993                         | 1.0%   | 1,444                     | 0.8%   | 549            | 2.4%   |
|              | \$ 202,834                    | 100.0% | \$ 179,599                | 100.0% | \$ 23,235      | 100.0% |

|              | December 31, 2011             |        |                           |        |                |        |
|--------------|-------------------------------|--------|---------------------------|--------|----------------|--------|
|              | Totals                        |        | Commercial Mortgage Loans |        | SBA 7(a) Loans |        |
|              |                               | %      |                           | %      |                | %      |
|              | <i>(Dollars in thousands)</i> |        |                           |        |                |        |
| Satisfactory | \$ 189,836                    | 92.2%  | \$ 167,397                | 91.6%  | \$ 22,439      | 96.5%  |
| OAEM         | 3,354                         | 1.6%   | 3,317                     | 1.8%   | 37             | 0.2%   |
| Substandard  | 10,790                        | 5.2%   | 10,569                    | 5.8%   | 221            | 1.0%   |
| Doubtful     | 1,983                         | 1.0%   | 1,442                     | 0.8%   | 541            | 2.3%   |
|              | \$ 205,963                    | 100.0% | \$ 182,725                | 100.0% | \$ 23,238      | 100.0% |

Our provision for loan losses (excluding reductions of loan losses) as a percentage of our weighted average outstanding Loans Receivable Subject To Credit Risk was 0.24% and 0.18% during the three months ended March 31, 2012 and 2011, respectively. To the extent one or several of our borrowers experience significant operating difficulties and we are forced to liquidate the collateral underlying the loan, future losses may be substantial.

The activity in our loan loss reserves was as follows:

|                            | Three Months Ended March 31, 2012 |                           |                |
|----------------------------|-----------------------------------|---------------------------|----------------|
|                            | Total                             | Commercial Mortgage Loans | SBA 7(a) Loans |
|                            | <i>(In thousands)</i>             |                           |                |
| Balance, beginning of year | \$ 1,812                          | \$ 1,329                  | \$ 483         |
| Provision for loan losses  | 482                               | 410                       | 72             |

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|                                |          |          |        |
|--------------------------------|----------|----------|--------|
| Reduction of loan losses       | (7)      | (7)      |        |
| Principal balances written-off | (15)     |          | (15)   |
| Balance, end of period         | \$ 2,272 | \$ 1,732 | \$ 540 |

**Table of Contents****PMC COMMERCIAL TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Unaudited)*

|                                | Three Months Ended March 31, 2011 |                       |               |
|--------------------------------|-----------------------------------|-----------------------|---------------|
|                                | Total                             | Commercial            | SBA 7(a)      |
|                                |                                   | Mortgage<br>Loans     | Loans         |
|                                |                                   | <i>(In thousands)</i> |               |
| Balance, beginning of year     | \$ 1,609                          | \$ 1,303              | \$ 306        |
| Provision for loan losses      | 378                               | 310                   | 68            |
| Reduction of loan losses       | (65)                              | (47)                  | (18)          |
| Principal balances written-off | (35)                              |                       | (35)          |
| <b>Balance, end of period</b>  | <b>\$ 1,887</b>                   | <b>\$ 1,566</b>       | <b>\$ 321</b> |

Information on those loans considered to be impaired loans was as follows:

|   | March 31, 2012  |                       |               | December 31, 2011 |                   |               |
|---|-----------------|-----------------------|---------------|-------------------|-------------------|---------------|
|   | Total           | Commercial            | SBA 7(a)      | Total             | Commercial        | SBA 7(a)      |
|   |                 | Mortgage<br>Loans     | Loans         |                   | Mortgage<br>Loans | Loans         |
|   |                 | <i>(In thousands)</i> |               |                   |                   |               |
| Impaired loans requiring reserves (1)               | \$ 7,456        | \$ 7,055              | \$ 401        | \$ 7,411          | \$ 7,027          | \$ 384        |
| Impaired loans expected to be fully recoverable (1) | 834             | 681                   | 153           | 846               | 689               | 157           |
| <b>Total impaired loans (2)</b>                     | <b>\$ 8,290</b> | <b>\$ 7,736</b>       | <b>\$ 554</b> | <b>\$ 8,257</b>   | <b>\$ 7,716</b>   | <b>\$ 541</b> |
| Loan loss reserves                                  | \$ 646          | \$ 421                | \$ 225        | \$ 563            | \$ 372            | \$ 191        |

*(1) Includes loans classified as troubled debt restructurings.**(2) The unpaid principal balance of our impaired commercial loans was \$7,933,000 and \$7,940,000 at March 31, 2012 and December 31, 2011, respectively. The unpaid principal balance of our impaired SBA 7(a) loans (excluding the government guaranteed portion) was \$615,000 and \$593,000 at March 31, 2012 and December 31, 2011, respectively.*

|                                   | Three Months Ended March 31, 2012 |                       |          | Three Months Ended March 31, 2011 |                   |          |
|-----------------------------------|-----------------------------------|-----------------------|----------|-----------------------------------|-------------------|----------|
|                                   | Total                             | Commercial            | SBA 7(a) | Total                             | Commercial        | SBA 7(a) |
|                                   |                                   | Mortgage<br>Loans     | Loans    |                                   | Mortgage<br>Loans | Loans    |
|                                   |                                   | <i>(In thousands)</i> |          |                                   |                   |          |
| Average impaired loans            | \$ 8,261                          | \$ 7,726              | \$ 535   | \$ 2,444                          | \$ 2,053          | \$ 391   |
| Interest income on impaired loans | \$ 89                             | \$ 87                 | \$ 2     | \$ 2                              | \$                | \$ 2     |

Our recorded investment in Non-Accrual Loans at March 31, 2012 of \$3,685,000 was comprised of \$402,000 of SBA 7(a) loans and \$3,283,000 of commercial mortgage loans. Our recorded investment in Non-Accrual Loans at December 31, 2011 of \$1,820,000 was comprised of \$384,000 of SBA 7(a) loans and \$1,436,000 of commercial mortgage loans. We did not have any loans receivable past due 90 days or more which were

accruing interest at March 31, 2012 or December 31, 2011.

