PMC COMMERCIAL TRUST /TX
Form 10-Q
May 15, 2006

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

(Mark One)

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

For the quarterly period ended **March 31, 2006**

OR

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

For the transition period from _______ to _______ .

Commission File Number 1-13610

PMC COMMERCIAL TRUST

(Exact name of registrant as specified in its charter)

TEXAS	75-6446078
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
17950 Preston Road, Suite 600, Dallas, TX 75252	(972) 349-3200
(Address of principal executive offices)	(Registrant s telephone number)

Indicate by check mark whether the registrant (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 þ NO o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o

Indicate by check mark whether the Registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act). YES o NO þ

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

As of May 8, 2006, the Registrant had outstanding 10,741,921 Common Shares of Beneficial Interest, par value $.01 per share.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
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PART I

Financial Information

ITEM 1.

Financial Statements

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

	March 31, 2006	December 31, 2005
	(Unaudited)	
ASSETS		
Loans receivable, net	$ 157,498	$ 157,574
Retained interests in transferred assets	60,571	62,991
Real estate investments held for sale, net	6,708	15,470
Real estate investments, net	6,240	8,080
Restricted investments	4,457	3,532
Cash and cash equivalents	3,969	3,967
Rent and related receivables, net	1,192	1,489
Mortgage-backed security of affiliate	820	833
Deferred tax asset, net	385	349
Other assets	5,516	4,907
Total assets	$ 247,356	$ 259,192
LIABILITIES AND BENEFICIARIES EQUITY		
Liabilities:		
Junior subordinated notes	$ 27,070	$ 27,070
Notes and debentures payable	23,161	26,900
Credit facilities	20,705	24,205
Borrower advances	4,814	4,418
Redeemable preferred stock of subsidiary	3,598	3,575
Dividends payable	3,284	3,293
Accounts payable and accrued expenses	2,229	2,920
Debt and accrued expenses real estate investments held for sale	1,771	6,273
Deferred income	863	749
Due to affiliates, net	31	856
Other liabilities	1,048	1,016
Total liabilities	88,574	101,275
Commitments and contingencies		
Cumulative preferred stock of subsidiary	900	900
Beneficiaries equity:		

Common shares of beneficial interest; authorized 100,000,000 shares of $0.01 par value; 11,028,271 shares issued at March 31, 2006 and December 31, 2005, 10,741,921 and 10,766,021 shares outstanding at March 31, 2006 and December 31, 2005, respectively	110	110
Additional paid-in capital	152,064	152,047
Net unrealized appreciation of retained interests in transferred assets	3,852	4,519
Cumulative net income	127,341	122,300
Cumulative dividends	(122,254)	(119,031)
	161,113	159,945
Less: Treasury stock; at cost, 286,350 shares and 262,250 shares at March 31, 2006 and December 31, 2005, respectively	(3,231)	(2,928)
Total beneficiaries equity	157,882	157,017
Total liabilities and beneficiaries equity	$ 247,356	$ 259,192

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

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

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(Unaudited)	
Revenues:		
Interest income	$ 3,682	$ 2,487
Income from retained interests in transferred assets	2,253	2,527
Hotel property revenues	434	
Lease income	58	299
Other income	874	957
Total revenues	7,301	6,270
Expenses:		
Interest	1,460	1,032
Salaries and related benefits	1,060	1,055
General and administrative	607	597
Hotel property expenses	383	
Provision for loss on rent and related receivables	300	
Depreciation	62	81
Provision for loan losses, net	51	153
Realized losses on retained interests in transferred assets	48	21
Total expenses	3,971	2,939
Income before income tax provision, minority interest and discontinued operations	3,330	3,331
Income tax provision	(84)	(158)
Minority interest (preferred stock dividend of subsidiary)	(22)	(22)
Income from continuing operations	3,224	3,151
Discontinued operations:		
Net gains on sales of real estate	1,877	136
Impairment losses	(73)	
Net earnings	13	829
	1,817	965

Net income	$ 5,041	$ 4,116
Weighted average shares outstanding:		
Basic	10,746	10,877
Diluted	10,746	10,891
Basic and diluted earnings per share:		
Income from continuing operations	$ 0.30	$ 0.29
Discontinued operations	0.17	0.09
Net income	$ 0.47	$ 0.38

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

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

	Three Months Ended March 31, 2006	2005
	(Unaudited)	
Net income	$ 5,041	$ 4,116
Change in unrealized appreciation (depreciation) of retained interests in transferred assets:		
Net unrealized depreciation arising during period	(489)	(1,384)
Net realized gains included in net income	(178)	(171)
	(667)	(1,555)
Comprehensive income	$ 4,374	$ 2,561

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

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

Three Months Ended March 31, 2005
(Unaudited)

	Common Shares of Beneficial Interest Outstanding	Par Value	Additional Paid-in Capital	Net Unrealized Appreciation of Retained Interests in Transferred Assets	Cumulative Net Income	Cumulative Dividends	Treasury Stock	Total Beneficiaries Equity
Balances, December 31, 2004	10,876,961	$ 110	$ 151,818	$ 5,120	$ 111,003	$ (105,462)	$ (1,285)	$ 161,304
Net unrealized depreciation				(1,555)				(1,555)
Shares issued through exercise of stock options	3,000		39					39
Dividends ($0.35 per share)						(3,807)		(3,807)
Net income					4,116			4,116
Balances, March 31, 2005	10,879,961	$ 110	$ 151,857	$ 3,565	$ 115,119	$ (109,269)	$ (1,285)	$ 160,097

Three Months Ended March 31, 2006
(Unaudited)

	Common Shares of Beneficial Interest Outstanding	Par Value	Additional Paid-in Capital	Net Unrealized Appreciation of Retained Interests in Transferred Assets	Cumulative Net Income	Cumulative Dividends	Treasury Stock	Total Beneficiaries Equity
Balances, December 31, 2005	10,766,021	$ 110	$ 152,047	$ 4,519	$ 122,300	$ (119,031)	$ (2,928)	$ 157,017
Net unrealized depreciation				(667)				(667)
Shares repurchased	(24,100)						(303)	(303)
Issuance of share options			17					17

Dividends ($0.30 per share)						(3,223)		(3,223)
Net income					5,041			5,041
Balances, March 31, 2006	10,741,921	$ 110	$ 152,064	$ 3,852	$ 127,341	$ (122,254)	$ (3,231)	$ 157,882

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

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

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(Unaudited)	
Cash flows from operating activities:		
Net income	$ 5,041	$ 4,116
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	71	437
Realized losses on retained interests in transferred assets	48	21
Net gains on sales of real estate	(1,877)	(136)
Deferred income taxes	(36)	(11)
Provision for loan losses	51	153
Provision for losses on rent and related receivables	300	
Impairment losses	73	
Premium income adjustment	8	29
Amortization and accretion, net	(41)	(106)
Share-based compensation	17	
Loans funded, held for sale	(860)	(1,555)
Proceeds from sale of guaranteed loans	418	1,940
Loan fees collected, net	80	152
Capitalized loan origination costs	(106)	(36)
Change in operating assets and liabilities:		
Due to/from affiliates, net	(825)	16
Other assets	(231)	(634)
Borrower advances	396	(149)
Accounts payable and accrued expenses	(710)	(519)
Other liabilities	(291)	(329)
Net cash provided by operating activities	1,526	3,389
Cash flows from investing activities:		
Loans funded	(3,766)	(6,696)
Principal collected on loans receivable	13,695	7,388
Principal collected on notes receivable		133
Principal collected on retained interests in transferred assets	1,712	1,700
Proceeds from assets acquired in liquidation held for sale, net	531	113
Proceeds from sales of hotel properties, net	2,529	2,012
Proceeds from mortgage-backed security of affiliate	13	37
Investment in retained interests in transferred assets		(818)
Investment in PMC Preferred Capital Trust-A		(820)
Investment in restricted investments, net	(925)	(344)
Purchase of furniture, fixtures and equipment	(29)	(160)
Net cash provided by investing activities	13,760	2,545

