PMC COMMERCIAL TRUST /TX
Form 10-K
March 16, 2011

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

(Mark One)

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

For the Fiscal Year Ended December 31, 2010

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)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common shares of beneficial interest, $.01 par value	NYSE Amex

Securities registered pursuant to Section 12(g) of the Act: **None**

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 not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. YES o NO þ

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 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 o NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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 o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The aggregate market value of common shares held by non-affiliates of the Registrant, based upon the closing sale price of the Common Shares of Beneficial Interest on June 30, 2010 as reported on the NYSE Amex, was approximately $81 million. Common Shares of Beneficial Interest held by each officer and trust manager and by each person who owns 10% or more of the outstanding Common Shares of Beneficial Interest have been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 3, 2011, the Registrant had outstanding 10,559,554 Common Shares of Beneficial Interest.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant s Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

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PART IV

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Forward-Looking Statements

This Form 10-K 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. These statements include the plans and objectives of management for future operations, including plans and objectives relating to future growth of our loans receivable and availability of funds. 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. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties identified in this Form 10-K, including, without limitation, the risks identified under the caption Item 1A. Risk Factors. 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-K 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, except to the extent required by applicable securities laws.

PART I

Item 1. BUSINESS

INTRODUCTION

PMC Commercial Trust (PMC Commercial and together with its wholly-owned subsidiaries, the Company, our or w is a real estate investment trust (REIT) organized in 1993 that primarily originates loans to small businesses collateralized by first liens on the real estate of the related business. As a REIT, we seek to maximize shareholder value through long-term growth in dividends paid to our shareholders. We must distribute at least 90% of our REIT taxable income to shareholders to maintain our REIT status. See Tax Status. Our common shares are traded on the NYSE Amex under the symbol PCC.

We generate revenue primarily from the yield and other fees earned on our investments. Our loans are predominantly (94% at December 31, 2010) to borrowers in the hospitality industry. Our operations are located in Dallas, Texas and historically have included originating, servicing and selling commercial loans. During the years ended December 31, 2010 and 2009, our total revenues were approximately $15.5 million and $16.3 million, respectively, and our net income was approximately $4.3 million and $6.8 million, respectively. See Item 8. Financial Statements and Supplementary Data.

We originate loans through PMC Commercial and its wholly-owned lending subsidiaries: First Western SBLC, Inc. (First Western), PMC Investment Corporation (PMCIC) and Western Financial Capital Corporation (Western Financial). First Western is licensed as a small business lending company (SBLC) that originates loans through the Small Business Administration s (SBA) 7(a) Guaranteed Loan Program (SBA 7(a)). PMCIC and Western Financial are small business investment companies (SBICs).

First Western is a national Preferred Lender, as designated by the SBA, and originates, sells and services small business loans. As a non-bank SBA 7(a) program lender, First Western is able to originate loans on which a substantial portion of the loan (generally 75% to 85%) is guaranteed as to payment of principal and interest by the SBA. Due to the existence of the SBA guarantee, we are able to originate loans that meet the criteria of the SBA 7(a) Program and have less stringent underwriting criteria than our non-SBA 7(a) program loan originations. See Lending Activities SBA Programs.

We are focusing 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, and then sell the government guaranteed portion to investors.

Our ability to generate interest income, as well as other revenue sources, is dependent on economic, regulatory and competitive factors that influence interest rates and loan originations, and our ability to secure financing for our investment activities. The amount of revenue earned will vary based on:

- The volume of loans funded;
- The volume of loans which prepay;
- The timing and availability of leverage;
- The amount of non-performing loans;
- Recognition of premium, if any, on secondary market loan sales;
- The interest rate and type of loans originated (whether fixed or variable); and
- The general level of interest rates.

The majority of our loans have variable rates of interest. As a result, during periods of declining interest rates, our interest income is subject to interest rate risk. See Item 7a. Quantitative and Qualitative Disclosures About Market Risk.

Generally, in order to fund new loans, we need to borrow funds or sell loans. Since 2004, our leverage has primarily been provided through short-term credit facilities and the issuance of junior subordinated notes. Prior to that, our primary source of funds was structured loan transactions/securitizations. In structured loan transactions, we contributed loans to special purpose entities (SPEs) in exchange for cash and subordinate financial interests in those entities. At the current time, the market for commercial loan asset-backed securitizations is not available to us. Due to (1) the lack of a market for our type of securitization and the prospect that this market may never recover to its prior form or may return with costs or structures that we may not be able to accept and (2) limited availability of credit facilities, we continue to focus our lending activities on originating loans under the SBA 7(a) program.

RECENT ACCOUNTING CHANGES

The comparability of our financial statements was affected by two accounting rule changes, both effective January 1, 2010. The first accounting change was the consolidation of the assets and liabilities of our off-balance sheet securitization entities. Previously our interests in these entities were reflected as retained interests in transferred assets. The impact to our balance sheet was a gross up of approximately $20 million in assets and liabilities at January 1, 2010.

The second accounting change affected our accounting for secondary market loan sale transactions (the sale of the guaranteed portion of our SBA 7(a) loans to investors). The guaranteed portion of these loans may be sold (1) for a cash premium and a minimum 1% required servicing spread, (2) future servicing spread and no cash premium or (3) future servicing spread and a cash premium of 10%. Previously, all of these types of transactions were recorded as sales (*i.e.,* we recorded premium income). Effective January 1, 2010, we are required to permanently treat certain of the proceeds received from legally sold portions of loans (those loans sold solely for excess spread or those sold for a cash premium and excess spread) as secured borrowings for the life of the loan. For loans sold for a cash premium and excess spread, the cash premium is amortized as a reduction to interest expense over the life of the loan. Due to this accounting change, our premium income decreased from $1,343,000 during 2009 to $709,000 during 2010 while our sales of the guaranteed portion of SBA 7(a) loans increased to $28.4 million in 2010 from $25.0 million in 2009. Premiums collected during 2010 which have been deferred due to this accounting change and are reflected as a liability on our consolidated balance sheet were $1,439,000 at December 31, 2010.

LENDING ACTIVITIES

Overview

We are a national lender that primarily originates loans to small businesses, principally in the limited service hospitality industry. In addition to first liens on the real estate of the related business, our loans are typically personally guaranteed by the principals of the entities obligated on the loans.

We identify loan origination opportunities through personal contacts, internet referrals, attendance at trade shows and meetings, direct mailings, advertisements in trade publications and other marketing methods. We also generate loans through referrals from real estate and loan brokers, franchise representatives, existing borrowers, lawyers and accountants. Payments are sometimes made to non-affiliated individuals who assist in generating loan applications, with such payments generally not exceeding 1% of the principal amount of the originated loan.

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Limited Service Hospitality Industry

Our outstanding loans are generally collateralized by first liens on limited service hospitality properties and are typically for owner-operated facilities operating under national franchises, including, among others, Comfort Inn, Hampton Inn, Days Inn, Holiday Inn Express, Ramada and Best Western. We believe that franchise operations offer attractive lending opportunities because such businesses generally employ proven business concepts, have national reservation systems and advertising, consistent product quality, are screened and monitored by franchisors and generally have a higher rate of success when compared to other independently operated hospitality businesses.

Loan Originations and Underwriting

We believe that we successfully compete in certain sectors of the commercial real estate finance market, primarily the limited service hospitality sector, due to our diligent underwriting which is benefitted by our understanding of our borrowers businesses and our responsive customer service.

We consider traditional underwriting criteria such as:

The underlying cash flow of the tenant or owner-occupant;

The components, value and replacement cost of the borrower s collateral (primarily real estate);

The industry and competitive environment in which the borrower operates;

The financial strength of the guarantors;

Analysis of local market conditions;

The ease with which the collateral can be liquidated;

The existence of any secondary repayment sources;

Evaluation of the property operator; and

The existence of a franchise relationship.

Upon receipt of a completed loan application, our credit department conducts: (1) a detailed analysis of the potential loan, which typically includes a third-party licensed appraisal and a valuation by our credit department of the property that will collateralize the loan to ensure compliance with loan-to-value percentages, (2) a site inspection for real estate collateralized loans, (3) a review of the borrower s business experience, (4) a review of the borrower s credit history, and (5) an analysis of the borrower s debt-service-coverage, debt-to-equity and other applicable ratios. We also utilize local market economic information to the extent available.

We believe that our typical non-SBA 7(a) Program loan is distinguished from those of some of our competitors by the following characteristics:

Substantial down payments are required. We usually require an initial down payment of not less than 20% of the total cost of the project being financed. Our experience has shown that the likelihood of full repayment of a loan increases if the owner/operator is required to make an initial and substantial financial commitment to the project being financed.

Cash outs are typically not permitted. Generally, we will not make a loan in an amount greater than the lesser of 80% of either the replacement cost or current appraised value of the property which is collateral for the loan. For example, a hotel property may have been originally constructed for a cost of $2.0 million, with the owner/operator initially borrowing $1.6 million of that amount. At the time of the borrower s loan refinancing request, the property securing the loan is appraised at $4.0 million. Some of our competitors might loan from 70% to 90% or more of the new appraised value of the property and permit the owner/operator to receive a cash distribution from the proceeds. Generally, we would not permit this type of cash-out distribution.