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

*(Unaudited)*

Information on our troubled debt restructurings which consisted of four commercial mortgage loans was as follows at March 31, 2012:

|   | Recorded<br>Investment | Unpaid<br>Principal<br>Balance |
|---|------------------------|--------------------------------|
|   | <i>(In thousands)</i>  |                                |
| Troubled debt restructurings requiring reserves | \$ 5,594               | \$ 5,730                       |
| Troubled debt restructurings without reserves   | 681                    | 740                            |
| <b>Total troubled debt restructurings</b>       | <b>\$ 6,275</b>        | <b>\$ 6,470</b>                |
| <br>Loan loss reserves                          | <br>\$ 232             |                                |

The modifications were primarily extended interest only periods; however, for one loan the borrower filed Chapter 11 Bankruptcy and the plan was confirmed with modified terms including extended interest only and amortization periods. In addition, the interest rate was reduced on one of the commercial mortgage loans with an extended interest only period.

**Note 4. Other Assets:**

Other assets consisted of the following:

|  | March 31,<br>2012     | December 31,<br>2011 |
|--|-----------------------|----------------------|
|  | <i>(In thousands)</i> |                      |
| Deferred tax asset, net                  | \$ 1,569              | \$ 1,409             |
| Deferred borrowing costs, net            | 1,116                 | 1,128                |
| Servicing asset, net                     | 984                   | 979                  |
| Retained interests in transferred assets | 923                   | 996                  |
| Investment in variable interest entity   | 820                   | 820                  |
| Interest receivable                      | 709                   | 710                  |
| Prepaid expenses and deposits            | 327                   | 303                  |
| Other                                    | 611                   | 481                  |
|  | <b>\$ 7,059</b>       | <b>\$ 6,826</b>      |

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

(Unaudited)

**Note 5. Debt:**

Information on our debt was as follows:

|  | Carrying Value (1) |                      | Weighted Average<br>Coupon Rate at |                      |
|--|--------------------|----------------------|------------------------------------|----------------------|
|  | March 31,<br>2012  | December 31,<br>2011 | March 31,<br>2012                  | December 31,<br>2011 |
| <i>(Dollars in thousands, except footnotes)</i>          |                    |                      |                                    |                      |
| <i>Secured borrowings - government guaranteed loans:</i> |                    |                      |                                    |                      |
| Loans sold for a premium and excess spread               | \$ 31,905          | \$ 26,569            | 3.77%                              | 3.77%                |
| Loans sold for excess spread                             | 5,941              | 5,977                | 1.58%                              | 1.58%                |
|  | 37,846             | 32,546               |                                    |                      |
| Junior subordinated notes                                | 27,070             | 27,070               | 3.83%                              | 3.62%                |
| Revolving credit facility                                | 15,700             | 17,800               | 2.43%                              | 2.47%                |
| Debentures payable                                       | 13,183             | 13,181               | 4.99%                              | 4.99%                |
| Structured notes payable - 2003 Joint Venture (2)        |                    | 5,264                | N/A                                | 3.08%                |
| <b>Debt</b>  | <b>\$ 93,799</b>   | <b>\$ 95,861</b>     |                                    |                      |

(1) The face amount of debt as of March 31, 2012 and December 31, 2011 was \$93,806,000 and \$95,870,000, respectively.

(2) We repaid the 2003 Joint Venture structured notes on February 15, 2012.

Principal payments on our debt at March 31, 2012 were as follows:

Twelve

Months Ending

| March 31,  | Total            | Secured<br>Borrowings (1)<br><i>(In thousands)</i> | All Other<br>Debt (2) |
|------------|------------------|--|-----------------------|
| 2013       | \$ 979           | \$ 979   | \$                    |
| 2014       | 5,203            | 1,013  | 4,190                 |
| 2015       | 20,748           | 1,048  | 19,700                |
| 2016       | 1,085            | 1,085  |                       |
| 2017       | 1,125            | 1,125  |                       |
| Thereafter | 64,666           | 32,596   | 32,070                |
|            | <b>\$ 93,806</b> | <b>\$ 37,846</b>                                   | <b>\$ 55,960</b>      |

- (1) *Principal payments are 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 liquidations or charge-offs. No payment is due unless payments are received from the borrowers on the loans underlying them.*
- (2) *Represents the revolving credit facility, junior subordinated notes and debentures payable.*



**Table of Contents****PMC COMMERCIAL TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Unaudited)***Note 6. Share-Based Compensation Plans:**

We issued an aggregate of 10,000 restricted shares to executive officers on March 12, 2012 at the then current market price of the shares of \$7.27 (the closing price on March 9, 2012). 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 \$40,000 and \$49,000 during the three months ended March 31, 2012 and 2011, respectively, related to restricted shares. As of March 31, 2012, there was \$62,000 of total unrecognized compensation expense related to restricted shares which will be recognized over the next two years.

**Note 7. 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 8. Discontinued Operations:**

Discontinued operations consisted of the following:

|                               | Three Months Ended<br>March 31, |          |
|-------------------------------|---------------------------------|----------|
|                               | 2012                            | 2011     |
|                               | <i>(In thousands)</i>           |          |
| Gains on sales of real estate | \$                              | \$ 2     |
| Net operating losses          | (131)                           | (210)    |
| Impairment losses             | (18)                            |          |
| Discontinued operations       | \$ (149)                        | \$ (208) |

Net operating losses from discontinued operations relate to the operations and holding costs of our real estate owned.

Impairment losses represent declines in the estimated fair value of our real estate owned subsequent to initial valuation.

**Note 9. Earnings (Loss) Per Share ( EPS ):**

The computations of basic EPS are based on our weighted average shares outstanding. No shares were added to the weighted average shares outstanding for purposes of calculating diluted EPS during the three months ended March 31, 2012 as options were anti-dilutive. During the three months ended March 31, 2011, the weighted average shares outstanding were increased by 56,000 shares to reflect the dilutive effect of stock options.

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Not included in the computation of diluted EPS were outstanding options to purchase 95,000 and 35,000 common shares during three months ended March 31, 2012 and 2011, respectively, because the options' exercise prices were greater than the average market price of the shares.

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## PMC COMMERCIAL TRUST AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Note 10. Fair Value Measurements:**

For impaired loans measured at fair value on a nonrecurring basis during the three months ended March 31, 2012 and 2011, 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<br>March 31, |          | Provision for<br>Loan Losses<br>Three Months Ended<br>March 31, (2) |       |
|--------------------|--------------------------------|----------|---|-------|
|                    | 2012                           | 2011     | 2012  | 2011  |
|                    | <i>(In thousands)</i>          |          |   |       |
| Impaired loans (1) | \$ 7,644                       | \$ 2,174 | \$ 71   | \$ 18 |

- (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 our impaired 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.