Cash flows from financing activities:		
Proceeds from issuance of common shares		39
Purchase of treasury shares	(303)	
Repayment of revolving credit facility, net		(14,600)
Proceeds from issuance of SBA debentures		4,000
Proceeds from (repayment of) conduit warehouse facility, net	(3,500)	8,400
Proceeds from issuance of junior subordinated notes		27,070
Payment of principal on notes and mortgages payable and debentures	(8,249)	(27,302)
Payment of borrowing costs		(1,466)
Payment of dividends	(3,232)	(3,698)
Net cash used in financing activities	(15,284)	(7,557)
Net increase (decrease) in cash and cash equivalents	2	(1,623)
Cash and cash equivalents, beginning of year	3,967	9,065
Cash and cash equivalents, end of period	$ 3,969	$ 7,442

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

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

Note 1. Interim Financial Statements:

The accompanying consolidated balance sheet of PMC Commercial Trust (PMC Commercial or together with its wholly-owned subsidiaries, we, us or our) as of March 31, 2006 and the consolidated statements of income, comprehensive income, beneficiaries equity and cash flows for the three months ended March 31, 2006 and 2005 have not been audited by independent accountants. In the opinion of management, the financial statements reflect all adjustments necessary to fairly present our financial position at March 31, 2006 and our results of operations for the three months ended March 31, 2006 and 2005. These adjustments are of a normal recurring nature.

Certain notes and other information have been omitted from the interim financial statements presented in this Quarterly Report on Form 10-Q. 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, 2005.

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 retained interests in transferred assets, determination of reserves on our receivables and impairment analyses on our long-lived assets.

The results for the three months ended March 31, 2006 are not necessarily indicative of future financial results.

Note 2. Business:

PMC Commercial is a real estate investment trust (REIT) that either directly or through its subsidiaries, primarily originates loans to small businesses collateralized by first liens on the real estate of the related business. The majority of these loans are to borrowers in the hospitality industry. We also originate loans on commercial real estate to borrowers in the service, retail, multi-family and manufacturing industries and loans guaranteed by the Small Business Administration (SBA) collateralized by business assets and/or real estate. In addition, our investments include the ownership of commercial properties in the hospitality industry. Our common shares are traded on the American Stock Exchange under the symbol PCC.

Note 3. Consolidation:

We consolidate entities that we control by ownership of a majority voting interest as well as variable interest entities (VIEs) for which we are the primary beneficiary. To the extent we do not have a majority voting interest, we use the equity method to account for investments for which we have the ability to exercise significant influence over operating and financial policies. Consolidated net income includes our share of the net earnings of any entity accounted for using the equity method. The difference between consolidation and the equity method impacts certain financial ratios because of the presentation of the detailed line items reported in the financial statements. All material intercompany balances and transactions have been eliminated.

The consolidated financial statements include the accounts of PMC Commercial, First Western SBLC, Inc. (First Western), PMC Investment Corporation (PMCIC), Western Financial Capital Corporation (Western Financial), PMC Commercial Trust, Ltd. 1998-1 (PMCT Trust), PMC Funding Corp. (PMC Funding), PMC Asset Holding, LLC

(Asset Holding), PMC Conduit, L.P. (PMC Conduit), PMC Properties, Inc. (PMC Properties) and four separate subsidiaries created in conjunction with the purchase of four hotel properties in 1999.

First Western is licensed as a small business lending company that originates loans through the SBA 7(a) Guaranteed Loan Program. PMCIC and Western Financial are licensed specialized small business investment companies under the Small Business Investment Act of 1958, as amended (SBIA). PMCT Trust was formed in conjunction with our 1998 structured loan financing transaction. PMC Funding, Asset Holding and PMC Conduit hold assets on our behalf. PMC Properties is the operator, through third party managers, of our limited service hospitality properties.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

In addition, we own subordinate financial interests in several non-consolidated special purpose entities (*i.e.,* retained interests in transferred assets (Retained Interests)). These are PMC Capital, L.P. 1998-1 (the 1998 Partnership), PMC Capital, L.P. 1999-1 (the 1999 Partnership), PMC Joint Venture, L.P. 2000 (the 2000 Joint Venture), PMC Joint Venture, L.P. 2001 (the 2001 Joint Venture), PMC Joint Venture, L.P. 2002-1 (the 2002 Joint Venture) and PMC Joint Venture, L.P. 2003 (the 2003 Joint Venture, and together with the 2000 Joint Venture, the 2001 Joint Venture and the 2002 Joint Venture, the Joint Ventures, and the Joint Ventures together with the 1998 Partnership and the 1999 Partnership, the QSPEs) created in connection with structured loan sale transactions.

We account for our Retained Interests in accordance with Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (SFAS No. 140) and Emerging Issues Task Force Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets. While we are the servicer of the assets held by these QSPEs, we are required under the transaction documents to comply with strict servicing standards and are subject to the approval of the trustees and/or noteholders regarding any significant issues associated with the assets. As a result, we believe we have relinquished control of the assets sold to the QSPEs. Accordingly, the assets, liabilities, partners capital and results of operations of the QSPEs are not included in our consolidated financial statements.

Note 4. Reclassifications:

Certain prior period amounts have been reclassified to conform to the current year presentation. These reclassifications had no effect on previously reported net income or total beneficiaries equity.

Note 5. Share-Based Compensation Plans:

At March 31, 2006, we have options outstanding under share-based compensation plans. The 1993 Employee Share Option Plan and the Trust Manager Share Option Plan expired in December 2003; thus, no additional options will be issued under these two plans. The 2005 Equity Incentive Plan permits the grant of options to our employees, executive officers and Board of Trust Managers and restricted shares to our executive officers and Board of Trust Managers for up to 500,000 common shares. We use the fair value recognition provisions of SFAS No. 123R, Accounting for Stock-Based Compensation, to account for all awards granted, modified or settled.

We issued an aggregate of 9,060 restricted shares to executive officers and our Board of Trust Managers on June 11, 2005 at the then current market price of the shares at $14.54. Compensation expense is being recognized over the vesting period. We recorded compensation expense of approximately $17,000 during the three months ended March 31, 2006 for the vested portion of our restricted share issuance. As of March 31, 2006, there was approximately $32,000 of total unrecognized compensation expense related to the unvested restricted shares which will be recognized over the next fourteen months.

Note 6. Recently Issued Accounting Pronouncements:

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154 (SFAS No. 154), Accounting Changes and Error Corrections which replaces Accounting Principles Board (APB) Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements An Amendment of APB

Opinion No. 28. SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retroactive application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 did not have a material impact on our consolidated financial statements.

