PMC COMMERCIAL TRUST /TX
Form 10-K
March 15, 2007

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

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2006

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	American Stock Exchange

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

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 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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Common Shares of Beneficial Interest on June 30, 2006 as reported on the American Stock Exchange, was approximately $121 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 2, 2007, the Registrant had outstanding 10,753,803 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.

PMC COMMERCIAL TRUST
Form 10-K
For the Year Ended December 31, 2006

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Amendment No. 2 to Credit and Security Agreement
Subsidiaries of the Registrant
Consent of PricewaterhouseCoopers LLP
Section 302 Officer Certification - Chief Executive Officer
Section 302 Officer Certification - Chief Financial Officer
Section 906 Officer Certification - Chief Executive Officer
Section 906 Officer Certification - Chief Financial Officer

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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.

PART I

Item 1. BUSINESS

INTRODUCTION

PMC Commercial Trust (PMC Commercial and together with its wholly-owned subsidiaries, the Company, our or we) is a real estate investment trust (REIT) that primarily originates loans to small businesses collateralized by first liens on the real estate of the related business. Our loans are primarily to borrowers in the limited service hospitality industry. We also originate loans for commercial real estate primarily in the service, retail, multi-family and manufacturing industries. In addition, our investments include the ownership of commercial properties in the hospitality industry. 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. We pay dividends from the cash flow generated from operations. Our common shares are traded on the American Stock Exchange under the symbol PCC.

Our mission is to derive income primarily from the origination of real estate collateralized loans and from ownership in income producing real estate. Through conservative underwriting and exceptional service, we strive to provide our shareholders with the highest dividend, consistent with the focus on preservation of investment capital.

We generate revenue primarily from the yield and other fee income earned on our investments. Our operations are centralized in Dallas, Texas and include originating, servicing and selling commercial loans and to a lesser extent, property ownership. During the years ended December 31, 2006 and 2005, our total revenues were approximately $30.7 million and $25.1 million, respectively, and our net income was approximately $15.7 million and $11.3 million, respectively. See Item 8. Consolidated Financial Statements and Supplementary Data for additional financial information.

In addition to loans originated by PMC Commercial, we also originate loans through our subsidiaries. Our wholly-owned lending subsidiaries are: 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) Program). PMCIC and Western Financial are small business investment companies (SBICs). These subsidiaries were acquired in the merger with PMC Capital, Inc. (PMC Capital), our affiliate through common management, on February 29, 2004.

First Western is currently a Preferred Lender nationwide, as designated by the SBA, and originates, sells and services small business loans throughout the continental United States. 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%) is

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guaranteed as to payment of principal and interest by the SBA. A market exists for the sale of the guaranteed portion of First Western s loans and we receive cash premiums at the time of sale that approximate up to 10% of the principal amount of the loan sold. To the extent we are able to increase our volume of loans originated by our SBLC, there should be a corresponding increase in premiums received. In addition, due to the existence of the SBA guarantee, we are able to originate loans that would not typically meet our underwriting criteria due to the profitability of the loan including the premium received. See Lending Activities SBA Programs.

Our ability to generate interest income, as well as other loan related fees, is dependent upon 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 income earned varies based on the volume of loans funded, the timing and amount of structured loan transactions, the volume of loans which prepay and the resultant applicable prepayment fees, if any, the mix of loans (construction versus non-construction), the interest rate on loans originated and the general level of interest rates.

Generally, in order to fund new loans, we need to borrow funds or sell loans. From 1996 to 2003, our primary source of funds was structured loan transactions. In a structured loan transaction, we contribute loans receivable to a special purpose entity (SPE) in exchange for cash and a subordinate financial interest in that entity. If the SPE meets the definition of a qualifying special purpose entity (QSPE), we account for the transaction as a sale of our loans receivable; and as a result, neither the loans receivable contributed to the QSPE nor the notes payable issued by the QSPE are included in our consolidated financial statements. See Structured Loan Transactions. Since the completion of our last securitization in October 2003, our working capital has been provided through credit facilities and the issuance of junior subordinated notes in March 2005.

We have historically operated in two identifiable reportable segments: (1) the lending division, which originates loans to small businesses primarily in the hospitality industry and (2) the property division, which owns and operates certain of our hotel properties. As a result of sales of a majority of our hotel properties, at December 31, 2006, the lending division comprised approximately 98% of our total assets. See detailed financial information regarding our segments in Item 8. Consolidated Financial Statements and Supplementary Data.

LENDING ACTIVITIES

Overview

Our lending division originates loans to small businesses, primarily in the hospitality industry. For the year ended December 31, 2006, total revenues and income from continuing operations of our lending division were approximately $28.5 million (approximately 93% of our total revenues) and $15.0 million, respectively. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Summary.

We are a national lender that primarily originates small business loans in the limited service sector of the hospitality industry. In addition to first liens on real estate of the related business, our loans are generally 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, correspondence with local chambers of commerce, direct mailings, advertisements in trade publications and other marketing methods. We also generate loans through referrals from lawyers, accountants, real estate and loan brokers and existing borrowers. Payments are often 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.

Limited Service Hospitality Industry

Our loans are generally collateralized by first liens on limited service hospitality properties and are typically made for owner-operated facilities operating under national franchises. We believe that franchise operations offer attractive lending opportunities because such businesses generally employ proven business concepts, have national reservation systems, have 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.

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Lodging demand in the United States appears to correlate to changes in the United States Gross Domestic Product (U.S. GDP), with typically a two to three quarter lag. Given the relatively strong U.S. GDP growth over the past several years, continued improvement in 2007 lodging demand has been predicted by industry analysts. Such improvement will be dependent upon several factors including: the strength of the economy, the correlation of hotel demand to new hotel supply and the impact of global or domestic events on travel and the hotel industry. Leading industry analysts, including PricewaterhouseCoopers LLP, have published reports that predict the industry s results will continue to improve in 2007.

Loan Originations and Underwriting

We originate mortgage loans to small businesses primarily collateralized by commercial real estate. We believe that we successfully compete in certain sectors of the commercial real estate finance market due to our understanding of our borrowers businesses, the flexible loan terms that we offer and our responsive customer service. Our approach to assessing new commercial mortgage loans requires an analysis of the property operator, the replacement cost of the collateral, its liquidation value and an analysis of local market conditions.

We consider the underlying cash flow of the tenant or owner-occupant as well as more traditional real estate underwriting criteria such as:

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

The ease with which the collateral can be liquidated;

The industry and competitive environment in which the borrower operates;

The financial strength of the guarantors;

The existence of any secondary repayment sources; 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 an 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. All appraisals are performed by an approved, licensed third party appraiser and based on the market value, replacement cost and cash flow value approaches. We utilize nationwide independent appraisal firms and 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 value of the property which is collateral for the loan at the time of such loan. 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 property which is collateral for the loan.

Cash outs are typically not permitted. Generally, we will not make a loan in an amount greater than the lesser of either the replacement cost of the property which is collateral for the loan or the 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 $2,000,000, with the owner/operator borrowing $1,600,000 of that amount. At the time of the borrower s loan refinancing request, the property securing the loan is appraised at $4,000,000. 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 generally require the principals of the borrower to personally guarantee the loan.

We are currently originating primarily variable-rate loans. Our variable-rate loans are based on (1) LIBOR or (2) the prime rate (primarily related to our SBA 7(a) Program). Many of our competitors are presently pricing fixed-rate loans based on a spread over the interest rate swap market. We are currently offering fixed-rate loans to borrowers at approximately 3.5% over the 5-year treasury rate and anticipate the maximum amount of fixed-rate loans we will originate under this program to be approximately $30.0 million. We are continually evaluating the feasibility of utilizing the swap market or interest rate caps to lock in a fixed cost of funds so that we can offer a more competitive fixed-rate product. Based on the current interest rate environment, these alternative sources of pricing are not viable for us since there is significant exposure of loss of capital in the event of loan liquidation or

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prepayment. To the extent we are able to use the swap market or interest rate caps to lock in a fixed cost of funds, we believe our originations of fixed-rate loans would increase. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Current Operating Overview and Economic Factors Lending Division.

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

	At December 31,					
	2006			2005		
	Loans Receivable, net		Weighted Average Interest	Loans Receivable, net		Weighted Average Interest
	Amount	%	Rate	Amount	%	Rate
	(Dollars in thousands)					
Variable-rate LIBOR	$ 127,931	75.6%	9.4%	$ 120,645	76.6%	8.3%
Fixed-rate	23,419	13.9%	8.8%	18,651	11.8%	9.4%
Variable rate prime	17,831	10.5%	10.2%	18,278	11.6%	8.7%
Total	$ 169,181	100.0%	9.4%	$ 157,574	100.0%	8.5%

Our variable-rate loans receivable 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 receivable generally require level monthly payments of principal and interest calculated to amortize the principal over the remaining life of the loan.

Loan Activity

The following table details our loan activity for the years indicated:

	Years Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands)				
Loans receivable, net beginning of year	$ 157,574	$ 128,234	$ 50,534	$ 71,992	$ 78,486
Loans originated	71,530	58,852	53,659	31,320	32,776
Loans acquired in the merger (1)			55,144		
Principal collections (2)	(47,240)	(13,826)	(23,196)	(5,655)	(11,637)
Repayments of SBA 504 program loans (3)	(2,342)	(2,180)	(1,621)	(1,963)	(631)
Loans sold (4)	(6,373)	(7,785)	(6,222)		
Loans transferred to AAL (5)	(3,730)	(5,657)	(2,115)		
Structured loan sales (6)				(45,456)	(27,286)
Loan deemed to be repurchased from QSPE (7)			2,126		
Other adjustments (8)	(238)	(64)	(75)	296	284
Loans receivable, net end of year	$ 169,181	$ 157,574	$ 128,234	$ 50,534	$ 71,992

(1) Represents the estimated fair

value of loans acquired from PMC Capital in the merger.

(2) *Represents scheduled principal payments, maturities and prepayments.*

(3) *Represents second mortgages obtained through the SBA 504 Program which are repaid by certified development companies.*

(4) *Represents the guaranteed portion of SBA 7(a) Program loans sold through private placements to either dealers in government guaranteed loans or institutional investors.*

(5) *Loans receivable on which the collateral was foreclosed upon and the assets were subsequently classified as assets acquired in liquidation (AAL).*

(6) Loans receivable which were sold as part of structured loan sale transactions.

(7) Represents a loan receivable at its estimated fair value deemed to be repurchased from a QSPEs as a result of a delinquent loan on which we initiated foreclosure on the underlying collateral and were contractually allowed to repurchase from the QSPE.

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

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Quarterly Loan Originations

The following table is a breakdown of loans originated on a quarterly basis during the years indicated:

	Years Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands)				
First Quarter	$ 17,630	$ 8,251	$ 6,609	$ 9,009	$ 6,346
Second Quarter	13,536	11,236	17,255	12,103	6,506
Third Quarter	5,710	15,010	14,998	5,557	10,044
Fourth Quarter	34,654	24,355	14,797	4,651	9,880
Total	$ 71,530	$ 58,852	$ 53,659	$ 31,320	$ 32,776

Loan Portfolio Statistics

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

	At December 31,					
	2006			2005		
	Aggregate Portfolio	Sold Loans (1)	Loans Receivable	Aggregate Portfolio	Sold Loans (1)	Loans Receivable
	(Dollars in thousands)					
Portfolio outstanding (2)	$ 397,567	$ 227,874	$ 169,693	$ 447,220	$ 288,652	$ 158,568
Weighted average interest rate	9.5%	9.6%	9.4%	8.8%	8.9%	8.5%
Annualized average yield (3)	10.5%	10.1%	11.0%	9.4%	9.6%	8.9%
Weighted average contractual maturity (in years)	15.0	13.6	16.7	15.3	14.6	16.8
Impaired loans (4)	$ 5,415	$ 3,496	$ 1,919	$ 12,780	$ 5,558	$ 7,222
Hospitality industry concentration %	91.7%	90.0%	93.9%	91.5%	89.6%	94.9%
Texas concentration % (5)	24.7%	26.5%	22.3%	24.0%	28.9%	14.9%

(1) *In addition to loans of the QSPEs, includes secondary market sales of SBA 7(a) Program loans.*

(2) *Loan portfolio outstanding*

before loan loss reserves and deferred commitment fees.

(3) *The calculation of annualized 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) *Includes loans on which the collection of the balance of principal and interest is considered unlikely and on which the fair value of the collateral is less than the remaining unamortized principal balance (Problem Loans) and the principal balance of loans which have been identified as potential problem loans for which it is expected that a full recovery of the principal balance will be*

received through either collection efforts or liquidation of collateral (Special Mention Loans, and together with Problem Loans, Impaired Loans). We do not include the remaining outstanding principal of serviced loans pertaining to the guaranteed portion of loans sold into the secondary market since the SBA has guaranteed payment of principal on these loans.

(5) *We also had a concentration of approximately 10.3% of loans receivable in Ohio at December 31, 2006. No other concentrations greater than or equal to 10% existed at December 31, 2006 for our loans receivable, Sold Loans or Aggregate Portfolio.*

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Industry Concentration

The distribution of our loan portfolio by industry was as follows at December 31, 2006:

	Loans Receivable			Aggregate Portfolio		
	Number of Loans	Cost (1)	% of Total Cost	Number of Loans	Cost (1)	% of Total Cost
			(Dollars in thousands)			
Hotels and motels	161	$ 159,417	93.9%	311	$ 364,530	91.7%
Gasoline/service stations	16	6,638	3.9%	23	14,051	3.5%
Restaurants	15	1,219	0.7%	15	2,894	0.7%
Apartments/RV Parks	3	771	0.5%	7	4,532	1.1%
Retail, other	9	556	0.3%	9	1,601	0.4%
Services	10	364	0.2%	18	3,486	0.9%
Other	13	728	0.5%	16	6,473	1.7%
	227	$ 169,693	100.0%	399	$ 397,567	100.0%

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

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 s 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 (SBIA). 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 with such guarantees to an individual not exceeding $1.5 million. While the eligibility requirements of the SBA 7(a) Program vary by the industry of the borrower and other factors, the general eligibility requirements are that: (1) gross sales of the borrower cannot exceed $6.5 million, (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 $1.5 million. Maximum maturities for SBA 7(a) Program loans are 25 years for real estate and between seven and 15 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 the outstanding loans receivable and other investments or (2) $1.0 million, as well as 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 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 through the SBA 504 Program 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 $1.5 million (or $2 million for certain projects). Typical project costs range in size from $1 million to $6 million.

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 businesses that have a net worth not exceeding $18 million and have average annual fully taxable net income not exceeding $6 million for the most recent two fiscal years. 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.

PROPERTY DIVISION

We originally purchased a total of 30 properties, operated as Amerihost Inns, during 1998 and 1999. These properties were part of a sale and leaseback transaction with Arlington Hospitality, Inc. (AHI) whereby we purchased the properties from AHI and then leased the properties to a wholly-owned subsidiary of AHI, Arlington Inns, Inc. (AII and together with AHI, Arlington). We concurrently entered into a Master Lease Agreement with AHI and AII covering all the properties and entered into a guaranty agreement with AHI whereby AHI guaranteed all obligations of AII under the individual property lease agreements. AII filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code (Chapter 11) on June 22, 2005. AHI filed for bankruptcy protection under Chapter 11 on August 31, 2005.

We commenced selling properties during 2000, and we began 2006 with 13 owned Amerihost Inns and two Amerihost Inns acquired in liquidation of loans for a total of 15 properties. On January 13, 2006, AII rejected the leases and turned over property operations to us. We sold 12 of these properties during the first half of 2006. Our property division owns and operates our limited service hospitality properties through third party management companies. For the year ended December 31, 2006, total revenues and loss from continuing operations of our property division were approximately $2.2 million (approximately 7% of our total revenues) and $1.3 million, respectively.