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

|  | March 31,<br>2012     |                            | December 31,<br>2011 |                            |
|--|-----------------------|----------------------------|----------------------|----------------------------|
|  | Carrying<br>Amount    | Estimated<br>Fair<br>Value | Carrying<br>Amount   | Estimated<br>Fair<br>Value |
|  | <i>(In thousands)</i> |                            |                      |                            |
| <b>Assets:</b>                                   |                       |                            |                      |                            |
| Loans receivable, net                            | \$ 235,744            | \$ 223,372                 | \$ 234,427           | \$ 224,395                 |
| Cash and cash equivalents                        | 3,254                 | 3,254                      | 6,502                | 6,502                      |
| Restricted cash and cash equivalents             |                       |                            | 2,233                | 2,233                      |
| <b>Liabilities:</b>                              |                       |                            |                      |                            |
| SBIC debentures and structured notes payable     | 13,183                | 13,435                     | 18,445               | 19,027                     |
| Secured borrowings - government guaranteed loans | 37,846                | 37,846                     | 32,546               | 32,546                     |
| Revolving credit facility                        | 15,700                | 15,700                     | 17,800               | 17,800                     |
| Junior subordinated notes                        | 27,070                | 22,577                     | 27,070               | 22,595                     |

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We used Level 3 inputs to determine the estimated fair value of our financial instruments. 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.

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**PMC COMMERCIAL TRUST AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

*(Unaudited)*

*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 discount rate based on current market interest rates, prepayment tendencies and potential loan losses. Significant increases (decreases) in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement. Reserves are established based on numerous factors including, but not limited to, the creditor's payment history, collateral value, guarantor support, expected future cash flows 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.

*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 were comprised of our collection and reserve accounts of the securitization. The carrying amount was considered to be a reasonable estimate of their fair value due to (1) the maturity of the collection account and (2) the reserve account was used in conjunction with the exercise of our clean-up call option. At March 31, 2012, we no longer have any restricted cash and cash equivalents.

*SBIC debentures and structured notes 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. The structured notes payable were repaid on February 15, 2012.

*Secured borrowings - government guaranteed loans:* The estimated fair value approximates cost as the interest rates on these secured borrowings approximates current market interest rates.

*Revolving credit facility:* The carrying amount is a reasonable estimation of fair value as the interest rate on this instrument is variable and was set in a third-party transaction.

**Note 11. 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 \$23.2 million at March 31, 2012, of which \$12.2 million were for prime-based loans to be originated by our SBA 7(a) subsidiary, 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 February 2015. Future minimum lease payments are as follows:

Twelve Months

Ending

March 31,

Total

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|      | <i>(In thousands)</i> |
|------|-----------------------|
| 2013 | \$ 165                |
| 2014 | 213                   |
| 2015 | 200                   |
|      | \$ 578                |

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**PMC COMMERCIAL TRUST AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

*(Unaudited)*

*Employment Agreements*

We have employment agreements with our executive officers for terms expiring December 31, 2014. 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 salary paid to the executive officer.

*Litigation*

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, 2012 and results of operations for the three months ended March 31, 2012 and 2011 should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2011. 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, 2011.**

**EXECUTIVE SUMMARY****Quarterly Update, Operating Results and Strategic Alternatives**

Our income (loss) from continuing operations for the first quarter of 2012 was a loss of \$6,000 compared to income of \$1,124,000 (\$0.11 per share) during the first quarter of 2011. Net income (loss) decreased to a loss of \$155,000, (\$0.01) per share, during the first quarter of 2012 compared to income of \$916,000, or \$0.09 per share, for the first quarter of 2011. The primary reason for the decrease in income (loss) from continuing operations and net income (loss) were costs of \$850,000 related to the evaluation of strategic alternatives. Income from continuing operations and net income were \$844,000 and \$695,000, respectively, during the first quarter of 2012 before the impact of strategic alternative costs.

During 2011, we received certain inquiries expressing a preliminary interest in potential strategic transactions. The Board of Trust Managers (the Board) established a special committee of all of our independent trust managers to evaluate these inquiries as well as other potential strategic alternatives that could enhance shareholder value. The special committee hired an investment advisory firm to assist it in such evaluation. There can be no assurance that this process will result in any transaction or, if a transaction is undertaken, its terms or timing.

During the three months ended March 31, 2012, we expensed \$850,000 related to the evaluation of strategic alternatives consisting of \$561,000 in legal fees, \$136,000 in trust manager fees, \$118,000 of due diligence costs and \$35,000 of other expenses. On a cumulative basis, as of March 31, 2012, we have expensed \$1,628,000 related to potential strategic alternatives consisting of \$1,055,000 in legal fees, \$289,000 in trust manager fees, \$131,000 related to the investment advisor, \$118,000 of due diligence costs and \$35,000 of other expenses. During April 2012, we incurred an additional \$400,000 related to the evaluation of strategic alternatives. We have and will continue to execute our present business strategy while the special committee conducts its review. The special committee has not set a definitive schedule to complete its evaluation and does not intend to disclose developments with respect to this evaluation unless and until the evaluation has been completed, unless otherwise determined by us or required by law.



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In addition, our earnings continue to be negatively impacted by the deferral of gain recognition for accounting purposes on certain of our secondary market loan sales. During the first quarter of 2012, \$562,000 of gains were deferred while \$485,000 of gains were deferred during the first quarter of 2011. As of March 31, 2012, we have accumulated \$2.9 million of deferred cash premiums (included in secured borrowings government guaranteed loans) that will be amortized as a reduction to interest expense over the life of the loan using the effective interest method and any remaining balance is fully amortized when the loan is repaid in full or charged-off.

During the three months ended March 31, 2012 we funded \$10.7 million of loans. At March 31, 2012, our outstanding commitments to fund loans were \$23.2 million which was an \$8.9 million increase from our outstanding commitments at December 31, 2011. We expect that fundings during 2012 will be between \$50 million and \$60 million. During the first quarter of 2012 there was an increase in lending opportunities including an increase in opportunities that meet the criteria to be originated by our SBIC licensees.