The obligor is personally liable for the loan. We typically require the principals of the borrower to personally guarantee the loan.

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

		At December 31,					
		2010			2009		
		Loans Receivable, net		Weighted Average Interest Rate	Loans Receivable, net		Weighted Average Interest Rate
		Amount	%		Amount	%	
		(Dollars in thousands)					
Variable-rate	LIBOR	$ 125,606	53.9%	4.2%	$ 132,162	67.2%	4.0%
Fixed-rate		63,263	27.1%	9.1%	45,678	23.2%	9.0%
Variable-rate	prime	44,349	19.0%	5.7%	18,802	9.6%	5.4%
Total		$ 233,218	100.0%	5.8%	$ 196,642	100.0%	5.3%

Our variable-rate loans generally require monthly payments of principal and interest, reset on a quarterly basis, to amortize the principal over the remaining life of the loan. Fixed-rate loans generally require level monthly payments of principal and interest calculated to amortize the principal over the remaining life of the loan.

Due to a change in accounting rules, beginning January 1, 2010, (1) we now record 100% of SBA 7(a) loans sold as loans receivable on our balance sheet versus only the portion which is retained by us and (2) we consolidated the loans receivable of our previously off-balance sheet securitizations which were primarily fixed-rate loans. Since we are primarily originating SBA 7(a) loans, our percentage of variable-rate prime loans will continue to increase over time.

Industry Concentration

The distribution of our retained loan portfolio by industry was as follows at December 31, 2010:

	Number of Loans	Cost (1)	% of Total Cost
	(Dollars in thousands)		
Hotels and motels	222	$ 220,194	93.8%
Convenience stores/service stations	16	9,265	3.9%
Services	23	1,807	0.8%
Restaurants	28	928	0.4%
Retail	8	564	0.2%
Other	20	2,109	0.9%
	317	$ 234,867	100.0%

(1) Loan portfolio outstanding before loan loss reserves and deferred commitment fees.

Loan Portfolio Statistics

Information on our loans receivable (Retained Portfolio), loans which have been sold (either to the special purpose entities or secondary market sales of SBA 7(a) program loans) and on which we had retained interests (the Sold Loans) and our Retained Portfolio combined with our Sold Loans (the Aggregate Portfolio) was as follows:

	At December 31,					
	2010			2009		
	Aggregate Portfolio	Sold Loans (1)	Retained Portfolio	Aggregate Portfolio	Sold Loans	Retained Portfolio
	(Dollars in thousands)					
Portfolio outstanding (2)	$ 284,451	$ 49,584	$ 234,867	$ 273,687	$ 75,440	$ 198,247
Weighted average interest rate	5.7%	5.6%	5.8%	5.7%	6.7%	5.3%
Average yield (3)	5.8%	5.4%	5.8%	5.9%	6.8%	5.5%
Weighted average contractual maturity in years	15.5	18.2	14.9	14.9	14.6	15.0
Doubtful loans (4)	$ 912	$	$ 912	$ 3,239	$ 158	$ 3,081
Hospitality industry concentration	88.9%	66.0%	93.8%	88.4%	77.0%	92.7%
Texas concentration (5)	20.2%	23.4%	19.5%	22.6%	23.6%	22.2%

(1) Effective January 1, 2010, based on a change in accounting rules, we now consolidate the SPEs.

(2) Loan portfolio outstanding before loan loss reserves and deferred commitment fees.

(3) The calculation of average yield divides our interest income, prepayment fees and other loan related fees, adjusted by the provision for loan losses, by the weighted average outstanding portfolio.

(4) 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. We do not include the remaining outstanding principal of serviced loans pertaining to the government guaranteed portion of loans sold into the secondary market since the SBA has guaranteed payment of principal on these loans.

(5) No other concentrations greater than or equal to 10% existed at December 31, 2010 or 2009.

Loans Funded

The following table is a breakdown of loans funded during the years indicated:

	Years Ended December 31,				
	2010	2009	2008	2007	2006
			(In thousands)		
Commercial mortgage loans	$ 4,908	$ 2,425	$ 19,739	$ 28,416	$ 36,855
SBA 7(a) Program loans	33,532	28,010	10,971	2,888	8,537
SBA 504 program loans (1)			3,877	2,452	6,294
Total loans funded	$ 38,440	$ 30,435	$ 34,587	$ 33,756	$ 51,686

(1) *Represents second mortgages originated through the SBA 504 Program which have been repaid by certified development companies.*

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SBA Programs

General

We utilize programs established by the SBA to generate loan origination opportunities and provide us with a funding source as follows:

- We have an SBLC that originates loans through the SBA 7(a) program;
- We participate as a private lender in the SBA 504 Program which allows us to originate first mortgage loans with lower loan-to-value ratios;
- We have two licensed SBICs regulated under the Small Business Investment Act of 1958, as amended. Our SBICs use long-term funds provided by the SBA, together with their own capital, to provide long-term collateralized loans to eligible small businesses, as defined under SBA regulations.

Our regulated SBA subsidiaries are periodically examined and audited by the SBA to determine compliance with SBA regulations.

SBA 7(a) Program

Under the SBA 7(a) program, the SBA typically guarantees 75% of qualified loans over $150,000. While the eligibility requirements of the SBA 7(a) program vary by the industry of the borrower and other factors, the general eligibility requirements, as amended during 2010, are that: (1) gross sales of the borrower cannot exceed size standards set by the SBA (*i.e.,* $7.0 million for limited service hospitality properties), (2) liquid assets of the borrower and affiliates cannot exceed specified limits, and (3) the maximum aggregate SBA loan guarantees to a borrower cannot exceed $3.75 million. Maximum maturities for SBA 7(a) program loans are 25 years for real estate and between seven and 10 years for the purchase of machinery, furniture, fixtures and/or equipment. In order to operate as an SBLC, a licensee is required to maintain a minimum net worth (as defined by SBA regulations) of the greater of (1) 10% of its outstanding loans receivable and other investments or (2) $1.0 million, and is subject to certain other regulatory restrictions such as change in control provisions. See Item 1A. Risk Factors.

SBA 504 Program

The SBA 504 Program assists small businesses in obtaining subordinated, long-term financing by guaranteeing debentures available through certified development companies (CDCs) for the purpose of acquiring land, building, machinery and equipment and for modernizing, renovating or restoring existing facilities and sites. A typical finance structure for an SBA 504 Program project would include a first mortgage covering 50% of the project cost from a private lender, a second mortgage obtained from a CDC covering up to 40% of the project cost and a contribution of at least 10% of the project cost by the principals of the small businesses being assisted. We typically require at least a 20% contribution of the equity in a project by our borrowers. The SBA does not guarantee the first mortgage. Although the total sizes of projects utilizing the SBA 504 Program are unlimited, currently the maximum amount of subordinated debt in any individual project is generally $5.0 million (or $5.5 million for certain projects). Typical project costs range in size from $1.0 million to $6.0 million. Our SBA 504 Program has been inactive since the beginning of 2008 due to our limited liquidity.

SBIC Program

We originate loans to small businesses through our SBICs. According to SBA regulations, SBICs may make long-term loans to small businesses and invest in the equity securities of such businesses. Under present SBA regulations, eligible small businesses include those that have a net worth not exceeding $18 million and have average annual fully taxable net income not exceeding $6.0 million for the most recent two fiscal years. To the extent approved, an SBIC can issue debentures whose principal and interest is guaranteed to be paid to the debt holder in the event of non-payment by the SBIC. As a result, the debentures costs of funds are usually lower compared to alternative fixed-rate sources of funds available to us.

STRUCTURED LOAN TRANSACTIONS

While the securitization market is not currently a viable financing vehicle for us, prior to 2004, structured loan transactions were our primary method of obtaining funds for new loan originations. In structured loan transactions, we contributed loans to an SPE in exchange for a subordinated financial interest in that entity and obtained an opinion of counsel that the contribution of the loans to the SPE constituted a true sale of the loans. The SPE issued notes payable through a private placement to third parties and then distributed a portion of the notes payable proceeds to us. The notes payable are collateralized solely by the assets of the SPE. Since the SPEs met the definition of qualified SPEs (QSPEs), we accounted for the structured loan transactions as sales of our loans; and as a result, neither the loans contributed to the QSPE nor the notes payable issued by the QSPE were included in our consolidated financial statements. The terms of the notes payable issued by the QSPEs provide that the partners of these QSPEs are not liable for any payment on the notes. Accordingly, if the QSPEs fail to pay the principal or interest due on the notes, the sole recourse of the holders of the notes is against the assets of the QSPEs. We have no obligation to pay the notes, nor do the holders of the notes have any recourse against our assets. We service the loans pursuant to the transaction documents.

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When structured loan sale transactions were completed, our ownership interests in the QSPEs were accounted for as retained interests in transferred assets (Retained Interests) and recorded at the present value of the estimated future cash flows to be received from the QSPE. Effective January 1, 2010, due to a change in accounting rules, we now consolidate the assets and liabilities of the QSPEs.

All of our securitization transactions provide a clean-up call. A clean-up call is an option to repurchase the remaining transferred assets when the amount of the outstanding assets (or corresponding notes payable outstanding) falls to a level at which the cost of servicing those assets becomes burdensome.

