

PMC COMMERCIAL TRUST /TX  
Form 10-Q  
May 10, 2013  
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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, 2013

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)

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

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

**(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 1, 2013, the Registrant had outstanding 10,596,220 Common Shares of Beneficial Interest, par value \$0.01 per share.

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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>2013  | December 31,<br>2012 |
|--|--------------------|----------------------|
|  | <i>(Unaudited)</i> |                      |
| <b>ASSETS</b>  |                    |                      |
| Loans receivable, net:   |                    |                      |
| Commercial mortgage loans receivable   | \$ 121,122         | \$ 125,515           |
| SBIC commercial mortgage loans receivable  | 51,133             | 47,153               |
| SBA 7(a) loans receivable, subject to secured borrowings   | 37,522             | 38,349               |
| SBA 7(a) loans receivable  | 30,894             | 27,974               |
| Loans receivable, net  | 240,671            | 238,991              |
| Cash and cash equivalents  | 8,073              | 1,230                |
| Real estate owned  | 630                | 739                  |
| Other assets   | 7,080              | 6,747                |
| <b>Total assets</b>  | <b>\$ 256,454</b>  | <b>\$ 247,707</b>    |
| <b>LIABILITIES AND EQUITY</b>  |                    |                      |
| <b>Liabilities:</b>  |                    |                      |
| Debt:  |                    |                      |
| Secured borrowings - government guaranteed loans   | \$ 40,093          | \$ 41,008            |
| Junior subordinated notes  | 27,070             | 27,070               |
| SBIC debentures payable  | 23,190             | 17,190               |
| Revolving credit facility  | 15,200             | 11,900               |
| Debt   | 105,553            | 97,168               |
| Borrower advances  | 6,371              | 5,942                |
| Accounts payable and accrued expenses  | 3,899              | 4,078                |
| Dividends payable  | 1,347              | 1,293                |
| <b>Total liabilities</b>   | <b>117,170</b>     | <b>108,481</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; 11,132,549 and 11,125,883 shares issued at March 31, 2013 and December 31, 2012, respectively; 10,596,220 and 10,589,554 shares outstanding at March 31, 2013 and December 31, 2012, respectively | 111                | 111                  |
| Additional paid-in capital   | 153,097            | 153,072              |
| Net unrealized appreciation of retained interests in transferred assets  | 292                | 278                  |
| Cumulative net income  | 175,261            | 173,917              |
| Cumulative dividends   | (185,476)          | (184,151)            |
| <b>Beneficiaries equity before treasury stock</b>  | <b>143,285</b>     | <b>143,227</b>       |
| Less: Treasury stock; at cost, 536,329 shares at March 31, 2013 and December 31, 2012  | (4,901)            | (4,901)              |
| <b>Total beneficiaries equity</b>  | <b>138,384</b>     | <b>138,326</b>       |

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|   |                   |                   |
|---|-------------------|-------------------|
| Noncontrolling interests cumulative preferred stock of subsidiary | 900               | 900               |
| <b>Total equity</b>   | <b>139,284</b>    | <b>139,226</b>    |
| <b>Total liabilities and equity</b>                               | <b>\$ 256,454</b> | <b>\$ 247,707</b> |

*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</b> |                  |
|--|---------------------------|------------------|
|  | <b>March 31,</b>          |                  |
|  | <b>2013</b>               | <b>2012</b>      |
|  | <i>(Unaudited)</i>        |                  |
| <b>Revenues:</b>   |                           |                  |
| Interest income  | \$ 3,471                  | \$ 3,398         |
| Premium income   | 820                       | 113              |
| Other income   | 224                       | 276              |
| <b>Total revenues</b>  | <b>4,515</b>              | <b>3,787</b>     |
| <b>Expenses:</b>   |                           |                  |
| Salaries and related benefits  | 1,019                     | 1,144            |
| Interest   | 812                       | 883              |
| General and administrative   | 642                       | 460              |
| Provision for loan losses, net   | 242                       | 475              |
| Strategic alternatives   |                           | 850              |
| <b>Total expenses</b>  | <b>2,715</b>              | <b>3,812</b>     |
| <b>Income (loss) before income tax benefit (provision) and discontinued operations</b> | <b>1,800</b>              | <b>(25)</b>      |
| Income tax benefit (provision)   | (282)                     | 19               |
| <b>Income (loss) from continuing operations</b>  | <b>1,518</b>              | <b>(6)</b>       |
| Discontinued operations  | (174)                     | (149)            |
| <b>Net income (loss)</b>   | <b>\$ 1,344</b>           | <b>\$ (155)</b>  |
| <b>Weighted average shares outstanding:</b>  |                           |                  |
| Basic  | 10,591                    | 10,576           |
| Diluted  | 10,591                    | 10,576           |
| <b>Basic and diluted earnings (loss) per share:</b>                                    |                           |                  |
| Income (loss) from continuing operations   | \$ 0.14                   | \$               |
| Discontinued operations  | (0.02)                    | (0.01)           |
| <b>Net income (loss)</b>   | <b>\$ 0.12</b>            | <b>\$ (0.01)</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</b> |             |
|--|---------------------------|-------------|
|  | <b>March 31,</b>          |             |
|  | <b>2013</b>               | <b>2012</b> |
|  | <i>(Unaudited)</i>        |             |
| <b>Net income (loss)</b>   | \$ 1,344                  | \$ (155)    |
| Change in unrealized appreciation of retained interests in transferred assets: |                           |             |
| Net unrealized appreciation (depreciation) arising during period               | 37                        | (9)         |
| Net realized gains included in net income                                      | (23)                      | (36)        |
| Change in unrealized appreciation of retained interests in transferred assets  | 14                        | (45)        |
| <b>Comprehensive income (loss)</b>   | \$ 1,358                  | \$ (200)    |

*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, 2012<br><i>(Unaudited)</i>      |              |                                  |   |                             |                         |                   |   |                 |
|----------------------------------|--|--------------|----------------------------------|---|-----------------------------|-------------------------|-------------------|---|-----------------|
|                                  | Common<br>Shares of<br>Beneficial<br>Interest<br>Outstanding | Par<br>Value | Additional<br>Paid-in<br>Capital | Net<br>Unrealized<br>Appreciation<br>of<br>Retained<br>Interests<br>in<br>Transferred<br>Assets | Cumulative<br>Net<br>Income | Cumulative<br>Dividends | Treasury<br>Stock | Cumulative<br>Preferred<br>Stock of<br>Subsidiary | Total<br>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      |

|                                  | Three Months Ended March 31, 2013<br><i>(Unaudited)</i>      |              |                                  |   |                             |                         |                   |   |                 |
|----------------------------------|--|--------------|----------------------------------|---|-----------------------------|-------------------------|-------------------|---|-----------------|
|                                  | Common<br>Shares of<br>Beneficial<br>Interest<br>Outstanding | Par<br>Value | Additional<br>Paid-in<br>Capital | Net<br>Unrealized<br>Appreciation<br>of<br>Retained<br>Interests<br>in<br>Transferred<br>Assets | Cumulative<br>Net<br>Income | Cumulative<br>Dividends | Treasury<br>Stock | Cumulative<br>Preferred<br>Stock of<br>Subsidiary | Total<br>Equity |
| <b>Balances, January 1, 2013</b> | 10,589,554   | \$ 111       | \$ 153,072                       | \$ 278  | \$ 173,917                  | \$ (184,151)            | \$ (4,901)        | \$ 900  | \$ 139,226      |
| Net unrealized appreciation      |  |              |                                  | 14  |                             |                         |                   |   | 14              |
| Share-based compensation expense | 6,666  |              | 25                               |   |                             |                         |                   |   | 25              |
| Dividends (\$0.125 per share)    |  |              |                                  |   |                             | (1,325)                 |                   |   | (1,325)         |
| Net income                       |  |              |                                  |   | 1,344                       |                         |                   |   | 1,344           |

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**Balances, March 31,  
2013**

10,596,220    \$ 111    \$ 153,097    \$ 292    \$ 175,261    \$ (185,476)    \$ (4,901)    \$ 900    \$ 139,284