The net loss we experienced for the three months ended March 31, 2012 is the first recorded net loss in the Company's history. This loss resulted primarily from costs associated with evaluation of strategic alternatives and the decision by management to sell the guaranteed portion of the majority of our first quarter 2012 fully funded SBA 7(a) loans as hybrids (which defers gain recognition for accounting purposes and earns additional long-term servicing fees) versus solely for cash premiums (which allows for immediate income recognition of cash premiums). If costs continue to be incurred associated with evaluation of strategic alternatives at current or increased levels and/or management continues to sell the majority of our fully funded SBA 7(a) loans as hybrids versus solely for cash premiums, we could generate additional net losses in the future. In addition, a net loss negatively impacts our beneficiaries' equity. Our revolving credit facility requires that we maintain a minimum beneficiaries' equity of \$142.0 million. Currently, our beneficiaries' equity is \$145.0 million. If we continue to incur losses, we may be required to reduce our dividend to maintain compliance with this covenant.

## **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 continue to experience 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 and extended interest only periods, lack of cash flow, shortage of funds 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 a result, our litigation and foreclosure activity and related costs have increased.

As part of our efforts to assist those borrowers who are experiencing negative cash flows, we temporarily or permanently modified the terms of certain loans receivable or we have allowed reduced payments. We are not yet able to determine if these concessions were, or will be, sufficient to improve these borrowers' cash flows such that future modifications will not be necessary. We believe that economic conditions are improving, including those associated with the hospitality industry. However, there can be no certainty that these improved economic conditions will benefit borrowers whose cash flow was not sufficient to cover their debt service without capital investment to continue to be able to make payments in accordance with their loan documents.

There was an increase in mortgage defaults and foreclosures in the broader commercial real estate market and these defaults may continue. This increase was due in part to credit market turmoil and declining property cash flows and 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 will likely continue to experience a high level of 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, the holding periods for our REO have increased. The lagging impact of the adverse economic conditions may continue to have an adverse effect on our REO and the limited service hospitality industry which may result in additional impairment losses and the effect on our results of operations and financial condition may be material.

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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. The lagging impact of the adverse economic conditions may continue to have an adverse effect on the financial condition of individual borrowers and the limited service hospitality industry which 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 \$35 million unsecured revolving credit facility (the Revolver) matures on June 30, 2014 and has an interest rate of prime less 50 basis points or the 30-day LIBOR plus 2%, at our option. The total amount available under the Revolver will automatically increase by \$5 million to \$40 million on January 1, 2013 provided there is no event of default or potential default on that date and the non-performing loan ratio, as defined, is not more than 20% on that date.

**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 three months ended March 31, 2012, we sold \$6.2 million of the guaranteed portion of SBA 7(a) loans for either (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 190 basis points (including the 100 basis points required to be retained) and cash premiums of 10% (i.e., hybrid loan sales or hybrid). For hybrid loan sales, gains are not recognized at the time of sale due to accounting rules. The cash premium will instead be amortized as a reduction to interest expense over the life of the loan. Our deferred cash premiums at March 31, 2012 total \$2,860,000.

Our secondary market loan sale activity was as follows:

*Three Months Ended March 31, 2012*

| Type of Sale | Principal Sold | Cash Premium Received | Gain Recognized Upon Sale Book | Tax        |
|--------------|----------------|-----------------------|--------------------------------|------------|
| Cash premium | \$ 1,257,750   | \$ 157,700            | \$ 112,900                     | \$ 138,200 |
| Hybrid       | 4,989,750      | 499,000               |                                | 561,900    |
|              | \$ 6,247,500   | \$ 656,700            | \$ 112,900                     | \$ 700,100 |

*Three Months Ended March 31, 2011*

| Type of Sale | Principal Sold | Cash Premium Received | Gain Recognized Upon Sale Book | Tax        |
|--------------|----------------|-----------------------|--------------------------------|------------|
| Cash premium | \$ 4,680,000   | \$ 448,900            | \$ 431,000                     | \$ 491,700 |
| Hybrid       | 3,785,900      | 378,600               |                                | 484,700    |
|              | \$ 8,465,900   | \$ 827,500            | \$ 431,000                     | \$ 976,400 |



**Table of Contents****LOAN PORTFOLIO INFORMATION****Loan Activity**

During the three months ended March 31, 2012 we funded \$10.7 million of loans. At March 31, 2012, December 31, 2011 and March 31, 2011, our outstanding commitments to fund loans were \$23.2 million, \$14.3 million and \$12.5 million, respectively. We expect that fundings during 2012 will be between \$50 million and \$60 million.

In addition to our retained portfolio of \$237.8 million at March 31, 2012, we service \$61.5 million of aggregate principal balance of certain loans sold pursuant to Secondary Market Loan Sales that have been accounted for as sales. In addition, due to a change in accounting rules, beginning January 1, 2010, the aggregate principal balance remaining on loans that were sold in structured loan sale transactions were consolidated and included in our retained portfolio. Since we retained a residual interest in the cash flows from these loans, the performance of these loans impacted our profitability and our cash available for dividend distributions. Therefore, we provide information on both our loans retained (the Retained Portfolio) and combined with sold loans that we service (the Aggregate Portfolio).

Information on our Aggregate Portfolio, including prepayments, was as follows:

|                         | March 31,<br>2012             | 2011       | 2010       | December 31,<br>2009 | 2008       | 2007       |
|-------------------------|-------------------------------|------------|------------|----------------------|------------|------------|
|                         | <i>(Dollars in thousands)</i> |            |            |                      |            |            |
| Aggregate Portfolio (1) | \$ 299,250                    | \$ 297,453 | \$ 284,451 | \$ 273,687           | \$ 275,530 | \$ 326,368 |
| Loans funded (2)        | \$ 10,731                     | \$ 38,352  | \$ 38,440  | \$ 30,435            | \$ 34,587  | \$ 33,756  |
| Prepayments (2)         | \$ 5,442                      | \$ 10,352  | \$ 10,830  | \$ 12,795            | \$ 68,556  | \$ 84,137  |
| % Prepayments (3)       | 7.3%                          | 3.6%       | 4.0%       | 4.6%                 | 21.0%      | 21.2%      |

(1) Serviced Portfolio outstanding at the period ended before loan loss reserves and deferred commitment fees.

(2) During the years ended December 31 and the three months ended March 31, 2012.

(3) Represents prepayments as a percentage of the Aggregate Portfolio outstanding as of the beginning of the applicable year. For the three months ended March 31, 2012, represents annualized prepayments as a percentage of our Aggregate Portfolio outstanding.