TAX STATUS

PMC Commercial has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the Code). As a REIT, PMC Commercial is generally not subject to Federal income tax (including any applicable alternative minimum tax) to the extent that it distributes at least 90% of its REIT taxable income to shareholders. Certain of PMC Commercial s subsidiaries, including First Western and PMCIC, have elected to be treated as taxable REIT subsidiaries; thus, their earnings are subject to U.S. Federal income tax. To the extent PMC Commercial s taxable REIT subsidiaries retain their earnings and profits, these earnings and profits will be unavailable for distribution to our shareholders.

PMC Commercial may, however, be subject to certain Federal excise taxes and state and local taxes on its 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. REITs are subject to a number of organizational and operational requirements under the Code. See Item 1A. Risk Factors REIT Related Risks for additional tax status information.

EMPLOYEES

We employed 32 individuals including marketing professionals, investment professionals, operations professionals and administrative staff as of December 31, 2010. We have employment agreements with our executive officers. Our operations are conducted from our Dallas, Texas office. We believe the relationship with our employees is good.

COMPETITION

When originating loans we compete with other specialty commercial lenders, banks, broker dealers, other REITs, savings and loan associations, insurance companies and other entities that originate loans. Many of these competitors have greater financial and managerial resources than us, are able to provide services we are not able to provide (*i.e.,* depository services), and may be better able to withstand the impact of economic downturns.

Variable-rate lending: For our variable-rate loan products, we believe we compete effectively on the basis of interest rates, our long-term maturities and payment schedules, the quality of our service, our reputation as a lender, timely credit analysis and greater responsiveness to renewal and refinancing requests from borrowers.

Fixed-rate lending: In the current market, borrowers are looking predominately for fixed-rate loans; however, our ability to offer fixed-rate loans is constrained by our cost and availability of funds.

SECURITIES EXCHANGE ACT REPORTS

We file with or furnish to the Securities and Exchange Commission (SEC) in accordance with the Securities Exchange Act of 1934, as amended (the Exchange Act) our annual reports on Form 10-K, our quarterly reports on Form 10-Q and our current reports on Form 8-K. These reports are available free of charge on our website, www.pmctrust.com/investors, as soon as reasonably practicable after we electronically file the information with the SEC. We are providing the address to our internet site solely for the information of investors. We do not intend the address to be an active link or to otherwise incorporate the contents of the website into this report.

The SEC maintains an internet site, www.sec.gov, that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

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Item 1A. RISK FACTORS

Due to the complexity of the Company, a wide range of factors could materially affect our future developments and performance. In addition to the factors affecting specific business operations identified in connection with the description of these operations and the financial results of these operations described elsewhere in this report, management has identified the following important factors that could cause actual results to differ materially from those reflected in forward-looking statements or from our historical results. These factors, which are not all-inclusive, could have a material impact on our asset valuations, results of operations or financial condition and could also impair our ability to maintain dividend distributions at current or anticipated levels.

Investment Risks Lending Activities

Changes in economic conditions could have a continuing adverse effect on our profitability.

Turmoil in the financial markets adversely affects economic activity. This turmoil (including the effect of any perceived or actual economic recession) subjects our borrowers to financial stress which could impair their ability to satisfy their obligations to us. During periods of economic stress, delinquencies and losses may increase and losses may be substantial.

In addition, an increase in price levels generally, or in price levels in a particular sector such as the energy sector, could result in a shift in consumer demand away from limited service hospitality properties which collateralize the majority of our loans. A significant increase in gasoline prices within a short period of time could affect the limited service sector of the hospitality industry. A significant portion of the limited service hospitality loans collateralizing our loans are located on interstate highways. When gas prices sharply increase, occupancy rates for properties located on interstate highways may decrease. This may cause a reduction in revenue per available room. Any sustained increase in gasoline prices could materially and adversely affect the financial condition of our borrowers which could cause us to experience increased defaults.

Commercial mortgage loans expose us to a high degree of risk associated with investing in real estate.

The performance and value of our loans depends upon many factors beyond our control. Commercial real estate has experienced cyclical performance and significant fluctuations in the past that impacts the value of our real estate collateralized loans. The ultimate performance and value of our loans are subject to risks associated with the ownership and operation of the properties which collateralize our loans, including the property owner s ability to operate the property with sufficient cash flow to meet debt service requirements. The performance and value of the properties collateralizing our loans may be adversely affected by:

- Changes in national economic conditions;
- Changes in local real estate market conditions due to changes in national or local economic conditions or changes in local property market characteristics;
- The extent of the impact of the disruptions in the credit markets;
- The lack of demand for commercial real estate collateralized loans used in asset-backed securitizations which may be substantially reduced as a result of the disruptions in the credit markets;
- Competition from other properties;
- Changes in interest rates and the condition of the debt and equity capital markets;
- The ongoing need for capital improvements;
- Increases in real estate tax rates and other operating expenses (including utilities);
- A significant increase in gasoline prices in a short period of time;
- Adverse changes in governmental rules and fiscal policies; acts of God, including earthquakes, hurricanes and other natural disasters; acts of war or terrorism; or a decrease in the availability of or an increase in the cost of insurance;
- Adverse changes in zoning laws;
- The impact of environmental legislation and compliance with environmental laws; and,
- Other factors that are beyond our control or the control of the commercial property owners.

In the event that any of the properties underlying our loans experience any of the foregoing events or occurrences, the value of, and return on, such loans may be negatively impacted. Moreover, our profitability and the market price of our common shares may be negatively impacted.

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Payment defaults and other credit risks in our investment portfolio have increased, and may to continue to increase, which has caused, and may continue to cause, adverse effects on our cash flows, net income and ability to make distributions.

Recessionary economic conditions and adverse developments in the credit markets have led to business contraction, liquidity issues and other problems for many of the businesses we finance. As a result, payment defaults and other credit risks in our investment portfolio have substantially increased, and may continue to increase, which has caused, and may continue to cause, adverse effects on our cash flows, net income and ability to make distributions.

Changes to the facts and circumstances of the borrower and/or the physical condition of the collateral underlying the loan, the hospitality industry and the economy may require the establishment of significant additional loan loss reserves. 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.

Historically, we have not experienced significant losses for real estate secured loans due to our borrowers equity in their properties, the value of the underlying collateral, the cash flows from operations of the businesses and other factors such as having recourse to the guarantors. However, if the economy or the commercial real estate market does not improve, we could experience an increase in credit losses. In addition, due to the recently ended economic recession and the current economic environment, we believe that in general, our borrowers equity in their properties has eroded and may further erode which may result in an increase in foreclosure activity and credit losses.

We have increased, and may continue to increase, specific and general loan loss reserves due to current general business and economic conditions and increased credit and liquidity risks which have had, and may continue to have, an adverse effect on our financial performance. Our loan portfolio has been adversely affected by, and may continue to be adversely affected by, adverse economic developments affecting the business sectors in which our borrowers operate, primarily the limited service hospitality industry, reductions in the value of commercial real estate generally and the reduced availability of refinancing for commercial real estate investments as they mature. There can be no assurance that the loan loss reserves we establish in any particular reporting period will be sufficient or will not increase in a subsequent reporting period.

The commercial real estate loans we originate are subject to the risks of default and foreclosure which could result in losses to us.

The commercial real estate loans we originate are collateralized by income-producing properties (primarily limited service hospitality properties) and we are subject to risks of default and foreclosure. In the event of a default under a mortgage loan, we bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the unpaid principal balance of the mortgage loan, which could have a material adverse effect on our cash flows from operations. If a borrower defaults on one of our commercial real estate loans and the underlying property collateralizing the loan is insufficient to satisfy the outstanding balance of the loan, we may suffer a loss. In addition, during the foreclosure process we may incur costs related to the protection of our collateral including unpaid real estate taxes, legal fees, insurance and operating shortfalls to the extent the property is being operated by a court-appointed receiver.

Foreclosure and bankruptcy are complex and sometimes lengthy processes that are subject to Federal and state laws and regulations. An action to foreclose on a property is subject to many of the delays and expenses of other lawsuits if the defendant raises defenses or counterclaims. In the event of a default by a mortgagor, these restrictions, among other things, may impede our ability to foreclose on or sell the mortgaged property or to obtain proceeds sufficient to repay all amounts due to us on the mortgage loan. Borrowers have the option of seeking Federal bankruptcy protection which could delay the foreclosure process. In conjunction with the bankruptcy process, the terms of the loan agreements may be modified. Typically, delays in the foreclosure process will have a negative impact on our results of operations and/or financial condition due to direct and indirect costs incurred and possible deterioration of the value of the collateral.

Our ability to sell any properties we own as a result of foreclosure will be impacted by changes in economic and other conditions. Our ability to sell these properties and the prices we receive on their 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. If we are required to hold a property for an extended period of time or choose to operate the property, it could have a negative impact on our results of operations and/or financial condition due to direct and indirect costs incurred and possible deterioration of the value of the collateral resulting in impairment losses.

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We have specific risks associated with originating loans under the SBA 7(a) program.