*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 Ended</b> |                |
|--|---------------------------|----------------|
|  | <b>March 31,</b>          |                |
|  | <b>2013</b>               | <b>2012</b>    |
|  | <i>(Unaudited)</i>        |                |
| <b>Cash flows from operating activities:</b>   |                           |                |
| Net income (loss)  | \$ 1,344                  | \$ (155)       |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                           |                |
| Impairment losses  | 109                       | 18             |
| Deferred income taxes  | 28                        | (160)          |
| Provision for loan losses, net   | 242                       | 475            |
| Unrealized premium adjustment  | 222                       | 544            |
| Amortization and accretion, net  | (82)                      | (31)           |
| Share-based compensation   | 25                        | 40             |
| Capitalized loan origination costs   | (70)                      | (76)           |
| Loans funded, held for sale  | (8,145)                   | (4,941)        |
| Proceeds from sale of guaranteed loans   | 7,206                     | 1,258          |
| Principal collected on loans   | 180                       | 155            |
| Loan fees remitted, net  | (6)                       | (13)           |
| Change in operating assets and liabilities:  |                           |                |
| Other assets   | (159)                     | (146)          |
| Borrower advances  | 429                       | (178)          |
| Accounts payable and accrued expenses  | (236)                     | 70             |
| Other liabilities  | 16                        | 43             |
| <b>Net cash provided by (used in) operating activities</b>   | <b>1,103</b>              | <b>(3,097)</b> |
| <b>Cash flows from investing activities:</b>   |                           |                |
| Loans funded   | (7,277)                   | (5,790)        |
| Principal collected on loans   | 5,290                     | 7,584          |
| Principal collected on retained interests in transferred assets                                    | 24                        | 29             |
| Purchase of furniture and equipment  |                           | (7)            |
| Release of restricted cash and cash equivalents  |                           | 2,233          |
| <b>Net cash provided by (used in) investing activities</b>   | <b>(1,963)</b>            | <b>4,049</b>   |
| <b>Cash flows from financing activities:</b>   |                           |                |
| Proceeds from (repayment of) revolving credit facility, net  | 3,300                     | (2,100)        |
| Payment of principal on structured notes payable   |                           | (5,264)        |
| Proceeds from issuance of SBIC debentures  | 6,000                     |                |
| Proceeds from secured borrowings government guaranteed loans                                       |                           | 4,989          |
| Payment of principal on secured borrowings government guaranteed loans                             | (180)                     | (155)          |
| Payment of borrowing costs   | (146)                     |                |
| Payment of dividends   | (1,271)                   | (1,670)        |
| <b>Net cash provided by (used in) financing activities</b>   | <b>7,703</b>              | <b>(4,200)</b> |
| <b>Net increase (decrease) in cash and cash equivalents</b>  | <b>6,843</b>              | <b>(3,248)</b> |
| <b>Cash and cash equivalents, beginning of year</b>  | <b>1,230</b>              | <b>6,502</b>   |

|   |                 |                 |
|---|-----------------|-----------------|
| <b>Cash and cash equivalents, end of period</b> | <b>\$ 8,073</b> | <b>\$ 3,254</b> |
|---|-----------------|-----------------|

*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 of America ( 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, 2013 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, 2012.

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. Loans Receivable, net:**

Loans receivable, net, consisted of the following:

|   | March 31,<br>2013     | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | <i>(In thousands)</i> |                      |
| Commercial mortgage loans                     | \$ 124,102            | \$ 128,401           |
| SBIC commercial mortgage loans                | 51,613                | 47,621               |
| SBA 7(a) loans, subject to secured borrowings | 37,095                | 37,909               |
| SBA 7(a) loans                                | 31,211                | 28,196               |
| <b>Total loans receivable</b>                 | <b>244,021</b>        | <b>242,127</b>       |
| Adjusted by:                                  |                       |                      |
| Deferred capitalized costs, net               | 304                   | 277                  |
| Loan loss reserves                            | (3,654)               | (3,413)              |
| <b>Loans receivable, net</b>                  | <b>\$ 240,671</b>     | <b>\$ 238,991</b>    |

*Commercial mortgage loans*

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

*SBIC commercial mortgage loans*

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

*SBA 7(a) loans, subject to secured borrowings*

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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; therefore, no loan loss reserves are recorded on the \$37.1 million and \$37.9 million, respectively of government guaranteed portions of these SBA 7(a) loans included in loans receivable at March 31, 2013 and December 31, 2012.

### *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 \$2.3 million and \$2.1 million at March 31, 2013 and December 31, 2012, respectively.

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We have certain concentrations of investments. Substantially all of our revenue is generated from loans collateralized by hospitality properties. At both March 31, 2013 and December 31, 2012, our loans were 94% concentrated in the hospitality industry. Any economic factors that negatively impact the hospitality industry, including recessions, depressed commercial real estate markets, travel restrictions, gasoline prices, bankruptcies or other political or geopolitical events, could have a material adverse effect on our financial condition and results of operations.

At March 31, 2013 and December 31, 2012, 14% and 15%, respectively, 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, 2013 or December 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 approximately 5% of our loans receivable at both March 31, 2013 and December 31, 2012. 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, 2013                |        |                                 |        |                   |        |
|-----------------------------------|-------------------------------|--------|---------------------------------|--------|-------------------|--------|
|                                   | Totals                        |        | Commercial<br>Mortgage<br>Loans |        | SBA 7(a)<br>Loans |        |
|                                   | <i>(Dollars in thousands)</i> |        |                                 |        |                   |        |
| Current (1)                       | \$ 201,280                    | 97.3%  | \$ 170,770                      | 97.2%  | \$ 30,510         | 97.8%  |
| Between 30 and 59 days delinquent | 2,393                         | 1.2%   | 1,904                           | 1.1%   | 489               | 1.5%   |
| Between 60 and 89 days delinquent |                               |        |                                 |        |                   |        |
| Over 89 days delinquent (2)       | 3,253                         | 1.5%   | 3,041                           | 1.7%   | 212               | 0.7%   |
|                                   | \$ 206,926                    | 100.0% | \$ 175,715                      | 100.0% | \$ 31,211         | 100.0% |

(1) Includes \$8.5 million of loans classified as troubled debt restructurings which were current at March 31, 2013 based on revised note terms.

(2) Loans are classified as troubled debt restructurings. We are currently in the process of foreclosing on the collateral underlying these loans three limited service hospitality properties.

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December 31, 2012

| Category                              | Totals     |        | Commercial        |        | SBA 7(a)  |        |
|---------------------------------------|------------|--------|-------------------|--------|-----------|--------|
|                                       |            |        | Mortgage<br>Loans |        | Loans     |        |
| <i>(Dollars in thousands)</i>         |            |        |                   |        |           |        |
| Current (1)                           | \$ 198,282 | 97.1%  | \$ 170,429        | 96.8%  | \$ 27,853 | 98.8%  |
| Between 30 and 59 days delinquent (2) | 2,824      | 1.4%   | 2,482             | 1.4%   | 342       | 1.2%   |
| Between 60 and 89 days delinquent     | 1          |        |                   |        | 1         |        |
| Over 89 days delinquent (3)           | 3,111      | 1.5%   | 3,111             | 1.8%   |           |        |
|                                       | \$ 204,218 | 100.0% | \$ 176,022        | 100.0% | \$ 28,196 | 100.0% |

- (1) Includes \$7.6 million of loans classified as troubled debt restructurings which were current at December 31, 2012 based on revised note terms.
- (2) Includes \$2.3 million of loans classified as troubled debt restructurings. We are currently in the process of foreclosing on the collateral underlying an SBA 7(a) Program loan a limited service hospitality property with a principal balance of \$211,000.
- (3) Loans are classified as troubled debt restructurings. We are currently in the process of foreclosing on the collateral underlying these loans two limited service hospitality properties.

*Loan Loss Reserves*

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

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):

|                               | Totals     |       | March 31, 2013                  |       | SBA 7(a)  |       |
|-------------------------------|------------|-------|---------------------------------|-------|-----------|-------|
|                               |            |       | Commercial<br>Mortgage<br>Loans | %     | Loans     | %     |
| <i>(Dollars in thousands)</i> |            |       |                                 |       |           |       |
| Satisfactory                  | \$ 190,365 | 92.0% | \$ 160,394                      | 91.3% | \$ 29,971 | 96.0% |
| OAEM                          | 1,898      | 0.9%  | 1,423                           | 0.8%  | 475       | 1.5%  |
| Substandard                   | 11,136     | 5.4%  | 10,857                          | 6.2%  | 279       | 0.9%  |
| Doubtful                      | 3,527      | 1.7%  | 3,041                           | 1.7%  | 486       | 1.6%  |



|            |        |            |        |           |        |
|------------|--------|------------|--------|-----------|--------|
| \$ 206,926 | 100.0% | \$ 175,715 | 100.0% | \$ 31,211 | 100.0% |
|------------|--------|------------|--------|-----------|--------|

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

|              | December 31, 2012             |        |                   |        |           |        |
|--------------|-------------------------------|--------|-------------------|--------|-----------|--------|
|              |                               |        | Commercial        |        | SBA 7(a)  |        |
|              | Totals                        | %      | Mortgage<br>Loans | %      | Loans     | %      |
|              | <i>(Dollars in thousands)</i> |        |                   |        |           |        |
| Satisfactory | \$ 187,749                    | 92.0%  | \$ 159,994        | 90.9%  | \$ 27,755 | 98.5%  |
| OAEM         | 81                            |        |                   |        | 81        | 0.3%   |
| Substandard  | 13,043                        | 6.4%   | 12,917            | 7.3%   | 126       | 0.4%   |
| Doubtful     | 3,345                         | 1.6%   | 3,111             | 1.8%   | 234       | 0.8%   |
|              | \$ 204,218                    | 100.0% | \$ 176,022        | 100.0% | \$ 28,196 | 100.0% |