The following table summarizes our loan activity for the three months ended March 31, 2012 and 2011:

|   | Three Months Ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2012                            | 2011       |
|   | <i>(In thousands)</i>           |            |
| Loans receivable, net - beginning of year | \$ 234,427                      | \$ 233,218 |
| Loans funded (1)                          | 10,731                          | 8,072      |
| Principal reductions (1)                  | (8,997)                         | (7,541)    |
| Other adjustments (2)                     | (417)                           | (306)      |
| Loans receivable, net - end of period     | \$ 235,744                      | \$ 233,443 |

(1) See detailed information below.

(2) Represents the net change in loan loss reserves, discounts and deferred commitment fees.



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Detailed information on our loans funded and principal reductions were as follows:

|   | Three Months Ended<br>March 31, |                 |
|---|---------------------------------|-----------------|
|   | 2012                            | 2011            |
|   | <i>(In thousands)</i>           |                 |
| <b>Loans Funded:</b>                            |                                 |                 |
| SBA 7(a) loans                                  | \$ 6,587                        | \$ 7,866        |
| Commercial mortgage loans                       | 4,144                           | 206             |
| <b>Total loans funded</b>                       | <b>\$ 10,731</b>                | <b>\$ 8,072</b> |
| <b>Principal Reductions:</b>                    |                                 |                 |
| Scheduled principal payments                    | \$ 2,880                        | \$ 2,699        |
| Prepayments                                     | 4,859                           | 162             |
| Proceeds from sale of SBA 7(a) guaranteed loans | 1,258                           | 4,680           |
| <b>Total principal reductions</b>               | <b>\$ 8,997</b>                 | <b>\$ 7,541</b> |

**Retained Portfolio**

Our Retained Portfolio was comprised of the following:

|                       | March 31, 2012                |        |   | December 31, 2011            |        |   |
|-----------------------|-------------------------------|--------|---|------------------------------|--------|---|
|                       | Retained Portfolio<br>Amount  | %      | Weighted<br>Average<br>Interest<br>Rate | Retained Portfolio<br>Amount | %      | Weighted<br>Average<br>Interest<br>Rate |
|                       | <i>(Dollars in thousands)</i> |        |   |                              |        |   |
| Variable-rate - LIBOR | \$ 128,292                    | 54.4%  | 4.5%                                    | \$ 132,596                   | 56.6%  | 4.4%                                    |
| Variable-rate - prime | 62,093                        | 26.4%  | 5.8%                                    | 57,338                       | 24.4%  | 5.8%                                    |
| Fixed-rate            | 45,359                        | 19.2%  | 9.1%                                    | 44,493                       | 19.0%  | 9.2%                                    |
|                       | \$ 235,744                    | 100.0% | 5.7%                                    | \$ 234,427                   | 100.0% | 5.6%                                    |

As the majority of our loans have variable interest rates, during the current low interest rate environment, our interest income has been negatively impacted. To the extent LIBOR or the prime rate changes, we will have changes in interest income from our variable-rate loans.

**Portfolio Quality**

Our provision for loan losses (excluding reductions of loan losses) as a percentage of our weighted average outstanding Loans Receivable Subject To Credit Risk was 0.24% and 0.18% during the three months ended March 31, 2012 and 2011, respectively. To the extent one or several of our borrowers experience significant operating difficulties and we are forced to liquidate the collateral underlying the loans, future losses may be substantial.

Management closely monitors our loans which require evaluation for loan loss reserves based on specific criteria which classify the loans 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

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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.

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Management has classified our Loans Receivable Subject To Credit Risk as follows (balances represent our investment in the loans prior to loan loss reserves and deferred capitalized costs):

|              |            |        | March 31, 2012                  |        |                   |        |
|--------------|------------|--------|---------------------------------|--------|-------------------|--------|
|              | Totals     | %      | Commercial<br>Mortgage<br>Loans |        | SBA 7(a)<br>Loans |        |
|              |            |        | <i>(Dollars in thousands)</i>   |        |                   |        |
| Satisfactory | \$ 186,801 | 92.1%  | \$ 164,466                      | 91.6%  | \$ 22,335         | 96.1%  |
| OAEM         | 2,082      | 1.0%   | 1,950                           | 1.1%   | 132               | 0.6%   |
| Substandard  | 11,958     | 5.9%   | 11,739                          | 6.5%   | 219               | 0.9%   |
| Doubtful     | 1,993      | 1.0%   | 1,444                           | 0.8%   | 549               | 2.4%   |
|              | \$ 202,834 | 100.0% | \$ 179,599                      | 100.0% | \$ 23,235         | 100.0% |

|              |            |        | December 31, 2011               |        |                   |        |
|--------------|------------|--------|---------------------------------|--------|-------------------|--------|
|              | Totals     | %      | Commercial<br>Mortgage<br>Loans |        | SBA 7(a)<br>Loans |        |
|              |            |        | <i>(Dollars in thousands)</i>   |        |                   |        |
| Satisfactory | \$ 189,836 | 92.2%  | \$ 167,397                      | 91.6%  | \$ 22,439         | 96.5%  |
| OAEM         | 3,354      | 1.6%   | 3,317                           | 1.8%   | 37                | 0.2%   |
| Substandard  | 10,790     | 5.2%   | 10,569                          | 5.8%   | 221               | 1.0%   |
| Doubtful     | 1,983      | 1.0%   | 1,442                           | 0.8%   | 541               | 2.3%   |
|              | \$ 205,963 | 100.0% | \$ 182,725                      | 100.0% | \$ 23,238         | 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.

We are currently in the process of foreclosure proceedings on several properties collateralizing our loans. Borrowers have the option of seeking Federal bankruptcy protection which could delay the foreclosure process. In conjunction with the 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.

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.



**Table of Contents****RESULTS OF OPERATIONS****Three Months Ended March 31, 2012 Compared to the Three Months Ended March 31, 2011*****Overview***

|  | Three Months Ended<br>March 31, |          | Change     |          |
|--|---------------------------------|----------|------------|----------|
|  | 2012                            | 2011     | \$         | %        |
|  | <i>(Dollars in thousands)</i>   |          |            |          |
| Total revenues                           | \$ 3,787                        | \$ 4,056 | \$ (269)   | (6.6%)   |
| Total expenses                           | \$ 3,812                        | \$ 2,907 | \$ 905     | 31.1%    |
| Income (loss) from continuing operations | \$ (6)                          | \$ 1,124 | \$ (1,130) | (100.5%) |
| Net income (loss)                        | \$ (155)                        | \$ 916   | \$ (1,071) | (116.9%) |

Revenues declined during the three months ended March 31, 2012 primarily due to a decrease in recognized premium income while our expenses increased during the three months ended March 31, 2012 primarily due to costs associated with evaluating strategic alternatives.