The FASB issued SFAS No. 155 (SFAS No. 155), Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 in February 2006. SFAS No. 155 (1) permits fair value remeasurement for hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation, (2) clarifies which interest-only strip receivables are not subject to the requirements of SFAS No. 133, (3) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or hybrid financial instruments that

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contain an embedded derivative requiring bifurcation, (4) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and (5) amends SFAS No. 140 to eliminate the prohibition on a QSPE from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The Statement is effective for all financial instruments acquired or issued after fiscal years beginning after September 15, 2006. We have not yet evaluated the impact of SFAS No. 155 on our consolidated financial statements.

The FASB issued SFAS No. 156 (SFAS No. 156), Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140 in March 2006. SFAS No. 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. Subsequent to initial measurement, an entity may choose to use the amortization method or the fair value measurement method for future measurements. SFAS No. 156 also requires additional disclosures related to servicing assets and servicing liabilities. SFAS No. 156 is effective for fiscal years beginning after September 15, 2006. We have not yet evaluated the impact of SFAS No. 156 on our consolidated financial statements; however, we do not expect the adoption to have a material impact on our consolidated financial statements.

Note 7. Loans Receivable, net:

Loans receivable, net, consisted of the following:

	March 31, 2006	December 31, 2005
	(In thousands)	
SBIC commercial mortgage loans	$ 40,845	$ 41,749
SBA 7(a) Guaranteed Loan Program loans	15,768	16,367
Other commercial mortgage loans	101,402	100,452
Total loans receivable	158,015	158,568
Less:		
Deferred commitment fees, net	(469)	(567)
Loan loss reserves	(48)	(427)
Loans receivable, net	$ 157,498	$ 157,574

Additional information on our loans receivable, net, was as follows:

	March 31, 2006	December 31, 2005

		Loans Receivable Amount	%	Weighted Average Interest Rate	Loans Receivable Amount	%	Weighted Average Interest Rate
				(Dollars in thousands)			
Variable-rate	LIBOR	$ 126,627	80.4%	8.7%	$ 120,645	76.6%	8.3%
Fixed-rate		15,479	9.8%	9.4%	18,651	11.8%	9.4%
Variable-rate	prime	15,392	9.8%	9.1%	18,278	11.6%	8.7%
		$ 157,498	100.0%	8.8%	$ 157,574	100.0%	8.5%

Our loans receivable were approximately 93% concentrated in the hospitality industry at March 31, 2006. Any economic factors that negatively impact the hospitality industry could have a material adverse effect on our financial condition or results of operations.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The activity in our loan loss reserves was as follows:

	Three Months Ended March 31,	
	2006	2005
	(In thousands)	
Balance, beginning of year	$ 427	$ 164
Provision for loan losses	89	171
Reduction of loan losses	(38)	(18)
Principal balances written-off, net	(430)	
Balance, end of period	$ 48	$ 317

Impaired loans are defined by generally accepted accounting principles as loans for which it is probable that the lender will be unable to collect all amounts due based on the original contractual terms of the loan. Information on those loans considered to be impaired loans was as follows:

	March 31, 2006	December 31, 2005
	(In thousands)	
Impaired loans requiring reserves	$ 197	$ 1,073
Impaired loans expected to be fully recoverable (1)	478	5,056
Total impaired loans	$ 675	$ 6,129

	Three Months Ended March 31,	
	2006	2005
	(In thousands)	
Average impaired loans	$ 2,891	$ 4,918
Interest income on impaired loans (2)	$ 70	$ 13

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(1) Loans acquired were recorded at their estimated fair value and as such are reflected at discounted amounts. Certain of these loans have no reserves and are thus shown in impaired loans expected to be fully recoverable with respect to our recorded investment in the loan; however, we do not expect to collect all amounts due based on the original contractual terms of the note.

(2) Recorded primarily on the cash basis.

Our impaired loans have decreased from December 31, 2005 to March 31, 2006 due primarily to the foreclosure of the underlying collateral of three limited service hospitality properties.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 8. Real Estate Investments and Rent and Related Receivables:

Our real estate investments consisted of the following:

	March 31, 2006		December 31, 2005	
	Real Estate Investments	Real Estate Investments Held for Sale	Real Estate Investments	Real Estate Investment Held for Sale
	(Dollars in thousands)			
Land	$ 794	$ 960	$ 1,044	$ 2,041
Buildings and improvements	5,926	6,366	7,484	15,110
Furniture, fixtures and equipment	271	532	271	1,728
	6,991	7,858	8,799	18,879
Accumulated depreciation	(751)	(1,150)	(719)	(3,409)
	$ 6,240	$ 6,708	$ 8,080	$ 15,470
Number of Hotel Properties	3	4	4	9

At March 31, 2006, we owned seven hotel properties (individually, a Hotel Property). The properties were originally part of a sale and leaseback transaction commencing in 1998 with Arlington Hospitality, Inc. (AHI) whereby we purchased the properties from AHI and then leased the properties to a wholly-owned subsidiary of AHI, Arlington Inns, Inc. (AII and together with AHI, Arlington). We concurrently entered into a Master Lease Agreement with AHI and AII covering all the properties and entered into a guaranty agreement with AHI whereby AHI guaranteed all obligations of AII under the individual property lease agreements. The Master Lease Agreement, as amended, with the individual property lease agreements being known as the Lease Agreement.

During June 2005, AII filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code (Bankruptcy). On August 31, 2005, AHI filed for Bankruptcy (the Arlington Bankruptcy). AII made its January 2006 rent payment of approximately $203,000 which was recorded as income when earned. During the first quarter of 2005, our base rent was approximately $968,000.

On January 13, 2006, we received rejection notices on 12 individual property leases and as a result, we took possession and operated 13 Hotel Properties through third party management companies. During 2006, we sold six hotel properties for approximately $12.9 million and recognized net gains of approximately $1.9 million. We financed the sale of these properties through origination of loans aggregating approximately $10.2 million with interest rates of LIBOR plus spreads ranging from 3.85% to 4.80% and maturity and amortization periods of 20 years. It is our intention to sell the remaining properties in an orderly and efficient manner. Management believes that it is probable that we will sell four of the remaining seven Hotel Properties by the end of 2006, although no assurances can be given that we will be able to do so.

At March 31, 2006, the four properties that we anticipate will be sold within the next year were deemed held for sale and all operations relating to these properties are included in discontinued operations on our consolidated statements of income. In addition, we previously discontinued recording depreciation expense on the held for sale properties. For our Hotel Properties to be sold, we performed a recoverability test to determine if the expected net sales proceeds for the Hotel Properties exceeded the carrying value of the Hotel Properties. Based on this analysis, we recorded impairment losses of $43,000 during the three months ended March 31, 2006 related to buildings and improvements identified as impaired. Management s estimates of the values for property sales were based on market conditions at the time the analysis was performed. These values may change based on the numerous factors that impact the (1) local and national economy, (2) prospects for the hospitality industry, (3) timing of particular sales, (4) franchise affiliation and (5) particular operating results of the property.