At December 31, 2006, two of the three limited service hospitality properties that we own were included in our consolidated financial statements. We leased one of our three remaining hotel properties during the third quarter of 2006 and as a result of the lease structure, have deconsolidated the ownership and operations of the property. We are currently marketing to lease the remaining two properties. As a REIT, we cannot directly operate hotel properties; therefore, the properties are being operated by third party management companies.

STRUCTURED LOAN TRANSACTIONS

General

Structured loan transactions have historically been our primary method of obtaining funds for new loan originations. In a structured loan transaction, we contribute loans receivable to an SPE in exchange for a subordinate financial interest in that entity and obtain an opinion of counsel that the contribution of the loans receivable to the SPE constitutes a true sale of the loans receivable. The SPE issues notes payable (usually through a private placement) to third parties and then distributes a portion of the notes payable proceeds to us. The notes payable are collateralized solely by the assets of the SPE. If the SPE meets the definition of a QSPE, we account for the structured loan transaction as a sale of our loans receivable; and as a result, neither the loans receivable contributed to the QSPE nor the notes payable issued by the QSPE are 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 are the servicer of the loans pursuant to the transaction documents and are paid a fee of 30 basis points per year based on the principal outstanding.

When a structured loan sale transaction is completed our ownership interests in the QSPEs are 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. The difference between (1) the carrying value of the loans receivable sold and (2) the sum of (a) the cash received and (b) the relative fair value of our Retained Interests, constitutes the gain or loss on sale. Gains or losses on these sales may represent a material portion of our net income in the period in which the transactions occur.

All of our securitization transactions provide a clean-up call. A clean-up call is an option allowed by the transaction documents to repurchase the 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. The clean-up call option regarding a loan in a QSPE or SPE is exercised by the party that contributed the loan to the QSPE or SPE.

Since we have historically relied on structured loan transactions as our primary source of operating capital to fund new loan originations, any adverse changes in our ability to complete this type of transaction, including any negative impact on the asset-backed securities market for the type of product we generate, could have a detrimental effect on our ability to generate funds to originate loans. See Item 1A Risk Factors.

Structured Loan Sale Transactions

General

As of December 31, 2006, the QSPEs consisted of:

- PMC Capital, L.P. 1998-1 (the 1998 Partnership) and its related general partner;
- PMC Capital, L.P. 1999-1 (the 1999 Partnership) and its related general partner;
- PMC Joint Venture, L.P. 2000 (the 2000 Joint Venture) and its related general partner;
- PMC Joint Venture, L.P. 2001 (the 2001 Joint Venture) and its related general partner;
- PMC Joint Venture, L.P. 2002-1 (the 2002 Joint Venture) and its related general partner; and,
- PMC Joint Venture, L.P. 2003-1 (the 2003 Joint Venture, and together with the 2000 Joint Venture, the 2001 Joint Venture and the 2002 Joint Venture, the Joint Ventures) and its related general partner.

As a result of the merger, we acquired PMC Capital s subordinate interests in the Joint Ventures and 100% of the subordinate interests in the 1998 Partnership and the 1999 Partnership (collectively, the Acquired Structured Loan Sale Transactions). We previously owned subordinate interests in the Joint Ventures (the Originated Structured Loan Sale Transactions). Even though we own 100% of the subordinate interest in each of the Joint Ventures, since a portion was obtained through acquisition, we recorded these investments separately. At the date of acquisition, the fair value of the Acquired Structured Loan Sale Transactions became our cost.

In addition, First Western has Retained Interests related to the sale of loans originated pursuant to the SBA 7(a) Program.

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Originated Structured Loan Sale Transactions

Information relating to our Originated Structured Loan Sale Transactions was as follows:

	2000 Joint Venture	2001 Joint Venture	2002 Joint Venture	2003 Joint Venture
		(Dollars in thousands)		
Transaction date	12/18/00	06/27/01	04/12/02	10/07/03
Principal amount of loans sold:				
At time of sale	$ 55,675	$ 32,662	$ 27,286	$ 45,456
At December 31, 2006	$ 29,018	$ 9,161	$ 15,510	$ 25,480
Structured notes:				
At time of sale	$ 49,550	$ 30,063	$ 24,557	$ 40,910
At December 31, 2006	$ 23,597	$ 6,562	$ 12,740	$ 22,182
Weighted average interest rate on loans (1):				
At time of sale	9.63%	9.62%	9.23%	L+4.02%
At December 31, 2006	9.54%	9.70%	9.55%	L+4.02%
Required overcollateralization:				
At time of sale (2)	11.0%	8.0%	10.0%	10.0%
At December 31, 2006 (3)	19.1%	28.5%	17.7%	17.8%
Interest rate on the structured notes payable (1)	7.28%	6.36%	6.67%	L+1.25%
Rating of structured notes (4)	Aaa	Aaa	Aaa	Aaa
Cash reserve requirement (5)	6.0%	6.0%	6.0%	6.0%

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

(2) The required overcollateralization percentage at time of sale represents the portion of our Sold Loans retained by the QSPEs whose value is included in Retained Interests.

(3) The required overcollateralization percentage at December 31, 2006 was larger than the required overcollateralization percentage at time of sale since all principal payments

received on the underlying loans receivable are paid to the noteholders.

(4) *Structured notes issued by the QSPEs were rated by Moody s Investors Service, Inc.*

(5) *The cash reserve requirement is 6% of the principal amount of loans outstanding. Transactions all have minimum reserve requirements of 2% of the principal balance sold at the time of the sale.*

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Acquired Structured Loan Sale Transactions

Information relating to our Acquired Structured Loan Sale Transactions was as follows:

	1998 Partnership	1999 Partnership	2000 Joint Venture	2001 Joint Venture	2002 Joint Venture	2003 Joint Venture
			(Dollars in thousands)			
Principal amount of loans sold:						
At February 29, 2004	$ 21,702	$ 29,800	$ 17,345	$ 37,191	$ 36,102	$ 56,424
At December 31, 2006	$ 11,795	$ 15,060	$ 8,561	$ 17,931	$ 17,133	$ 38,631
Structured notes:						
At February 29, 2004	$ 21,221	$ 26,394	$ 15,636	$ 33,324	$ 32,932	$ 50,774
At December 31, 2006	$ 11,757	$ 11,579	$ 5,860	$ 15,875	$ 12,877	$ 32,954
Weighted average interest rate on loans (1):						
At February 29, 2004	P+1.22%	9.40%	9.20%	9.64%	9.58%	L+4.02%
At December 31, 2006	P+0.96%	9.07%	9.00%	9.67%	9.52%	L+4.02%
Required overcollateralization (2) (3):						
At February 29, 2004	10.5%	12.0%	15.7%	10.6%	12.0%	10.2%
At December 31, 2006	10.5%	23.8%	31.9%	22.0%	25.2%	15.0%
Mortgage-backed security (4)	5.0%					
Interest rate on structured notes (1)	P-1.00%	6.60%	7.28%	6.36%	6.67%	L+1.25%
Rating of structured notes (5)	Aaa	Aaa	Aaa	Aaa	Aaa	Aaa
Cash reserve requirement (6)	$ 1,329	$ 1,210	6.0%	6.0%	6.0%	6.0%

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

(2) The required overcollateralization percentage at February 29, 2004 represents the portion of our Sold Loans retained by the QSPEs whose value is included in Retained Interests.

(3) For the majority of the Acquired Structured Loan Sale Transactions, the

required overcollateralization percentage at December 31, 2006 was larger than the required overcollateralization percentage at February 29, 2004 since all principal payments received on the underlying loans receivable are paid to the noteholders.

(4) *Owned by PMC Commercial.*

(5) *Structured notes issued by the QSPEs were rated by Moody s Investors Service, Inc.*

(6) *The cash reserve requirement is generally 6% of the principal amount of loans outstanding. Transactions all have minimum reserve requirements of 2% of the principal balance sold at the time of the sale. The 1998 Partnership and the 1999 Partnership are currently at their minimum requirements.*

Retained Interests

As a result of our structured loan sale transactions, we have Retained Interests representing our residual interest in the loans sold to the QSPEs. When we securitize loans, we are required to recognize Retained Interests, which represent our right to receive net future cash flows, at their fair value. Our Retained Interests consist of (1) the required overcollateralization, which is the retention of a portion of each of the Sold Loans, (2) the reserve fund, which represents the required cash balance owned by the QSPE and (3) the interest-only strip receivable, which represents the future excess funds to be generated by the QSPE after payment of all obligations of the QSPE. Our Retained Interests are subject to credit, prepayment and interest rate risks. The estimated fair value of our Retained Interests is determined based on the present value of estimated future cash flows that we will receive from the QSPEs. The estimated future cash flows are calculated based on assumptions concerning, among other things, loan losses and

prepayment speeds. On a quarterly basis, we measure the fair value of, and record income relating to, the Retained Interests based upon the future anticipated cash flows discounted based on an estimate of market interest rates for investments of this type. Any appreciation of the Retained Interests is included in our balance sheet in beneficiaries equity. Any depreciation of Retained Interests is either included in our statement of income as either a permanent impairment (if there is a reduction in expected future cash flows) or on the balance sheet in beneficiaries equity as an unrealized loss.

We retain a portion of the default and prepayment risk associated with the underlying loans of our Retained Interests. Actual defaults and prepayments, with respect to estimating future cash flows for purposes of valuing our

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Retained Interests will vary from our assumptions, possibly to a material degree, and slower (faster) than anticipated prepayments of principal or lower (higher) than anticipated loan losses will increase (decrease) the fair value of our Retained Interests and related cash flows. We regularly measure our loan loss, prepayment and other assumptions against the actual performance of the loans sold. Although we believe that assumptions made as to the future cash flows are reasonable, actual rates of loss or prepayments will vary from those assumed and the assumptions may be revised based upon changes in facts or circumstances. See Item 1A Risk Factors Investments General There is no market for our Retained Interests and the value is volatile.

In accordance with generally accepted accounting principles, our consolidated financial statements do not include the assets, liabilities, partners capital, revenues or expenses of the QSPEs. As a result, at December 31, 2006 and 2005, our consolidated balance sheets do not include $207.7 million and $276.1 million in assets, respectively, and $156.5 million and $220.8 million in liabilities, respectively, related to these structured loan sale transactions recorded by the QSPEs. At December 31, 2006, the partners capital of the QSPEs was approximately $51.2 million compared to the estimated value of the associated Retained Interests of approximately $55.1 million.

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 45 individuals including marketing professionals, investment professionals, operations professionals and administrative staff as of December 31, 2006. In addition, we have employment agreements with our executive officers. Annual base salary during the terms of the contracts does not exceed $375,000 for any one individual. Our operations are conducted from our Dallas, Texas office. We believe the relationship with our employees is good.

COMPETITION

In 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 than we are. In addition, the yield curve combined with increased competition has caused margin compression.

Fixed-rate lending: As a result of the prolonged period in which the yield curve has been inverted or flat (*i.e.,* compression of long-term and short-term interest rates) combined with increased competition from fixed-rate lenders, our margins for fixed-rate loans contracted to the point where it is no longer economically viable for us to compete for fixed-rate loans. In addition, the market has changed where borrowers are looking predominately for fixed-rate loans; however, our ability to offer fixed-rate loans is constrained by our cost of funds. Local banks offer a five-year maturity, 20-year amortization loan (mini-perm loan) at a more attractive rate than we can offer based on our current sources of funds. Consequently, we are currently predominately committing to loans with a variable rate.

We continue to actively pursue alternative sources of funds and evaluate interest rate hedges to reduce our cost of funds and/or reduce interest rate risk, which may allow us to originate fixed-rate loans at more competitive rates.

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Variable-rate lending: For our variable-rate loan product, 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.

CUSTOMERS

In relation to our lending division, we are not dependent upon a single borrower, or a few borrowers, whose loss would have a material adverse effect on us. In addition, we have not loaned more than 10% of our assets to any single borrower.

SECURITIES EXCHANGE ACT REPORTS

The Company maintains an internet site at the following address: www.pmctrust.com. The information on the Company s website is not incorporated by reference in this annual report on Form 10-K.

We make available on or through our website certain reports and amendments to those reports that 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). These include our annual reports on Form 10-K, our quarterly reports on Form 10-Q and our current reports on Form 8-K. We make this information available on our website free of charge as soon as reasonably practicable after we electronically file the information with, or furnish it to, the SEC.

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Item 1A. RISK FACTORS

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. In addition, these factors could impair our ability to maintain dividend distributions at current levels.

Investment Risks Lending Activities

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 levels.

Our net income depends on our ability to originate loans at favorable spreads over our borrowing costs. In 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 which have greater financial resources than us. As a result, we may not be able to originate sufficient loans at favorable spreads over our borrowing costs, which would harm our results of operations and consequently, our ability to continue paying dividends at current levels.

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 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.

There is volatility in the valuation of our loans receivable which can require the establishment of loan loss reserves.

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 for us to liquidate such investments.

To the extent one or several of our borrowers experience significant operating difficulties and we are forced to liquidate the collateral underlying the loan, future losses may be substantial. The determination of whether significant doubt exists and whether a loan loss reserve is necessary for each loan requires judgment and consideration of the facts and circumstances existing at the evaluation date. 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.

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

The net income of our lending operations is materially 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 primarily originate variable-rate loans and have certain debt which is long-term and at fixed interest rates and preferred stock which is long-term with a fixed dividend yield. If the yield on loans originated with funds obtained from fixed-rate borrowings or preferred stock fails to cover the cost of such funds, our cash flow will be reduced.

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As a result of our current dependence on variable-rate loans, our interest income will be reduced during low interest rate environments. To the extent that LIBOR or the prime rate decreases from current levels, interest income on our currently outstanding loans receivable will decline.

Changes in interest rates do not have an immediate impact on the interest income of our fixed-rate loans receivable. Our interest rate risk on our fixed-rate loans receivable is primarily due to loan prepayments and maturities. The average maturity of our loan portfolio is less than their average contractual terms because of prepayments. The average life of mortgage loans receivable tends to increase when the current mortgage rates are substantially higher than rates on existing mortgage loans receivable and, conversely, decrease when the current mortgage rates are substantially lower than rates on existing mortgage loans receivable (due to refinancings of fixed-rate loans receivable at lower rates).

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

In deciding whether or not to extend credit or enter into transactions with potential borrowers and/or their guarantors, we rely on information furnished to us by or on behalf of potential borrowers and/or guarantors, including financial statements, construction invoices and other financial information. 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 that are materially misleading.

Investment Risks General

There is no market for our Retained Interests and the value is volatile.

Due to the limited number of entities that conduct transactions with similar assets, the relatively small size of our Retained Interests and the limited number of buyers for such assets, no readily ascertainable market exists for our Retained Interests. Therefore, our estimate of the fair value may vary significantly from what a willing buyer would pay for these assets. If a ready market existed for our Retained Interests, the value would be different and the difference may be significant.

The following is a sensitivity analysis of our Retained Interests as of December 31, 2006 to highlight the volatility that results when prepayments, loan losses and discount rates are different than our assumptions:

Changed Assumption	Estimated Fair Value	Asset Change (1)
	(In thousands)	
Losses increase by 50 basis points per annum (2)	$ 54,157	($1,567)
Losses increase by 100 basis points per annum (2)	$ 52,583	($3,141)
Rate of prepayment increases by 5% per annum (3)	$ 55,136	($ 588)
Rate of prepayment increases by 10% per annum (3)	$ 54,709	($1,015)
Discount rates increase by 100 basis points	$ 54,127	($1,597)
Discount rates increase by 200 basis points	$ 52,595	($3,129)

(1) Any depreciation of our Retained Interests is either included in the accompanying statement of income as a permanent impairment (if there is a reduction in expected future cash flows) or on our

balance sheet in beneficiaries equity as an unrealized loss.