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

***Revenues***

We had a slight increase in interest income of \$31,000 during the three months ended March 31, 2012 compared to the comparable period of 2011. Our weighted average loans receivable remained relatively constant at \$234.7 million during the three months ended March 31, 2012 compared to \$233.3 million during the three months ended March 31, 2011.

Premium income results from certain sales of the government guaranteed portion of SBA 7(a) loans into the secondary market. We record premium income at the time of sale for those sales for solely cash premiums and the required 1% servicing spread. We sold less loans for solely cash premiums and the required 1% servicing spread during the three months ended March 31, 2012 than the comparable period of 2011.

Other income consisted of the following:

|  | Three Months Ended<br>March 31, |        |
|--|---------------------------------|--------|
|  | 2012                            | 2011   |
|  | <i>(In thousands)</i>           |        |
| Servicing income                         | \$ 125                          | \$ 97  |
| Retained interests in transferred assets | 54                              | 53     |
| Loan related income - other              | 47                              | 46     |
| Prepayment fees                          | 19                              |        |
| Other                                    | 30                              | 62     |
|  | \$ 275                          | \$ 258 |

**Table of Contents****Interest Expense**

Interest expense consisted of the following:

|                           | Three Months Ended<br>March 31, |        |
|---------------------------|---------------------------------|--------|
|                           | 2012                            | 2011   |
|                           | <i>(In thousands)</i>           |        |
| Secured borrowings        | \$ 280                          | \$ 186 |
| Junior subordinated notes | 264                             | 243    |
| Debentures payable        | 171                             | 122    |
| Revolver                  | 124                             | 127    |
| Structured notes payable  | 21                              | 273    |
| Other                     | 23                              | 22     |
|                           | \$ 883                          | \$ 973 |

The weighted average cost of our funds decreased to 3.5% during the three months ended March 31, 2012 compared to 4.0% during the three months ended March 31, 2011.

Secured borrowings increase as we sell SBA 7(a) loans solely for excess servicing spreads. Interest expense on our secured borrowings will continue to increase unless we sell loans solely for cash and the 1% required servicing spread or we experience significant prepayments. The weighted average balance outstanding on our secured borrowings was \$35.3 million during three months ended March 31, 2012 compared to \$23.8 million during the three months ended March 31, 2011.

The increase in interest expense on debentures payable is due to an increase in debentures outstanding. One of our SBICs issued \$5.0 million in debentures in September 2011 at an interest rate of 2.877% plus an annual fee of 0.515%.

Interest expense on our structured notes payable has decreased due to principal payments received from the underlying loans. We repaid the remaining balance of the 2003 Joint Venture notes on February 15, 2012; thus, we no longer have any structured notes payable outstanding.

**Other Expenses**

General and administrative expense decreased to \$460,000 during the three months ended March 31, 2012 compared to \$504,000 during the three months ended March 31, 2011 primarily due to a reduction in legal fees.

During the first quarter of 2012, we expensed \$850,000 in costs associated with evaluation of strategic alternatives including legal fees, trust manager fees and due diligence costs. As we continue to evaluate potential strategic alternatives, these fees and other related expenses will continue to be incurred and may increase.

Our provision for loan losses, net was \$475,000 during the three months ended March 31, 2012 compared to \$313,000 during the three months ended March 31, 2011. Our provision for loan losses primarily relates to limited service hospitality properties.

**Table of Contents****Discontinued Operations**

|                               | Three Months Ended<br>March 31, |          |
|-------------------------------|---------------------------------|----------|
|                               | 2012                            | 2011     |
|                               | <i>(In thousands)</i>           |          |
| Net operating losses          | \$ (131)                        | \$ (210) |
| Gains on sales of real estate |                                 | 2        |
| Impairment losses             | (18)                            |          |
| Discontinued operations       | \$ (149)                        | \$ (208) |

Our net operating losses from discontinued operations relate to the operations and holding costs of our REO. We expect these costs to continue until the properties are sold.

Impairment losses represent declines in the estimated fair value of our REO subsequent to initial valuation.

**LIQUIDITY AND CAPITAL RESOURCES****Cash Flow Analysis**

Information on our cash flow was as follows:

|                                       | Three Months Ended<br>March 31, |            |            |
|---------------------------------------|---------------------------------|------------|------------|
|                                       | 2012                            | 2011       | Change     |
|                                       | <i>(In thousands)</i>           |            |            |
| Cash used in operating activities     | \$ (3,097)                      | \$ (1,314) | \$ (1,783) |
| Cash provided by investing activities | 4,049                           | 3,184      | 865        |
| Cash used in financing activities     | (4,200)                         | (1,575)    | (2,625)    |
| Net cash flow                         | \$ (3,248)                      | \$ 295     | \$ (3,543) |

**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 flow from 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 from operating activities. Modified Cash is calculated by adjusting our cash flow from 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, a non-GAAP financial measurement, is one of the factors used by our 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 the Board's dividend policy regarding returns of capital, 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.

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

|  | Three Months Ended    |            |
|--|-----------------------|------------|
|  | March 31,             |            |
|  | 2012                  | 2011       |
|  | <i>(In thousands)</i> |            |
| Net cash used in operating activities      | \$ (3,097)            | \$ (1,314) |
| Change in operating assets and liabilities | 211                   | 850        |
| Operating Loan Activity                    | 3,528                 | 2,018      |
| Modified Cash                              | \$ 642                | \$ 1,554   |

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, 2012 and 2011, dividend distributions were greater than our Modified Cash by \$1,028,000 and \$136,000, respectively. To the extent our operations include expenses related to the evaluation of strategic alternatives, the majority of these expenses are not currently expenses for tax purposes and are viewed as capital in nature by our Board. If we need working capital to fund any shortfall in operating cash flows to cover our dividend distributions, we would need to borrow the funds from our Revolver or use funds from the repayment of principal on loans receivable.