We sell the guaranteed portion of our SBA 7(a) loans into the secondary market. These sales have resulted in our earning premium income and/or have created a stream of future servicing spread. There can be no assurance that we will be able to continue originating these loans, that a secondary market will exist or that we will continue to realize premiums upon the sale of the guaranteed portion of these loans. For a few months during late 2008 and early 2009 the secondary market for SBA 7(a) loans offered minimal loan premiums and we suspended loan sales. While premiums rebounded during 2010 there can be no assurance that premiums will remain at current levels.

Since we sell the guaranteed portion of our SBA 7(a) loans, we incur credit risk on the non-guaranteed portion of the loans. We share pro-rata with the SBA in any recoveries. In the event of default on an SBA loan, our pursuit of remedies against a borrower is subject to SBA approval. If the SBA establishes that a loss on an SBA guaranteed loan is attributable to significant technical deficiencies in the manner in which the loan was originated, funded or serviced by us, the SBA may seek recovery of the principal loss related to the deficiency from us. With respect to the guaranteed portion of SBA loans that have been sold, the SBA will first honor its guarantee and then seek compensation from us in the event that a loss is deemed to be attributable to technical deficiencies. There can be no assurance that we will not experience significant deficiencies with our underwriting of SBA loans which could have a material adverse affect on us through failure of the SBA to honor a guarantee or the costs to correct any deficiencies. Although the SBA has never declined to honor its guarantees with respect to SBA loans made by our SBA 7(a) subsidiary, no assurance can be given that the SBA would not attempt to do so in the future.

Curtailment of our ability to utilize the SBA 7(a) program could adversely affect our financial condition and results of operations.

We are dependent upon the Federal government to maintain the SBA 7(a) loan program. There can be no assurance that the program will be maintained or that loans will continue to be guaranteed at current levels. In addition, there can be no assurance that our SBA 7(a) lending subsidiary will be able to maintain its status as a Preferred Lender or that we can maintain our SBA 7(a) license.

If we cannot continue originating and selling government guaranteed loans, we would experience a decrease in future servicing spreads and no longer generate premium income. From time-to-time the SBA has reached its internal budgeted limits and ceased to guarantee loans for a stated period of time. In addition, the SBA may change its rules regarding loans or Congress may adopt legislation that would have the effect of discontinuing or changing loan programs.

Our profitability may be impacted by the volume of SBA 7(a) loan originations.

Our net income and ability to continue to pay dividends at current or anticipated levels is dependent upon the volume of our SBA 7(a) loan originations due to the ability to sell the government guaranteed portion of these loans. In originating SBA 7(a) loans, we compete with other SBA 7(a) lenders, specialty commercial lenders, banks, broker dealers, other REITs, savings and loan associations, insurance companies and other entities that originate loans, many of which have greater financial resources than us. Any unanticipated reduction in the volume of these loan originations could negatively affect us.

There are significant risks in lending to small businesses.

Our loans receivable consist primarily of loans to small, privately-owned businesses. There is no publicly available information about these businesses; therefore, we must rely on our own due diligence to obtain information in connection with our investment decisions. Our borrowers may not meet net income, cash flow and other coverage tests typically imposed by banks. A borrower s ability to repay its loan may be adversely impacted by numerous factors, including a downturn in its industry or other negative local or macro economic conditions. Deterioration in a borrower s financial condition and prospects may be accompanied by deterioration in the collateral for the loan. In addition, small businesses typically depend on the management talents and efforts of one person or a small group of people for their success. The loss of services of one or more of these persons could have an adverse impact on the operations of the small business. Small companies are typically more vulnerable to customer preferences, market conditions and economic downturns and often need additional capital to expand or compete. These factors may have an impact on the ultimate recovery of our loans receivable from such businesses. Loans to small businesses, therefore, involve a high degree of business and financial risk, which can result in substantial losses and accordingly should be considered speculative.

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We depend on the accuracy and completeness of information provided by potential borrowers and guarantors.

In deciding whether to extend credit or enter into transactions with potential borrowers and/or their guarantors, we rely on certain information furnished to us by or on behalf of potential borrowers and/or guarantors. We also rely on representations of potential borrowers and/or guarantors as to the accuracy and completeness of that information. Our financial condition and results of operations could be negatively impacted to the extent we rely on financial statements or other information that is materially misleading.

Longer term loans and our real estate owned (REO) may be illiquid and their value may decrease.

Our commercial real estate loans and real estate acquired through foreclosure are relatively illiquid investments. Therefore, we may be unable to vary our portfolio promptly in response to changing economic, financial and investment conditions. As a result, the fair market value of these investments may decrease in the future and losses may result.

There is typically no public market or established trading market for the loans we originate. The illiquid nature of our loans may adversely affect our ability to dispose of such loans at times when it may be advantageous or necessary for us to liquidate such investments.

Changes in interest rates could negatively affect lending operations, which could result in reduced earnings and dividends.

As a result of our current dependence on variable-rate loans, our interest income will be reduced during low interest rate environments. During any period that LIBOR or the prime rate decreases, interest income on our loans will decline.

Changes in interest rates do not have an immediate impact on the interest income of our fixed-rate loans. Our interest rate risk on our fixed-rate loans is primarily due 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 refinancings of fixed-rate loans at lower rates).

Our net income is dependent upon the spread between the rate at which we borrow funds and the rate at which we loan these funds. During periods of changing interest rates, interest rate mismatches could negatively impact our net income, dividend yield, and the market price of our common shares.

At the present time, we are primarily originating variable-rate loans and have certain debt which is long-term and at fixed interest rates. If the yield on loans originated with funds obtained from fixed-rate borrowings fails to cover the cost of such funds, our cash flow will be reduced.

Competition might prevent us from originating loans at favorable yields, which would harm our results of operations and our ability to continue paying dividends at current or anticipated levels.

Our net income depends on our ability to originate loans at favorable spreads, over our cost of funds. In originating loans, we compete with other SBA 7(a) lenders, specialty commercial lenders, banks, broker dealers, other REITs, savings and loan associations, insurance companies and other entities that originate loans, many of which have greater financial resources than us. As a result, we may not be able to originate sufficient loans at favorable spreads over our cost of funds, which would harm our results of operations and consequently, our ability to continue paying dividends at current or anticipated levels.

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Our operating results will depend, in part, on the effectiveness of our marketing programs.

In general, due to the highly competitive nature of our business, we must execute efficient and effective promotional and marketing programs. We may, from time to time, change our marketing strategies, including the timing or nature of promotional programs. The effectiveness of our marketing and promotion practices is important to our ability to locate potential borrowers and retain existing borrowers. If our marketing programs are not successful, our results of operations and financial condition may be adversely affected.

Liquidity and Capital Resources Risks

In general, in order for us to repay indebtedness on a timely basis, we may be required to dispose of assets when we would not otherwise do so and at prices which may be below the net book value of such assets. Dispositions of assets could have a material adverse effect on our financial condition and results of operations.

If an event of default occurs under our revolving credit facility (Revolver), the lender is permitted to accelerate repayment of the outstanding obligation.

The occurrence of an event of default permits the lender under our Revolver to accelerate repayment of all amounts due, to terminate commitments thereunder, and allows the mortgage loan collateral held as security for the Revolver to be liquidated by the lender to satisfy any balance outstanding and due pursuant to the Revolver.

The existence of an event of default restricts us from borrowing under our Revolver and from declaring dividends or other cash distributions to our shareholders. There can be no assurance that an event of default will not occur.

Our operating results could be negatively impacted by our inability to access certain financial markets.

We rely upon access to capital markets as a source of liquidity to satisfy our working capital needs, grow our business and invest in loans. Turmoil in the capital markets has constrained equity and debt capital available for investment in commercial real estate. Prolonged recent recessionary conditions, continued distress in the limited service hospitality industry and increased loan losses could further limit access to these markets and may restrict us from continuing our current business strategy or implementing new business strategies.

Our operating results could be negatively impacted by our inability to extend the maturity of, or replace, our Revolver on acceptable terms, if at all.

If we are unable to replace or extend our Revolver upon its maturity (December 31, 2011) or if the terms of the extension were cost prohibitive, we could be required to repay the outstanding balance which would become immediately due or may choose to accept terms which are significantly less favorable in terms of costs or restrictions than the current terms of our facility. Our investments are predominantly long-term; therefore, if the Revolver matures without an extension or replacement, we could be forced to liquidate or otherwise dispose of assets at a time we would not ordinarily do so and/or at prices which we may not believe are reasonable. In addition, if the Revolver is not extended or replaced, we would need an additional source of funds to originate loans and grow. Our results of operations, prospects and financial condition could be negatively impacted if the Revolver is not extended or is extended with a significant increase in rate, fees or restrictions.

Turmoil in financial markets could increase our cost of borrowing and impede access to or increase the cost of financing our operations or investments.

To the extent credit and equity markets continue to experience significant disruption, many businesses will be unable to obtain financing on acceptable terms, if at all. In addition, when equity markets experience rapid and wide fluctuations in value, credit availability could diminish or disappear. During periods of credit and equity market disruptions, our cost of borrowing may increase and it may be more difficult or impossible to obtain financing on acceptable terms.

The market demand for structured loan transactions may not return to previous levels which would negatively affect our earnings and the potential for growth.

Continued unavailability of the asset-backed securities market to us has had, and could continue to have, an adverse effect on our financial condition and results of operations. Our long-term ability to grow may depend on our ability to sell asset-backed securities through structured loan transactions. In the current economic market, the availability of funds has been diminished and/or has become non-existent or the spread charged for funds has increased. In addition, political or geopolitical events could impact the availability and cost of capital.