(2) *If we experience significant losses (i.e., in excess of anticipated losses), the effect on our Retained Interests would first be to reduce the value of the interest-only strip receivables. To the extent the interest-only strip receivables could not fully absorb the losses, the effect would then be to reduce the value of our reserve funds and then the value of our required overcollateralization.*

(3) *For example, a 16% assumed rate of prepayment would be increased to 21% or 26% based on increases of 5% or 10% per annum, respectively.*

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

Changes in any of these assumptions or actual results which deviate from assumptions will affect the estimated fair value of our Retained Interests, possibly to a material degree. There can be no assurance as to the accuracy of these estimates.

We have a concentration of investments in the hospitality industry and in certain states, 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, 2006, our loans receivable were approximately 94% concentrated in the hospitality industry and approximately 94% of the loans sold to our QSPEs were concentrated in the hospitality industry. Any economic factors that negatively impact the hospitality industry, including terrorism, travel restrictions, bankruptcies or other political or geopolitical events, could have a material adverse effect on our financial condition and results of operations.

At December 31, 2006, approximately 22% of our loans receivable were collateralized by properties in Texas, approximately 10% were collateralized by properties in Ohio and approximately 24% of the loans sold to our QSPEs were collateralized by properties in Texas. No other state had a concentration of 10% or greater of our loans receivable, loans sold to our QSPEs or Aggregate Portfolio at December 31, 2006. 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 are subject to prepayment risk on our Retained Interests and loans receivable which could result in losses or reduced earnings and negatively affect our cash available for distribution to shareholders.

Our prepayment activity has increased. Prepayment activity on our aggregate fixed-rate loans receivable has remained at high levels as a result of the continued low long-term interest rate environment combined with increased competition and the reduction or expiration of prepayment fees. In addition, prepayment activity for our aggregate variable-rate loans has increased since borrowers with variable-rate loans are generally seeking fixed-rate loans due to currently marketed fixed-rate interest rates being lower than the current interest rate on their loan and/or concerns of possible rising interest rates.

The proceeds from the prepayments we receive are either used to repay debt or invested initially in temporary investments. 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.

Prepayments on loans sold to the QSPEs may have a negative impact on our financial condition or results of operations. Prepayments of loans receivable with higher interest rates negatively impact the value of our Retained Interests to a greater extent than prepayments of loans receivable with lower interest rates. Prepayments in excess of assumptions will cause a decline in the fair value of our Retained Interests primarily relating to a reduction in the excess funds (our interest-only strip receivable) expected from our structured loan sale transactions. For example, if a $1.0 million loan with an interest rate of 10% prepays and the all-in cost of that QSPE s structured notes was 7%, we would lose the 3% spread we had expected to receive on that loan in future periods. Our all-in costs include interest, servicing, trustee and other ongoing costs. The spread that is lost may be offset in part or in whole by any prepayment fee that we collect.

Our SBLC sells the guaranteed portion of most of its originated loans through private placements (Secondary Market Sales). These sales are particularly sensitive to prepayments. Our Retained Interests in these loan sales consists only of the spread between the interest collected from the borrower and the interest paid to the purchaser of the guaranteed portion of the loan. Therefore, to the extent the prepayments of these loans exceed estimates, we lose the estimated fair value of the associated Retained Interests.

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 stock.

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

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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 stock; however, the effect could be adverse.

Liquidity and Capital Resources Risks

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. Although we believe that we maintain sufficient access to these financial markets, adverse changes in the economy, the overall health of the limited service hospitality industry and increased loan losses could limit access to these markets and restrict us from continuing our current operating strategy or implementing new operating strategies.

The market for structured loan transactions may decline, which would decrease the availability of, and/or increase the cost of, working capital and negatively affect the potential for growth.

We will continue to need capital to fund loans. Historically, we have sold loans receivable as part of structured loan transactions, borrowed from financial institutions and issued equity securities to raise capital. A reduction in the availability of funds from financial institutions or the asset-backed securities market could have a material adverse effect on our financial condition and our results of operations. Our long-term ability to continue to grow depends, to a large extent, on our ability to sell asset-backed securities through structured loan transactions. In certain economic markets the availability of funds may be diminished or the spread charged for funds may increase causing us to delay a structured loan transaction. In addition, terrorist attacks or political or geopolitical events could impact the availability and cost of capital.

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:

- As a result of certain economic conditions, investors in the type of asset-backed securities that we place may increase our cost of capital by widening the spreads (over a benchmark such as LIBOR or treasury rates) they require in order to purchase the asset-backed securities or cease acquiring our type of asset-backed security;

- A deterioration in the performance of our loans receivable or the loans receivable of our prior transactions (for example, higher than expected loan losses or delinquencies) may deter potential investors from purchasing our asset-backed securities;

- 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; 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.

Significant changes in any of these criteria may result in us temporarily suspending the use of structured loan transactions and we may seek other sources of financing. A reduction in the availability 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 or to acquire real estate.

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. As a result, we use leverage to fund 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 by us 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. 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.

Operating Risks

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

Several factors may impact the hospitality industry. Many of the businesses to which we have made, or will make, loans may be susceptible to economic slowdowns or recessions. During economic downturns, there may be reductions in business travel and consumers generally take fewer vacations. Terrorism, bankruptcies or other political or geopolitical events could negatively affect our borrowers. Our non-performing assets are likely to increase during these periods. These conditions could lead to losses in our portfolio and a decrease in our interest income, net income and assets.

Another factor which affects the limited service sector of the hospitality industry is a significant rise in gasoline prices within a short period of time. A significant portion of the limited service hospitality properties collateralizing our loans are located on interstate highways. When gas prices sharply increase, occupancy rates for properties located on interstate highways may decrease. These factors may cause a reduction in revenue per available room. 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.

Many of our competitors have greater financial and managerial resources than us and are able to provide services 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 stock price.

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

- Interest rate changes;
- The volume and timing of loan originations and prepayments of our loans receivable;
- 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.

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 to us for the selection, acquisition, structuring, monitoring and sale of our portfolio assets and the borrowings used to acquire these assets. We have entered into employment agreements with our executive officers. 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, changes in which 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, we 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 us. The Jobs and Growth Tax Relief Reconciliation Act of 2003 reduced the tax rate on both dividends and long-term capital gains for most non-corporate taxpayers to 15% until 2008. 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.

To the extent a loan becomes a problem loan, we will deliver a default notice and begin foreclosure and liquidation proceedings when we determine that pursuit of these remedies is the most appropriate course of action. Foreclosure and bankruptcy are complex and sometimes time consuming processes that are subject to Federal and state laws and regulations, as well as various guidelines imposed by mortgage investors.

In conjunction with the operations of our assets acquired in liquidation and hotel properties, we are subject to numerous Federal, state and local laws and government regulations including environmental, occupational health and safety, state and local taxes and laws relating to access for disabled persons.

Regarding our owned properties, under various Federal, state and local laws, ordinances and regulations, a current or former owner or operator of real estate may be considered liable for the costs of remediating or removing hazardous substances found on its property, regardless of whether or not the property owner or operator was responsible for its presence. Such liability may be imposed by the Environmental Protection Agency or any state or local government authority regardless of fault. The ultimate costs under environmental laws and the timing of these costs are difficult to predict, and the liability under some environmental laws related to contaminated sites can be imposed retroactively, may be on a joint and several basis and could be material to our financial statements or results of operations.

The Americans with Disabilities Act of 1990 (ADA) requires all public accommodations and commercial facilities to meet federal requirements related to access and use by disabled persons. Compliance with the ADA requirements could require removal of access barriers. Although we believe that the properties that we own or finance are substantially in compliance with these requirements, a determination that the properties are not in compliance with the ADA could result in the imposition of fines by the U.S. Government or an award of damages to private litigants.

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 limitation 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 capital 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.

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.

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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, no more than 20% 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 PMCIC, First Western, PMC Funding Corp. and PMC Properties, Inc. (PMC Properties). PMC Funding Corp. holds assets on our behalf. PMC Properties is the operator, through third party management companies, of our hotel properties.

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 20% 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 20% of the value of our total assets (including our taxable REIT subsidiary stock and securities). 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 20% 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.

Hotel Property Ownership Risks

We are dependent on third party management for the operation and management of our hotel properties and we are subject to operating risks of hotel properties.

We are dependent upon third party managers to operate and manage our hotel properties. As a REIT, PMC Commercial cannot directly operate the hotel properties. The operating results of our hotel properties are subject to a variety of risks which could negatively impact their cash flows.

We are incurring costs including holding costs and operating costs until the remaining two properties are leased. There can be no assurance that we will be able to find new tenants for our hotel properties or negotiate to receive the same amount of historical lease income.

We could encounter risks that adversely affect real estate ownership.

Our real estate investments are subject to a variety of risks including, but not limited to:

- adverse changes in general or local economic or real estate market conditions;
- changes in zoning laws;
- changes in traffic patterns and neighborhood characteristics;
- increases in assessed valuation and real estate tax rates;
- increases in the cost of property insurance;
- governmental regulations and fiscal policies;

- the potential for uninsured or underinsured property losses; and
- the impact of environmental laws and regulations.

Materialization of any of these risks could cause us to incur losses, and our results of operations and financial condition could be adversely impacted.

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We may be required to make significant capital improvements to maintain our hotel properties and their flags.

We may be required to replace furniture, fixtures and equipment or to make other capital improvements or renovations to the hotel properties which could affect our liquidity. We could also need periodic capital improvements to comply with standards associated with any flag under franchise agreements. These capital improvements may cause a disruption of operations and potential lost room revenue to the extent not covered by insurance and/or a reduction of return on our investment in these hotel properties.

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.

At December 31, 2006, two of the three limited service hospitality properties that we own were included in our consolidated financial statements. Of our consolidated properties, one property is located in Illinois and one is in Ohio. The Illinois property has 60 rooms and was built in 1995. The Ohio property has 79 rooms and was built in 1990. We are currently marketing to lease these two properties. The remaining property owned by our unconsolidated subsidiary is located in Indiana, was built in 1992 and has 60 rooms.

Item 3. LEGAL PROCEEDINGS

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

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the fourth quarter of 2006.

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PART II

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

The Common Shares are traded on the American Stock Exchange (the AMEX) under the symbol PCC. The following table sets forth, for the periods indicated, the high and low sales prices as reported on the AMEX and the regular and special dividends per share declared by us for each such period.

Quarter Ended	High	Low	Regular Dividends Per Share	Special Dividends Per Share
December 31, 2006	$ 15.43	$ 13.65	$ 0.30	$ 0.10
September 30, 2006	$ 14.72	$ 12.68	$ 0.30	
June 30, 2006	$ 13.59	$ 12.40	$ 0.30	
March 31, 2006	$ 13.80	$ 12.19	$ 0.30	
December 31, 2005	$ 13.48	$ 11.26	$ 0.30	
September 30, 2005	$ 13.67	$ 11.30	$ 0.30	
June 30, 2005	$ 15.44	$ 12.80	$ 0.30	
March 31, 2005	$ 15.65	$ 14.64	$ 0.35	
December 31, 2004	$ 15.98	$ 14.40	$ 0.34	
September 30, 2004	$ 15.44	$ 14.00	$ 0.34	
June 30, 2004	$ 15.55	$ 13.03	$ 0.34	
March 31, 2004	$ 17.20	$ 14.77	$ 0.38	

On March 2, 2007, there were approximately 1,250 holders of record of Common Shares and the last reported sales price of the Common Shares was $14.87.

Our shareholders are entitled to receive dividends when and as declared by our Board of Trust Managers (the Board). Our Board considers many factors in determining dividend policy including, but not limited to, expectations for future earnings, REIT taxable income, the interest rate environment, competition, our ability to obtain leverage and our loan portfolio activity. The Board also uses REIT taxable income plus tax depreciation in determining the amount of dividends declared. In addition, as a REIT we are required to pay out 90% of 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. We anticipate, as a result of earnings from our core business and gains generated on our property sales, that we will maintain our current regular quarterly dividend of $0.30 per share through the end of 2007.

We have certain covenants within our debt facilities that limit our ability to pay out returns of capital as part of our dividends. These restrictions have not historically limited the amount of dividends we have paid and management does not believe that they will restrict future dividend payments. See Selected Consolidated 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 Consolidated 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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Item 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following is a summary of our Selected Consolidated Financial Data as of and for the five years in the period ended December 31, 2006. 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,				
	2006	2005	2004 (1)	2003	2002
	(In thousands, except per share information)				
Total revenues	$ 30,677	$ 25,099	$ 20,916	$ 9,983	$ 11,212
Income from continuing operations (2)	$ 13,648	$ 9,378	$ 9,923	$ 4,763	$ 6,194
Discontinued operations (2)	$ 2,036	$ 1,919	$ 3,265	$ 2,700	$ 3,180
Gain on sale of loans receivable	$	$	$	$ 711	$ 562
Extraordinary item: negative goodwill	$	$	$ 11,593	$	$
Net income	$ 15,684	$ 11,297	$ 24,781	$ 8,174	$ 9,936
Basic weighted average common shares outstanding	10,748	10,874	10,134	6,448	6,444
Basic and diluted earnings per common share:					
Income from continuing operations and gain on sale of loans receivable (2)	$ 1.27	$ 0.86	$ 0.98	$ 0.85	$ 1.05
Extraordinary item: negative goodwill	$	$	$ 1.14	$	$
Net income	$ 1.46	$ 1.04	$ 2.44	$ 1.27	$ 1.54
Dividends declared, common	$ 13,975	$ 13,569	$ 14,140	$ 9,932	$ 10,440
Dividends per common share	$ 1.30	$ 1.25	$ 1.40	$ 1.54	$ 1.62

	At December 31,				
	2006	2005	2004 (1)	2003	2002
	(In thousands)				
Loans receivable, net	$ 169,181	$ 157,574	$ 128,234	$ 50,534	$ 71,992
Retained Interests	$ 55,724	$ 62,991	$ 70,523	$ 30,798	$ 23,532
Real estate investments, net	$ 4,414	$ 8,080	$ 36,223	$ 41,205	$ 44,928
Real estate investments, held for sale, net	$	$ 15,470	$ 1,859	$ 2,134	$ 1,877
Total assets	$ 240,404	$ 259,192	$ 253,840	$ 131,736	$ 149,698
Debt	$ 64,841	$ 84,040	$ 75,349	$ 33,380	$ 48,491
Redeemable preferred stock of subsidiary	$ 3,668	$ 3,575	$ 3,488	$	$

(1) On February 29, 2004, we merged with PMC Capital. Primarily as a result of the merger, total

beneficiaries equity and total assets increased. The merger also resulted in a substantial increase in revenues and expenses. Revenues increased as a result of the income generated by the assets acquired from PMC Capital. Prior to the merger, we had no employees and most of our overhead was paid through an advisory relationship with PMC Capital. Subsequent to the merger, we are internally managed.

(2) Effective January 1, 2002, we adopted SFAS No. 144, Accounting for the Impairment of or Disposal of Long-Lived Assets (SFAS No. 144). In accordance with SFAS No. 144, gains and losses on property sales are classified within discontinued

operations subsequent to the adoption. In addition, the operations of our hotel properties sold subsequent to January 1, 2002 have been reflected as discontinued operations in our accompanying statements of income and the prior period financial statements have been reclassified to reflect the operations of these properties as discontinued operations during all periods presented above.

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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.

BUSINESS

We are primarily a commercial lender that originates loans to small businesses that are principally collateralized by first liens on the real estate of the related business. We then sell certain of our loans receivable through privately-placed structured loan transactions. Historically, we have retained residual interests in all loans receivable sold through our subordinate financial interest in the related qualifying special purpose entities (QSPEs).

Our revenues have historically included the following:

- Interest earned on our loans receivable;
- Lease and operating income on our hotel properties;
- Income on our Retained Interests; and
- Other related loan fees, including servicing fees, late fees, prepayment fees, assumption fees and construction monitoring fees.

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 income earned will vary based on the volume of loans funded, the timing and amount of structured loan transactions, the volume of loans receivable which prepay, the mix of loans (construction versus non-construction), the interest rate and type of loans originated (whether fixed or variable) as well as the general level of interest rates. 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.