Our provision for loan losses (excluding reductions of loan losses and recoveries) as a percentage of our weighted average outstanding Loans Receivable Subject to Credit Risk was 0.14% and 0.24% during the three months ended March 31, 2013 and 2012, 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, 2013 |                   |                   |
|--------------------------------|-----------------------------------|-------------------|-------------------|
|                                | Commercial                        |                   |                   |
|                                | Total                             | Mortgage<br>Loans | SBA 7(a)<br>Loans |
|                                | <i>(In thousands)</i>             |                   |                   |
| Balance, beginning of year     | \$ 3,413                          | \$ 2,850          | \$ 563            |
| Provision for loan losses      | 301                               | 163               | 138               |
| Reduction of loan losses       | (59)                              | (59)              |                   |
| Principal balances written-off | (1)                               |                   | (1)               |
| Balance, end of period         | \$ 3,654                          | \$ 2,954          | \$ 700            |

|                                | Three Months Ended March 31, 2012 |                   |                   |
|--------------------------------|-----------------------------------|-------------------|-------------------|
|                                | Commercial                        |                   |                   |
|                                | Total                             | Mortgage<br>Loans | SBA 7(a)<br>Loans |
|                                | <i>(In thousands)</i>             |                   |                   |
| Balance, beginning of year     | \$ 1,812                          | \$ 1,329          | \$ 483            |
| Provision for loan losses      | 482                               | 410               | 72                |
| Reduction of loan losses       | (7)                               | (7)               |                   |
| Principal balances written-off | (15)                              |                   | (15)              |
| Balance, end of period         | \$ 2,272                          | \$ 1,732          | \$ 540            |



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## PMC COMMERCIAL TRUST AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(Unaudited)*

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

|   | Total            | March 31, 2013<br>Commercial<br>Mortgage<br>Loans<br>(In thousands) | SBA 7(a)<br>Loans |
|---|------------------|---|-------------------|
| Impaired loans requiring reserves (1)               | \$ 10,893        | \$ 9,413  | \$ 1,480          |
| Impaired loans expected to be fully recoverable (1) | 2,208            | 2,089   | 119               |
| <b>Total impaired loans (2)</b>                     | <b>\$ 13,101</b> | <b>\$ 11,502</b>  | <b>\$ 1,599</b>   |
| Loan loss reserves                                  | \$ 1,730         | \$ 1,488  | \$ 242            |

  

|   | Total            | December 31, 2012<br>Commercial<br>Mortgage<br>Loans<br>(In thousands) | SBA 7(a)<br>Loans |
|---|------------------|--|-------------------|
| Impaired loans requiring reserves (1)               | \$ 10,927        | \$ 10,049  | \$ 878            |
| Impaired loans expected to be fully recoverable (1) | 2,244            | 2,123  | 121               |
| <b>Total impaired loans (3)</b>                     | <b>\$ 13,171</b> | <b>\$ 12,172</b>   | <b>\$ 999</b>     |
| Loan loss reserves                                  | \$ 1,535         | \$ 1,382   | \$ 153            |

- (1) Balances represent our recorded investment. Includes loans classified as troubled debt restructurings.
- (2) The unpaid principal balance of our impaired commercial mortgage loans was \$12,176,000 at March 31, 2013. The unpaid principal balance of our impaired SBA 7(a) loans (excluding the government guaranteed portion) was \$494,000 at March 31, 2013.
- (3) The unpaid principal balance of our impaired commercial mortgage loans was \$12,704,000 at December 31, 2012. The unpaid principal balance of our impaired SBA 7(a) loans (excluding the government guaranteed portion) was \$362,000 at December 31, 2012.

|                                   | Three Months Ended March 31, 2013 |                                 |                   | Three Months Ended March 31, 2012 |                                 |                   |
|-----------------------------------|-----------------------------------|---------------------------------|-------------------|-----------------------------------|---------------------------------|-------------------|
|                                   | Total                             | Commercial<br>Mortgage<br>Loans | SBA 7(a)<br>Loans | Total                             | Commercial<br>Mortgage<br>Loans | SBA 7(a)<br>Loans |
| Average impaired loans            | \$ 12,842                         | \$ 11,707                       | \$ 1,135          | \$ 8,261                          | \$ 7,726                        | \$ 535            |
| Interest income on impaired loans | \$ 109                            | \$ 89                           | \$ 20             | \$ 89                             | \$ 87                           | \$ 2              |

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Our recorded investment in Non-Accrual Loans at March 31, 2013 of \$5,039,000 was comprised of \$217,000 SBA 7(a) loans and \$4,822,000 of commercial mortgage loans. Our recorded investment in Non-Accrual Loans at December 31, 2012 of \$5,768,000 was comprised of an \$855,000 SBA 7(a) loan and \$4,913,000 of commercial mortgage loans. Included within the SBA 7(a) loan at December 31, 2012 was the government guaranteed portion of \$634,000 (*i.e.*, the loan had a related secured borrowing as it was sold as a hybrid) on which we have no credit loss exposure. We did not have any loans receivable past due 90 days or more which were accruing interest at March 31, 2013 or December 31, 2012.

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

Our troubled debt restructurings consist of loans with a recorded investment at March 31, 2013 of \$4.2 million which were modified voluntarily under agreements to allow extended interest only periods instead of the principal and interest payments required by the notes. In addition, loans with a recorded investment at March 31, 2013 of \$5.9 million were modified involuntarily through Chapter 11 bankruptcy proceedings. The bankruptcy plans were confirmed with modified terms including extended interest only and amortization periods or modification of timing of payments combined with interest rate adjustments. Of our troubled debt restructurings, loans with a recorded investment of \$8.3 million are no longer complying with their modified terms, including lack of required payments at March 31, 2013. We are currently in the process of foreclosing on the collateral underlying these loans.

Detailed information on our troubled debt restructurings was as follows:

|   | March 31, 2013  |   |   |   |
|---|---|---|---|---|
|   | Commercial Mortgage Loans<br>Unpaid<br>Recorded<br>Investment | Commercial Mortgage Loans<br>Unpaid<br>Principal<br>Balance | SBA 7(a) Loan<br>Recorded<br>Investment | SBA 7(a) Loan<br>Unpaid<br>Principal<br>Balance |
|   | <i>(In thousands)</i>   |   |   |   |
| Troubled debt restructurings requiring reserves (1) | \$ 9,393  | \$ 10,035   | \$ 212                                  | \$ 237  |
| Troubled debt restructurings without reserves       | 2,093   | 2,141   |   |   |
| <b>Total troubled debt restructurings</b>           | <b>\$ 11,486</b>  | <b>\$ 12,176</b>  | <b>\$ 212</b>                           | <b>\$ 237</b>                                   |
| Number of loans                                     | 8   |   | 1                                       |   |
| Loan loss reserves                                  | \$ 1,488  |   | \$ 131                                  |   |
|   |   |   |   |   |
|   | December 31, 2012   |   |   |   |
|   | Commercial Mortgage Loans<br>Unpaid<br>Recorded<br>Investment | Commercial Mortgage Loans<br>Unpaid<br>Principal<br>Balance | SBA 7(a) Loan<br>Recorded<br>Investment | SBA 7(a) Loan<br>Unpaid<br>Principal<br>Balance |
|   | <i>(In thousands)</i>   |   |   |   |
| Troubled debt restructurings requiring reserves (1) | \$ 10,049   | \$ 10,531   | \$ 854                                  | \$ 846  |
| Troubled debt restructurings without reserves       | 2,123   | 2,172   |   |   |
| <b>Total troubled debt restructurings</b>           | <b>\$ 12,172</b>  | <b>\$ 12,703</b>  | <b>\$ 854</b>                           | <b>\$ 846</b>                                   |
| Number of loans                                     | 8   |   | 1                                       |   |
| Loan loss reserves                                  | \$ 1,382  |   | \$ 130                                  |   |

(1)

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*At December 31, 2012, the SBA 7(a) loan recorded investment and unpaid principal balance include the government guaranteed portion of \$634,000 on which we have no credit loss exposure. However, during 2013, the government guaranteed portion of \$634,000 was reclassified from secured borrowings to loans receivable, net, representing a non-cash transaction since it was repurchased by the SBA from the secondary market. Therefore, at March 31, 2013, the SBA 7(a) loan recorded investment and unpaid principal balance do not include the government guaranteed portion of \$634,000.*

**Table of Contents****PMC COMMERCIAL TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Unaudited)***Note 3. Other Assets:**

Other assets consisted of the following:

|  | March 31,<br>2013     | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | <i>(In thousands)</i> |                      |
| Deferred tax asset, net                  | \$ 1,599              | \$ 1,626             |
| Servicing asset, net                     | 1,348                 | 1,261                |
| Deferred borrowing costs, net            | 1,346                 | 1,218                |
| Investment in a variable interest entity | 827                   | 820                  |
| Retained interests in transferred assets | 763                   | 773                  |
| Interest receivable                      | 721                   | 620                  |
| Prepaid expenses and deposits            | 356                   | 330                  |
| Other                                    | 120                   | 99                   |
|  | \$ 7,080              | \$ 6,747             |

**Note 4. Debt:**

Information on our debt was as follows:

|  | March 31,<br>2013                               | December 31,<br>2012 | Weighted Average<br>Coupon Rate at<br>March 31,<br>2013 | December 31,<br>2012 |
|--|---|----------------------|---|----------------------|
|  | <i>(Dollars in thousands, except footnotes)</i> |                      |   |                      |
| <i>Secured borrowings government guaranteed loans:</i>       |   |                      |   |                      |
| Loans sold for a premium and excess spread principal         | \$ 31,279                                       | \$ 32,062            | 4.09%   | 4.09%                |
| Loans sold for a premium and excess spread deferred premiums | 2,998   | 3,099                | NA  | NA                   |
| Loans sold for excess spread                                 | 5,816   | 5,847                | 1.58%   | 1.58%                |
|  | 40,093  | 41,008               |   |                      |
| Junior subordinated notes                                    | 27,070  | 27,070               | 3.56%   | 3.61%                |
| Debentures payable (1)                                       | 23,190  | 17,190               | 4.06%   | 4.47%                |
| Revolving credit facility (2)                                | 15,200  | 11,900               | 2.64%   | 2.30%                |
| Debt   | \$ 105,553                                      | \$ 97,168            |   |                      |

(1) Our SBIC subsidiaries issued a total of \$6.0 million of debentures in March 2013 with an interest rate of 2.351% plus an annual fee of 0.515%. The debentures mature in 10 years and have semi-annual interest only payments until maturity.