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A number of factors could impair our ability, or alter our decision, to complete a structured loan transaction. These factors include, but are not limited to:

- Investors in the type of asset-backed securities that we place are limited and may increase our cost of capital by widening the spreads (over a benchmark such as LIBOR or treasury rates) they require in order to begin purchasing these asset-backed securities again;
- A deterioration in the performance of our loans or the loans of our prior transactions (for example, higher than expected loan losses or delinquencies) may deter potential investors from purchasing our asset-backed securities assuming investor demand for our asset-backed securities returns;
- A deterioration in the operations or market perception of the limited service sector of the hospitality industry may deter potential investors from purchasing our asset-backed securities or lower the available rating from the rating agencies assuming investor demand for our asset-backed securities returns; and
- A change in the underlying criteria utilized by the rating agencies may cause transactions to receive lower ratings than previously issued thereby increasing the cost on our transactions.

Currently, a market for our type of securitization does not exist. Continued unavailability or an increased cost of this source of funds could have a material adverse effect on our financial condition and results of operations since working capital may not be available or available at acceptable spreads to fund future loan originations.

The market demand for secondary market sales may decline or be temporarily suspended.

The market for the sale of the government guaranteed portion of SBA 7(a) loans may diminish and/or the premiums, if any, achieved on selling loans into that market may be reduced which could have a material adverse effect on our ability to create availability under our Revolver and originate new loans. This market dislocation could be a result of decreased investor demand for asset-backed securities in general or loans to a particular industry and/or increased investor yield requirements.

Continuation of the unprecedented market volatility may have an impact on our access to capital markets.

The capital and credit markets have experienced volatility and disruption. The volatility and disruption reached unprecedented levels during 2008 including decreased liquidity to acquire the government guaranteed portion of loans which are typically sold into the secondary market. In addition, the capital markets tightened credit availability to companies without regard to their underlying financial strength. If recent levels of market disruption and volatility were to continue or deteoriorate, we may experience an adverse effect, which may be material, on our ability to access capital markets and on our financial condition and results of operations.

We use leverage to fund our capital needs which magnifies the effect of changing interest rates on our earnings.

We have borrowed funds and intend to borrow additional funds for our capital needs. Private lenders and the SBA have fixed dollar claims on our assets superior to the claims of the holders of our common shares. Leverage magnifies the effect that rising or falling interest rates have on our earnings. Any increase in the interest rate earned on investments in excess of the interest rate on the funds obtained from borrowings would cause our net income and earnings per share to increase more than they would without leverage, while any decrease in the interest rate earned by us on investments would cause net income and earnings per share to decline by a greater amount than they would without leverage. Leverage is thus generally considered a speculative investment technique.

Investment Risks General

We have concentrations of investments which may negatively impact our financial condition and results of operations.

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

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At December 31, 2010, 19.5% of our Retained Portfolio of loans and 20% of our Aggregate Portfolio of loans were collateralized by properties in Texas. No other state had a concentration of 10% or greater of our Retained Portfolio or Aggregate Portfolio at December 31, 2010. A decline in economic conditions in any state in which we have a concentration of investments could have a material adverse effect on our financial condition and results of operations.

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

We are subject to prepayment risk on our loans receivable which could result in losses or reduced earnings and negatively affect our cash available for distribution to shareholders.

We experience prepayments on our loans receivable. Assuming capital availability, during decreasing interest rate environments and when competition is greater, prepayments of our fixed-rate loans have generally been re-loaned or committed to be re-loaned at lower interest rates than the prepaid loans receivable. For prepayments on variable-rate loans, if the spread we charge over LIBOR or the prime rate were to decrease, the lower interest rates we would receive on these new loans receivable would have an adverse effect on our results of operations and, depending upon the rate of future prepayments, may further impact our results of operations.

Changes in our business strategy or restructuring of our business may increase our costs or otherwise affect the profitability of our business.

As changes in our business environment occur, we may need to adjust our business strategies to meet these changes or we may otherwise find it necessary to restructure our operations. In addition, external events such as changes in macro-economic conditions may impair the value of our assets. If these changes or events occur, we may incur costs to change our business strategy and may need to write-down the value of our assets. We may also need to invest in new businesses that have short-term returns that are negative or low and whose ultimate business prospects are uncertain. In any of these events, our costs may increase, we may have significant charges associated with the write-down of assets or return on new investments may be lower than prior to the change in strategy or restructuring.

Our Board of Trust Managers may change operating policies and strategies without shareholder approval or prior notice and such change could harm our business and results of operations and the value of our common shares.

Our Board of Trust Managers has the authority to modify or waive our current operating policies and strategies, including PMC Commercial s election to operate as a REIT, without prior notice and without shareholder approval. We cannot predict the effect any changes to our current operating policies and strategies would have on our business, operating results and value of our common shares; however, the effect could be adverse.

We may not be able to successfully integrate new investments, which could decrease our profitability.

Our future business and financial performance may depend, in part, on our ability to grow through successfully integrating new investments. We may incur significant costs in the evaluation of new investment opportunities. Successfully integrating new investments puts pressure on our marketing and management resources and we may fail to invest sufficient funds to make it successful. If we are not successful in the integration of new investments, our results of operations could be materially adversely affected, our revenues could decrease and our profitability could decline.

Operating Risks

The occurrence of further adverse developments in the mortgage finance and credit markets may affect our business.

The mortgage industry is under enormous pressure due to numerous economic and industry related factors. Many companies operating in the mortgage sector have failed and others are facing serious operating and financial challenges. At the same time, many mortgage securities have been downgraded and delinquencies and credit performance of mortgage loans have deteriorated. We face significant challenges due to these adverse conditions in pricing and financing our mortgage assets. There can be no assurance that these conditions will stabilize or that they will not worsen. These adverse changes in the mortgage finance and credit markets may eliminate or reduce the availability of, or increase the cost of, significant sources of funding for us.

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Economic slowdowns, negative political events and changes in the competitive environment have affected and could adversely affect future operating results.

Several factors impact the hospitality industry. Many of the businesses to which we have made, or will make, loans are susceptible to economic slowdowns or recessions. Generally, during economic downturns there may be reductions in business travel and consumers take fewer vacations. In addition, the environment for travel can be significantly affected by a variety of factors including adverse weather conditions or natural disasters, health concerns, international, political or military developments and terrorist attacks. If revenue for the limited service sector of the hospitality industry were to experience significant sustained reductions, the ability of our borrowers to meet their obligations could be impaired and loan losses could increase. Bankruptcies, recessions, or other political or geopolitical events could continue to negatively affect our borrowers. Our non-performing assets may increase during these periods. These conditions could lead to additional losses in our portfolio and a decrease in our interest income, net income and the value of our assets.

We believe the risks associated with our operations are more severe during periods of economic slowdown or recession. Declining real estate values may further reduce the level of new mortgage loan originations, since borrowers often use existing property value increases to support investment in additional properties.

Borrowers may also be less able to meet their debt service, property tax, insurance and/or franchise fee requirements if the commercial real estate market does not rebound. Furthermore, declining commercial real estate values significantly increase the likelihood that we will incur losses on our loans in the event of default because the value of our collateral may be insufficient to cover our exposure. Increased payment defaults, foreclosures and/or losses could adversely affect our results of operations, financial condition, liquidity, business prospects and our ability to make dividend distributions.

Many of our competitors have greater financial and managerial resources than us and are able to provide services that we are not able to provide (*i.e.,* depository services). As a result of these competitors size and diversified income resources, they may be better able to withstand the impact of economic downturns.

There may be significant fluctuations in our quarterly results which may adversely affect our share price.

Our quarterly operating results fluctuate based on a number of factors, including, among others:

- Interest rate changes;
- Expenses related to REO or assets currently in the foreclosure process;
- The amount of non-performing loans;
- The volume and timing of loan originations and prepayments of our loans receivable;
- Recognition of premium, if any, on secondary market loan sales;
- The recognition of gains or losses on investments;
- The level of competition in our markets; and
- General economic conditions, especially those which affect the hospitality industry.

As a result of the above factors, quarterly results should not be relied upon as being indicative of performance in future quarters.

Establishing loan loss reserves entails significant judgment and may materially impact our results of operations.

We evaluate our loans for possible impairment on a quarterly basis. Our impairment analysis includes general and specific loan loss reserves. The determination of whether significant doubt exists and whether a specific loan loss reserve is necessary requires judgment and consideration of the facts and circumstances existing at the evaluation date. Our evaluation of the possible establishment of a specific loan loss reserve is based on, among other things, a review of our historical loss experience, the financial strength of any guarantors, adverse circumstances that may affect the ability of the borrower to repay interest and/or principal and, to the extent the payment of the loan appears impaired, the estimated fair value of the collateral. The estimated fair value of the collateral is determined by management based on the appraised value, tax assessed value and/or cash flows. Additionally, further changes to the facts and circumstances of the individual borrowers, the limited service hospitality industry and the economy may require the establishment of additional loan loss reserves and the effect to our results of operations may be material. If our judgments underlying the establishment of our loan loss reserves are not correct, our results of operations may be materially impacted.