EXECUTIVE SUMMARY

Lending

During 2006, our loan originations were approximately $71.5 million, of which approximately $19.8 million were originated in connection with sales of our Amerihost hotel properties and assets acquired in liquidation. While we were able to originate our highest quarterly loan volume in our history during the fourth quarter of 2006, we continue to be faced with many challenges in 2007.

The competitive marketing challenges that we are facing have impacted our financial position through the significant amount of prepayments of our outstanding portfolio and are expected to impact future operating results. These challenges include:

- The loan products we offer do not include a competitive fixed-rate loan product and our volume of origination for variable-rate loans has diminished as many potential customers have sought a fixed-rate loan product;
- The margins we currently receive between the interest rate we charge our borrowers and the interest rate we are charged by our lenders have compressed;
- Prepayments have been at all time highs and caused significant reductions in both our serviced and retained portfolios;
- The differential between short-term interest rates (the prime rate is currently 8.25%) and long-term interest rates (5-year treasury rates are approximately 4.7%) has resulted in fixed-rate loans being more attractive than higher priced variable-rate loans; and
- An inverse/flat yield curve has eliminated the premium we historically achieved for providing a longer term (typically 20 years) fully amortizing loan.

As a result of these loan origination challenges and our goal to expand our portfolio, we are exploring additional investment opportunities. We expect to identify and invest in opportunities in the real estate market that are natural additions to supplement our core business. Currently, we are evaluating investments including, but not limited to, ownership of office buildings, retail centers, office warehouses and other real estate, convenience and service stations, restaurants, joint venture ownership of hotels and acquisitions of real estate related businesses. We

are also evaluating opportunities with banks (or internet banks) which may provide alternative and/or lower costs of funds that will allow us to lend against real estate collateral. In order to finance these investments, we anticipate utilization of our credit facilities. While we are using resources to evaluate these opportunities, there can be no assurance that we will ultimately invest in any of these alternatives. In addition, some of these alternatives may initially generate negative cash flow and could impact our ability to maintain our dividend payments at their current levels. However, we anticipate, that as a result of earnings from our core business and gains generated on our property sales, that we will maintain our current regular quarterly dividend of $0.30 per share through the end of 2007.

We also anticipate expansion of our Small Business Administration s (SBA) 7(a) Guaranteed Loan Program (SBA 7(a) Program). Our wholly-owned subsidiary, First Western SBLC, Inc. (First Western), is licensed as a small business lending company that originates loans through the SBA 7(a) Program. First Western is a Preferred Lender nationwide, as designated by the SBA. This Preferred Lender status should shorten the time period necessary to originate SBA 7(a) Program loans. While we anticipate that as a result of this change, our originations under the SBA 7(a) Program will increase, to date we have not realized a significant increase in origination volume or commitments since our marketing efforts generally take time to provide benefits. We recently expanded our marketing initiatives for origination of SBA 7(a) Program loans and anticipate increased volume as a result.

Competition

The number of lenders who compete with us for limited service hospitality loans has increased and many of these competitors have a lower cost of funds and are therefore able to offer rates below what we can offer. The yield curve combined with increased competition has caused margin compression.

Fixed-rate lending: As a result of the prolonged period in which the yield curve has been inverted or flat (*i.e.,* compression of long-term and short-term interest rates) combined with increased competition from fixed-rate lenders, our margins for fixed-rate loans contracted to the point where it is no longer economically viable for us to compete for fixed-rate loans. In addition, the market has changed where borrowers are looking predominately for fixed-rate loans; however, our ability to offer fixed-rate loans is constrained by our cost of funds. Local banks offer a five-year maturity, 20-year amortization loan (mini-perm loan) at a more attractive rate than we can offer based on our current sources of funds. Consequently, we are currently predominately committing to loans with a variable rate.

If we reduce our rates in order to originate fixed-rate loans, it is likely that the spread on our next fixed-rate securitization would be significantly lower than we have historically achieved on our fixed-rate securitizations. In addition, there is a risk that during the interim period between when we make loans with fixed interest rates and when we complete a fixed-rate structured loan transaction, if rates were to rise, we would be negatively affected by interest rate spread compression. We continue to actively pursue alternative sources of funds and evaluate interest rate hedges to reduce our cost of funds and/or reduce interest rate risk, which may allow us to originate fixed-rate loans at more competitive rates.

Variable-rate lending: Due to increased competition from variable-rate lenders, our margins for variable-rate loans have also contracted. Whereas historically we originated variable-rate loans at 3.5% to 4.5% over LIBOR, currently we are offering rates between 3.0% to 4.0% over LIBOR.

In addition, as a result of our weighted average spread over LIBOR being reduced on our variable-rate loan originations, we anticipate that the spread between the interest rate on new loan originations and the cost of funds may be less than the spread of 2.77% on our variable-rate securitization completed during 2003.

Prepayments

During 2006, we experienced significant prepayment activity. Prepayments of our retained portfolio were approximately $40.7 million during 2006 compared to approximately $9.4 million during 2005. In addition, during 2006 we had prepayments of approximately $46.8 million in loans sold as part of securitizations compared to approximately $31.7 million during 2005. This increased activity is primarily a result of competitors providing refinance opportunities for our borrowers combined with the effect of the reduction or expiration of our prepayment fees on certain of our loans due to the structure of the fees (*i.e.,* expiration of lock out or yield maintenance provisions). We believe that we will continue to see high levels of prepayment activity during 2007. During January and February 2007, prepayments of our retained portfolio and our loans sold as part of securitizations were

approximately $7.6 million and $10.8 million, respectively.

Property Ownership

We originally purchased a total of 30 properties, operated as Amerihost Inns, during 1998 and 1999. In June 2005, Arlington Inns, Inc. (AII) filed for bankruptcy protection. This was followed in August 2005 with the bankruptcy filing of Arlington Hospitality, Inc. (AHI and together with AII, Arlington), the parent of AII and the guarantor of all lease obligations.

We commenced selling properties during 2000, and we began 2006 with 13 owned Amerihost Inns and two Amerihost Inns acquired in liquidation of loans for a total of 15 properties. On January 13, 2006, AII rejected the leases and turned over property operations to us. We sold 12 of these properties during the first half of 2006.

At December 31, 2006, two of the three hotel properties that we own were included in our consolidated financial statements. As a REIT, PMC Commercial cannot directly operate these properties; therefore, we are dependent upon third party management companies to operate and manage our hotel properties. As these properties have mortgages (which were assumed in the original purchase from AHI) with significant prepayment penalties, we do not anticipate selling these properties until the properties market values increase or the prepayment penalties decrease.

One hotel property is owned by our non-consolidated subsidiary and was leased effective September 29, 2006. The lessee has the option, and is expected to exercise this option, to purchase the property for $1,825,000 at termination of the lease in January 2011, or earlier if certain events occur. Due to the nature of the lease, the subsidiary that owns the hotel property is no longer consolidated in our financial statements and the equity method is used to account for our investment in the subsidiary effective September 29, 2006. We are currently marketing to lease the remaining two properties.

We have significant outstanding claims against Arlington s bankruptcy estate. Based on information provided through the bankruptcy proceedings and an estimate of net cash proceeds available to the unsecured creditors, we recorded impairments on these claims during 2005 and 2006 and valued those claims at approximately $0.6 million at December 31, 2006. Arlington has objected to our claims and initiated a complaint in the bankruptcy seeking, among other things, the return of payments Arlington made pursuant to the leases and the Master Lease Agreement. Although the value of our claims against Arlington is significantly higher than Arlington s claims against us, there is no assurance that we will collect our claims from Arlington nor is there any assurance we will not be required to make payments to the bankruptcy estate in connection with Arlington s initiated claim.

CURRENT OPERATING OVERVIEW AND ECONOMIC FACTORS

The following provides a summary of our current operating overview and significant economic factors that may have an impact on our financial condition and results of operations. The factors described below could impact the volume of loan originations, the income we earn on our assets, our ability to complete a securitization, the performance of our loans, the operations of our properties and/or the performance of the QSPEs.

Lending Division

Loans originated during 2006 were $71.5 million (of which approximately $19.8 million were originated in conjunction with sales of our Amerihost hotel properties and assets acquired in liquidation) which is greater than the $58.9 million of loans we originated during 2005. We currently anticipate loan originations to be between $55 million and $70 million during 2007. At December 31, 2006 and 2005, our outstanding commitments to fund new loans were approximately $32.6 million and $50.5 million, respectively. The majority of our current commitments are for variable-rate loans which provide an interest rate match with our present sources of funds.

Several key factors (as described both in Executive Summary and in more detail below) that affect our estimates of future loan originations are as follows:

- our current inability to originate fixed-rate loans with an adequate spread;
- borrowers looking to fix their cost of capital (borrow at fixed rates);
- uncertainty as to the cost of funds of future securitizations; and
- increased competition from local banks and other lenders, who are willing to lend at lower rates.

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We believe that in this interest rate environment borrowers are looking predominately for fixed-rate loans; however, to the extent we originate fixed-rate loans, we have potential exposure to interest rate risk. Local bank competitors offer, among other things, five-year fixed-rate loans with rates that are below the long-term interest rates that we can presently offer. Historically, the rate for our fixed-rate product needed to be around 3.75% to 4.00% over the 10-year treasury rate in order to provide us with what management believed was a reasonable spread. With the 10-year treasury rate at approximately 4.7%, historically the rate we needed to obtain was approximately 8.50% to 8.75% for a quality loan with a 20-year amortization and maturity. The local banks currently offer a five-year maturity, 20-year amortization loan at approximately 7.25% to 8.00%. Management believes that the difference between our competitor s fixed rate products and our variable-rate products is causing a greater percentage of borrowers to take on the refinancing risk that rates will not rise significantly or be unavailable in five years and they are therefore accepting refinancing with our competitor s mini-perm loans. Many of our competitors are presently pricing fixed-rate loans based on a spread over the interest rate swap market. We are currently offering fixed-rate loans to borrowers at approximately 3.5% over 5-year treasury rates and anticipate the maximum amount of fixed-rate loans we will originate under this program to be approximately $30.0 million. We are continually evaluating the feasibility of utilizing the swap market or interest rate caps to lock in a fixed cost of funds so that we can offer a more competitive fixed-rate product. Based on the current interest rate environment, these alternative sources of pricing are not viable for us since there is significant exposure of loss of capital in the event of loan liquidation or prepayment. To the extent we are able to use the swap market or interest rate caps to lock in a fixed cost of funds, we believe our originations of fixed-rate loans would increase.

The net interest margin for our leveraged portfolio is dependent upon the difference between the cost of our borrowed funds and the rate at which we invest these funds (the net interest spread.) In general, a significant reduction in net interest spread may have a material adverse effect on our results of operations and may cause us to re-evaluate our lending focus. See Executive Summary. In addition, the weighted average spread over LIBOR for our variable-rate loans has decreased to 4.0% at December 31, 2006 from 4.2% at December 31, 2005.

While we have been unable to effectively compete for fixed-rate loans, we believe that our LIBOR-based loan program (1) allows us to compete more effectively with the diminishing market share of variable-rate products, (2) provides us with a more attractive securitization product and (3) provides us with a net interest spread that is less susceptible to interest rate risk than fixed-rate loan programs.

Lodging Industry

Lodging demand in the United States appears to correlate to changes in U.S. GDP, with typically a two to three quarter lag. Given the relatively strong U.S. GDP growth over the past several years, continued improvement in 2007 lodging demand has been predicted by industry analysts. Such improvement will be dependent upon several factors including the strength of the economy, the correlation of hotel demand to new hotel supply and the impact of global or domestic events on travel and the hotel industry. Leading industry analysts, including PricewaterhouseCoopers LLP, have published reports that predict the industry s results will continue to improve in 2007.

PORTFOLIO INFORMATION

Lending Activities

General

Our lending activities consist primarily of originating loans to borrowers who operate properties in the hospitality industry.

Loans originated and principal repayments of our loans receivable were as follows:

	Years Ended December 31,	
	2006	2005
	(In millions)	
Loan Originations:		
Commercial mortgage loans	$ 36.9	$ 35.9
SBA 7(a) Program loans	8.5	10.7
Loans originated in connection with sale of assets acquired in liquidation and hotel properties	19.8	8.5
SBA 504 program loans (1)	6.3	3.8
Total loans originated	$ 71.5	$ 58.9
Principal Repayments:		
Prepayments	$ 40.7	$ 9.4
Proceeds from the sale of SBA 7(a) guaranteed loans	6.4	7.8
Scheduled principal payments	5.3	3.8
Balloon maturities or SBA 504 program loans	3.6	2.8
Total principal repayments	$ 56.0	$ 23.8

(1) Represents second mortgages obtained through the SBA 504 Program which are repaid by certified development companies.

At December 31, 2006, approximately $145.8 million of our loans receivable had a variable interest rate (reset on a quarterly basis) based primarily on the 90-day LIBOR, or the prime rate (primarily related to our SBA 7(a) Program) with a weighted average interest rate of approximately 9.5%. The spread that we charge over LIBOR generally ranges from 3.0% to 4.0% and the spread we charge over the prime rate generally ranges from 1.25% to 2.50%. The LIBOR and prime rate used in determining interest rates during the first quarter of 2007 (set on January 1, 2007) was 5.36% and 8.25%, respectively. Changes in LIBOR or the prime rate will have an impact on our interest income from our variable-rate loans receivable. In addition, at December 31, 2006, approximately $23.4 million of our loans receivable had a fixed interest rate with a weighted average interest rate of approximately 8.8%. See Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Prepayment Activity

Our prepayment activity has increased. Prepayment activity for our aggregate fixed-rate loans receivable has remained at high levels as a result of the continued low long-term interest rate environment combined with increased competition and the reduction or expiration of prepayment fees. Prepayment activity for our aggregate variable-rate

loans receivable has increased since borrowers with variable-rate loans are generally seeking fixed-rate loans due to currently marketed fixed-rate interest rates being lower than the current interest rate on their loan and/or concerns of possible rising interest rates. We believe that we will continue to see prepayment activity at these higher levels during 2007.

The timing and volume of our prepayment activity for both our variable and fixed-rate loans receivable fluctuate and are impacted by numerous factors including the following:

The competitive lending environment (*i.e.,* availability of alternative financing);

The current and anticipated interest rate environment;

The market value of limited service hospitality properties; and

The amount of the prepayment fee and the length of prepayment prohibition, if any.

When loans receivable are repaid prior to their maturity, we generally receive prepayment fees. Prepayment fees result in one-time increases in our income. In addition, prepayments of Sold Loans will have an impact on our financial condition and results of operations. Prepayments of Sold Loans with higher interest rates negatively impact the value of our Retained Interests to a greater extent than prepayments of Sold Loans with lower interest rates. Prepayments in excess of our assumptions will cause a decline in the value of our Retained Interests primarily relating to a reduction in the excess funds (our interest-only strip receivable) expected from our structured loan sale

transactions. The spread that is lost may be offset in part or in whole by the prepayment fee that we collect. Many of the prepayment fees for our aggregate fixed-rate loans receivable are based upon a yield maintenance premium which provides for greater prepayment fees as interest rates decrease. For our aggregate fixed-rate loans receivable, these fees are generally greater for those loans with higher interest rates although the prepayment fees also decline as the loans get closer to their maturity. In addition, certain loans receivable have prepayment prohibitions of up to five years. Prepayment fees for our aggregate variable-rate loans receivable and fixed-rate loans receivable whose prepayment prohibition have expired are generally not significant. For our loans receivable, the proceeds from the prepayments we receive are either used to repay debt or invested initially in temporary investments. It is difficult for us to accurately predict the volume or timing of prepayments since the factors listed above are not all-inclusive and changes in one factor are not isolated from changes in another which might magnify or counteract the rate or volume of prepayment activity.