**Investing Activities**

Our primary investing activity is the origination of loans and collections on our investment portfolio. During the three months ended March 31, 2012 and 2011, the primary source of funds was principal collected on loans, net of loans funded of \$1,794,000 and \$1,487,000, respectively. We expect that this will continue to be our primary source of funds from investing activities. In addition, during the three months ended March 31, 2012, restricted cash and cash equivalents of \$2,233,000 were released in connection with the exercise of the clean-up call option on our 2003 Joint Venture structured notes. During the three months ended March 31, 2011, we received cash proceeds from our unconsolidated subsidiary of \$1,373,000 when our lessee exercised its fixed purchase option.

Based on our outstanding loan portfolio at March 31, 2012, our estimated collection of principal payments during the next twelve months are approximately \$12.2 million. Of this, approximately \$10.0 million could be available to repay a portion of the balance outstanding under the Revolver. The remaining \$2.2 million would be used to repay secured borrowings and for working capital of our SBICs.

**Financing Activities**

We used funds from financing activities during the three months ended March 31, 2012 and 2011 primarily (1) to pay dividends of \$1,670,000 and \$1,690,000, respectively, and (2) for net repayment on our Revolver of \$2,100,000 and \$1,600,000, respectively. Proceeds from Secondary Market Loans Sales recorded as secured borrowings during the three months ended March 31, 2012 and 2011 were \$4,989,000 and \$3,786,000, respectively. In addition, we repaid structured notes of \$5,264,000 during the three months of 2012 compared to \$1,960,000 during the comparable period of 2011.

**Sources and Uses of Funds****Liquidity Overview**

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, including evaluation of strategic alternatives. 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 the Revolver. We believe these sources of funds will be sufficient to meet our liquidity requirements in the short-term.

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Our unsecured \$35 million Revolver matures on June 30, 2014. The interest rate is prime less 50 basis points or the 30-day LIBOR plus 2%, at our option. The total amount available under the Revolver is subject to increase on January 1, 2013 by \$5 million to \$40 million provided there is no event of default or potential default on that date and the non-performing loan ratio, as defined, is not more than 20% on that date. Certain covenants, among other things, limit our ability to incur indebtedness, grant liens, make investments and sell assets. Our most significant covenant is a minimum beneficiaries equity covenant (\$142.0 million).

Currently we believe that access to debt capital through new warehouse lines, trust preferred securities or securitization issuances is not available to us or, to the extent available, with terms that would be unacceptable to us. During the recession that commenced in 2008, banks and other lending institutions tightened lending standards and restricted credit to long-term real estate lenders like ourselves as they rebuilt their capital bases. The structured credit markets, including the asset-backed securities (ABS) markets, and warehouse credit facilities were severely curtailed. These sources of funds are currently not available to us due to, among other things, (1) the market conditions described above, (2) the long-term maturities of our loans, (3) our concentration in the hospitality industry and (4) our relatively small size. In addition, there is currently no market for issuance of trust preferred securities (junior subordinated notes) for real estate companies and we do not anticipate this market to be available in the future. The lack of liquidity in ABS, commercial mortgage-backed securities and other commercial mortgage markets continues today and has negatively impacted commercial real estate sales and financing activity over the past several years. While we believe these conditions have improved and will continue to improve since commercial real estate market fundamentals should return over the long-term, we are unable to predict how long these conditions will continue and what long-term impact this will have on these markets.

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 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 and terminate commitments thereunder 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. In the event of a default on our Revolver, we will rely on Modified Cash, principal payments (including prepayments), and (if necessary) proceeds from asset and loan sales to satisfy our liquidity requirements.

### ***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 and other 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.

Since 2005, our working capital has primarily been provided through credit facilities and principal payments (including prepayments) on loans receivable. Prior to 2005, our primary source of long-term funds was structured loan sale transactions and the issuance of junior subordinated notes. At the current time, there is a limited market for commercial loan asset-backed securitizations and there is no current market for the issuance of trust preferred securities (junior subordinated notes). We cannot anticipate when, or if, these markets will be available to us in the future. Until these markets become available, our ability to grow is limited.

The relatively limited amount of capital available to originate new commercial mortgage loans has caused us to restrict non-SBA 7(a) and non-SBIC loan origination activity. A reduction in the availability of sources of funds could have a material adverse effect on our financial condition and results of operations. If sources of funds 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 currently has aggregate availability of \$35 million, matures June 30, 2014. 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 have commitments from the SBA for the issuance of \$10 million in SBIC debentures and anticipate drawing down these debentures, subject to SBA approval, during the third and/or fourth quarter of 2012. During the second quarter of 2012, we requested commitments from the SBA for additional debentures of \$10 million which would be used to fund loans within our SBICs. There can be no assurance that these commitments will be approved.

## **Table of Contents**

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 2012, we anticipate that our Modified Cash will be utilized to fund our expected 2012 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, 2012, we were in compliance with the covenants of this facility. Our most significant covenant is a minimum beneficiaries' equity covenant (\$142.0 million). While we anticipate maintaining compliance with these covenants, there can be no assurance that we will be able to do so.

### ***Uses of Funds***

In general, the primary use of our funds is to originate loans and for repayment of principal and interest on our debt. In addition, we use funds for operating deficits and holding costs of our REO and properties in the process of foreclosure and to evaluate strategic alternatives.

Our outstanding commitments to fund new loans were \$23.2 million at March 31, 2012, of which \$12.2 million were for prime-rate based loans to be originated under the SBA 7(a) program, 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 \$14.1 million related to these loans; however, the guaranteed portion of our SBA 7(a) 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 2012, we anticipate loan fundings will range from \$50 million to \$60 million.

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.

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, 2012, the sources of funds for our dividend distributions of \$1.7 million were Modified Cash of \$0.6 million and principal collections on our loans receivable of \$1.1 million.

### **SEASONALITY**

Generally, we are not subject to seasonal trends. However, since we primarily lend to the limited service hospitality industry, loan delinquencies and requests for deferments typically rise temporarily in the winter months due primarily to reductions in business travel and consumer vacations.

### **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 does not necessarily correlate directly to any individual factor.

We have a minimum beneficiaries' equity covenant (\$142.0 million) within our Revolver that may limit our ability to pay out returns of capital as part of our dividends. This covenant has not historically limited the amount of dividends we have paid. Currently, our beneficiaries' equity is \$145.0 million. If we continue to incur losses, we may be required to reduce our dividend to maintain compliance with this covenant.