At December 31, 2010 and 2009, we had loan loss reserves of $1,609,000 and $1,257,000, respectively, including general loan loss reserves of $1,100,000 and $650,000, respectively. Our provision for loan losses (excluding reductions of loan losses) as a percentage of our weighted average outstanding loans receivable (excluding SBA 7(a) loans receivable, subject to secured borrowings) was 0.46% and 0.57% during 2010 and 2009, respectively. To the extent one or several of our loans experience significant operating difficulties and we are forced to liquidate the loans, future losses may be substantial.

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If we lower our dividend, the market value of our common shares may decline.

The level of our dividend is established by our Board of Trust Managers from time to time based on a variety of factors, including market conditions, actual and projected cash flows and REIT taxable income and maintenance of REIT status. Various factors could cause our Board of Trust Managers to decrease our dividend level, including continued credit market dislocations, terms of our Revolver covenants, additional borrower defaults resulting in a material reduction in our cash flows or material losses resulting from loan liquidations. If we lower our dividend, the market value of our common shares could be adversely affected.

We have risk and substantial expenses associated with holding and/or operating our REO.

Our REO is subject to a variety of risks including, but not limited to:

- We are dependent upon third-party managers to operate and manage our REO. As a REIT, PMC Commercial or its subsidiaries cannot directly operate hospitality properties;
- Our REO may be operated at a loss and such losses may be substantial;
- Our insurance coverage may not be sufficient to fully insure our businesses and assets from claims and/or liabilities, including environmental liabilities;
- We may be required to make significant capital improvements to maintain our REO;
- In conjunction with the operations of our REO, we are subject to numerous Federal and state laws and government regulations including environmental, occupational health and safety, state and local taxes and laws relating to access for disabled persons; and
- Under various laws and regulations, we may be considered liable for the costs of remediating or removing hazardous substances found on our property, regardless of whether we were responsible for its presence.

The ultimate costs may be material to our financial condition or results of operations.

We depend on our key personnel, and the loss of any of our key personnel could adversely affect our operations.

We depend on the diligence, experience and skill of our key personnel (executive officers) who provide management services for the selection, acquisition, structuring, monitoring and sale of our portfolio assets and the borrowings used to acquire these assets. The loss of any executive officer could harm our business, financial condition, cash flow and results of operations.

We operate in a highly regulated environment and subsequent changes could adversely affect our financial condition or results of operations.

As a company whose common shares are publicly traded, we are subject to the rules and regulations of the SEC. In addition, many of our operations are regulated by the SBA. Changes in laws that govern our entities may significantly affect our business. Laws and regulations may be changed from time to time, and the interpretations of the relevant laws and regulations are also subject to change. Any change in the laws or regulations governing our business could have a material impact on our financial condition or results of operations.

At any time, U.S. Federal income tax laws governing REITs or the administrative interpretations of those laws may be amended. Any of those new laws or interpretations thereof may take effect retroactively and could adversely affect our financial condition or results of operations. The tax rate on both dividends and long-term capital gains for most non-corporate taxpayers to 15% has been reduced through 2012. This reduced maximum tax rate generally does not apply to ordinary REIT dividends, which continue to be subject to tax at the higher tax rates applicable to ordinary income (a maximum rate of 35%). However, the 15% maximum tax rate does apply to certain REIT distributions. This legislation may cause shares in non-REIT corporations to be a more attractive investment to individual investors than shares in REITs and may adversely affect the market price of our common shares.

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REIT Related Risks

Failure to qualify as a REIT would subject PMC Commercial to U.S. Federal income tax.

If a company meets certain income and asset diversification and income distribution requirements under the Code, it can qualify as a REIT and be entitled to pass-through tax treatment. We would cease to qualify for pass-through tax treatment if we were unable to comply with these requirements. PMC Commercial is also subject to a non-deductible 4% excise tax (and, in certain cases, corporate level income tax) if we fail to make certain distributions. Failure to qualify as a REIT would subject us to Federal income tax as if we were an ordinary corporation, resulting in a substantial reduction in both our net assets and the amount of income available for distribution to our shareholders.

We believe that we have operated in a manner that allows us to qualify as a REIT under the Code and intend to continue to so operate. Although we believe that we are organized and operate as a REIT, no assurance can be given that we will continue to remain qualified as a REIT. Qualification as a REIT involves the application of technical and complex provisions of the Code for which there are limited judicial or administrative interpretations and involves the determination of various factual matters and circumstances not entirely within our control. In addition, no assurance can be given that new legislation, regulations, administrative interpretations or court decisions will not significantly change the tax laws with respect to qualification as a REIT or the Federal income tax consequences of such qualification.

In addition, compliance with the REIT qualification tests could restrict our ability to take advantage of attractive investment opportunities in non-qualifying assets, which would negatively affect the cash available for distribution to our shareholders.

If PMC Commercial fails to qualify as a REIT, we may, among other things:

- Not be allowed a deduction for distributions to our shareholders in computing our taxable income;
- Be subject to U.S. Federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates;
- Be subject to increased state and local taxes; and,
- Unless entitled to relief under certain statutory provisions, be disqualified from treatment as a REIT for the taxable year in which we lost our qualification and the four taxable years following the year during which we lost our qualification.

As a result of these factors, failure to qualify as a REIT could also impair our ability to expand our business and raise capital, substantially reduce the funds available for distribution to our shareholders and may reduce the market price of our common shares.

Ownership limitations associated with our REIT status may restrict change of control or business combination opportunities.

In order for PMC Commercial to qualify as a REIT, no more than 50% in value of our outstanding common shares may be owned, directly or indirectly, by five or fewer individuals during the last half of any calendar year. Individuals include natural persons, private foundations, some employee benefit plans and trusts, and some charitable trusts.

To preserve PMC Commercial s REIT status, our declaration of trust generally prohibits any shareholder from directly or indirectly owning more than 9.8% of any class or series of our outstanding common shares or preferred shares without specific waiver from our Board of Trust Managers. The ownership limitation could have the effect of discouraging a takeover or other transaction in which holders of our common shares might receive a premium for their shares over the then prevailing market price or which holders might believe to be otherwise in their best interests.

Failure to make required distributions to our shareholders would subject us to tax.

In order to qualify as a REIT, an entity generally must distribute to its shareholders, each taxable year, at least 90% of its taxable income, other than any net capital gain and excluding the non-distributed taxable income of taxable REIT subsidiaries. As a result, our shareholders receive periodic distributions from us. Such distributions are taxable as ordinary income to the extent that they are made out of current or accumulated earnings and profits. To the extent that a REIT satisfies the 90% distribution requirement, but distributes less than 100% of its taxable income, it will be subject to Federal corporate income tax on its undistributed income. In addition, the REIT will incur a 4% nondeductible excise tax on the amount, if any, by which its distributions in any calendar year are less than the sum of:

- 85% of its ordinary income for that year;
- 95% of its capital gain net income for that year; and
- 100% of its undistributed taxable income from prior years.

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We have paid out, and intend to continue to pay out, our REIT taxable income to shareholders in a manner intended to satisfy the 90% distribution requirement and to avoid Federal corporate income tax.

Our taxable income may substantially exceed our net income as determined based on generally accepted accounting principles (GAAP) because, for example, capital losses will be deducted in determining GAAP income, but may not be deductible in computing taxable income. In addition, we may invest in assets that generate taxable income in excess of economic income or in advance of the corresponding cash flow from the assets, referred to as excess non-cash income. Although some types of non-cash income are excluded in determining the 90% distribution requirement, we will incur Federal corporate income tax and the 4% excise tax with respect to any non-cash income items if we do not distribute those items on an annual basis. As a result of the foregoing, we may generate less cash flow than taxable income in a particular year. In that event, we may be required to use cash reserves, incur debt, or liquidate non-cash assets at rates or times that we regard as unfavorable in order to satisfy the distribution requirement and to avoid federal corporate income tax and the 4% excise tax in that year.

Our ownership of and relationship with our taxable REIT subsidiaries will be limited, and a failure to comply with the limits would jeopardize our REIT status and may result in the application of a 100% excise tax.

Subject to certain restrictions, a REIT may own up to 100% of the stock of one or more taxable REIT subsidiaries. A taxable REIT subsidiary may earn income that would not be qualifying income if earned directly by the parent REIT. Both the subsidiary and the REIT must jointly elect to treat the subsidiary as a taxable REIT subsidiary. A corporation of which a taxable REIT subsidiary directly or indirectly owns more than 35% of the voting power or value of the stock will automatically be treated as a taxable REIT subsidiary. Overall, as of December 31, 2010, no more than 25% of the value of a REIT s assets may consist of stock or securities of one or more taxable REIT subsidiaries. A taxable REIT subsidiary generally will pay income tax at regular corporate rates on any taxable income that it earns. In addition, the taxable REIT subsidiary rules limit the deductibility of interest paid or accrued by a taxable REIT subsidiary to its parent REIT to assure that the taxable REIT subsidiary is subject to an appropriate level of corporate taxation. The rules also impose a 100% excise tax on certain transactions between a taxable REIT subsidiary and its parent REIT that are not conducted on an arm s-length basis.