Our SBLC sells the guaranteed portion of most of its originated loans through private placements. These sales are especially sensitive to prepayments. Our Retained Interests in these loan sales consist only of the spread between the interest collected from the borrower and the interest paid to the purchaser of the guaranteed portion of the loan. Therefore, to the extent the prepayments of these loans exceed estimates, there is a significant impact on the value of the associated Retained Interests. In addition, loans originated under the SBA 7(a) Program do not have prepayment fees which are retained by us.

Impaired Loans

Our policy with respect to loans receivable which are in arrears as to interest payments for a period in excess of 60 days is generally to discontinue the accrual of interest income. To the extent a loan becomes a Problem Loan (as defined below), we will deliver a default notice and begin foreclosure and liquidation proceedings when we determine that pursuit of these remedies is the most appropriate course of action.

Senior management closely monitors our impaired loans which are classified into two categories: Problem Loans and Special Mention Loans (together, Impaired Loans). Our Problem Loans are 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. Our Special Mention Loans are those loans receivable that are either not complying or had previously not complied with their contractual terms but we expect a full recovery of the principal balance through either collection efforts or liquidation of collateral.

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Historically, we have not had a significant amount of Impaired Loans or delinquent loans nor have we had a significant amount of charged-off loans. Our Impaired Loans were as follows (balances represent our investment in the loans prior to loan loss reserves and deferred commitment fees):

	At December 31,	
	2006	2005
	(Dollars in thousands)	
Problem Loans:		
Loans receivable	$ 1,887	$ 1,587
Sold loans of QSPEs (1)		
	$ 1,887	$ 1,587
Special Mention Loans:		
Loans receivable (2)	$ 32	$ 5,635
Sold loans of QSPEs (1)	3,496	5,558
	$ 3,528	$ 11,193
Percentage Problem Loans:		
Loans receivable	1.1%	1.0%
Sold loans of QSPEs (1)		
Percentage Special Mention Loans:		
Loans receivable		3.6%
Sold loans of QSPEs (1)	1.9%	2.3%

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

(2) *During 2005, amounts include*

two loans collateralized by limited service hospitality properties with an estimated fair value of approximately $3.3 million related to the Arlington bankruptcy which were liquidated during January 2006 and reclassified to assets acquired in liquidation. We sold these assets acquired in liquidation during 2006 with no resulting losses.

At December 31, 2006 and 2005, we had reserves of approximately $63,000 and $427,000, respectively, against loans receivable that we have deemed to be Impaired Loans. Our provision for loan losses (excluding reductions of loan losses) as a percentage of our weighted average outstanding loans receivable was 0.11% and 0.24% during 2006 and 2005, 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. The decrease in our total Impaired Loans from 2005 to 2006 is due primarily to foreclosure of the underlying collateral of three limited service hospitality properties, repayment in full and assumption of certain loans and improved performance of a sold loan which is no longer considered to be an Impaired Loan.

Retained Interests

At December 31, 2006 and 2005, the estimated fair value of our Retained Interests was approximately $55.7 million and $63.0 million, respectively. As a result of our structured loan sale transactions, we have Retained Interests representing the subordinate interest in loans receivable that have been contributed to QSPEs and have been recorded as sold. When we securitize loans receivable, we are required to recognize Retained Interests, which represents our right to receive net future cash flows, at their estimated fair value. Our Retained Interests consist of (1) the retention of a portion of each of the Sold Loans (the required overcollateralization), (2) contractually required cash balances owned by the QSPE (the reserve fund) and (3) future excess funds to be generated by the QSPE after payment of all obligations of the QSPE (the interest-only strip receivable). Retained Interests are subject to credit, prepayment and interest rate risks.

The estimated fair value of our Retained Interests is based on estimates of the present value of future cash flows we expect to receive from the QSPEs. Estimated future cash flows are based in part upon estimates of prepayment speeds and loan losses. Prepayment speeds and loan losses are estimated based on the current and

anticipated interest rate and competitive environments and our historical experience with these and similar loans receivable. The discount rates utilized are determined for each of the components of Retained Interests as estimates of market rates based on interest rate levels considering the risks inherent in the transaction. Changes in any of our assumptions, or actual results which deviate from our assumptions, may materially affect the value of our Retained Interests.

The net unrealized appreciation on our Retained Interests at December 31, 2006 and 2005 was approximately $3.3 million and $4.5 million, respectively. The primary reason for the decrease in unrealized appreciation on our Retained Interests was prepayments. Any appreciation of our Retained Interests is included on our consolidated balance sheets in beneficiaries equity. Any depreciation of our Retained Interests is either included in the consolidated statements of income as a permanent impairment (if there is a reduction in expected future cash flows) or on our consolidated balance sheet in beneficiaries equity as an unrealized loss. Reductions in expected future cash flows generally occur as a result of decreases in expected yields, increases in anticipated loan losses or increases in prepayment speed assumptions. Any unrealized appreciation of our Retained Interests will be recognized as income over the estimated remaining life of the Retained Interests through a higher effective yield.

Assets Acquired in Liquidation

We have not historically had a significant amount of assets acquired in liquidation. With regard to properties acquired through foreclosure, deferred maintenance issues may have to be addressed as part of the operation of the property or it may not be economically justifiable to operate the property prior to its sale. To the extent keeping the property in operation is deemed to assist in attaining a higher value upon sale, we will take steps to do so including hiring third party management companies to operate the property.

In connection with the sale of our assets acquired in liquidation to third parties, we may finance a portion of the purchase price of the property. These loans will typically bear market rates of interest. While these loans are evaluated using the same methodology as our loans receivable, certain lending criteria may not be able to be achieved.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and our results of operations is based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Our management has discussed the development and selection of these critical accounting policies and estimates with the audit committee of our Board of Trust Managers, and the audit committee has reviewed the disclosures relating to these policies and estimates included in this annual report.

We believe the following critical accounting considerations and significant accounting policies represent our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Valuation of Loans Receivable

Loan loss reserves are established based on a determination, through an evaluation of the recoverability of individual loans receivable, that significant doubt exists as to the ultimate realization of the loan receivable. We monitor the loan portfolio on an ongoing basis and evaluate the adequacy of our loan loss reserves. In our analysis, we review various factors, including the value of the collateral underlying the loan receivable and the borrower s payment history. The determination of whether significant doubt exists and whether a loan loss reserve is necessary for each loan requires judgment and consideration of the facts and circumstances existing at the evaluation date. Changes to the facts and circumstances of the borrower, the hospitality industry and the economy may require the establishment of significant additional loan loss reserves. If a determination is made that significant doubt exists as to the ultimate collection of our loans receivable, the effect on our results of operations may be material.

At December 31, 2006 and 2005, we had reserves of approximately $63,000 and $427,000, respectively, against loans receivable that we have deemed to be Impaired Loans. Our provision for loan losses (excluding reductions of loan losses) as a percentage of our weighted average outstanding loans receivable was 0.11% and 0.24% during 2006 and 2005, respectively.

The limited service hospitality industry experienced difficult operating periods from 2001 through 2003;

however, this trend reversed with subsequent years experiencing positive trends. In addition, theses positive trends are expected to continue during 2007. This positive trend along with our experience with liquidations of properties underlying impaired loans and the knowledge gained from such liquidations has benefited us in achieving lower losses from loan liquidations. As a result, our reserves have decreased. 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.

Valuation of Retained Interests

Due to the limited number of entities that conduct structured loan sale transactions with similar assets, the relatively small size of our Retained Interests and the limited number of buyers for such assets, no readily ascertainable market exists for our Retained Interests. Therefore, our estimate of fair value may vary significantly from what a willing buyer would pay for these assets.

The estimated fair value of our Retained Interests is determined based on the present value of estimated future cash flows from the QSPEs. This valuation is our most volatile critical accounting estimate since it is dependent upon estimates of future cash flows that are based on the performance of the underlying loans receivable and estimates of discount rates. Prepayments or losses in excess of estimates will cause unrealized depreciation and ultimately permanent impairments. The estimated future cash flows are calculated based on assumptions including, among other things, prepayment speeds and loan losses. We regularly measure loan loss and prepayment assumptions against the actual performance of the loans receivable sold and to the extent adjustments to our assumptions are deemed necessary, they are made on a quarterly basis. If prepayment speeds occur at a faster rate than anticipated, or future loan losses either occur quicker, or in amounts greater than expected, the fair value of the Retained Interests will decline and total income in future periods would be reduced. For example, if a $1.0 million loan with an interest rate of 10% prepays and the all-in cost of that QSPE s structured notes was 7%, we would lose the 3% spread we had expected to receive on that loan in future periods. The spread that is lost may be offset in part or in whole by any prepayment fee that we collect. If prepayments occur slower than anticipated, or future loan losses are either slower than or less than expected, cash flows would exceed estimated amounts, the estimated fair value of our Retained Interests would increase and total income in future periods would be enhanced. Although we believe that assumptions as to the future cash flows of the structured loan sale transactions are reasonable, actual rates of loss or prepayments may vary significantly from those assumed and other assumptions may be revised based upon anticipated future events. Over the past three years, there has been no significant change in the methodology employed in valuing these assets. The discount rates utilized in computing the net present value of future cash flows are based on an estimate of the inherent risks associated with each cash flow stream. Purchasers of these types of investments may utilize different discount rates in determining the fair value of the estimated future cash flows.

As a result of the merger, we acquired PMC Capital s subordinate interests in the Joint Ventures and 100% of the subordinate interests in the 1998 Partnership and the 1999 Partnership (collectively, the Acquired Structured Loan Sale Transactions). We previously owned subordinate interests in the Joint Ventures (the Originated Structured Loan Sale Transactions).

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Constant prepayment rates and aggregate losses assumed were as follows for our Originated Structured Loan Sale Transactions (Originated) and Acquired Structured Loan Sale Transactions (Acquired):

	Constant Prepayment Rate At December 31,		Aggregate Losses Assumed At December 31,	
	2006	2005	2006	2005
Originated:				
2000 Joint Venture	18.0%	11.0%	1.45%	2.74%
2001 Joint Venture	18.0%	12.0%		2.63%
2002 Joint Venture	18.0%	12.0%	1.42%	3.72%
2003 Joint Venture	16.0%	12.0%	1.36%	2.51%
Acquired:				
Secondary Market Sales (1)	20.0%	20.0%		
1998 Partnership	16.0%	12.5%	1.71%	3.12%
1999 Partnership	18.0%	14.0%	1.82%	2.43%
2000 Joint Venture	18.0%	14.0%	1.39%	3.28%
2001 Joint Venture	18.0%	12.0%	1.20%	2.06%
2002 Joint Venture	18.0%	12.0%	1.79%	2.68%
2003 Joint Venture	16.0%	12.0%	1.48%	2.77%

(1) There are no losses assumed on Secondary Market Sales as the SBA has guaranteed payment of principal on these loans.

Constant prepayment rates have generally increased from 2005 to 2006 primarily due to increased historical prepayments and the anticipated continuation of high levels of prepayments due to increased competition and the reduction or expiration of prepayment fees in a significant portion of the underlying portfolio.

Aggregate losses assumed have generally decreased from December 31, 2005 to December 31, 2006 primarily based on decreased portfolio outstanding, historical losses being significantly below original estimates and the continued positive performance of our securitized loans and the limited service hospitality industry.

Discount rates utilized from December 31, 2005 to December 31, 2006 have increased by approximately 20 basis points (0.20%) due primarily to rising interest rates.

The following is a sensitivity analysis of our Retained Interests as of December 31, 2006 to highlight the volatility that results when prepayments, loan losses and discount rates are different than our assumptions:

Changed Assumption	Estimated Fair Value	Asset Change (1)
	(In thousands)	
Losses increase by 50 basis points per annum (2)	$ 54,157	($1,567)
Losses increase by 100 basis points per annum (2)	$ 52,583	($3,141)

Rate of prepayment increases by 5% per annum (3)	$ 55,136	($ 588)
Rate of prepayment increases by 10% per annum (3)	$ 54,709	($1,015)
Discount rates increase by 100 basis points	$ 54,127	($1,597)
Discount rates increase by 200 basis points	$ 52,595	($3,129)

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

(2) If we experience significant losses (i.e., in excess of anticipated losses), the effect on our Retained Interests would first reduce the value of the interest-only strip receivables. To the extent the interest-only strip receivables could not fully absorb the losses, the effect would then be to reduce the value of our reserve funds and then the value of our required overcollateralization.

(3) For example, a 16% assumed rate of prepayment would be increased to 21% or 26% based on increases of 5% or 10% per annum, respectively.

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

Valuation of Rent and Related Receivables

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

We performed an analysis of our anticipated future proceeds related to the Arlington bankruptcy to determine the collectibility of our investment in the rent and related receivables based on best available information provided to us through the bankruptcy proceedings. As a result, we established an allowance of $1,255,000 during 2005. We recorded additional allowances of $925,000 during 2006. Accordingly, our net recorded investment was $567,000 at December 31, 2006. To the extent there is a reduction of the anticipated future proceeds, we would record an additional allowance against these receivables.

Valuation of Real Estate Investments

At December 31, 2006, two of the three hotel properties that we own were included in our consolidated financial statements. As these properties have mortgages (which were assumed in the original purchase from AHI) with significant prepayment penalties, we do not anticipate selling these properties until the properties market values increase or the prepayment penalties decrease. We are currently marketing to lease these two properties.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment of or Disposal of Long-Lived Assets, (SFAS No. 144) our hotel properties are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. We consider each hotel property to be an identifiable component of our business. In accordance with SFAS No. 144, we do not consider hotels as held for sale until it is probable that the sale will be completed within one year. The determination of held for sale status is assessed based on all available facts and circumstances, including management s intent and ability to eliminate the cash flows of the property from the Company s operations and management s intent and ability not to have significant continuing involvement in the operations of the property.

We discontinue depreciation on hotel properties if they are classified as held for sale. Upon designation of a hotel property as held for sale, we compare the carrying value of the hotel property to its estimated fair value, less costs to sell. We will reclassify the hotel property to real estate investment held for sale on our consolidated balance sheet at the lesser of its carrying value or its estimated fair value, less costs to sell. Any adjustment to the carrying value of a hotel property classified as held for sale is reflected in discontinued operations in our consolidated statements of income as impairment losses. In addition, the operating results of those properties classified as held for sale or that have been sold are included in discontinued operations.

We periodically review our real estate investments for impairment. If facts or circumstances support the possibility of impairment, we will prepare a projection of the undiscounted future cash flows without interest charges for the specific property. Impairment exists if the estimate of future cash flows expected to result from the use and ultimate disposition of the specific property is less than its carrying value. If impairment is indicated, an adjustment will be made to the carrying value of the property based on the difference between the current estimated fair value and the depreciated cost of the asset.

Revenue Recognition Policies

Interest Income

Interest income includes interest earned on loans and our short-term investments and the amortization of net loan origination fees and discounts. Interest income on loans is accrued as earned with the accrual of interest generally suspended when the related loan becomes a non-accrual loan. A loan receivable is generally classified as non-accrual (a Non-Accrual Loan) if (1) it is past due as to payment of principal or interest for a period of more than 60 days, (2) any portion of the loan is classified as doubtful or is charged-off or (3) if the repayment in full of the principal and/or interest is in doubt. Generally, loans are charged-off when management determines that we will be unable to collect any remaining amounts due under the loan agreement, either through liquidation of collateral or other means. Interest income on a Non-Accrual Loan is recognized on either the cash basis or the cost recovery basis.

When originating a loan receivable, we generally charge a commitment fee. These fees, net of costs, are deferred and recognized as an adjustment of yield over the life of the related loan receivable using a method which approximates the effective interest method.

For purchased loans, we may have discounts representing the difference between the unamortized principal balance of the loan and its estimated fair value at the date of purchase. For performing loans, these discounts are recognized as an adjustment of yield over the life of the related loan receivable using a method which approximates the effective interest method.