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- (2) *Proceeds on the revolving credit facility were \$15,800,000 and \$8,200,000 during the three months ended March 31, 2013 and 2012, respectively. Repayments on the revolving credit facility were \$12,500,000 and \$10,300,000 during the three months ended March 31, 2013 and 2012, respectively.*

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## PMC COMMERCIAL TRUST AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Principal payments on, and estimated amortization of, our debt at March 31, 2013 was as follows:

| Twelve<br>Months Ending | Secured Borrowings |                       |                          |                       |
|-------------------------|--------------------|-----------------------|--------------------------|-----------------------|
|                         | Total              | Principal (1)         | Deferred<br>Premiums (2) | All Other<br>Debt (3) |
| March 31,               |                    |                       |                          |                       |
|                         |                    | <i>(In thousands)</i> |                          |                       |
| 2014                    | \$ 5,440           | \$ 1,098              | \$ 152                   | \$ 4,190              |
| 2015                    | 20,488             | 1,136                 | 152                      | 19,200                |
| 2016                    | 1,327              | 1,175                 | 152                      |                       |
| 2017                    | 1,369              | 1,217                 | 152                      |                       |
| 2018                    | 1,413              | 1,261                 | 152                      |                       |
| Thereafter              | 75,516             | 31,208                | 2,238                    | 42,070                |
|                         | \$ 105,553         | \$ 37,095             | \$ 2,998                 | \$ 65,460             |

- (1) *Principal payments are generally dependent upon cash flows received from the underlying loans. Our estimate of their repayment is based on scheduled principal payments on the underlying loans. Our estimate will differ from actual amounts to the extent we experience prepayments and/or loan liquidations or charge-offs. No payment is due unless payments are received from the borrowers on the underlying loans.*
- (2) *Represents cash premiums collected on loans sold for excess spread and a cash premium of 10% which are amortized as a reduction to interest expense over the life of the loan. Our estimate of their amortization will differ from actual amounts to the extent we experience prepayments and/or loan liquidations or charge-offs.*
- (3) *Represents the revolving credit facility, junior subordinated notes and debentures payable.*

**Note 5. Share-Based Compensation Plans:**

We issued an aggregate of 6,666 shares to our executive officers on March 14, 2013 at the then current market price of the shares of \$7.22 (the closing price on March 13, 2013). We issued an aggregate of 10,000 shares our 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). 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 \$25,000 and \$40,000 during the three months ended March 31, 2013 and 2012, respectively, related to restricted shares. As of March 31, 2013, there was \$37,000 of total unrecognized compensation expense related to restricted shares which will be recognized over the next two years.

**Table of Contents****PMC COMMERCIAL TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Unaudited)***Note 6. Other Income:**

Other income consisted of the following:

|  | Three Months Ended<br>March 31, |        |
|--|---------------------------------|--------|
|  | 2013                            | 2012   |
|  | <i>(In thousands)</i>           |        |
| Servicing income                         | \$ 104                          | \$ 126 |
| Loan related income other                | 52                              | 47     |
| Retained interests in transferred assets | 41                              | 54     |
| Prepayment fees                          |                                 | 19     |
| Other                                    | 27                              | 30     |
|  | \$ 224                          | \$ 276 |

**Note 7. Severance and Related Benefits:**

In October 2012, we entered into a mutual separation agreement with our former Chief Executive Officer under which the former Chief Executive Officer's employment with the Company ended and pursuant to which he agreed to serve as a consultant to us for a one-year period. In connection with this separation agreement, we recorded severance and related benefits expense of \$2,114,000 during the fourth quarter of 2012.

Included within accounts payable and accrued expenses on our consolidated balance sheet is the remaining liability for severance payments of \$1,800,000 which was paid in May 2013.

**Note 8. Discontinued Operations:**

Discontinued operations consisted of the following:

|                         | Three Months Ended<br>March 31, |          |
|-------------------------|---------------------------------|----------|
|                         | 2013                            | 2012     |
|                         | <i>(In thousands)</i>           |          |
| Net operating losses    | \$ (65)                         | \$ (131) |
| Impairment losses       | (109)                           | (18)     |
| Discontinued operations | \$ (174)                        | \$ (149) |

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

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 ):**

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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, 2013 or 2012 as options were anti-dilutive.

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

Not included in the computation of diluted EPS were outstanding options to purchase 113,000 and 95,000 common shares during the three months ended March 31, 2013 and 2012, respectively because the options' exercise prices were greater than the average market price of the shares.

**Note 10. Dividends Declared:**

The Board of Trust Managers declared a \$0.125 per common share quarterly dividend to common shareholders of record on March 28, 2013 which was paid on April 8, 2013.

**Note 11. Fair Value Measurements:**

For impaired loans measured at fair value on a nonrecurring basis during the three months ended March 31, 2013 and 2012, the following table provides the carrying value of the related individual assets at quarter end. We used Level 3 inputs to determine the estimated fair value of our impaired loans.

|                    | Carrying Value at     |          | Provision for      |                    |
|--------------------|-----------------------|----------|--------------------|--------------------|
|                    | March 31,             |          | Loan Losses        |                    |
|                    | 2013                  | 2012     | Three Months Ended | Three Months Ended |
|                    |                       |          | March 31, (2)      | March 31, (2)      |
|                    | <i>(In thousands)</i> |          |                    |                    |
| Impaired loans (1) | \$ 11,372             | \$ 7,644 | \$ 106             | \$ 71              |

- (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 (loss) 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 value of our real estate owned at March 31, 2013 and December 31, 2012 was \$630,000 and \$739,000, respectively.

Our retained interests in transferred assets ( Retained Interests ) are recorded at estimated fair value using Level 3 inputs. In determining the estimated fair value of our Retained Interests, we use a present value technique with assumptions of prepayment tendencies and a current discount rate. No credit losses are assumed for our Retained Interests since the SBA has guaranteed the principal on these loans. The estimated fair value of our Retained Interests at March 31, 2013 and December 31, 2012 was \$763,000 and \$773,000, respectively.

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

The estimated fair values of our financial instruments (not recorded at fair value on our consolidated balance sheets) were as follows:

|  | March 31,<br>2013  |                            | December 31,<br>2012 |                            | Level |
|--|--------------------|----------------------------|----------------------|----------------------------|-------|
|  | 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 Subject to Credit Risk                  | \$ 203,149         | \$ 183,996                 | \$ 200,642           | \$ 181,112                 | 3     |
| SBA 7(a) loans receivable, subject to secured borrowings | 37,522             | 42,130                     | 38,349               | 43,096                     | 3     |
| <b>Liabilities:</b>                                      |                    |                            |                      |                            |       |
| SBIC debentures  | 23,190             | 23,836                     | 17,190               | 18,027                     | 3     |
| Secured borrowings government guaranteed loans           | 40,093             | 40,093                     | 41,008               | 41,008                     | 3     |
| Revolving credit facility                                | 15,200             | 15,200                     | 11,900               | 11,900                     | 3     |
| Junior subordinated notes                                | 27,070             | 22,607                     | 27,070               | 22,592                     | 3     |

We used Level 3 inputs to determine the estimated fair value of our financial instruments. In general, estimates of fair value differ from the carrying amounts of the financial assets and liabilities primarily as a result of the effects of discounting future cash flows. Considerable judgment is required to interpret market data and develop estimates of fair value. Accordingly, the estimates presented may not be indicative of the amounts we could realize in a current market exchange.

*Loans Receivable Subject to Credit Risk:* 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.

*SBA 7(a) loans receivable, 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. 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 and prepayment tendencies taking into consideration the lack of credit risk.

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

*Secured borrowings government guaranteed loans:* The estimated fair value approximates cost as the interest rates on these secured borrowings approximates current market interest rates. Includes the unamortized deferred cash premiums collected on the sale of the government guaranteed portions of the loans.

*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.



**Table of Contents****PMC COMMERCIAL TRUST AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Unaudited)***Note 12. 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 \$10.7 million at March 31, 2013, of which \$6.6 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                 |
|               |  | <i>(In thousands)</i> |
| 2014          |  | \$ 213                |
| 2015          |  | 200                   |
|               |  | \$ 413                |

*Employment Agreements*

We have employment agreements with our two executive officers for three-year terms expiring December 31, 2015. 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.

*SBA Related*

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 our SBLC, 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.