**Table of Contents****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.

The following reconciles net income (loss) to REIT taxable income:

|  | Three Months Ended<br>March 31, |          |
|--|---------------------------------|----------|
|  | 2012                            | 2011     |
|  | <i>(In thousands)</i>           |          |
| Net income (loss)                                | \$ (155)                        | \$ 916   |
| Book/tax differences:                            |                                 |          |
| Gains related to real estate                     |                                 | 448      |
| Strategic alternatives                           | 850                             |          |
| Amortization and accretion                       | (157)                           | (16)     |
| Loan valuation                                   | 405                             | 188      |
| Other, net                                       | 82                              | 30       |
| Subtotal   | 1,025                           | 1,566    |
| Adjustment for TRS net loss (income), net of tax | 58                              | (28)     |
| REIT taxable income                              | \$ 1,083                        | \$ 1,538 |
| Distributions declared                           | \$ 1,694                        | \$ 1,691 |
| Weighted average common shares outstanding       | 10,576                          | 10,561   |

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.

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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 current income tax expense) is materially different than our net income (loss). The following table reconciles our net income (loss) to our Adjusted Taxable Income, Net of Current Tax Expense:

|   | Three Months Ended March 31, 2012       |         |         |
|---|---|---------|---------|
|   | Combined                                | REIT    | TRS s   |
|   | <i>(In thousands, except footnotes)</i> |         |         |
| Net loss  | \$ (155)                                | \$ (97) | \$ (58) |
| Book vs. tax timing differences                     | 1,655                                   | 1,180   | 475 (1) |
| Taxable income                                      | 1,500                                   | 1,083   | 417     |
| Special item (2)                                    | (850)                                   | (850)   |         |
| Taxable Income, adjusted for special item           | 650                                     | 233     | 417     |
| Current income tax expense                          | (142)                                   |         | (142)   |
| Adjusted Taxable Income, Net of Current Tax Expense | \$ 508                                  | \$ 233  | \$ 275  |

|   | 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 (3)                                    | (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  |

(1) Includes \$529,000 and \$468,000 of timing differences during the three months ended March 31, 2012 and 2011, respectively, related to Secondary Market Loan Sales.

(2) Timing difference related to currently non-deductible expenses related to strategic alternatives.

(3) Recognition of deferred gain for tax purposes on a 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 (loss), 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 continuing to experience 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 the Revolver.

**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;

significant rises in gasoline prices within a short period of time 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 further reduce the estimated fair 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 operations from increased losses on our Retained Portfolio:

|   | Three Months<br>Ended<br>March 31,<br>2012 | Year Ended<br>December 31,<br>2011<br><i>(In thousands)</i> | Three Months<br>Ended<br>March 31,<br>2011 |
|---|--|---|--|
| Provision for loan losses                           |  |   |  |
| As reported (1)                                     | \$ 482                                     | \$ 826  | \$ 378                                     |
| Annual loan losses increase by 50 basis points (2)  | 729  | 1,860   | 641  |
| Annual loan losses increase by 100 basis points (2) | 975  | 2,894   | 904  |

(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, 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 debt is 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, 2012, our loans are 81% 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 \$190.4 million of variable-rate loans at March 31, 2012. The estimated fair value of our variable-rate loans (\$179.8 million at March 31, 2012) is dependent upon several factors including changes in interest rates and the market for the type of loans we have originated.

We had \$45.3 million and \$44.5 million of fixed-rate loans at March 31, 2012 and December 31, 2011, 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, 2012 and December 31, 2011, we had \$190.4 million and \$189.9 million of variable-rate loans, respectively, and \$80.6 million and \$82.7 million of variable-rate debt, respectively. On the difference between our variable-rate loans and our variable-rate debt (\$109.8 million and \$107.2 million at March 31, 2012 and December 31, 2011, 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 have been and 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, 2012 and December 31, 2011, 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 \$275,000 and \$268,000, 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 REIT compliance issues. 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 and secured borrowings government guaranteed loans. At both March 31, 2012 and December 31, 2011, \$13.2 million 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, 2012, each hypothetical 100 basis points increase in interest rates would increase interest expense and decrease net income by approximately \$806,000. Our fixed-rate debt at March 31, 2012 was comprised of SBA debentures.

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, 2012 and December 31, 2011:

|  | Twelve Month Periods Ending March 31, |          |           |          |          |            | Carrying Value | Fair Value (1) |
|--|---------------------------------------|----------|-----------|----------|----------|------------|----------------|----------------|
|  | 2013                                  | 2014     | 2015      | 2016     | 2017     | Thereafter |                |                |
|  | <i>(Dollars in thousands)</i>         |          |           |          |          |            |                |                |
| Fixed-rate debt (2)                                | \$                                    | \$ 4,183 | \$ 4,000  | \$       | \$       | \$ 5,000   | \$ 13,183      | \$ 13,435      |
| Variable-rate debt (LIBOR and prime based) (3) (4) | 979                                   | 1,013    | 16,748    | 1,085    | 1,125    | 59,666     | 80,616         | 76,124         |
| Totals   | \$ 979                                | \$ 5,196 | \$ 20,748 | \$ 1,085 | \$ 1,125 | \$ 64,666  | \$ 93,799      | \$ 89,559      |

- (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, 2012 was 5.0%.
- (3) Principal payments on 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 liquidations and charge-offs.
- (4) The weighted average interest rate of our variable-rate debt at March 31, 2012 was 3.4%.



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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, 2012. 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, 2012 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, 2011.

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

None.

**ITEM 3. Defaults upon Senior Securities**

None.

**ITEM 4. Mine Safety Disclosures**

Not applicable.

**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  |
| ***101.INS | XBRL Instance Document   |
| ***101.SCH | XBRL Taxonomy Extension Schema Document  |
| ***101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| ***101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |
| ***101.LAB | XBRL Taxonomy Extension Label Linkbase Document  |
| ***101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document   |

\* Filed herewith.

\*\* Furnished herewith

\*\*\* In accordance with Regulation S-T, the XBRL-related information in Exhibit No. 101 shall be deemed furnished and not filed under sections 11 or 12 of the Securities Act of 1933 and/or under section 18 of the Securities and Exchange Act of 1934, and otherwise is not subject to liability under these sections.



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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: 5/10/12

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

Date: 5/10/12

/s/ Barry N. Berlin  
Barry N. Berlin  
Executive Vice President and

Chief Financial Officer

(Principal Accounting Officer)