At March 31, 2006, three of our Hotel Properties had mortgages (which were assumed in the original purchase from AHI) with significant prepayment penalties. Therefore, we do not anticipate selling these properties until the properties market

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(Unaudited)

values increase or the prepayment penalties decrease. Until the properties are sold, we will either operate the properties through third party management companies or lease the properties. At March 31, 2006, these properties were considered to be held and used and all operations relating to these properties were included in continuing operations in our consolidated statements of income. We generated hotel property revenues of approximately $434,000 consisting primarily of room revenues and $383,000 in hotel property expenses consisting primarily of general and administrative expenses related to these properties during the three months ended March 31, 2006. For our Hotel Properties to be held and used, we performed a recoverability test to determine if the future undiscounted cash flows over our expected holding period for the Hotel Properties exceeded the carrying value of the Hotel Properties. Future cash flows are based on estimated future property operations or rent payments to be received on the Hotel Properties and expected proceeds from the sale. Based on this analysis, no additional impairment losses were recorded during the three months ended March 31, 2006.

At March 31, 2006, our rent and related receivables consisted of unpaid rent, property taxes, legal fees incurred, termination damages, notes receivable and other charges (the Arlington Claims) of approximately $2,747,000 before reserves. As a result of the uncertainty and timing of collection, our claim in the Arlington Bankruptcy is well in excess of our recorded investment in the Arlington Claims.

We performed an analysis of our anticipated future proceeds related to the Arlington Bankruptcy to determine the collectibility of our investment in the rent and related receivables based on best available information provided to us through the bankruptcy proceedings. As a result, we established an allowance of approximately $1,255,000 during 2005. We recorded an additional allowance of $300,000 during the three months ended March 31, 2006 primarily resulting from a reduction in available cash due to unanticipated and unforecasted cash expenditures by Arlington. Accordingly, our net recorded investment was $1,192,000 as of March 31, 2006. To the extent there is a reduction of the anticipated future proceeds, we would record an additional allowance against these receivables.

Note 9. Retained Interests:

In our structured loan sale transactions, we contributed loans receivable to a QSPE in exchange for cash and beneficial interests in that entity. The QSPE issued notes payable (the Structured Notes) to unaffiliated parties (Structured Noteholders). The QSPE then distributed a portion of the proceeds from the Structured Notes to us. The Structured Notes are collateralized solely by the assets of the QSPE which means that should the financial assets in the QSPE be insufficient for the trustee to make payments on the Structured Notes, the Structured Noteholders have no recourse against us. Upon the completion of our structured loan sale transactions, we recorded the transfer of loans receivable as a sale in accordance with SFAS No. 140. As a result, the loans receivable contributed to the QSPE, the Structured Notes issued by the QSPE, and the operating results of the QSPE are not included in our consolidated financial statements. The difference between (1) the carrying value of the loans receivable sold and (2) the sum of (a) the cash received and (b) the relative fair value of our Retained Interests, constituted the gain or loss on sale. Retained Interests are carried at estimated fair value, with realized gains and losses recorded in net income and unrealized gains and losses recorded in beneficiaries equity.

We completed joint structured loan sale transactions with PMC Capital, Inc., our affiliate through common management. Our interests related to the loans receivable we contributed to these structured loan sale transactions are the Originated Structured Loan Sale Transactions. During 2004, we acquired PMC Capital s Retained Interests in the Joint Ventures and 100% of the 1998 Partnership and the 1999 Partnership (collectively, the Acquired Structured

Loan Sale Transactions).

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Information pertaining to our Originated Structured Loan Sale Transactions as of March 31, 2006 was as follows:

	2000 Joint Venture	2001 Joint Venture	2002 Joint Venture	2003 Joint Venture
		(Dollars in thousands)		
Principal outstanding on sold loans	$ 30,734	$ 21,567	$ 20,214	$ 30,879
Structured Notes balance outstanding	$ 25,318	$ 19,035	$ 17,497	$ 26,441
Cash in the collection account	$ 322	$ 319	$ 290	$ 304
Cash in the reserve account	$ 1,858	$ 1,304	$ 1,218	$ 1,866
Weighted average interest rate on loans (1)	9.55%	9.61%	9.60%	L+4.02%
Discount rate assumptions (2)	7.9% to 12.6%	7.9% to 12.6%	8.1% to 12.8%	8.5% to 12.6%
Constant prepayment rate assumption (3)	11.00%	12.00%	12.00%	12.00%
Weighted average remaining life of loans (4)	3.13 years	3.80 years	3.93 years	3.69 years
Aggregate losses assumed (5)	2.65%	2.88%	3.67%	2.51%
Aggregate principal losses to date (6)	0.33%	%	%	%

(1) Variable interest rates are denoted by the spread over the 90-day LIBOR (L).

(2) Discount rates utilized were (a) 7.9% to 8.5% for our required overcollateralization, (b) 9.6% to 9.8% for our reserve funds and (c) 12.6% to 12.8% for our interest-only strip receivables.

(3) The prepayment rate was based on the actual performance of the loan pools, adjusted for anticipated principal prepayments considering similar loans.

(4) The weighted average remaining life of loans was calculated by summing the product of (a) the sum of the principal collections expected in each future period multiplied by (b) the number of periods until collection, and then dividing that total by (c) the remaining principal balance.

(5) Represents aggregate estimated future losses as a percentage of the principal outstanding based upon per annum losses ranging from 0.0% to 1.25% to the extent any loans are likely to be liquidated in the next twelve months, estimated losses were assumed to occur during that period. No losses are assumed in the twelve months ending March 31, 2007 for those structured loan sale transactions with no current potential impaired loans.

(6) Represents aggregate principal losses to date as a percentage of the principal outstanding at inception. For the 2000 Joint Venture, represents the loss on a loan receivable repurchased by PMC Commercial due to a loan modification and assumption.

Information pertaining to our Acquired Structured Loan Sale Transactions as of March 31, 2006 was as follows:

	1998 Partnership	1999 Partnership	2000 Joint Venture	2001 Joint Venture	2002 Joint Venture	2003 Joint Venture
	(Dollars in thousands)					
Principal outstanding on sold loans	$ 15,752	$ 18,439	$ 11,056	$ 20,401	$ 22,299	$ 42,391
Structured Notes balance outstanding	$ 15,020	$ 15,014	$ 8,376	$ 18,265	$ 18,053	$ 37,068
Cash in the collection account	$ 292	$ 311	$ 131	$ 1,950	$ 261	$ 749
Cash in the reserve account	$ 1,333	$ 1,214	$ 669	$ 1,337	$ 1,347	$ 2,579
Weighted average interest rate of loans (1)	P+1.11%	9.09%	9.06%	9.67%	9.63%	L+4.02%
Discount rate assumptions (2)	8.9% to 12.6%	7.9% to 12.6%	8.3% to 13.0%	8.1% to 12.8%	8.0% to 12.7%	8.5% to 12.6%
Constant prepayment rate assumption (3)	12.50%	14.00%	14.00%	12.00%	12.00%	12.00%
Weighted average remaining life of loans (4)	3.15 years	2.94 years	2.23 years	3.08 years	3.78 years	4.16 years
Aggregate principal losses assumed (5)	3.17%	2.58%	3.07%	2.47%	2.64%	2.85%
Aggregate principal losses to date (6)	%	%	4.28%	1.78%	1.31%	%

(1) *Variable interest rates are denoted by the spread over (under) the prime rate (P) or the 90-day LIBOR (L).*

(2) *Discount rates utilized were (a) 7.9% to 8.9% for our required overcollateralization, (b) 9.6% to 10.0% for our reserve funds and (c) 12.6% to 13.0% for our interest-only strip receivables.*