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In certain instances, including liquidation or charge-off of an SBA guaranteed loan, we may have a receivable for the SBA's guaranteed portion of legal fees, operating expenses, property taxes paid, etc. related to the loan or the collateral (upon foreclosure). While we believe expenses incurred were justified and necessary for the care and preservation of the collateral and within the established rules of the SBA, there can be no assurance that the SBA will reimburse us. In addition, reimbursement from the SBA is a time consuming and lengthy process and the SBA may seek compensation from us related to reimbursement of expenses which it does not believe were necessary for the care and preservation of the loan or its collateral. Although the SBA has never declined to reimburse us for its portion of material expenses, no assurance can be given that the SBA would not do so in the future. We have evaluated our SBA receivables and believe that our financial statements fairly reflect these receivables at their appropriate net realizable value.

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**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, 2013 and results of operations for the three months ended March 31, 2013 and 2012 should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2012. 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, 2012.**

**EXECUTIVE SUMMARY**

**Business Strategy**

We remain committed to enhancing our core operations by continuing to focus on maintaining and increasing our SBA 7(a) Program loan origination volume, continuing our recently revised emphasis on our SBIC loan origination volume and increasing our loan originations outside of our SBA and SBIC programs. We have increased our marketing efforts to identify more loan origination opportunities for SBA eligible loans with a principal amount greater than \$2.0 million and have funded three of these larger loans during the three months ended March 31, 2013. Despite increased efforts, in many instances if either the opportunities do not meet our underwriting standards, the borrowers do not meet SBA 7(a) Program eligibility requirements or the loans are able to be financed through more traditional lending sources, we may not be able to continue to originate these larger balance SBA 7(a) Program loans at these levels. However, we remain optimistic that our marketing efforts will result in additional larger balance SBA 7(a) Program loan origination opportunities.

Our portfolio continues to be predominantly comprised of variable-rate loans, which when combined with the historically low level of interest rates, has continued to negatively impact our results of operations. We should experience increased revenues if interest rates rise. While we believe that our current business plan has been successful and stable, we are working on strategic growth initiatives to build shareholder value. In addition to executing organic growth opportunities through our SBA and SBIC lending platforms, we are exploring the potential for other opportunities for growth including obtaining alternative sources of leverage and evaluating complementary lines of business. Costs associated with exploration of these opportunities have been, and will continue to be incurred, and may be material.

**General Economic Environment**

***Commercial Real Estate and Lodging Industry***

The recession subjected our borrowers to financial stress. 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



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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. 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 property improvements or maintenance issues jeopardizing continuation of franchises, terminating franchises, non-payment of franchise fees, conversion to lesser franchises or independent status, deterioration of the physical property (our collateral) and declining property values. Typically, losses on real estate secured loans are not as significant as non-real estate secured loans due to the 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.

As part of our efforts to assist those borrowers who are experiencing negative cash flows, we have temporarily or permanently modified the terms of certain loans receivable or have allowed reduced payments. In some instances, 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. Additional modifications continue to occur to assist some of these borrowers. In other instances, borrowers have defaulted on their modified terms. We also have temporarily or permanently modified the terms of certain loans receivable or have allowed reduced payments to borrowers who have just recently begun experiencing negative cash flows. 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 is not currently sufficient to cover their debt service so that they are able to continue to make payments in accordance with their loan documents without capital investment.

Due to the recession, 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 (and related holding costs) 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. Currently, we are in the process of foreclosing on the collateral underlying three limited service hospitality properties.

### ***Competition***

Borrowers are predominantly looking for fixed-rate loans. Historically, local banks offered a five-year maturity, 20-year amortization loan ( mini-perm bank loan ). During the recession, these types of loans were not causing significant competition to us as they were not as common as they had been historically. Recently, the market has changed such that local banks are again offering this product which has increased competition for loans.

We are experiencing increased competition for SBA 7(a) Program loans from SBA 7(a) lenders. SBA 7(a) Program loans generally have variable rates of interest based on a spread over the prime rate. Recently, our competitors have narrowed this spread. Therefore, we have been, and may continue to, reduce our interest rates to match our competitors' quoted interest rates for SBA 7(a) Program loans. When interest rates are reduced, our net interest income and premium income (to the extent recognized) will be negatively affected which would decrease our income from continuing operations and net income.

### ***Liquidity***

Our \$40 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. We are currently in the process of negotiating an agreement with our current lender that would, among other things, extend the facility for at least one year. There can be no assurance that we will be able to finalize this agreement.

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During March 2013, each of our SBICs issued \$3.0 million of SBIC debentures. The interest rate on the debentures is 2.351% plus an annual fee of 0.515%. We have commitments from the SBA for the issuance of \$5.0 million in SBIC debentures. During 2012, we requested a commitment for additional debentures of \$5.0 million which were approved during May 2013. We have \$4.2 million of SBIC debentures which mature in September 2013 and expect these debentures to be repaid using the SBICs' cash on hand, our Revolver or through issuance of new debentures.

**Secondary Market Loan Sales**

We continue to focus on the origination of SBA 7(a) Program 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. The SBA guaranteed portions of these loans are sold in legal sale transactions to either dealers in government guaranteed loans or institutional investors ( Secondary Market Loan Sales ) as the loans are fully funded.

During the three months ended March 31, 2013, we sold \$7.2 million of the government guaranteed portion of SBA 7(a) loans for 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. We did not sell the government guaranteed portion of any SBA 7(a) loans for solely servicing spread or for future servicing spread and cash premiums of 10% ( hybrid loan sales or hybrid ) during the three months ended March 31, 2013. For hybrid loan sales and sales solely for servicing spread, gains are not recognized at the time of sale due to accounting rules. The cash premium collected on hybrid loan sales is instead amortized as a reduction to interest expense over the life of the loan. Our deferred cash premiums at March 31, 2013 total \$2,998,000.

Our secondary market loan sale activity was as follows:

*Three Months Ended March 31, 2013*

| Type of Sale | Principal Sold | Cash Premiums Received | Gain Recognized Upon Sale |            |
|--------------|----------------|------------------------|---------------------------|------------|
|              |                |                        | Book                      | Tax        |
| Cash premium | \$ 7,206,000   | \$ 1,042,000           | \$ 820,000                | \$ 904,000 |
|              | \$ 7,206,000   | \$ 1,042,000           | \$ 820,000                | \$ 904,000 |

*Three Months Ended March 31, 2012*

| Type of Sale | Principal Sold | Cash Premiums Received | Gain Recognized Upon Sale |            |
|--------------|----------------|------------------------|---------------------------|------------|
|              |                |                        | Book                      | Tax        |
| Cash premium | \$ 1,258,000   | \$ 158,000             | \$ 113,000                | \$ 138,000 |
| Hybrid       | 4,990,000      | 499,000                |                           | 562,000    |
|              | \$ 6,248,000   | \$ 657,000             | \$ 113,000                | \$ 700,000 |

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

During the three months ended March 31, 2013 we funded \$15.4 million of loans. At March 31, 2013, December 31, 2012 and March 31, 2012, our outstanding commitments to fund loans were \$10.7 million, \$19.5 million and \$23.2 million, respectively. We expect to fund loans of between \$55 million and \$65 million during 2013.

In addition to our retained portfolio of \$244.0 million at March 31, 2013, we service \$76.2 million of aggregate principal balance of certain loans sold pursuant to Secondary Market Loan Sales that have been accounted for as sales. 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>2013             | 2012       | 2011       | December 31,<br>2010 | 2009       | 2008       |
|-------------------------|-------------------------------|------------|------------|----------------------|------------|------------|
|                         | <i>(Dollars in thousands)</i> |            |            |                      |            |            |
| Aggregate Portfolio (1) | \$ 320,158                    | \$ 313,541 | \$ 297,453 | \$ 284,451           | \$ 273,687 | \$ 275,530 |
| Loans funded (2)        | \$ 15,422                     | \$ 54,161  | \$ 38,352  | \$ 38,440            | \$ 30,435  | \$ 34,587  |
| Prepayments (2)         | \$ 4,363                      | \$ 20,181  | \$ 10,352  | \$ 10,830            | \$ 12,795  | \$ 68,556  |
| % Prepayments (3)       | 5.6%                          | 6.8%       | 3.6%       | 4.0%                 | 4.6%       | 21.0%      |

(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, 2013.