For loans originated under the SBA 7(a) Program, when we sell the SBA guaranteed portion of the loans, a portion of the sale proceeds representing the difference in the face amount of the unguaranteed portion of the loans and the value of the loans (the Retained Loan Discount) is determined on a relative fair value basis and is recorded as a reduction in basis of the retained portion of the loan rather than premium income. The Retained Loan Discount is amortized to interest income over the life of the underlying loan using the effective interest method unless the underlying loan receivable is prepaid or sold.

Income from Retained Interests

The income from our Retained Interests represents the accretion (recognized using the effective interest method) on our Retained Interests which is determined based on estimates of future cash flows and includes any fees collected (*i.e.,* late fees, prepayment fees, etc.) by the QSPEs in excess of anticipated fees. We update our cash flow assumptions on a quarterly basis and any changes to cash flow assumptions impact the yield on our Retained Interests.

Lease Income

Lease income consists primarily of base rent on our properties and when applicable, straight-line rental income. We record lease income on a straight-line basis (when applicable) over the estimated lease term to the extent collectibility is reasonably assured.

RESULTS OF OPERATIONS

Year Ended December 31, 2006 Compared to the Year Ended December 31, 2005

Overview

Our income from continuing operations increased by $4,270,000 to $13,648,000 ($1.27 per share) during 2006 from $9,378,000 ($0.86 per share) during 2005. The lending division s income from continuing operations increased to $14,977,000 during 2006 from $11,807,000 during 2005. Our property division s loss from continuing operations decreased to $1,329,000 during 2006 from $2,429,000 during 2005. As described in more detail below, significant changes between these periods were:

An increase in interest income of $3,882,000 due primarily to increases in variable interest rates and our weighted average loans outstanding;

A gain from early extinguishment of debt of $563,000 resulting from the repayment of $7,310,000 of debentures with unamortized premiums; and

An increase in other income of $535,000 due primarily to prepayment fees received; partially offset by

An increase in interest expense of $747,000 due primarily to increases in variable interest rates and borrowings under our conduit facility, and

A net decrease in hotel property related income of $385,000 as a result of the rejection in January 2006 of our hotel property leases by our tenant and the subsequent operation of the properties by third party management companies.

Discontinued operations increased by $117,000 to $2,036,000 ($0.19 per share) during 2006 from $1,919,000 ($0.18 per share) during 2005. As described in more detail below, significant changes between these periods were:

Impairment losses decreased by $1,680,000; partially offset by

Net gains on property sales decreased by $192,000; and

Net earnings from our hotel properties decreased by $1,371,000.

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

Revenues

Interest income consisted of the following:

	Years Ended December 31,		
	2006	2005	Increase
	(In thousands)		
Interest income loans	$ 14,781	$ 11,106	$ 3,675
Accretion of loan fees and discounts	437	297	140
Interest income idle funds	242	175	67
	$ 15,460	$ 11,578	$ 3,882

The increase in interest income loans was primarily attributable to increases in (1) variable interest rates (both prime and LIBOR) and (2) our weighted average loans receivable outstanding of $18.7 million (14%) to $155.6 million during 2006 from $136.9 million during 2005. The weighted average LIBOR and prime rate used in the determination of interest rates charged to our borrowers increased by approximately 180 basis points and 190 basis points, respectively from 2005 to 2006. Our weighted average interest rate increased from 8.5% at December 31, 2005 to 9.4% at December 31, 2006. As of December 31, 2006, approximately 86% of our loans receivable had variable interest rates.

Income from Retained Interests decreased $68,000 primarily due to (1) a decrease in the weighted average balance of our Retained Interests outstanding of $6.9 million to $58.3 million during 2006 compared to $65.2 million during 2005 and (2) a decrease in unanticipated prepayment fees of $242,000. Partially offsetting these decreases was an increase in accretion income primarily due to an increase in anticipated future cash flows resulting mainly from a reduction in future anticipated losses. The income from our Retained Interests consists of the accretion on our Retained Interests which is determined based on estimates of future cash flows and includes any fees collected by the QSPEs in excess of anticipated fees. The yield on our Retained Interests, which is comprised of the income earned less permanent impairments, increased to 14.1% during 2006 from 13.8% during 2005. Excluding the impact of permanent impairments, the yield on our Retained Interests increased to 16.1% during 2006 from 14.5% during 2005.

Other income consisted of the following:

	Years Ended December 31,		Increase
	2006	2005	(Decrease)
	(In thousands)		
Prepayment fees	$ 1,653	$ 590	$ 1,063
Servicing income	1,025	1,222	(197)
Premium income	499	618	(119)
Other loan related income	403	646	(243)
Equity in earnings of unconsolidated subsidiaries	76	45	31
	$ 3,656	$ 3,121	$ 535

Prepayment activity has remained at high levels and we believe that we will continue to see prepayment activity at these higher levels during 2007. Prepayment activity for our fixed-rate loans receivable has remained at high levels as a result of the continued low long-term interest rate environment combined with increased competition and the effect of the reduction or expiration of prepayment fees. In addition, prepayment activity for our variable-rate loans receivable has increased since borrowers with variable-rate loans are generally seeking fixed-rate loans due to currently marketed fixed interest rates being lower than the current interest rate on their loan and/or concerns of rising interest rates. To the extent that prepayments are for variable-rate loans, the prepayment fees will generally not be as great as the fees on our fixed-rate loans.

We earn fees for servicing all loans held by the QSPEs and loans sold into the secondary market by First Western. As these fees are based on the principal balances of sold loans outstanding, until we complete our next securitization, they will decrease over time as scheduled principal payments and prepayments occur.

Premium income results from the sale of First Western s loans into the secondary market. We sold 14 loans during both 2006 and 2005 and collected cash premiums of $615,000 and $700,000 during 2006 and 2005, respectively. Effective in May 2006, First Western is a Preferred Lender nationwide. In addition, we recently expanded our marketing initiatives for origination of SBA 7(a) Program loans. As a result, we anticipate that our originations under the SBA 7(a) Program should increase; however, to date we have not realized a significant increase in origination volume or commitments since our marketing efforts generally take time to provide benefits. To the extent we are able to increase our volume of loans originated by First Western, there should be a corresponding increase in premiums received.

Other loan related income includes late fees, assumption fees, forfeited commitment fees and other fees. These fees primarily represent one-time increases in our other income when collected and/or earned. Other loan related income decreased from 2005 to 2006 primarily due to a decrease in assumption fees.

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Interest Expense

Interest expense consisted of the following:

	Years Ended December 31, 2006	2005	Increase (Decrease)
	(In thousands)		
Junior subordinated notes	$ 2,318	$ 1,497	$ 821
Conduit facility	1,383	724	659
Debentures payable	813	971	(158)
Mortgages on hotel properties	304	346	(42)
Structured notes	201	451	(250)
Revolving credit facility	125	214	(89)
Uncollateralized notes payable		223	(223)
Other	291	262	29
	$ 5,435	$ 4,688	$ 747

Total interest expense increased primarily as a result of an increase in variable interest rates (LIBOR) and outstanding borrowings under our conduit facility. The weighted average LIBOR used in the determination of interest rates charged on our outstanding obligations with variable interest rates increased by approximately 180 basis points from 2005 to 2006. The weighted average cost of our funds at December 31, 2006 was 7.1% compared to 6.5% at December 31, 2005. In addition, during March 2005 we prepaid $20 million of uncollateralized notes with proceeds from our junior subordinated notes. Interest on our junior subordinated notes increased (1) by approximately $400,000 since they were outstanding 12 months during 2006 compared to ten months during 2005 and (2) by approximately $400,000 due to increases in LIBOR. Interest on our conduit facility and revolving credit facility increased primarily as a result of increased utilization of the facilities mainly to fund loans during the fourth quarter of 2006. Our average outstanding balance on our credit facilities increased to $18.4 million during 2006 compared to $13.2 million during 2005.

On September 1, 2006, we prepaid, without penalty, $7,310,000 of fixed-rate SBA debentures with an interest rate of approximately 8.5%. In addition, the remaining balance outstanding on our structured notes was repaid on December 1, 2006.

Other Expenses

Our combined expenses for general and administrative and salaries and related benefits remained relatively constant at $7,387,000 during 2006 compared to $7,548,000 during 2005. General and administrative expenses decreased to $2,648,000 during 2006 from $2,995,000 during 2005 primarily related to a decrease in legal fees, mainly those associated with Arlington s bankruptcies. Salaries and related benefits increased to $4,739,000 during 2006 from $4,553,000 during 2005 due primarily to an increase in bonuses to executive officers and cost of living increases.

Permanent impairments on Retained Interests were $1,167,000 for 2006 resulting from reductions in expected future cash flows due primarily to increased actual and anticipated prepayments. During 2005, we had $467,000 of permanent impairments on Retained Interests primarily due to reductions in expected future cash flows due to increased anticipated and actual prepayments mainly on our acquired Retained Interests.

Impairment losses were $436,000 for 2005 while we had no impairment losses during 2006. Our impairment losses recorded during 2005 were a result of Arlington s defaults under the lease agreements. We performed a recoverability test to determine if the future undiscounted cash flows over our expected holding period for the hotel properties exceeded the carrying value of the hotel properties. Future cash flows were based on estimated future rent payments to be received on the hotel properties, proceeds from the sale and/or termination fees and property operations, if applicable.

Provision for losses on rent and related receivables was $925,000 and $1,255,000 during 2006 and 2005, respectively. Provision for losses during 2006 primarily resulted from reductions in available cash due to

unanticipated and unforecasted cash expenditures by Arlington. Provision for losses during 2005 pertained to our initial evaluation of rent and related receivables subsequent to the bankruptcy of AHI. We performed analyses of our anticipated future distribution related to the bankruptcy of Arlington based on best available information provided to us through the bankruptcy proceedings to determine the collectibility of our investment in the rent and related receivables. Due to the uncertainties regarding the bankruptcy proceedings, there can be no assurance that we will be awarded, or ultimately receive, any proceeds from the Arlington bankruptcy proceedings. To the extent there is a reduction of the anticipated future proceeds, we would record an additional allowance against these receivables. The bankruptcy estates/debtors continue to litigate certain claims asserted by other creditors, including claims related to the initial financing provided to the debtors and other outstanding secured claims. These disputes have led to protracted and expensive litigation that has yet to be completed. Our anticipated recovery continues to be diminished and delayed as long as these disputes remain outstanding. The litigation between the debtors and the other creditors has been expensive and will continue to have an adverse effect on our potential recovery. As for our claims in the bankruptcy cases (and the debtors claims in response), we anticipate trying to negotiate a settlement of those claims with the debtors; however, there is no certainty that we will be able to settle with the debtors or that any settlement would be approved by the official unsecured creditor s committee or the Bankruptcy Court, among others. Further, our future prospects for recovery from the bankruptcy estates continues to be impacted by the litigation with third parties.

Provision for loan losses, net, was $103,000 during 2006 and $298,000 during 2005. We recorded loan loss reserves of $186,500 during 2005 primarily related to a limited service hospitality property on which significant doubt existed as to the ultimate realization of the loan. The primary collateral underlying the loan was acquired through foreclosure during January 2006 and the property was sold in May 2006.

Income tax provision remained constant at $649,000 during 2006 compared to $658,000 during 2005. Our income tax provision decreased due to an increase in costs reimbursed by one of our taxable lending subsidiaries to PMC Commercial Trust. This decrease was offset by an increase in the profitability of our lending subsidiaries due to increased interest income and prepayment fees.

Hotel Property Activity

Hotel property activity consists of lease income, hotel property revenues and expenses. During 2005, we recorded lease revenue of $942,000 compared to $58,000 during 2006, a decrease of $884,000. Effective February 1, 2006, upon rejection of the leases by our former tenant, we no longer collected rent on the hotel properties. As a result, during January 2006 we commenced operating the hotel properties through third party management companies. The operations of hotel properties sold prior to December 31, 2006 are included in discontinued operations. Partially offsetting the decrease in lease income is net income of $499,000 generated from the operations of our remaining hotel properties during 2006. Hotel property revenues were $2,113,000 and hotel property expenses were $1,614,000 during 2006.

One of our remaining hotel properties was leased effective September 29, 2006 with annual base rent of $116,700. The lessee has the option, and is expected to exercise this option, to purchase the property for $1,825,000 at termination of the lease in January 2011 or earlier if certain events occur. Due to the nature of the lease, the subsidiary that owns the hotel property is no longer consolidated in our financial statements and the equity method is used to account for our investment in the subsidiary effective September 29, 2006. We are currently marketing to lease the remaining two properties.

Gain on Early Extinguishment of Debt

Gain on early extinguishment of debt represents a gain of $563,000 resulting from the repayment of $7,310,000 of SBA debentures owed by our SBICs which were prepaid, without penalty, on September 1, 2006. The debentures had a carrying value of $7,873,000 when repaid. When acquired in the merger, these debentures were recorded at fair value which was greater than face value. Management s decision to repay the debentures was based upon excess cash at the subsidiary levels which was unavailable, due to SBIC requirements, to be used by the parent company. In addition, there were no significant loan commitments at the SBIC level.

Discontinued Operations

We had net realized gains on the sales of real estate of $2,064,000 during 2006 resulting primarily from the sale of ten hotel properties for approximately $20.6 million generating gains of approximately $1.9 million and eight assets

acquired in liquidation for approximately $4.1 million generating gains of approximately $0.2 million. As the

down payments received were not sufficient to qualify for full accrual gain treatment on certain of the sales, we recorded initial installment gains and deferred the remaining gains. Our deferred gains total approximately $1.6 million at December 31, 2006. We had net realized gains on sale of real estate of $2,256,000 during 2005 resulting primarily from the sale of (1) six hotel properties for net sales proceeds of approximately $12.8 million and cost of sales of approximately $11.5 million and (2) two assets acquired in liquidation (one of which was a limited service hospitality property and the other a retail establishment) for net sales proceeds of approximately $2.8 million and cost of sales of approximately $1.9 million. In addition, during 2005 we sold a limited service hospitality property for $3,098,000. As the down payment received was not sufficient to qualify for full accrual gain treatment, we recorded an installment gain of approximately $86,000 during 2005 and the remaining gain of approximately $344,000 was deferred. Deferred gains are recorded to income as principal is received on the related loans receivable until the required amount of cash proceeds are obtained from the purchaser to qualify for full accrual gain treatment. In addition, upon receipt of updated financial information from the purchaser, if the requirements are met, the transaction would qualify for the full accrual method and the remaining deferred gain would be recognized.

Impairment losses were $94,000 for 2006. We performed a recoverability test to determine if the expected net sales proceeds for the hotel properties exceeded the carrying value of the hotel properties. Based on this analysis, we recorded impairment losses of $43,000 on our hotel properties during 2006. In addition, we recorded an impairment loss of $51,000 related to an asset acquired in liquidation due to a decline in the estimate of its value. During 2005, we recorded impairment losses of $1,774,000 on our hotel properties.

Net earnings from discontinued operations were $66,000 during 2006 compared to $1,437,000 during 2005. During 2005, our tenant was obligated for rent. Due to the tenant s bankruptcy filing, effective January 2006 the leases were rejected and for any properties that had not been sold we commenced operations through third party management companies. Accordingly, the primary reason for the decrease in net earnings from discontinued operations was a reduction in rent income, including base rent and straight-line rent, of approximately $3.7 million when comparing 2006 to 2005. This reduction was partially offset by a decrease in depreciation expense of approximately $0.9 million due to the discontinuation of depreciation on our held for sale properties and a reduction in property tax expense of $0.9 million resulting primarily from the sale of properties. Net earnings from discontinued operations included 12 and 16 hotel properties during 2006 and 2005, respectively, and assets acquired in liquidation (primarily three limited service hospitality properties) during 2006.