(3) *The prepayment rate was based on the actual performance of the loan pools, adjusted for anticipated principal prepayments considering similar loans.*

(4) *The weighted average remaining life of loans was calculated by summing the product of (a) the sum of the principal collections expected in each future period multiplied by (b) the number of periods until collection, and then dividing that total by (c) the remaining principal balance.*

(5) *Represents aggregate estimated future losses as a percentage of the principal outstanding based upon per annum losses ranging from 0.0% to 1.75%. To the extent any loans are likely to be liquidated in the next twelve months, estimated losses were assumed to occur during that period. No losses are assumed in the twelve months ending March 31, 2007 for those structured loan sale transactions with no current potential impaired loans.*

(6) *Represents aggregate principal losses to date as a percentage of the principal outstanding at inception. For the 2000 Joint Venture, represents historical losses incurred prior to our acquisition. For the 2001 Joint Venture and the 2002 Joint Venture, represents losses on delinquent loans receivable with a charged-off status repurchased by PMC Commercial.*

At March 31, 2006, none of the loans sold to the QSPEs were delinquent over 60 days as to principal and interest.

First Western has Retained Interests related to the sale of loans originated pursuant to the SBA 7(a) Guaranteed Loan Program. The SBA guaranteed portions of First Western s loans receivable are sold to either dealers in government guaranteed loans receivable or institutional investors (Secondary Market Loan Sales) as the loans are fully funded. On Secondary Market Loan Sales, we may retain an excess spread between the interest rate paid to us from our borrowers and the rate we pay to the purchaser of the guaranteed portion of the note and servicing costs. At March 31, 2006, the aggregate principal balance of First Western s serviced loans receivable on which we had an excess spread was approximately $38.8 million and the weighted average excess spread was approximately 0.7%. In determining the fair value of our Retained Interests related to Secondary Market Loan Sales, our assumptions at March 31, 2006 included a prepayment speed of 20% per annum and a discount rate of 12.6%.

The estimated fair value of our Retained Interests is based upon an estimate of the discounted future cash flows we will receive. In determining the present value of expected future cash flows, estimates are made in determining the amount and timing of those cash flows and the discount rates. The amount and timing of cash flows is generally determined based on estimates of loan losses and anticipated prepayment speeds relating to the loans receivable contributed to the QSPE. Actual loan losses and prepayments may vary significantly from assumptions. The discount rates that we utilize in computing the estimated fair value are based upon estimates of the inherent risks associated with each cash flow stream. Due to the limited

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number of entities that conduct transactions with similar assets, the relatively small size of our Retained Interests and the limited number of buyers for such assets, no readily ascertainable market exists. Therefore, our estimate of the fair value may or may not vary from what a willing buyer would pay for these assets.

The components of our Retained Interests are as follows:

(1) Our required overcollateralization (the OC Piece). The OC Piece represents the excess of the loans receivable contributed to the QSPE over the principal amount of the Structured Notes Payable issued by the QSPE, which serves as additional collateral for the Structured Noteholders.
(2) The Reserve Fund and the interest earned thereon. The Reserve Fund represents cash that is required to be kept in a liquid cash account by the QSPE, pursuant to the terms of the transaction documents, as collateral for the Structured Noteholders, a portion of which was contributed by us to the QSPE upon formation and a portion of which is built up over time by the QSPE from the cash flows of the underlying loans receivable.
(3) The interest-only strip receivable (the IO Receivable). The IO Receivable is comprised of the cash flows that are expected to be received by us in the future after payment by the QSPE of (a) all interest and principal due to the Structured Noteholders, (b) all principal and interest on the OC Piece, (c) any required funding of the Reserve Fund and (d) on-going costs of the transaction.

Our Retained Interests consisted of the following:

	March 31, 2006				
	Estimated Fair Value				
	OC Piece	Reserve Fund	IO Receivable	Total	Cost
	(In thousands)				
First Western	$	$	$ 731	$ 731	$ 703
1998 Partnership	900	1,032	374	2,306	2,240
1999 Partnership	3,811	936	426	5,173	5,157
2000 Joint Venture	8,791	2,076	835	11,702	10,539
2001 Joint Venture	7,100	2,269	2,087	11,456	10,585
2002 Joint Venture	7,734	2,118	1,812	11,664	10,766
2003 Joint Venture	10,861	3,726	2,952	17,539	16,729
	$ 39,197	$ 12,157	$ 9,217	$ 60,571	$ 56,719

	December 31, 2005				
	Estimated Fair Value				
	OC Piece	Reserve Fund	IO Receivable	Total	Cost
	(In thousands)				
First Western	$	$	$ 779	$ 779	$ 741
1998 Partnership	915	1,048	412	2,375	2,306

1999 Partnership	3,885	955	499	5,339	5,240
2000 Joint Venture	8,953	2,231	892	12,076	10,809
2001 Joint Venture	7,227	2,619	2,440	12,286	11,023
2002 Joint Venture	7,890	2,147	1,831	11,868	10,803
2003 Joint Venture	10,878	4,304	3,086	18,268	17,550
	$ 39,748	$ 13,304	$ 9,939	$ 62,991	$ 58,472

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The following sensitivity analysis of our Retained Interests as of March 31, 2006 highlights the volatility that results when prepayments, losses and discount rates are different than our assumptions:

Changed Assumption		Estimated Fair Value	Asset Change (1)
		(In thousands)	
Losses increase by 50 basis points per annum (2)	$	57,919	($2,652)
Losses increase by 100 basis points per annum (2)	$	55,290	($5,281)
Rate of prepayment increases by 5% per annum (3)	$	59,774	($797)
Rate of prepayment increases by 10% per annum (3)	$	59,137	($1,434)
Discount rates increase by 100 basis points	$	58,330	($2,241)
Discount rates increase by 200 basis points	$	56,206	($4,365)

(1) Any depreciation of our Retained Interests is either included in the accompanying statement of income as a realized loss (if there is a reduction in expected future cash flows) or on our balance sheet in beneficiaries equity as an unrealized loss.

(2) If we experience losses in excess of anticipated losses, the effect on our Retained Interests would first reduce the value of the IO Receivables. To the extent the IO Receivables could not fully absorb the losses, the effect would then be to reduce the value of our Reserve Funds and then the value of our OC Pieces.

(3) For example, an 8% assumed rate of prepayment would be increased to 13% or 18% based on increases of 5% or 10% per annum, respectively.

These sensitivities are hypothetical and should be used with caution. Values based on changes in these assumptions generally cannot be extrapolated since the relationship of the change in an assumption to the change in fair value is not linear. The effect of a variation in a particular assumption on the fair value of our Retained Interests is calculated without changing any other assumption. In reality, changes in one factor are not isolated from changes in another which might magnify or counteract the sensitivities.

We monitor the governing pooling and servicing agreements for each of our structured loan sale transactions and believe the servicing-related terms set forth therein are industry standard and consistent with QSPE criteria. Accounting standard setters are currently assessing servicing activities involving QSPEs and, consequently, there may now be some uncertainty with respect to the accounting for sale transactions involving QSPEs. As accounting standard setters continue to interpret QSPE criteria under SFAS No. 140, there may be a material resultant impact on our consolidated financial statements.