(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, 2013, 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, 2013 and 2012:

|   | Three Months Ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2013                            | 2012       |
|   | <i>(In thousands)</i>           |            |
| Loans receivable, net beginning of year                     | \$ 238,991                      | \$ 234,427 |
| Loans funded (1)  | 15,422                          | 10,731     |
| Principal reductions (1)                                    | (12,676)                        | (8,997)    |
| Reclassification from secured borrowing to loans receivable | (634)                           |            |
| Other adjustments (2)                                       | (432)                           | (417)      |
| Loans receivable, net end of period                         | \$ 240,671                      | \$ 235,744 |

(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, |                  |
|---|---------------------------------|------------------|
|   | 2013                            | 2012             |
|   | <i>(In thousands)</i>           |                  |
| <b>Loans Funded:</b>                            |                                 |                  |
| SBA 7(a) loans                                  | \$ 10,934                       | \$ 6,587         |
| Commercial mortgage loans                       | 4,488                           | 4,144            |
| <b>Total loans funded</b>                       | <b>\$ 15,422</b>                | <b>\$ 10,731</b> |
| <b>Principal Reductions:</b>                    |                                 |                  |
| Scheduled principal payments                    | \$ 3,604                        | \$ 2,880         |
| Prepayments                                     | 1,866                           | 4,859            |
| Proceeds from sale of SBA 7(a) guaranteed loans | 7,206                           | 1,258            |
| <b>Total principal reductions</b>               | <b>\$ 12,676</b>                | <b>\$ 8,997</b>  |

**Retained Portfolio**

Our Retained Portfolio was comprised of the following:

|                     | March 31, 2013     |               |   | December 31, 2012  |               |   |
|---------------------|--------------------|---------------|---|--------------------|---------------|---|
|                     | Retained Portfolio |               | Weighted<br>Average<br>Interest<br>Rate | Retained Portfolio |               | Weighted<br>Average<br>Interest<br>Rate |
|                     | Amount             | %             | (Dollars in thousands)                  | Amount             | %             | Rate                                    |
| Variable-rate LIBOR | \$ 126,697         | 52.7%         | 4.7%                                    | \$ 126,308         | 52.9%         | 4.6%                                    |
| Variable-rate prime | 72,760             | 30.2%         | 5.9%                                    | 70,859             | 29.6%         | 5.9%                                    |
| Fixed-rate          | 41,214             | 17.1%         | 9.0%                                    | 41,824             | 17.5%         | 9.0%                                    |
|                     | <b>\$ 240,671</b>  | <b>100.0%</b> | <b>5.8%</b>                             | <b>\$ 238,991</b>  | <b>100.0%</b> | <b>5.8%</b>                             |

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 and recoveries) as a percentage of our weighted average outstanding Loans Receivable Subject to Credit Risk was 0.14% and 0.24% during the three months ended March 31, 2013 and 2012, 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 not yet certain. Loans classified as OAEM are generally loans for which the credit quality of the borrowers has temporarily deteriorated.

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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.



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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):

|                               | Totals     |        | March 31, 2013            |        |                |        |
|-------------------------------|------------|--------|---------------------------|--------|----------------|--------|
|                               |            |        | Commercial Mortgage Loans |        | SBA 7(a) Loans |        |
|                               |            | %      |                           | %      |                | %      |
| <i>(Dollars in thousands)</i> |            |        |                           |        |                |        |
| Satisfactory                  | \$ 190,365 | 92.0%  | \$ 160,394                | 91.3%  | \$ 29,971      | 96.0%  |
| OAEM                          | 1,898      | 0.9%   | 1,423                     | 0.8%   | 475            | 1.5%   |
| Substandard                   | 11,136     | 5.4%   | 10,857                    | 6.2%   | 279            | 0.9%   |
| Doubtful                      | 3,527      | 1.7%   | 3,041                     | 1.7%   | 486            | 1.6%   |
|                               | \$ 206,926 | 100.0% | \$ 175,715                | 100.0% | \$ 31,211      | 100.0% |

|                               | Totals     |        | December 31, 2012         |        |                |        |
|-------------------------------|------------|--------|---------------------------|--------|----------------|--------|
|                               |            |        | Commercial Mortgage Loans |        | SBA 7(a) Loans |        |
|                               |            | %      |                           | %      |                | %      |
| <i>(Dollars in thousands)</i> |            |        |                           |        |                |        |
| Satisfactory                  | \$ 187,749 | 92.0%  | \$ 159,994                | 90.9%  | \$ 27,755      | 98.5%  |
| OAEM                          | 81         |        |                           |        | 81             | 0.3%   |
| Substandard                   | 13,043     | 6.4%   | 12,917                    | 7.3%   | 126            | 0.4%   |
| Doubtful                      | 3,345      | 1.6%   | 3,111                     | 1.8%   | 234            | 0.8%   |
|                               | \$ 204,218 | 100.0% | \$ 176,022                | 100.0% | \$ 28,196      | 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 three limited service hospitality properties and expect these processes to be completed during the second and third quarters of 2013.

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, 2013 Compared to the Three Months Ended March 31, 2012*****Overview***

|  | Three Months Ended<br>March 31, |          | Change     |         |
|--|---------------------------------|----------|------------|---------|
|  | 2013                            | 2012     | \$         | %       |
|  | <i>(In thousands)</i>           |          |            |         |
| Total revenues                           | \$ 4,515                        | \$ 3,787 | \$ 728     | 19.2%   |
| Total expenses                           | \$ 2,715                        | \$ 3,812 | \$ (1,097) | (28.8%) |
| Income (loss) from continuing operations | \$ 1,518                        | \$ (6)   | \$ 1,524   | NM      |
| Net income (loss)                        | \$ 1,344                        | \$ (155) | \$ 1,499   | NM      |

Revenues increased during the three months ended March 31, 2013 primarily due to an increase in recognized premium income from the sale of the government guaranteed portion of our SBA 7(a) loans while expenses decreased primarily due to elimination of costs associated with evaluation of strategic alternatives.

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

***Revenues***

Interest income increased during the three months ended March 31, 2013 by 2.1% to \$3,471,000 during the three months ended March 31, 2013 from \$3,398,000 during the three months ended March 31, 2012. Our weighted average loans receivable increased to \$238.7 million during the three months ended March 31, 2013 compared to \$234.7 million during the three months ended March 31, 2012. Partially offsetting this increase in weighted average loans receivable was a decrease in the base LIBOR to 0.31% during the three months ended March 31, 2013 compared to 0.58% during the three months ended March 31, 2012.

Premium income results from certain sales of the government guaranteed portion of SBA 7(a) Program loans into the secondary market. We record premium income at the time of sale for those sales for solely cash premiums and the SBA required 1% servicing spread. We sold more loans for solely cash premiums and the SBA required 1% servicing spread during the three months ended March 31, 2013 than the comparable period of 2012. In addition, there was improvement in the market for Secondary Market Loan Sales as average premiums increased from 12.6% during the three months ended March 31, 2012 to 14.5% during the three months ended March 31, 2013.

Premium income will not equal collected cash premiums because premium income represents the difference between the fair value attributable to the sale of the government guaranteed portion of the loan and the principal balance (cost) of the loan adjusted by costs of origination. Our premium income increased to \$820,000 during the three months ended March 31, 2013 compared to \$113,000 during the three months ended March 31, 2012. If markets stay at present levels, we expect that we will sell the majority of our loans solely for cash premiums and the SBA required 1% servicing spread during 2013.

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Other income consisted of the following:

|  | Three Months Ended<br>March 31, |        |
|--|---------------------------------|--------|
|  | 2013                            | 2012   |
|  | <i>(In thousands)</i>           |        |
| Servicing income                         | \$ 104                          | \$ 126 |
| Loan related income other                | 52                              | 47     |
| Retained interests in transferred assets | 41                              | 54     |
| Prepayment fees                          |                                 | 19     |
| Other                                    | 27                              | 30     |
|  | \$ 224                          | \$ 276 |

We earn fees for servicing loans sold into the secondary market solely for cash premiums. As these fees are based on the principal balances of the loans outstanding, they will increase as more loans are sold into the secondary market and decrease over time as scheduled principal payments and prepayments occur.

Prepayment fee income is dependent upon a number factors and is not generally predictable as the volume and mix of loans prepaying is not known.

**Interest Expense**

Interest expense consisted of the following:

|                           | Three Months Ended<br>March 31, |        |
|---------------------------|---------------------------------|--------|
|                           | 2013                            | 2012   |
|                           | <i>(In thousands)</i>           |        |
| Secured borrowings        | \$ 246                          | \$ 280 |
| Junior subordinated notes | 244                             | 264    |
| Debentures payable        | 206                             | 171    |
| Revolver                  | 93                              | 124    |
| Other                     | 23                              | 44     |
|                           | \$ 812                          | \$ 883 |

The weighted average cost of our funds remained constant at 3.5% during the three months ended March 31, 2013 and 2012.

Secured borrowings increase as we sell SBA 7(a) loans for excess servicing spreads. Interest expense on our secured borrowings will likely continue to increase unless we sell loans solely for cash and the SBA 1% required servicing spread or we experience significant prepayments and/or charge-offs. The weighted average balance outstanding on our secured borrowings was \$40.6 million during three months ended March 31, 2013 compared to \$35.3 million during the three months ended March 31, 2012. Offsetting interest expense on secured borrowings is amortization of cash premiums from hybrid loan sales of \$101,000 and \$33,000 during the three months ended March 31, 2013 and 2012, respectively.

Interest expense on SBA debentures has increased due to the issuance of \$4.0 million of debentures in August 2012 and \$6.0 million in March 2013.

The weighted average outstanding under our Revolver decreased from \$17.5 million during the three months ended March 31, 2012 to \$11.9 million during the three months ended March 31, 2013.



**Table of Contents****Other Expenses**

Salaries and related benefits decreased \$125,000 (10.9%) during the three months ended March 31, 2013 compared to the three months ended March 31, 2012 due primarily to changes in executive management during the fourth quarter of 2012.