Year Ended December 31, 2005 Compared to the Year Ended December 31, 2004

Overview

Our income from continuing operations decreased to $9,378,000 during 2005 from $9,923,000 during 2004. Income from continuing operations during 2005 includes a provision for loss on our rent and related receivables of $1,255,000, impairment losses of $436,000 on our real estate investments held for use and permanent impairments on our Retained Interests of $467,000. Income from continuing operations during 2004 includes permanent impairments on our Retained Interests of $1,182,000. Excluding these significant non-cash items, our income from continuing operations would have remained relatively constant at $11,536,000 during 2005 compared to $11,105,000 during 2004. The lending division s income from continuing operations increased to $11,807,000 during 2005 from $9,960,000 during 2004 while our property division had losses from continuing operations of $2,429,000 during 2005 and $37,000 during 2004 due primarily to the losses described above.

Our total revenues increased by approximately $4.2 million compared to 2004 primarily from an increase in interest income due to an increase in our loans receivable outstanding and an increase in variable interest rates (both prime and LIBOR). Our loans receivable increased as a result of loans acquired in the merger ($55.1 million) and loan originations during 2004 ($53.7 million) and 2005 ($58.9 million). During 2005, our income from Retained Interests increased approximately $0.7 million due to the merger, increased accretion rates and unanticipated prepayment fees.

Our total expenses increased by approximately $4.2 million primarily as a result of (1) increased overhead (comprised of salaries and related benefits, general and administrative and advisory and servicing fees expense) of approximately $1.9 million due in large part to the increase in our serviced investment portfolio from the merger (upon merger with PMC Capital, we became a self-managed REIT whereas historically we were managed by PMC Capital pursuant to an advisory and servicing agreement) and increased professional fees primarily relating to

Arlington s bankruptcy and increased accounting/auditing fees, (2) a provision for loss on our rent and related receivables of approximately $1.3 million, (3) increased interest expense of approximately $0.8 million due primarily to an increase in outstanding debt mainly due to borrowings necessary to fund our increased loan portfolio and an increase in LIBOR which increased interest on our variable-rate debt and (4) impairment losses of

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approximately $0.4 million on our real estate investments included in continuing operations. The merger substantially increased our overhead effective March 1, 2004 as a result of the significant increase in assets under management. Therefore, the impact was less in 2004 (ten months post merger) than 2005 (12 months).

Our discontinued operations provided income of $3.3 million during 2004 and $1.9 million during 2005. Included in discontinued operations were gains on sales of real estate of $2,256,000 during 2005 resulting primarily from the sale of six hotel properties and two assets acquired in liquidation. In addition, we incurred impairment losses of $1,774,000 during 2005 related to our hotel properties.

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

Revenues

Interest income consisted of the following:

	Years Ended December 31,		Increase
	2005	2004	(Decrease)
	(In thousands)		
Interest income loans	$ 11,106	$ 7,588	$ 3,518
Accretion of loan fees and discounts	297	290	7
Interest income idle funds	175	284	(109)
	$ 11,578	$ 8,162	$ 3,416

The increase in interest income loans was primarily attributable to an increase in (1) our loan portfolio (our weighted average loans receivable outstanding increased $36.1 million (36%) to $136.9 million during 2005 from $100.8 million during 2004) primarily as a result of loans acquired in the merger and loan originations and (2) the weighted average interest rate on our loans receivable from 7.1% at December 31, 2004 to 8.5% at December 31, 2005. The increase in our weighted average interest rate is primarily due to increases in LIBOR and the prime rate. At December 31, 2005, approximately 88% of our loans receivable had variable interest rates.

Lease income consisted of the following:

	Years Ended December 31,		Increase
	2005	2004	(Decrease)
	(In thousands)		
Base rent	$ 696	$ 821	$ (125)
Straight-line rent	215	107	108
Percentage rent	24	83	(59)
Other	7	6	1
	$ 942	$ 1,017	$ (75)

In addition to rent being paid during 2005, rent was paid for January 2006; however, during January 2006, Arlington rejected all remaining property leases.

Changes in, and descriptions of, lease income are as follows:

Base rent: Base rent consisted of the required monthly rental payment obligation from Arlington. Base rent declined due to the decrease in the pay rate from approximately 10.5% to 8.5% of the stated value established for the hotel properties based on the terms of the lease agreement (effective October 2004);

Straight-line rent: In accordance with the terms of the lease agreement, beginning in October 2004, we recorded lease income on a straight-line basis based on all remaining payments due from Arlington over the remaining fixed non-cancelable term of the lease agreement; however, due to the uncertainty of collection we discontinued recording straight-line rent effective July 1, 2005;

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Percentage rent: We historically received percentage rent equal to 4% of the gross room revenues of the hotel properties for future capital expenditures. Arlington did not pay the percentage rent due commencing May 2005. Due to the uncertainty of collection, we discontinued recording percentage rent effective May 1, 2005.

The primary reasons for the increase in income from Retained Interests of approximately $0.7 million were (1) increased accretion income of approximately $588,000 due to a combination of a full year of accretion during 2005 for Retained Interests acquired in the merger compared to ten months during 2004 and an increase in accretion rates and (2) an increase in the collection of unanticipated prepayment fees of approximately $80,000. The weighted average balance of our Retained Interests decreased during 2005 to $65.2 million from $65.9 million during 2004. The income from our Retained Interests consists of the accretion earned on our Retained Interests which is determined based on estimates of future cash flows and includes any fees collected by the QSPEs in excess of anticipated fees. The yield on our Retained Interests, which is comprised of the income earned less permanent impairments, increased to 13.8% during 2005 from 11.5% during 2004. Excluding the impact of permanent impairments, the yield on our Retained Interests increased to 14.5% during 2005 from 13.3% during 2004.

Other income consisted of the following:

	Years Ended December 31,		Increase
	2005	2004	(Decrease)
	(In thousands)		
Servicing income	$ 1,222	$ 1,142	$ 80
Other loan related income	646	475	171
Premium income	618	526	92
Prepayment fees	590	656	(66)
Equity in earnings of unconsolidated subsidiary	45		45
Debt release income		175	(175)
	$ 3,121	$ 2,974	$ 147

As a result of the merger, we earn fees for servicing all loans held by the QSPEs and loans sold into the secondary market by our SBLC. As these fees are based on the principal balances of Sold Loans outstanding, they will naturally decrease over time as scheduled principal payments and prepayments occur. The increase during 2005 compared to 2004 is due primarily to the merger occurring on February 29, 2004.

Our prepayment activity has remained at relatively high levels. Prepayment fees on our variable-rate loans receivable are generally less than on our fixed-rate loans receivable which are generally based on a yield maintenance premium. At December 31, 2005, approximately 88% of our loans receivable had variable interest rates; therefore, while our prepayment activity has continued at higher levels, the prepayment fees we received have decreased.

Other loan related income includes late fees, assumption fees, forfeited commitment fees and other fees. These fees represent one-time increases in our other income when collected and/or earned.

Premium income results from the sale of loans into the secondary market by our SBLC. We sold 14 loans during 2005 and collected cash premiums of approximately $700,000. To the extent we were to increase our volume of loans originated by our SBLC, there should be a corresponding increase in premiums received.

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Interest Expense

Interest expense consisted of the following:

	Years Ended December 31, 2005	2004	Increase (Decrease)
	(In thousands)		
Junior subordinated notes	$ 1,497	$	$ 1,497
Debentures	971	976	(5)
Conduit facility	724		724
Mortgages on hotel properties	346	361	(15)
Structured notes	451	880	(429)
Uncollateralized notes payable	223	970	(747)
Revolving credit facility	214	471	(257)
Other	262	215	47
	$ 4,688	$ 3,873	$ 815

Interest expense increased primarily as a result of an increase in our outstanding debt which corresponded to the increase in our loan portfolio including the loans acquired in the merger. Our average debt outstanding increased by 8% to $78.3 million during 2005 from $72.5 million during 2004. In addition, since we have variable-rate debt, the cost of funds on that debt has increased due to increases in LIBOR and the prime rate. The weighted average cost of our funds at December 31, 2005 was 6.5% compared to 5.9% at December 31, 2004.

During March 2005, we prepaid $20 million of uncollateralized notes with proceeds from our junior subordinated notes. The cost of funds on the junior subordinated notes is LIBOR plus 3.25%. The cost of funds for the uncollateralized notes payable was 7.44% on $10 million and LIBOR plus 1.3% on the other $10 million. In addition, the cost of funds for our conduit facility approximates LIBOR, plus 1% and our current revolving credit facility cost of funds is LIBOR plus 1.625%.

During March 2005, we rolled-over $4.0 million of debentures and repaid $3.0 million of debentures. Our debentures had a weighted average cost of funds of 6.0% at December 31, 2005.

At December 31, 2005, we had mortgage notes related to our hotel properties included in continuing operations. These mortgages mature from January 2011 to December 2017 and have restrictive provisions which provide for substantial prepayment penalties.

The average structured notes outstanding decreased to $6.2 million during 2005 from $13.0 million during 2004.

Other Expenses

During the first two months of 2004, (1) our overhead expense for identifying, originating and servicing our investment portfolio and costs of corporate overhead was covered by an investment advisory agreement with PMC Capital and (2) other general and administrative costs were limited primarily to professional fees, directors and officers insurance, trust manager fees and shareholder expenses. As a result of the merger, on March 1, 2004, we became a self-managed REIT and our assets under management substantially increased from approximately $244.4 million to approximately $563.9 million. Beginning March 1, 2004, our operating expenses consisted of salaries and related benefits, rent and other general and administrative expenses necessary to service our investment portfolio, identify and originate new investments and provide for our corporate administrative needs. Since our assets under management increased, the increase in our general and administrative expenses is greater than our historical advisory fee expense.

Our combined general and administrative expenses, advisory fee expense and salaries and related benefits during 2005 increased from $5.7 million during 2004 to $7.5 million during 2005 primarily as a result of the increased costs related to our larger investment portfolio and corporate structure. In addition, our professional fees, including accounting, legal and consulting services, increased to $1,755,000 during 2005 from $880,000 during

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2004. The increase related primarily to accounting and auditing fees and legal fees, including those associated with Arlington s bankruptcies. Direct costs associated with the Sarbanes-Oxley Act of 2002 were approximately $390,000 during both 2005 and 2004. Our salaries and related benefits were $3,557,000 for the ten months of 2004 or $4,268,000 on an annualized basis compared to $4,553,000 during 2005. The 6.7% increase was primarily due to cost of living salary increases and increased costs associated with share-based compensation awards.

Permanent impairments on Retained Interests were $467,000 during 2005 compared to $1,182,000 during 2004. The permanent impairments during 2005 resulted primarily from reductions in expected future cash flows due to increased anticipated and actual prepayments primarily on our acquired Retained Interests while the permanent impairments during 2004 resulted primarily from reductions in expected future cash flows due to increased anticipated and actual prepayments and anticipated losses primarily on our acquired Retained Interests.

We recorded impairment losses of $436,000 during 2005 on our hotel properties to be held and used. We performed a recoverability test to determine if the future undiscounted cash flows over our expected holding period for the hotel properties exceeded their carrying value. Future cash flows are based on anticipated proceeds from the sale and anticipated property operations or lease income. No impairment losses were recorded during 2004.

We performed an analysis of our anticipated future proceeds related to the Arlington bankruptcy based on best available information provided to us through the bankruptcy proceedings to determine the collectibility of our investment in the rent and related receivables. Based on this analysis, we recorded a provision for loss of $1,255,000 during 2005. If anticipated future proceeds decline, we would record an additional allowance against these receivables and losses would result.

Our provision for (reduction of) loan losses, net, was $298,000 during 2005 and ($253,000) during 2004. We recorded loan loss reserves of $186,500 during 2005 primarily related to a limited service hospitality property on which significant doubt existed as to the ultimate realization of the loan. The primary collateral underlying the loan was acquired through foreclosure during January 2006. The property was sold in May 2006. During 2004, we reversed $675,000 of previously recorded loan loss reserves due to the reduction in the expected loss on a loan collateralized by a limited service hospitality property due to repayment in full of all principal on the loan. We recorded loan loss reserves of $422,000 during 2004 primarily related to two limited service hospitality properties on which significant doubt existed as to the ultimate realization of the loans.

Our income tax provision increased to $658,000 during 2005 compared to $116,000 during 2004. PMC Commercial has four wholly-owned taxable REIT subsidiaries which are subject to Federal income taxes. The income generated from these taxable REIT subsidiaries is taxed at normal corporate rates.

Discontinued Operations

During 2005, 16 hotel properties were included in discontinued operations while during 2004, 18 hotel properties were included in discontinued operations. The primary reasons for the decrease in net earnings from discontinued operations of approximately $2.1 million during 2005 were (1) property tax expense of $895,000 recorded during 2005 for the properties sold or considered held for sale, (2) lease termination fee income of $624,000 recorded during 2004 and (3) a 20% reduction in rent charged from 2004 to 2005. Per the lease agreement, Arlington is obligated to pay all property taxes on the hotel properties. However, to the extent Arlington did not make the required property tax payments, these property taxes were our responsibility, although we are pursuing recovery from Arlington. Pursuant to the sale of a hotel property in August 2004, we received a lease termination fee from Arlington in the form of a note receivable with an estimated fair value of $624,000 which is included in net earnings from discontinued operations.

We had gains on the sales of real estate of $2,256,000 during 2005 resulting primarily from the sale of (1) six hotel properties for net sales proceeds of approximately $12.8 million and cost of sales of approximately $11.5 million and (2) two assets acquired in liquidation (one of which was a limited service hospitality property and the other a retail establishment) for net sales proceeds of approximately $2.8 million and cost of sales of approximately $1.9 million. In addition, during 2005 we sold a limited service hospitality property for $3,098,000. As the down payment received was not sufficient to qualify for full accrual gain treatment, we recorded an installment gain of approximately $86,000 during 2005 and the remaining gain of approximately $344,000 was deferred.

During 2004 we had a net loss on sales of real estate of $252,000 primarily comprised of the sale of a limited service hospitality property acquired through liquidation of the collateral underlying a loan and the sale of two hotel

properties. The limited service hospitality property was sold for approximately $1.5 million and generated

a gain of approximately $205,000. The two hotel properties were sold during August 2004 and December 2004 for approximately $1.8 million each resulting in losses of approximately $354,000 and $116,000, respectively.

For our hotel properties to be sold, we performed a recoverability test to determine if the expected net sales proceeds for the hotel properties exceeded their carrying value. As a result, we recorded impairment losses of $1,774,000 during 2005. No impairment losses were recorded during 2004.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Analysis

Information on our cash flow was as follows:

	Years Ended December 31, 2006	2005	Change
	(in thousands)		
Cash provided by operating activities	$ 13,832	$ 16,029	$ (2,197)
Cash provided by (used in) investing activities	$ 16,377	$ (12,962)	$ 29,339
Cash used in financing activities	$ (30,437)	$ (8,165)	$ (22,272)

In general, we experienced significantly greater positive cash flow from investing activities during 2006 due to the heavy prepayments on our loans combined with low amounts of cash used for originating loans. These cash flows were used, in general, to repay outstanding debt which increased our cash used in financing activities. See Executive Summary.

Operating Activities

Our net cash flow from operating activities is primarily used to fund our dividends. The decrease in cash provided by operating activities was primarily related to changes in our operating assets and liabilities. We had a decrease of $2,410,000 in borrower advances due primarily to the repayment of certain loans and release of borrower advances. Our dividends paid during 2006 and 2005, included in financing activities, were $12,903,000 and $14,037,000, respectively.