In accordance with SFAS No. 140, our consolidated financial statements do not include the assets, liabilities, partners capital, revenues or expenses of the QSPEs. As a result, at March 31, 2006 and December 31, 2005 our consolidated balance sheets do not include the $254.6 million and $276.1 million of assets, respectively, and $200.7 million and $220.8 million of liabilities, respectively, related to our structured loan sale transactions recorded by our QSPEs. At March 31, 2006, the partners capital of our QSPEs was approximately $53.8 million compared to the value of the associated Retained Interests of $59.8 million.

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The following information summarizes the financial position of the QSPEs at March 31, 2006 and December 31, 2005.

Summary of Financial Position:

	1998 Partnership		1999 Partnership		2000 Joint Venture	
	March 31, 2006	December 31, 2005	March 31, 2006	December 31, 2005	March 31, 2006	December 31, 2005
	(In thousands)					
Loans receivable, net	$ 15,728	$ 15,969	$ 18,439	$ 20,203	$ 41,790	$ 42,263
Total assets	$ 17,429	$ 17,682	$ 20,087	$ 21,947	$ 44,995	$ 48,253
Structured Notes	$ 15,020	$ 15,240	$ 15,014	$ 16,795	$ 33,694	$ 36,697
Total liabilities	$ 15,099	$ 15,314	$ 15,098	$ 16,889	$ 33,796	$ 36,809
Partners capital	$ 2,330	$ 2,368	$ 4,989	$ 5,058	$ 11,199	$ 11,444

	2001 Joint Venture		2002 Joint Venture		2003 Joint Venture	
	March 31, 2006	December 31, 2005	March 31, 2006	December 31, 2005	March 31, 2006	December 31, 2005
	(In thousands)					
Loans receivable, net	$ 41,968	$ 49,175	$ 42,513	$ 42,843	$ 73,270	$ 75,566
Total assets	$ 47,059	$ 52,918	$ 45,889	$ 46,256	$ 79,109	$ 89,017
Structured Notes	$ 37,300	$ 42,731	$ 35,550	$ 35,844	$ 63,509	$ 72,782
Total liabilities	$ 37,399	$ 42,845	$ 35,649	$ 35,944	$ 63,682	$ 72,964
Partners capital	$ 9,660	$ 10,073	$ 10,240	$ 10,312	$ 15,427	$ 16,053

The following information summarizes the results of operations of the QSPEs.

Summary of Operations:

	Three Months Ended March 31,					
	1998 Partnership		1999 Partnership		2000 Joint Venture	
	2006	2005	2006	2005	2006	2005
	(In thousands)					
Interest income	$ 343	$ 316	$ 445	$ 526	$ 1,013	$ 1,239
Total revenues	$ 344	$ 317	$ 459	$ 528	$ 1,016	$ 1,306
Reduction of losses	$ (1)	$ (1)	$	$	$ (17)	$
Interest expense	$ 236	$ 195	$ 265	$ 323	$ 625	$ 805
Total expenses	$ 250	$ 212	$ 284	$ 344	$ 644	$ 847
Net income	$ 94	$ 105	$ 175	$ 184	$ 372	$ 459

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	Three Months Ended March 31,					
	2001 Joint Venture		2002 Joint Venture		2003 Joint Venture	
	2006	2005	2006	2005	2006	2005
	(In thousands)					
Interest income	$ 1,124	$ 1,372	$ 1,041	$ 1,152	$ 1,687	$ 1,455
Total revenues	$ 1,348	$ 1,728	$ 1,049	$ 1,492	$ 1,706	$ 1,460
Provision for (reduction of) losses, net	$	$ (315)	$	$ 141	$ (6)	$
Interest expense	$ 640	$ 818	$ 595	$ 742	$ 949	$ 733
Total expenses	$ 679	$ 552	$ 630	$ 925	$ 1,006	$ 804
Net income	$ 669	$ 1,176	$ 419	$ 567	$ 700	$ 656

The income from our Retained Interests represents the accretion (recognized using the effective interest method) on our Retained Interests which is determined based on estimates of future cash flows and includes any fees collected (*i.e.,* late fees, prepayment fees, etc.) by the QSPEs in excess of anticipated fees. We update our cash flow assumptions on a quarterly basis and any changes to cash flow assumptions impact the yield on our Retained Interests. The annualized yield on our Retained Interests, which is comprised of the income earned less realized losses, was 13.2% and 11.4% during the three months ended March 31, 2006 and 2005, respectively.

Servicing fee income for the three months ended March 31, 2006 and 2005 for loans held by the QSPEs was approximately $186,000 and $224,000, respectively. We have not established a servicing asset or liability related to the loans held by our QSPEs as the servicing fees are considered adequate compensation.

We received approximately $4.0 million and $4.2 million in cash distributions from the QSPEs during the three months ended March 31, 2006 and 2005, respectively.

Note 10. Other Assets:

Other assets consisted of the following:

	March 31,	December 31,

	2006	2005
	(In thousands)	
Assets acquired in liquidation, net	$ 1,439	$ 1,014
Deferred borrowing costs, net	1,260	1,340
Investment in Preferred Trust	820	820
Interest receivable	709	698
Prepaid expenses and deposits	701	653
Other	587	382
Other assets	$ 5,516	$ 4,907

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Note 11. Debt:

Information on our outstanding debt was as follows:

	March 31, 2006		December 31, 2005			Current Weighted
	Face Amount	Carrying Value	Face Amount	Carrying Value	Current Range of Maturities	Average Coupon Rate
			(In thousands)			
Notes and debentures payable:						
Debentures	$ 15,500	$ 16,091	$ 15,500	$ 16,125	2010 to 2015	7.10%
Mortgage notes (1)	5,420	5,420	11,473	11,473	2009 to 2017	8.20%
Structured notes	2,973	2,973	5,167	5,167	2006 to 2018	6.37%
	23,893	24,484	32,140	32,765		
Junior Subordinated Notes	27,070	27,070	27,070	27,070	2035	7.78%
Credit facilities:						
Conduit Facility	20,705	20,705	24,205	24,205	2008	5.65%
Revolving credit facility					2006	N/A
	20,705	20,705	24,205	24,205		
Redeemable preferred stock of subsidiary	4,000	3,598	4,000	3,575	2009 to 2010	4.00%
Other	11	11			2006	9.50%
Debt	$ 75,679	$ 75,868	$ 87,415	$ 87,615		

(1) We have mortgages on our Hotel Properties which are considered held-for-sale totaling approximately $1.3 million and $5.9 million at March 31, 2006 and December 31, 2005, respectively, included in debt and accrued expenses real estate investments on our consolidated balance sheets.

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Principal payments required on our debt at March 31, 2006 were as follows (face amount):

Twelve Months Ending March 31,	Total (1)
	(In thousands)
2007	$ 1,921
2008	21,331
2009	685
2010	3,973
2011	4,165
Thereafter	43,604
	$ 75,679

(1) *Maturities of the structured notes are dependent upon the timing of the cash flows received from the underlying loans receivable; however, for purposes of determining our debt maturities, principal payments were estimated based on required principal payments on the underlying loans receivable.*

Debentures

Debentures represent amounts due to the SBA as a result of borrowings made pursuant to the SBIA. The debentures have a weighted average cost of funds of approximately 6.0% and semi-annual interest only payments.