Our taxable REIT subsidiaries are subject to normal corporate income taxes. We continuously monitor the value of our investments in taxable REIT subsidiaries for the purpose of ensuring compliance with the rule that no more than 25% of the value of our assets may consist of taxable REIT subsidiary stock and securities (which is applied at the end of each calendar quarter). The aggregate value of our taxable REIT subsidiary stock and securities is less than 25% of the value of our total assets (including our taxable REIT subsidiary stock and securities) as of December 31, 2010. In addition, we will scrutinize all of our transactions with our taxable REIT subsidiaries for the purpose of ensuring that they are entered into on arm s-length terms in order to avoid incurring the 100% excise tax described above. There are no distribution requirements applicable to the taxable REIT subsidiaries and after-tax earnings may be retained. There can be no assurance, however, that we will be able to comply with the 25% limitation on ownership of taxable REIT subsidiary stock and securities on an ongoing basis so as to maintain REIT status or to avoid application of the 100% excise tax imposed on certain non-arm s-length transactions.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

We lease office space for our corporate headquarters in Dallas, Texas under an operating lease which expires in October 2011.

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Item 3. LEGAL PROCEEDINGS

We had significant outstanding claims against Arlington Hospitality, Inc. s and its subsidiary Arlington Inns, Inc. s (together Arlington) bankruptcy estates. Arlington objected to our claims and initiated a complaint in the bankruptcy seeking, among other things, return of certain payments Arlington made pursuant to the property leases and the master lease agreement.

While confident a substantial portion of our claims would have been allowed and the claims against us would have been disallowed, due to the exorbitant cost of defense coupled with the likelihood of reduced available assets in the debtors estates to pay claims, we executed an agreement with Arlington to settle our claims against Arlington and Arlington s claims against us. The settlement provides that Arlington will dismiss its claims seeking the return of certain payments made pursuant to the property leases and master lease agreement, and substantially reduces our claims against the Arlington estates. The settlement further provides for mutual releases among the parties. The Bankruptcy Court approved the settlement. Accordingly, there are no remaining assets or liabilities recorded in the accompanying consolidated financial statements related to this matter. However, the settlement will only become final upon the Bankruptcy Court s approval of Arlington s liquidation plan which was filed during the third quarter of 2007. Due to the complexity of the bankruptcy, we cannot estimate when, or if, the liquidation plan will be approved.

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 4. RESERVED

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PART II

Item 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common shares are currently traded on the NYSE Amex under the symbol PCC. The following table sets forth, for the periods indicated, the high and low sales prices as reported on the NYSE Amex and the regular dividends per share declared by us for each such period.

Quarter Ended	High	Low	Regular Dividends Per Share
December 31, 2010	$ 8.95	$ 8.10	$ 0.160
September 30, 2010	$ 9.19	$ 7.50	$ 0.160
June 30, 2010	$ 8.91	$ 7.25	$ 0.160
March 31, 2010	$ 8.00	$ 7.00	$ 0.160
December 31, 2009	$ 8.00	$ 7.02	$ 0.160
September 30, 2009	$ 7.70	$ 6.20	$ 0.160
June 30, 2009	$ 8.45	$ 5.35	$ 0.160
March 31, 2009	$ 8.46	$ 4.21	$ 0.225

On March 3, 2011, there were approximately 785 holders of record of our common shares, excluding stockholders whose shares were held by brokerage firms, depositories and other institutional firms in street name for their customers. The last reported sales price of our common shares on March 3, 2011 was $8.95.

Our shareholders are entitled to receive dividends when and as declared by our Board of Trust Managers (the Board). In determining dividend policy, our Board considers many factors including, but not limited to, actual and projected cash flows available for dividend distribution, expectations for future earnings, REIT taxable income and maintenance of REIT status, the economic environment, competition, our ability to obtain leverage and our loan portfolio performance. In order to maintain REIT status, PMC Commercial is required to pay out 90% of REIT taxable income. Consequently, the dividend rate on a quarterly basis will not necessarily correlate directly to any single factor such as REIT taxable income or earnings expectations.

Our Board maintained our quarterly dividend at $0.16 per share for the first quarter dividend to be paid in April 2011. We anticipate that the Board will adjust the dividend as needed, on a quarterly basis, thereafter.

We have certain covenants within our revolving credit facility 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. See Selected Financial Data in Item 6, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources in Item 7 and Financial Statements and Supplementary Data in Item 8 for additional information concerning dividends.

We have not had any sales of unregistered securities during the last three years.

See Item 12 in this Form 10-K for information regarding our equity compensation plans.

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Performance Graph

The following information in Item 5 is not deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 (Exchange Act) or to the liabilities of Section 18 of the Exchange Act, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act, except to the extent the Company specifically incorporates it by reference into such a filing.

The line graph below compares the percentage change in the cumulative total shareholder return on our common shares of beneficial interest with the cumulative total return of the Russell 2000 and our Peer Group which consists of all publicly traded mortgage REITs, mortgage-backed security REITs and specialty finance REITs listed on the NYSE, NYSE Amex and the NASDAQ on which coverage is provided by SNL Financial LP for the period from December 31, 2005 through December 31, 2010 assuming an investment of $100 on December 31, 2005 and the reinvestment of dividends. The share price performance shown on the graph is not necessarily indicative of future price performance.

			December 31,			
Index	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
PMC Commercial Trust	100.00	133.92	105.12	83.16	93.54	114.01
Russell 2000	100.00	118.37	116.51	77.15	98.11	124.46
PMC Commercial Trust Peer Group	100.00	142.35	114.28	75.09	95.35	118.59

Source: SNL Financial LC

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Item 6. SELECTED FINANCIAL DATA

The following is a summary of our Selected Financial Data as of and for the five years in the period ended December 31, 2010. The following data should be read in conjunction with our consolidated financial statements and the notes thereto and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this Form 10-K. The selected financial data presented below has been derived from our consolidated financial statements.

	Years Ended December 31,				
	2010	2009	2008	2007	2006
	(In thousands, except per share information)				
Total revenues (1)	$ 15,463	$ 16,267	$ 23,117	$ 27,295	$ 28,973
Total expenses (1)	$ 10,752	$ 10,377	$ 13,776	$ 14,717	$ 15,355
Income from continuing operations (1)	$ 4,842	$ 6,057	$ 9,022	$ 12,094	$ 13,532
Discontinued operations (2)	$ (545)	$ 704	$ 784	$ 1,041	$ 2,152
Net income	$ 4,297	$ 6,761	$ 9,806	$ 13,135	$ 15,684
Basic weighted average common shares outstanding	10,554	10,573	10,767	10,760	10,748
Basic and diluted earnings per common share:					
Income from continuing operations	$ 0.46	$ 0.57	$ 0.84	$ 1.12	$ 1.26
Net income	$ 0.41	$ 0.64	$ 0.91	$ 1.22	$ 1.46
Dividends declared, common	$ 6,756	$ 7,445	$ 10,908	$ 12,915	$ 13,975
Dividends per common share	$ 0.64	$ 0.705	$ 1.015	$ 1.20	$ 1.30

	At December 31,				
	2010 (4)	2009	2008	2007	2006
	(In thousands)				
Loans receivable, net (3)	$ 233,218	$ 196,642	$ 179,807	$ 165,969	$ 169,181
Retained Interests	$ 1,010	$ 12,527	$ 33,248	$ 48,616	$ 55,724
Total assets	$ 252,127	$ 228,243	$ 227,524	$ 231,420	$ 240,404
Debt	$ 92,969	$ 68,509	$ 61,814	$ 62,953	$ 68,509

(1) The decrease in total revenues and income from continuing operations is primarily due to declines in LIBOR. At December 31, 2010, 54% of our loans were based on LIBOR.

(2) We foreclosed on the underlying collateral of three hospitality properties during 2010 which are generating significant losses. We are currently marketing to sell these properties.

(3) Our loans receivable increased during 2009 primarily due to the consolidation of several previously off-balance sheet securitizations which reached their clean-up call option.

(4) Effective January 1, 2010, due to a change in accounting rules, we now consolidate the assets and liabilities of the QSPEs. In addition, effective January 1, 2010, due to a change in accounting rules, we are now required to permanently treat proceeds received from legally sold portions of loans pursuant to Secondary Market Loan

Sales (those sold for excess spread or those sold for a 10% cash premium and excess spread) as secured borrowings for the life of the loan.

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Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our Consolidated Financial Statements and the related notes that appear elsewhere in this document. For a more detailed description of the risks affecting our financial condition and results of operations, see Risk Factors in Item 1A of this Form 10-K.

Business Overview

We are primarily a commercial mortgage lender that originates loans to small businesses that are principally collateralized by first liens on the real estate of the related business. Our outstanding loans are predominantly (94% at December 31, 2010) to borrowers in the hospitality industry.

We are organized as a REIT. Our loan underwriting is consistent and, among other things, typically requires (1) significant equity investments by the borrower in the property, (2) personal guarantees from the borrower, (3) operating experience by the borrower and (4) evidence of adequate repayment ability. We do not originate any higher-risk loans such as option ARM products, junior lien mortgages, high loan-to-value ratio mortgages, interest only loans, subprime loans or loans with initial teaser rates. We also do not originate any residential loans.