General and administrative expense increased \$182,000 (40%) during the three months ended March 31, 2013 compared to the three months ended March 31, 2012. General and administrative expenses are comprised of (1) corporate overhead including legal and professional fees, sales and marketing expenses, public company and regulatory costs and (2) expenses related to assets currently in the process of foreclosure. Our corporate overhead increased to \$502,000 during the three months ended March 31, 2013 compared to \$454,000 during the three months ended March 31, 2012 primarily due to increased legal and other professional fees. Expenses related to assets currently in the process of foreclosure increased to \$140,000 during the three months ended March 31, 2013 compared to \$6,000 during the three months ended March 31, 2012. These expenses incurred during the foreclosure process for problem loans are primarily related to property taxes incurred, protection of the asset and operating deficits funded to receivers. Expenses incurred during 2013 primarily relate to two hospitality properties which are currently in receivership. The foreclosure process is expected to be completed during the third quarter of 2013. We expect these costs to continue until the foreclosure processes are completed. Once complete, costs associated with foreclosed properties are included in discontinued operations.

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. The special committee was dissolved during December 2012. Costs associated with exploration of new opportunities for growth have been, and will continue to be incurred, and may be material.

Our provision for loan losses, net was \$242,000 during the three months ended March 31, 2013 compared to \$475,000 during the three months ended March 31, 2012. Our provision for loan losses primarily relates to limited service hospitality properties included in troubled debt restructurings, including properties currently in the process of foreclosure. Our reserves are categorized as follows:

|          | March 31,<br>2013   | December 31,<br>2012 |
|----------|---------------------|----------------------|
| Specific | \$ 1,730,000        | \$ 1,535,000         |
| General  | 1,924,000           | 1,878,000            |
|          | <b>\$ 3,654,000</b> | <b>\$ 3,413,000</b>  |

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.

Income tax provision (benefit) was \$282,000 during the three months ended March 31, 2013 compared to (\$19,000) during the three months ended March 31, 2012 related to our taxable REIT subsidiaries. Our taxable REIT subsidiaries had taxable income of \$747,000 during the three months ended March 31, 2013 compared to \$417,000 during the three months ended March 31, 2012. See Taxable Income. The increase primarily relates to increased interest income of our SBIC subsidiary and our SBA 7(a) subsidiary and a reduction in loans sold by our SBA 7(a) subsidiary as hybrids which had the effect of increasing our deferred tax expense during the three months ended March 31, 2013.

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

|                                | Three Months Ended<br>March 31, |                 |
|--------------------------------|---------------------------------|-----------------|
|                                | 2013                            | 2012            |
|                                | <i>(In thousands)</i>           |                 |
| Net operating losses           | \$ (65)                         | \$ (131)        |
| Impairment losses              | (109)                           | (18)            |
| <b>Discontinued operations</b> | <b>\$ (174)</b>                 | <b>\$ (149)</b> |

Our net operating losses relate to the operations and holding costs of our REO included in discontinued operations.

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, |                   |                  |
|---|---------------------------------|-------------------|------------------|
|   | 2013                            | 2012              | Change           |
|   | <i>(In thousands)</i>           |                   |                  |
| Net cash provided by (used in) operating activities | \$ 1,103                        | \$ (3,097)        | \$ 4,200         |
| Net cash provided by (used in) investing activities | (1,963)                         | 4,049             | (6,012)          |
| Net cash provided by (used in) financing activities | 7,703                           | (4,200)           | 11,903           |
| <b>Net cash flow</b>                                | <b>\$ 6,843</b>                 | <b>\$ (3,248)</b> | <b>\$ 10,091</b> |

**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 of Trust Managers (the Board ) in its determination of dividends and their timing. In respect to our dividend policy, we believe that the disclosure of Modified Cash adds additional transparency to our dividend calculation and intentions. However, Modified Cash may differ significantly from dividends paid due to 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 provided by (used in) operating activities to Modified Cash:

|   | Three Months Ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2013                            | 2012       |
|   | <i>(In thousands)</i>           |            |
| Net cash provided by (used in) operating activities | \$ 1,103                        | \$ (3,097) |
| Change in operating assets and liabilities          | (50)                            | 211        |
| Operating Loan Activity                             | 759                             | 3,528      |
| <br>Modified Cash                                   | <br>\$ 1,812                    | <br>\$ 642 |

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, 2013, Modified Cash was greater than our dividend distributions by \$541,000. During the three months ended March 31, 2012, dividend distributions were greater than our Modified Cash by \$1,028,000. 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 available funds from the repayment of principal on loans receivable.

The increase in our net cash provided by (used in) operating activities during the three months ended March 31, 2013 was due primarily to the sale of the government guaranteed portion of our SBA 7(a) loans for cash premiums (which allows for sale treatment per accounting rules) compared to selling these government guaranteed portions as hybrids which reflects proceeds as secured borrowings in financing activities.

**Investing Activities**

Our primary investing activity is the origination of loans and collections on our investment portfolio. During the three months ended March 31, 2013, the primary use of funds was loans funded, net of principal collected on loans of \$1,987,000. During the three months ended March 31, 2012, the primary source of funds was loans funded, net of principal collected on loans of \$1,794,000. We expect that principal collections on our loans 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.

Based on our outstanding loan portfolio at March 31, 2013, our estimated collection of scheduled principal payments during the next twelve months are approximately \$13.5 million. Of this, approximately \$10.4 million could be available to repay a portion of the balance outstanding under the Revolver. The remaining \$3.1 million would be used to repay secured borrowings and for obligations of our SBICs.

**Financing Activities**

We used funds from financing activities during the three months ended March 31, 2013 and 2012 primarily to pay dividends of \$1,271,000 and \$1,670,000, respectively. We had net proceeds from our Revolver of \$3,300,000 during the three months ended March 31, 2013 compared to net repayments on our Revolver of \$2,100,000 during the three months ended March 31, 2012. Each of our SBIC subsidiaries issued \$3.0 million in SBIC debentures during March 2013. Proceeds from Secondary Market Loan Sales recorded as secured borrowings during the three months ended March 31, 2012 were \$4,989,000. We did not sell the government guaranteed portion of any SBA 7(a) loans as hybrids during the three months ended March 31, 2013. To the extent we sell the government guaranteed portion of SBA 7(a) loans as hybrids, proceeds from Secondary Market Loan Sales included in financing activities will increase.

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### **Sources and Uses of Funds**

#### ***Liquidity Summary***

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund loans and other investments, pay dividends, fund debt service and for other general corporate purposes. Our primary sources of funds to meet our 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, (3) borrowings under the Revolver and (4) issuance of SBIC debentures. We believe these sources of funds will be sufficient to meet our liquidity requirements.

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 2013, our Modified Cash will be utilized to fund a portion of our expected 2013 dividend distributions and will not be available to fund portfolio growth or for the repayment of principal due on our debt.

#### ***Sources of Funds***

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

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

Our unsecured \$40 million Revolver, with availability of \$24.8 million at March 31, 2013, matures on June 30, 2014. The interest rate is prime less 50 basis points or the 30-day LIBOR plus 2%, at our option. We are currently in the process of negotiating an agreement with our current lender that would, among other things, extend the facility for at least one year. There can be no assurance that we will be able to finalize this agreement. 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 of \$132.0 million at January 1, 2013. In addition, the loss of either of our named executive officers would cause an event of default on our Revolver. At March 31, 2013, we were in compliance with the covenants of this facility. While we anticipate maintaining compliance with these covenants, there can be no assurance that we will be able to do so.

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 its commitment to lend thereunder. 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, available principal payments (including prepayments), and (if necessary) proceeds from asset and loan sales to satisfy our liquidity requirements. To the extent we need additional capital, there can be no assurance that we would be able to increase the amount available under the Revolver or identify other sources of funds at an acceptable cost, if at all.

At March 31, 2013, we had commitments from the SBA for the issuance of \$5.0 million in SBIC debentures. During 2012, we requested a commitment for additional debentures of \$5.0 million which were approved during May 2013. Approval of SBIC debenture commitments can be a time consuming and lengthy process.

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) 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.



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### ***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. Our outstanding commitments to fund new loans were \$10.7 million at March 31, 2013, of which \$6.6 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 \$1.6 million related to these SBA 7(a) loans (excluding any premium received upon sale); 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 2013, we anticipate that we will fund loans of between \$55 million to \$65 million.

There may be several months between when the initial balance of an SBA 7(a) Program 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 have \$4.2 million of SBIC debentures which mature in September 2013 and expect these debentures to be repaid using the SBICs' cash on hand, our Revolver or through issuance of new debentures.

We have a liability for borrower advances of \$6.4 million at March 31, 2013. In general, as part of the monitoring process to verify that the borrowers' cash equity is utilized for its intended purpose, we receive deposits from our borrowers and release funds upon presentation of appropriate documentation. When distributions are requested and approved, these borrower advances represent a use of funds which we expect to be paid with cash on hand and/or our Revolver.

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, 2013, the source of funds for our dividend distributions of \$1.3 million was Modified Cash.

### **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 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 (loss) and maintenance of REIT status, the economic environment, our ability to obtain leverage, loan portfolio performance and our ability to maintain a stable dividend considering the foregoing factors. Consequently, the dividend rate on a quarterly basis does not necessarily correlate directly to any individual factor.

The Board declared a \$0.125 per common share quarterly dividend to common shareholders on March 28, 2013 which was paid on April 8, 2013.