Mortgage Notes

As of March 31, 2006, we had four mortgage notes, each collateralized by a Hotel Property. The net book value of our mortgaged real estate investments was approximately $8.2 million at March 31, 2006. Three of the mortgage notes are through our subsidiaries formed to issue the mortgage notes and one is through PMC Commercial. During 2006, we sold three Hotel Properties with mortgage notes totaling $3.2 million and the mortgages were repaid. The mortgage note of PMC Commercial relates to one of our Hotel Properties held for sale, has an interest rate of 8.25%, matures in June 2009 and has an amortization period of 20 years. At March 31, 2006 and December 31, 2005, the aggregate balances outstanding on these obligations were approximately $1.3 million and $5.9 million, respectively. During May 2006, the $1.3 million mortgage was prepaid, without penalty.

The three mortgage notes of our subsidiaries relate to our three Hotel Properties to be held and used and have a weighted average interest rate of approximately 8.2% at March 31, 2006. During 2006, we sold one of these Hotel Properties with a mortgage note of approximately $1.5 million and the mortgage note was repaid. These mortgages are amortized over 20 years, mature from January 2011 to December 2017 and have restrictive provisions which provide for substantial prepayment penalties. At March 31, 2006 and December 31, 2005, the aggregate balances outstanding on these mortgage notes were approximately $4.1 million and $5.6 million, respectively, of which approximately $1.5 million and $3.0 million at March 31, 2006 and December 31, 2005 were guaranteed by PMC Commercial, respectively.

Structured Notes

In June 1998, PMC Commercial formed PMCT Trust, a bankruptcy remote partnership that completed a private placement of fixed-rate loan-backed notes (the Trust Structured Notes). The Trust Structured Notes have a stated maturity in 2019; however, repayment of their principal is based on collections of principal on the underlying loans receivable. The Trust Structured Notes are collateralized by the loans receivable that we contributed to the partnership. At March 31, 2006 and December 31, 2005, the principal amount of the outstanding underlying loans receivable was approximately $8.2 million and $10.8 million, respectively. We have no obligation to pay the Trust Structured Notes, nor do the holders of the Trust Structured Notes have any recourse against our assets. Accordingly, if PMCT Trust fails to pay the Trust Structured Notes, the sole recourse of the holders of the Trust Structured Notes is against the assets of PMCT Trust.

Junior Subordinated Notes

During 2005, PMC Commercial issued Junior Subordinated Notes which are subordinated to PMC Commercial s existing debt. The Junior Subordinated Notes bear interest at a floating rate which resets on a quarterly basis at the 90-day LIBOR

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plus 3.25% (computed on a 360-day year). The Junior Subordinated Notes may be redeemed at our option, without penalty, beginning on March 30, 2010. Interest payments are due on a quarterly basis.

Conduit Facility
During 2005, we entered into a three-year $100.0 million Conduit Facility expiring February 6, 2008. Interest payments on the advances are payable by PMC Conduit on a monthly basis at a rate approximating LIBOR, plus 1% and PMC Conduit s principal repayment obligations are expected to be financed through future securitizations of the loans collateralizing advances under the Conduit Facility. In addition, we are charged an unused fee equal to 12.5 basis points computed based on the daily available balance. The Conduit Facility allows for advances based on the amount of eligible collateral sold and has minimum requirements. At March 31, 2006, approximately $33.7 million of our loans were owned by PMC Conduit. The Conduit Facility has covenants, the most restrictive of which are maximum delinquency ratios for our contributed loans and serviced portfolio, as defined in the transaction documents. At the end of each annual period, the lenders have the option to extend their respective commitments to make advances for an additional 364-day period. At March 31, 2006, we were in compliance with the covenants of this facility.

Revolving Credit Facility
PMC Commercial has a revolving credit facility that matures in December 2006 and provides us with credit availability up to $20 million. We are charged interest on the balance outstanding under the revolving credit facility at our election of either the prime rate of the lender less 75 basis points or 162.5 basis points over the 30, 60 or 90-day LIBOR. In addition, we are charged an unused fee equal to 37.5 basis points computed based on our daily available balance. The credit facility requires us to meet certain covenants, the most restrictive of which (1) provides for an asset coverage test based on our cash and cash equivalents, loans receivable, Retained Interests and real estate investments as a ratio to our senior debt and (2) limits our ability to pay out returns of capital as part of our dividends. At March 31, 2006, we were in compliance with the covenants of this facility.

Redeemable Preferred Stock of Subsidiary
PMCIC has outstanding 40,000 shares of $100 par value, 4% cumulative preferred stock (the 4% Preferred Stock). The 4% Preferred Stock is held by the SBA pursuant to the SBIA.

The 4% Preferred Stock was issued during 1994 ($2.0 million) and 1995 ($2.0 million) and must be redeemed at par no later than 15 years from the date of issuance. In accordance with SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, we have classified the 4% Preferred Stock as a liability on our consolidated balance sheet. Dividends of approximately $40,000 were recognized on the 4% Preferred Stock during both the three months ended March 31, 2006 and 2005 and are included in interest expense on our consolidated statements of income.

Interest Paid
During the three months ended March 31, 2006 and 2005, interest paid was approximately $1.8 million and $1.7 million, respectively.

Note 12. Cumulative Preferred Stock of Subsidiary:

PMCIC has outstanding 30,000 shares of $100 par value, 3% cumulative preferred stock (the 3% Preferred Stock) held by the SBA pursuant to the SBIA.

PMCIC is entitled to redeem, in whole or part, the 3% Preferred Stock by paying the par value ($3.0 million) of these securities plus dividends accumulated and unpaid on the date of redemption. While the 3% Preferred Stock may be redeemed, redemption is not mandatory. Dividends of approximately $22,000 were recognized on the 3% Preferred Stock during both the three months ended March 31, 2006 and 2005 and are reflected in our consolidated statements of income as minority interest.

Note 13. Earnings Per Share:

The computations of basic earnings per common share are based on our weighted average shares outstanding. The weighted

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average number of common shares outstanding was approximately 10,746,000 and 10,877,000 for the three months ended March 31, 2006 and 2005, respectively. For purposes of calculating diluted earnings per share, the weighted average shares outstanding were increased by approximately 14,000 shares during the three months ended March 31, 2005 for the dilutive effect of options to purchase common shares. During the three months ended March 31, 2006, no shares were added to the weighted average shares outstanding for purposes of calculating diluted earnings per share as all options were anti-dilutive.

Not included in the computation of diluted earnings per share were outstanding options to purchase 169,613 and 54,875 common shares during the three months ended March 31, 2006 and 2005, respectively, because the options exercise prices were greater than the average market price of the shares.

Note 14. Dividends Declared:

The Board of Trust Managers declared a $0.30 per share quarterly dividend to common shareholders of record on March 31, 2006, which was paid on April 10, 2006.

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

Note 15. Share Repurchase Program:

On August 31, 2005, our Board of Trust Managers authorized a share repurchase program for up to $10.0 million for the purchase of outstanding Common Shares, expiring August 31, 2006. The Common Shares may be purchased from time to time in the open market or pursuant to negotiated transactions. As of March 31, 2006, we had acquired 153,500 common shares under the share repurchase program for an aggregate purchase price of approximately $1,946,000, including commissions.