Our business of originating loans is affected by general commercial real estate fundamentals and the overall economic environment. We have designed our strategy to be flexible so that we can adjust our loan activities in anticipation of, and in reaction to, changes in the commercial real estate capital and property markets and the overall economy as well as changes to the specific characteristics of the underlying real estate assets that serve as collateral for the majority of our investments.

As a result of the continued economic uncertainty for commercial mortgage lenders, we are focusing our origination efforts on SBA 7(a) loans which require less capital due to the ability to sell the government guaranteed portion of such loans. We utilize the SBA 7(a) program to originate small business loans, primarily secured by real estate, and then sell the government guaranteed portion to investors.

EXECUTIVE SUMMARY

General

We are a commercial finance company that specializes in lending to the limited service hospitality industry. In general, both the commercial finance and hospitality industries experienced turbulence during 2009 and 2010. We believe the economic environment is complicated and risky and will continue to present challenges to us and our industry.

We believe that our commercial lending business has strong long-term fundamentals. However, due to these economic conditions, we have experienced the following:

- Loan origination limitations due to availability of liquidity;
- Reduced operating margins due to lack of economies of scale;
- Limited access to capital, and if such capital is available, at increased costs;
- An increase in non-accrual loans;
- An increase in REO and foreclosure proceedings;
- An increase in the holding period related to REO with a corresponding increase in expenses related to these assets;
- An increase in loan loss reserves and asset impairments;
- An inability to engage in structured loan transactions; and

Reduced cash available for distribution to shareholders, particularly as our portfolio yield was reduced by lower variable interest rates, scheduled maturities, prepayments and non-performing loans.

We seek to position ourselves to be able to take advantage of opportunities once market conditions improve and to maximize shareholder value over time. To do this, we will continue to focus on:

- Paying dividends to our shareholders;
- Originating quality assets and earning interest and fees;
- Enhancing cash flows from our investment portfolio;
- Increasing our volume of SBA 7(a) loan originations;
- Repositioning and marketing of non-performing assets;
- Exploring alternative financing sources; and
- Exploring alternative strategic activities.

We believe that these are the appropriate steps to position us for long-term growth.

General Economic Environment

Commercial Real Estate and Lodging Industry

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

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

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

Liquidity

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

Banks and other lending institutions have tightened lending standards and restricted credit to long-term real estate lenders as they rebuilt their capital bases. The structured credit markets, including the asset-backed securities (ABS) markets, were severely curtailed. While delinquencies in the commercial real estate markets remained low during 2008, the lack of liquidity in ABS, commercial mortgage-backed securities (CMBS) and other commercial mortgage markets negatively impacted commercial real estate sales and financing activity during 2009 and 2010. While we believe these conditions are temporary and the commercial real estate market fundamentals will return over the long-term, we are unable to predict how long these conditions will continue and what long-term impact this will have on the market.

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A major part of our business plan was to originate loans and then sell those loans through privately-placed structured loan transactions while retaining residual interests in the loans sold by retaining a subordinate financial interest. This was successful and allowed us to grow our portfolio of serviced loans to approximately $500 million during 2004. While we believe that a portion of our retained portfolio of loans could be used as collateral for a securitization, a market for our type of securitization may not be available at terms which are acceptable to us in the future.

We currently are targeting 2011 SBA 7(a) loan origination volume of between $40 million and $50 million. We anticipate net funding needs for these originations to be between $8 million and $11 million during 2011 after sale of the guaranteed portion of the loans. Our current credit facility is anticipated to be sufficient to allow us to fund our anticipated loan originations.

Lodging Industry Trends

The lodging industry experienced declining demand over the past few years. With the onset of the recession, all forms of travel accommodations experienced revenue decreases as consumer spending dropped and revenue per available room (RevPAR) reduced by 13.7% during the three year period ended December 31, 2010 according to statistics compiled by Smith Travel Research (STR). Part of the reduction in RevPAR was caused by an increase in hotel room supply during that period.

Lodging demand in the United States generally appears to correlate to changes in U.S. GDP. The hospitality industry including the limited service hospitality segment experienced reduced RevPAR, occupancy and average daily room rates (ADRs). Leading lodging industry analysts, including PricewaterhouseCoopers LLP, have noted the following:

- Economic growth is expected to slowly accelerate during 2011;
- Occupancy levels and average daily room rates are expected to increase during 2011 due to increasing demand; and
- RevPAR is expected to increase during 2011.

We are hopeful that the expectation of economic growth, due primarily to an anticipated increase in consumer spending and an anticipated sharp increase in business spending, will benefit the recovery of the hospitality industry. Researchers from STR anticipate that the current economic recovery and suppressed construction activity for new hotels will support a 7.4% increase in RevPAR during 2011.

While occupancy levels, average daily room rates and RevPAR are expected to increase during 2011; they are not expected to reach levels attained during 2007.

Strategic Alternatives

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

SBA 7(a) Program and Regulatory Environment

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

Commencing in February 2009, legislative provisions were passed which provided the SBA with temporary funding to eliminate fees on SBA 7(a) loans and provided increased SBA guarantee percentages on SBA 7(a) loans for up to 90% on certain loans. In addition, legislation was passed in September 2010 that contained provisions to allow the SBA to support larger loans and provide more financing options to a larger segment of small businesses including permanently increasing the 7(a) loan limit from $2 million to $5 million.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Act), passed in July 2010, provides new regulations and oversight of the financial services industry. While all provisions of the Act have not been finalized for implementation, we do not believe the Act will have a material impact on us.

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Secondary Market Loan Sales

General

During 2010, we sold $28.4 million of the guaranteed portion of SBA 7(a) Program loans. Loans were sold for (1) cash premiums and 100 basis points (1%) (the minimum spread required to be retained pursuant to SBA regulations) as the servicing spread on the sold portion of the loan, (2) future servicing spreads averaging 438 basis points (including the 100 basis points required to be retained) and no cash premiums, or (3) future servicing spreads averaging 168 basis points (including the 100 basis points required to be retained) and cash premiums of 10% (*i.e.,* hybrid loan sales). As a result of the new accounting rules regarding sale treatment for selling the guaranteed portion of our SBA 7(a) loans, during 2010, no gain was recognized at the time of sale for any of these loans.

Even though recognition of premium income is deferred as a result, management believes the best economic opportunity was to forego the up-front cash premiums in lieu of significant future servicing spread or to sell the loan for an up-front cash premium and lesser future servicing spread (than if the loan was sold solely for future servicing spread). On these loan sales, we receive a spread between the interest rate due to us from our borrowers and the rate payable to the purchasers of the guaranteed portions of the loans.

Cash Premium Loan Sales

For the 2010 loan sales where we received cash premiums and the minimum servicing spread of 1%, sale treatment will occur after all contingencies have been satisfied which should occur 90 to 120 days after the proceeds were received. We recorded $709,000 in gains on sale during 2010 relating to these loans sales (reflected as premium income included in other income in our consolidated income statements). Once gains are recorded, there is no significant difference between the old and new accounting rules for these sales. During February 2011, the SBA rescinded the contingency period; therefore, there will be no deferral of gain recognition on these sales after that date.

Servicing Spread Loan Sales

For tax purposes, since all Secondary Market Loan Sales are legal sales, we are required to record gains based on present value cash flow techniques consistent with the book accounting treatment utilized until January 1, 2010. Consequently, for tax purposes, we had gains of $681,000 during 2010 related to sales of loans solely for excess spread but will not recognize any gains for book purposes. Instead, we will record book income as we receive the average 438 basis point spread as we service the sold portion of the loan. There can be no assurance that the loans will remain outstanding until maturity. However, management believes that the discounted present value of the future servicing spreads will be greater than the cash premiums we would have received since we expect the income received on the sold portion over the life of the loans (and the future incremental cash flows) to exceed the foregone cash premiums.

Hybrid Loan Sales

For tax purposes, we had gains of $1,758,000 during 2010 related to hybrid loan sales but will not recognize gain for book purposes. For book purposes, the cash premium is amortized as a reduction of interest expense over the life of the loan using the interest method. We record income as we receive the average 168 basis point excess spread as we service the sold portion of the loan. Management believes that the discounted present value of the future servicing spreads will be greater than the foregone cash premiums we would have received since we expect the income received on the sold portion over the life of the loans (and the future incremental cash flows) to exceed the foregone cash premiums.

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In summary, our Secondary Market Loan Sales were as follows during 2010:

Type of Sale	Principal Sold	Premium Received	Gain Upon Sale Book	Gain Upon Sale Tax
Cash premium	$ 7,736,000	$ 758,000	$ 709,000	$ 817,000
Servicing spread	6,188,000			681,000
Hybrid	14,521,000	1,452,000		1,758,000
	$ 28,445,000	$ 2,210,000	$ 709,000	$ 3,256,000

The following highlights the difference between selling a loan for cash premium versus selling a loan for future excess spread versus selling a loan for a cash premium and future excess spread:

	Cash Premium	Servicing Spread	Hybrid
Loan amount	$ 1,000,000	$ 1,000,000	$ 1,000,000
Guaranteed portion of total loan	90.00%	90.00%	90.00%
Guaranteed loan amount	$ 900,000	$ 900,000	$ 900,000
Rate paid by borrower	6.00%	6.00%	6.00%
Rate paid to purchaser	5.00%	1.75	