We have a covenant within our Revolver that may limit our ability to pay returns of capital as part of our dividends. This covenant has not historically limited the amount of dividends we have paid.

### **TAXABLE INCOME**

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

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

|   | Three Months Ended<br>March 31, |                 |
|---|---------------------------------|-----------------|
|   | 2013                            | 2012            |
|   | <i>(In thousands)</i>           |                 |
| Net income (loss)                                       | \$ 1,344                        | \$ (155)        |
| Book/tax differences:                                   |                                 |                 |
| Strategic alternatives                                  |                                 | 850             |
| Amortization and accretion                              | (12)                            | (157)           |
| Severance payments                                      | (6)                             | (8)             |
| Loan valuation  | 105                             | 405             |
| Impairment losses                                       | 108                             |                 |
| Other, net  | 32                              | 90              |
| <b>Subtotal</b>   | <b>1,571</b>                    | <b>1,025</b>    |
| Adjustment for TRS net loss (income), net of tax        | (525)                           | 58              |
| <b>REIT taxable income</b>                              | <b>\$ 1,046</b>                 | <b>\$ 1,083</b> |
| Distributions declared                                  | \$ 1,325                        | \$ 1,694        |
| <b>Basic weighted average common shares outstanding</b> | <b>10,591</b>                   | <b>10,576</b>   |

As a REIT, PMC Commercial generally will not be subject to corporate level Federal income tax on net income that is currently distributed to shareholders provided the distribution exceeds 90% of REIT taxable income.

We anticipate that we will have a REIT taxable loss during the second quarter of 2013 based on deductibility of \$1.8 million of severance payments during May 2013 and a realized loss for federal income tax purposes on the sale of our retail establishment included in real estate owned of \$530,000 during April 2013.

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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. The following table reconciles our net income (loss) to our Adjusted Taxable Income, Net of Current Tax Expense:

|  | Three Months Ended March 31, 2013       |                 |               |
|--|---|-----------------|---------------|
|  | Combined                                | REIT            | TRS s         |
|  | <i>(In thousands, except footnotes)</i> |                 |               |
| Net income   | \$ 1,344                                | \$ 819          | \$ 525        |
| Book versus tax timing differences                         | 449                                     | 227             | 222(1)        |
| <b>Taxable income</b>                                      | <b>1,793</b>                            | <b>1,046</b>    | <b>747</b>    |
| Current income tax expense                                 | (254)                                   |                 | (254)         |
| <b>Taxable Income, Net of Current Tax Expense</b>          | <b>\$ 1,539</b>                         | <b>\$ 1,046</b> | <b>\$ 493</b> |
|  | Three Months Ended March 31, 2012       |                 |               |
|  | Combined                                | REIT            | TRS s         |
|  | <i>(In thousands, except footnotes)</i> |                 |               |
| Net loss   | \$ (155)                                | \$ (97)         | \$ (58)       |
| Book versus tax timing differences                         | 1,655                                   | 1,180           | 475(1)        |
| <b>Taxable income</b>                                      | <b>1,500</b>                            | <b>1,083</b>    | <b>417</b>    |
| Special item (2)   | (850)                                   | (850)           |               |
| <b>Taxable Income, adjusted for special item</b>           | <b>650</b>                              | <b>233</b>      | <b>417</b>    |
| Current income tax expense                                 | (142)                                   |                 | (142)         |
| <b>Adjusted Taxable Income, Net of Current Tax Expense</b> | <b>\$ 508</b>                           | <b>\$ 233</b>   | <b>\$ 275</b> |

(1) Includes \$84,000 and \$587,000 of timing differences during the three months ended March 31, 2013 and 2012, respectively, related to Secondary Market Loan Sales.

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

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 (loss). 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 results of operations 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, SBIC debentures 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;

amount and timing of required property improvements by franchisors;

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>2013 | Year Ended<br>December 31,<br>2012 | Three Months<br>Ended<br>March 31,<br>2012 |
|---|--|------------------------------------|--|
| Provision for loan losses                           |  |                                    |  |
|   |  | <i>(In thousands)</i>              |  |
| As reported (1)                                     | \$ 301                                     | \$ 2,505                           | \$ 482                                     |
| Annual loan losses increase by 50 basis points (2)  | 564  | 3,509                              | 729  |
| Annual loan losses increase by 100 basis points (2) | 828  | 4,513                              | 975  |

(1) Excludes reductions of loan losses and recoveries.

(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 and 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 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 discount rate based on a current 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, 2013, our loans are 83% variable-rate at spreads over LIBOR or the prime rate. Increases or decreases in LIBOR or the prime rate will generally not have a material impact on the fair value of our variable-rate loans. We had \$202.5 million of variable-rate loans at March 31, 2013. The estimated fair value of our variable-rate loans (\$185.2 million at March 31, 2013) is dependent upon several factors including changes in interest rates and the market for the type of loans we have originated.

We had \$41.5 million and \$42.0 million of fixed-rate loans at March 31, 2013 and December 31, 2012, 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, 2013 and December 31, 2012, we had \$202.5 million and \$200.2 million of variable-rate loans, respectively, and \$82.4 million and \$80.0 million of variable-rate debt, respectively. On the difference between our variable-rate loans and our variable-rate debt (\$120.1 million and \$120.2 million at March 31, 2013 and December 31, 2012, 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 both March 31, 2013 and December 31, 2012, 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 \$300,000 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 fix our cost of funds and hedge against rising interest rates; however, to date we have not employed any hedging strategies.

**DEBT**

Our debt was comprised of SBIC debentures, junior subordinated notes, the Revolver and secured borrowings government guaranteed loans. At March 31, 2013 and December 31, 2012, \$23.2 million and \$17.2 million, respectively, of our debt had fixed rates of interest (SBIC debentures) 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, 2013, each hypothetical 100 basis points increase in interest rates would increase interest expense and decrease net income by approximately \$824,000.

The following presents 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, 2013 and December 31, 2012.

**March 31, 2013**

|   | Twelve Month Periods Ending March 31, |                  |                 |                 |                 |                  | Carrying Value    | Fair Value (1)    |
|---|---------------------------------------|------------------|-----------------|-----------------|-----------------|------------------|-------------------|-------------------|
|   | 2014                                  | 2015             | 2016            | 2017            | 2018            | Thereafter       |                   |                   |
|   | <i>(Dollars in thousands)</i>         |                  |                 |                 |                 |                  |                   |                   |
| Fixed-rate debt (2)                                   | \$ 4,190                              | \$ 4,000         | \$              | \$              | \$              | \$ 15,000        | \$ 23,190         | \$ 23,836         |
| Variable-rate debt (LIBOR and prime based)<br>(3) (4) | 1,250                                 | 16,488           | 1,327           | 1,369           | 1,413           | 60,516           | 82,363            | 77,900            |
| <b>Totals</b>   | <b>\$ 5,440</b>                       | <b>\$ 20,488</b> | <b>\$ 1,327</b> | <b>\$ 1,369</b> | <b>\$ 1,413</b> | <b>\$ 75,516</b> | <b>\$ 105,553</b> | <b>\$ 101,736</b> |

- (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, 2013 was 4.1%.
- (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, 2013 was 3.3%.





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|   | Years Ending December 31,     |                  |                 |                 |                 | Thereafter       | Carrying Value   | Fair Value (1)   |
|---|-------------------------------|------------------|-----------------|-----------------|-----------------|------------------|------------------|------------------|
|   | 2013                          | 2014             | 2015            | 2016            | 2017            |                  |                  |                  |
|   | <i>(Dollars in thousands)</i> |                  |                 |                 |                 |                  |                  |                  |
| Fixed-rate debt (2)                                     | \$ 4,190                      | \$               | \$ 4,000        | \$              | \$              | \$ 9,000         | \$ 17,190        | \$ 18,027        |
| Variable-rate debt (LIBOR and prime rate based) (3) (4) | 1,932                         | 13,173           | 1,312           | 1,353           | 1,397           | 60,811           | 79,978           | 75,499           |
| <b>Totals</b>   | <b>\$ 6,122</b>               | <b>\$ 13,173</b> | <b>\$ 5,312</b> | <b>\$ 1,353</b> | <b>\$ 1,397</b> | <b>\$ 69,811</b> | <b>\$ 97,168</b> | <b>\$ 93,526</b> |

- (1) *The estimated fair value is based on a present value calculation based on prices of the same or similar instruments after considering risk, current interest rates and remaining maturities.*
- (2) *The weighted average interest rate of our fixed-rate debt at December 31, 2012 was 4.5%.*
- (3) *Principal payments on the 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 December 31, 2012 was 3.3%.*

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**ITEM 4.**

**Controls and Procedures**

**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, management has evaluated the effectiveness of our disclosure controls and procedures (as defined under rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of March 31, 2013. 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, 2013 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, 2012.

**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).   |
| *4.1       | Debenture dated March 4, 2013 for \$3,000,000 loan with SBA   |
| *4.2       | Debenture dated March 4, 2013 for \$3,000,000 loan with SBA   |
| 10.1       | Separation Agreement and General Release dated October 26, 2012 between PMC Commercial Trust and Lance B. Rosemore (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on October 29, 2012). |
| *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: 5/10/13

/s/ Jan F. Salit  
Jan F. Salit  
President and  
Chief Executive Officer

Date: 5/10/13

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