Note 16. Taxable Income:

PMC Commercial has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the Code). To qualify as a REIT, PMC Commercial must meet a number of organizational and operational requirements, including a requirement that we distribute at least 90% of our taxable income to our shareholders. As a REIT, PMC Commercial generally will not be subject to corporate level Federal income tax on net income that is currently distributed to shareholders. We may, however, be subject to certain Federal excise taxes and state and local taxes on our income and property. If PMC Commercial fails to qualify as a REIT in any taxable year, it will be subject to Federal income taxes at regular corporate rates (including any applicable alternative minimum tax) and will not be able to qualify as a REIT for four subsequent taxable years.

In order to meet our prior year taxable income distribution requirements, we may make an election under the Code to treat a portion of the distributions declared in the current year as distributions of the prior year s taxable income.

PMC Commercial has wholly-owned taxable REIT subsidiaries (TRS s) which are subject to Federal income taxes: PMCIC, First Western, PMC Funding and PMC Properties. The income generated from the TRS s is taxed at normal corporate rates. We account for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes which uses the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The measurement of net deferred tax assets is adjusted by a valuation allowance, if, based on our ongoing assessment of this future realization, it is more likely than not that they will not be realized.

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The following table reconciles our net income to REIT taxable income:

	Three Months Ended March 31, 2006	2005
	(In thousands, except per share data)	
Net income	$ 5,041	$ 4,116
Less: TRS net income, net of tax	(178)	(229)
Add: Book depreciation	71	437
Less: Tax depreciation	(334)	(360)
Book/tax difference on Retained Interests, net	228	515
Book/tax difference on lease income		(381)
Book/tax difference on property sales	350	(39)
Impairment losses	43	
Provision for loss on rent and related receivables	300	
Book/tax difference on loans receivable	(889)	110
Other book/tax differences, net	5	(37)
REIT taxable income	$ 4,637	$ 4,132
Distributions declared	$ 3,223	$ 3,807
Dividends declared per share	$ 0.30	$ 0.35

Income tax provision related to the TRS s consists of the following:

	Three Months Ended March 31, 2006	2005
	(In thousands)	
Federal:		
Current provision	$ 120	$ 169
Deferred benefit	(36)	(11)

Income tax provision	$	84	$	158

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The provision for income taxes results in effective tax rates that differ from Federal statutory rates of 35%. The reconciliation of TRS income tax attributable to net income computed at Federal statutory rates to income tax expense was as follows:

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(In thousands)	
Income before income taxes for TRS s	$ 262	$ 387
Expected Federal income tax provision	$ 92	$ 135
Preferred dividend of subsidiary recorded as minority interest	8	8
Other adjustment	(16)	15
Income tax provision	$ 84	$ 158

The components of the net deferred tax asset were as follows:

	March 31, 2006	December 31, 2005
	(In thousands)	
Deferred tax assets:		
Secondary Market Loan Sales	$ 146	$ 142
Servicing asset	116	132
Loan valuation	84	92
Premiums on acquired notes and debentures payable	96	101
Operating loss carryforwards	50	8
Other	34	23
Total gross deferred tax assets	526	498
Deferred tax liabilities:		
Discount on acquired redeemable preferred stock of subsidiary	141	149
Total gross deferred tax liabilities	141	149

Deferred tax asset, net	$	385	$	349

Our operating loss carryforwards were generated by PMC Properties and are available to offset future taxable income of PMC Properties. Based on estimates of future pretax earnings for the properties, management believes that we will realize the full benefit of these net operating loss carryforwards. The net operating loss carryforwards expire from 2025 to 2026.

We paid $335,000 and $130,000 in income taxes during the three months ended March 31, 2006 and 2005, respectively.

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Note 17. Other Income:

Other income consisted of the following:

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(In thousands)	
Prepayment fees	$ 446	$ 338
Servicing income (1)	280	325
Other loan related income	98	129
Premium income (1)	34	163
Equity in earnings of unconsolidated subsidiary	16	2
Other income	$ 874	$ 957

(1) We earn fees for servicing all loans held by the QSPEs and First Western s loans sold into the secondary market. Premium income results from the sale of First Western s loans pursuant to Secondary Market Loan Sales.

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Note 18. Discontinued Operations:

Discontinued operations of our hotel properties (12 hotel properties and 16 hotel properties during the three months ended March 31, 2006 and 2005, respectively) and assets acquired in liquidation (primarily two limited service hospitality properties during the three months ended March 31, 2006) consisted of the following:

	Three Months Ended March 31,	
	2006	2005
	(In thousands)	
Hotel and Lease Operations:		
Revenues:		
Lease income base and other	$ 145	$ 854
Straight-line rent income		487
Hotel operating revenues	708	
Total revenues	853	1,341
Expenses:		
Depreciation	9	356
Interest expense (1)	107	155
Hotel operating expenses	688	
Total expenses	804	511
Net earnings, hotel and lease operations	49	830
Assets Acquired in Liquidation Operations:		
Revenues	129	
Expenses	165	1
Net losses, assets acquired in liquidation operations	(36)	(1)
Total net earnings	13	829
Net gains on sales of real estate	1,877	136
Impairment losses	(73)	

Discontinued operations	$ 1,817	$ 965

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(1) Represents interest expense on the mortgages payable related to hotel properties included in discontinued operations. The mortgages payable will either be repaid as a result of the sales or as they mature. No additional interest expense was allocated to discontinued operations.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
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(Unaudited)

Property sales included in discontinued operations consisted of the following:

	Three Months Ended March 31, 2006		2005
	(In thousands, except number of property sales and footnotes)		
Properties sold:			
Hotel properties	6		1
Assets acquired in liquidation	3		1
	9		2
Hotel Properties:			
Sales proceeds	$ 12,948	(1)(2)	$ 2,012
Cost of sales	(11,092)		(1,885)
	1,856		127
Assets Acquired in Liquidation:			
Sales proceeds	3,458	(3)(4)	100
Cost of sales	(3,437)		(91)
	21		9
Net gains on sales of real estate	$ 1,877		$ 136

(1) We financed the sale of these hotel properties through origination of loans aggregating $10,244,000 with interest rates of LIBOR plus spreads ranging from 3.85% to 4.80%.

(2) Includes a hotel property with sales proceeds of $2,200,000, including origination of a loan of $1,760,000. As the down payment received was not sufficient to qualify for full accrual gain treatment, we recorded an installment gain of approximately $102,000 and the remaining gain of approximately $409,000 was deferred and is included in deferred income on our consolidated balance sheets.

(3) Includes a limited service hospitality property sold during 2005 for which the down payment was not sufficient to qualify for gain treatment. We recognized approximately $2,000 of installment gains on this sale during the three months ended March 31, 2006. In addition, includes two limited service hospitality properties sold during 2006 for which the down payments were not sufficient to qualify for full accrual gain treatment. Therefore, we recorded installment gains of approximately $16,000 and the remaining gains of approximately $62,000 was deferred and is included in deferred income in our consolidated balance sheet.

(4) *We financed the sale of these assets acquired in liquidation through origination of loans totaling $2,760,000 with interest rates of LIBOR plus 4%.*

PMC COMMERCIAL TRUST AND SUBSIDIARIES
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Note 19. Supplemental Disclosure of Cash Flow Information:

Information regarding our non-cash activities was as follows:

	Three Months Ended March 31,	
	2006	2005
	(In thousands)	
Non-cash investing activities:		
Loans receivable originated in connection with sales of hotel properties	$ 10,244	