Investing Activities

During 2006, the primary sources of funds were (1) net principal collected on Retained Interests of $5,085,000, (2) net proceeds from the sales of hotel properties and assets acquired in liquidation of $4,307,000 and (3) principal collected on loans receivable in excess of loans funded of $3,872,000. During 2005, the primary sources of funds were net proceeds from the sales of hotel properties and assets acquired in liquidation of $10,940,000 and net principal collected on Retained Interests of $4,080,000. Funds used in investing activities during 2005 consisted primarily of loans funded in excess of principal collected on loans receivable of $26,859,000. The change in net loans funded is primarily due to high prepayment activity. This increased prepayment activity is primarily a result of competitors providing refinance opportunities to our borrowers combined with the effect of the reduction or expiration of prepayment fees on certain of our loans due to the structure of the fees (*i.e.,* expiration of lock out or yield maintenance provisions). In addition, prepayment activity for our variable-rate loans receivable has increased since borrowers with variable-rate loans are generally seeking fixed-rate loans due to currently marketed fixed interest rates being lower than the current interest rate on their loan and/or concerns of rising interest rates. We believe that we will continue to see prepayment activity at these higher levels during 2007.

Financing Activities

We used funds in financing activities during 2006 primarily for payment of principal on mortgages payable and debentures of $19,994,000 and dividends of $12,903,000. Our primary source of funds during 2006 was net borrowings on our conduit facility of $2,763,000. Other financing activities during 2005 were generally a repositioning of our debt. We refinanced or repaid (1) $20,000,000 in uncollateralized notes payable acquired in the merger, (2) $3,000,000 of SBA debentures acquired in the merger and (3) $14,600,000 on our revolving credit facility

with proceeds of $27,070,000 of junior subordinated notes and net proceeds of $24,205,000 from our conduit facility.

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Sources and Uses of Funds

General

In general, our liquidity requirements include origination of new loans, debt principal payment requirements, payment of dividends and operating costs. We intend to utilize, as deemed appropriate by prevailing market conditions, a combination of the following sources to generate funds:

- Operating revenues;
- Principal collections on existing loans receivable and Retained Interests;
- Structured loan financings or sales;
- Advances under our conduit facility;
- Borrowings under our short-term uncollateralized revolving credit facility (the Revolver);
- Issuance of SBA debentures;
- Issuance of junior subordinated notes; and/or
- Common equity issuance

We had $3.7 million of cash and cash equivalents at December 31, 2006, of which $2.1 million was available only for future operating commitments of our SBICs. Pursuant to SBA rules and regulations, our SBICs cannot advance funds to us. As a result, we borrow funds on our revolving credit facility or conduit facility to make investments even though our SBICs have available cash and cash equivalents. Our outstanding commitments to fund new loans were $32.6 million at December 31, 2006, of which $2.6 million were for prime-rate based loans to be originated by First Western, the government guaranteed portion of which (approximately 75% of each individual loan) will be sold into the secondary market. Commitments have fixed expiration dates and generally require payment of a fee to us. Since some commitments expire without the proposed loan closing, total committed amounts do not necessarily represent future cash requirements.

We expect that these sources of funds and cash on hand will be sufficient to meet our working capital needs. However, there can be no assurance that we will be able to raise funds through these financing sources. A reduction in the availability of the above sources of funds could have a material adverse effect on our financial condition and results of operations. If these sources are not available, we may have to originate loans at reduced levels or sell assets, potentially on unfavorable terms. Historically, our primary funding source has been the securitization and sale of our loans receivable. Since the completion of our last securitization in October 2003, our working capital has been provided through credit facilities and the issuance of junior subordinated notes in March 2005.

During 2006, we had significant prepayments on our loan portfolio. This excess cash was used to repay debt. Due to this debt reduction, our debt to equity ratio has decreased to 0.52 to 1.00 at December 31, 2006 from 0.64 to 1.00 at December 31, 2005. As a result, we believe our ability to incur additional leverage is currently greater now than at December 31, 2005.

As a REIT we must distribute to our shareholders at least 90% of our REIT taxable income to maintain our tax status under the Code. Accordingly, to the extent the sources above represent taxable income, such amounts have historically been distributed to our shareholders. In general, if we receive less cash from our portfolio of investments, we can lower the dividend so as not to cause any material cash shortfall. During 2007, we anticipate that our cash flows from operating activities will be utilized to fund our expected 2007 dividend distributions and generally will not be available to fund portfolio growth or for the repayment of principal due on our debt.

Source of Funds

Prior to 2004, our primary source of long-term funds was structured loan sale transactions. We generated net proceeds of $39.9 million, $24.0 million, $29.5 million and $49.2 million from the completion of our 2003, 2002,

2001 and 2000 structured loan sale transactions, respectively. The proceeds from future structured loan transactions, if any, are expected to be greater as a result of the merger. However, the timing of future securitization transactions is dependent upon our portfolio and loan originations. As a result of higher than anticipated prepayments on our loan portfolio, we do not anticipate completing our next structured loan transaction until the third or fourth quarter of 2007 when we expect to have a sufficient pool of primarily variable-rate loans to complete a securitization.

Since we have historically relied on structured loan transactions as our primary source of operating capital to fund new loan originations, any adverse changes in our ability to complete this type of transaction, including any

negative impact on the asset-backed securities market for the type of product we generate, could have a detrimental effect on our ability to sell loans receivable thereby reducing our ability to originate loans. The timing of a structured loan transaction also has significant impact on our financial condition and results of operations. We currently have a significant amount of available capital under our Revolver and conduit facility.

A number of factors could impair our ability, or alter our decision, to complete a structured loan transaction. See Item 1A. Risk Factors.

Our subsidiary, PMC Conduit, L.P. (PMC Conduit) has a three-year $100.0 million conduit facility expiring February 6, 2008. Interest payments on the advances are payable by PMC Conduit at a rate approximating 1% over LIBOR and PMC Conduit s principal repayment obligations are expected to be refinanced through future securitizations of the loans collateralizing advances under the conduit facility. In addition, we are charged an unused fee equal to 12.5 basis points computed based on the daily available balance. During February 2007, the interest rate was modified to a rate approximating 85 basis points over LIBOR. PMC Commercial has not guaranteed the repayment of the advances outstanding under the conduit facility. The conduit facility allows for advances based on the amount of eligible collateral sold to the conduit facility and has minimum requirements. At December 31, 2006, approximately $43.6 million of our loans were owned by PMC Conduit and we had outstanding advances of approximately $27.0 million. We had availability of $7.4 million under the conduit facility at December 31, 2006 without additional sales of loans receivable to PMC Conduit. At December 31, 2006, PMC Commercial had available approximately $17.3 million of loans which are eligible to be sold to PMC Conduit. The conduit facility has covenants, the most restrictive of which are maximum delinquency ratios for our contributed loans and serviced portfolio, as defined in the transaction documents. In addition, the conduit facility is subject to cross default provisions with the Revolver. At December 31, 2006, we were in compliance with the covenants of this facility.

At December 31, 2006, we had availability of $20.0 million under our Revolver which matures December 31, 2007. Under our Revolver, we are charged interest on the balance outstanding at our election of either the prime rate of the lender less 75 basis points or 162.5 basis points over the 30, 60 or 90-day LIBOR. In addition, we are charged an unused fee equal to 37.5 basis points computed based on our daily available balance. The credit facility requires us to meet certain covenants, the most restrictive of which provides for an asset coverage test based on our cash and cash equivalents, loans receivable, Retained Interests and real estate investments as a ratio to our senior debt and limits our ability to pay out returns of capital as part of our dividends. The ratio must exceed 1.25 times. At December 31, 2006, we were in compliance with the covenants of this facility.

At December 31, 2006, one of our SBICs had $3.0 million in available commitments from the SBA, expiring in June 2007, to issue future debentures. These debentures will have 10-year maturities, will be charged interest (established on the date of issuance) at a spread over the 10-year treasury rate and will have semi-annual interest-only payments. To the extent funds are needed to originate loans by our SBICs, these pre-approved debentures can be issued subject to regulatory compliance; however, we do not anticipate utilization of this commitment.

Use of Funds

The primary use of our funds is to originate commercial mortgage loans to small businesses in the limited service hospitality industry. During 2007, we anticipate loan originations will range from $55 million to $70 million. See Current Operating Overview and Significant Economic Factors for information on current market conditions. As a REIT, we also use funds for the payment of dividends to shareholders. We also use funds for payment of our operating overhead including salaries and other general and administrative expenses and we have payment requirements of principal and interest on our borrowings.

We may use funds to repurchase loans from the QSPEs which (1) become charged-off as defined in the transaction documents either through delinquency or initiation of foreclosure or (2) reach maturity.

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Information on Consolidated Debt

Information on our consolidated debt was as follows at December 31, 2006:

	Face Amount *(In thousands)*	Range of Maturities	Weighted Average Coupon Rate	Interest Type
Junior subordinated notes (1)	$ 27,070	2035	8.62%	Variable
Debentures	8,190	2013 to 2015	5.90%	Fixed
Mortgage notes (2)	2,642	2011 to 2017	8.02%	Fixed
Conduit facility	26,968	2008	6.35%	Variable
Redeemable preferred stock of subsidiary	4,000	2009 to 2010	4.00%	Fixed
	$ 68,870			

(1) The junior subordinated notes may be redeemed at our option, without penalty, beginning March 30, 2010 and are subordinated to PMC Commercial s existing debt.

(2) Does not include a mortgage note with a principal balance of approximately $1.3 million and a fixed interest rate of 8.5% due January 1, 2011 of an unconsolidated subsidiary.

Seasonality

Generally, our lending segment is not subject to seasonal trends. However, since we primarily lend to the limited service hospitality industry, loan delinquencies typically rise temporarily during the winter months due primarily to

reductions in business travel and consumer vacations.

Revenues for the limited service sector of the hospitality industry are generally lower during the winter months due to weather conditions and business and leisure travel trends, especially in the northeast and midwest sections of the United States where many of our hotel properties collateralizing our loans are located.

Impact of Inflation

In general, if we originate fixed-rate loans while we borrow funds at variable rates, we would have an interest rate mismatch. In an inflationary environment, if variable-rates were to rise significantly and we were originating fixed-rate loans, our net interest margin would be reduced. In general, we have matched our fixed-rate debt with fixed-rate producing assets. We primarily originate variable-rate loans and have approximately $54.0 million (approximately 79% of total debt) in variable-rate debt; therefore, we do not believe inflation will have a significant adverse impact on us in the near future. Over the last three years, inflation has not had a significant impact on us.

To the extent costs of operations (*i.e.,* utilities, salaries, etc.) rise while economic conditions prevent a matching rise in revenues (*i.e.,* room rates, amenities, etc.), our borrowers would be negatively impacted and loan losses could be affected. Accordingly, our borrowers and our results of operations can be impacted by inflation. In addition, in an inflationary environment we may experience pressure to increase our income and dividend yield to maintain our stock price.

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SUMMARIZED CONTRACTUAL OBLIGATIONS, COMMITMENTS AND CONTINGENCIES

The following summarizes our contractual obligations at December 31, 2006:

		Payments Due by Period			
Contractual Obligations	Total	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
	(In thousands, except footnotes)				
Debt:					
Mortgage notes and debentures payable (1)	$ 10,832	$ 142	$ 319	$ 1,222	$ 9,149
Revolver (2)					
Redeemable preferred stock of subsidiary (3)	4,000		2,000	2,000	
Conduit facility	26,968		26,968		
Junior subordinated debt (4)	27,070				27,070
Interest:					
Consolidated debt (1)	72,581	4,760	6,193	5,889	55,739
Mortgage note of unconsolidated subsidiary	402	108	198	96	
Other Contractual Obligations:					
Mortgage note of unconsolidated subsidiary (5)	1,300	65	146	1,089	
Operating lease (6)	973	179	394	400	
Total contractual cash obligations	$ 144,126	$ 5,254	$ 36,218	$ 10,696	$ 91,958

(1) Mortgage notes and debentures payable are presented at face value. For the interest obligation, the variable-rate in effect at December 31, 2006 was utilized and no change in variable interest rates was assumed.

(2) We had availability of

$20.0 million under our Revolver at December 31, 2006.

(3) *The 4% preferred stock of our subsidiary (presented at par value) is required to be repaid at par in September 2009 ($2.0 million) and May 2010 ($2.0 million). Dividends of approximately $160,000 are due annually on the 4% preferred stock of our subsidiary (recorded as interest expense).*

(4) *The junior subordinated notes may be redeemed at our option, without penalty, beginning March 30, 2010 and are subordinated to PMC Commercial s existing debt.*

(5) *Represents a mortgage note with a fixed interest rate of 8.5% of an unconsolidated subsidiary.*

(6) *Represents future minimum lease payments under our operating lease for office space.*

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Our commitments at December 31, 2006 are summarized as follows:

Other Commitments	Total Amounts Committed	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
		Amount of Commitment Expiration Per Period			
	(In thousands, except footnotes)				
Environmental (1)	$	$	$	$	$
Other commitments (2)	32,634	32,634			
Total commitments	$ 32,634	$ 32,634	$	$	$

(1) *PMC Funding Corp. (PMC Funding) has a recorded liability of approximately $300,000 at December 31, 2006 related to a loan with collateral that has environmental remediation obligations which are the primary responsibility of our borrower. Under purchase accounting, the liability was assumed and the loan was acquired by PMC Commercial in the merger with PMC Capital. The loan was originated in connection with the sale of the underlying collateral by*

PMC Funding to the borrower. The sale was financed by PMC Capital through a loan with a current outstanding principal balance of approximately $475,000 which is in default. As a result, we filed a lawsuit in the State of Georgia to appoint a receiver to operate the property and determine if current environmental remediation plans are being followed. The Court has refused to appoint a receiver at the present time. The borrower has filed a counterclaim alleging, among other things, breach of contract and non-default under the loan documents. We do not believe there is any merit to the counterclaim and intend to vigorously pursue all remedies available to us under the law.

During 2005, we were informed by the Georgia Department of Natural Resources that the current remediation plan for the property has certain aspects that require revision. While our borrower has the primary responsibility for the environmental remediation, to the extent we elect to foreclose, we currently believe that the estimated fair value of the collateral underlying the loan exceeds the current outstanding principal balance on the loan. At the present time, we have been unable to quantify additional costs, if any, of the potential changes in remediation methods requested by the State of Georgia; however, these costs could be material and

may exceed the value of the collateral net of the recorded liability and the current outstanding principal balance of the loan.

(2) *Represents loan commitments and approvals outstanding.*

If the SBA establishes that a loss on an SBA guaranteed loan is attributable to significant technical deficiencies in the manner in which the loan was originated, funded or serviced by our subsidiary, First Western, the SBA may seek recovery of funds 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.

See Note 22 to the accompanying consolidated financial statements for a detailed discussion of commitments and contingencies.

OFF-BALANCE SHEET ARRANGEMENTS

Our off-balance sheet arrangements have historically been structured as sales which are our primary method of obtaining funds for new loan originations. In a structured loan sale transaction, we contribute loans receivable to a QSPE that is not subject to consolidation in exchange for cash and beneficial interests in that entity. The QSPE issues notes payable (usually through a private placement) to unaffiliated parties and then distributes a portion of the notes payable proceeds to us. The notes payable are collateralized solely by the assets of the QSPE. The terms of the notes payable issued by the QSPEs provide that the owners of these QSPEs are not liable for any payment on the notes. Accordingly, if the financial assets in the QSPE are insufficient for the trustee 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 QSPE. We have no obligation to pay the notes, nor do the holders of the notes have any recourse against our assets. We account for structured loan sale transactions as sales of our loans receivable and the SPE meets the definition of a QSPE; as a result, neither the loans receivable contributed to the QSPE nor the notes payable issued by the QSPE are included in our consolidated financial statements. See Item 1. Business Structured Loan Transactions and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Valuation of Retained Interests.

On September 29, 2006, we entered into a lease agreement for one of our hotel properties. The property has a

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mortgage with a principal balance of $1.3 million with a significant prepayment penalty. Therefore, we structured the lease with the potential buyer of the property for a term equal to the term remaining on the mortgage (matures January 1, 2011) and then a purchase with a price of $1,825,000. Annual base rent on the lease is $116,700 and the lease is a triple net lease. The lessee provided us with a substantial non-refundable up-front payment of $452,000. The hotel property is owned by a separate subsidiary and is the subsidiary s primary asset. Based on this lease agreement, including the fixed price purchase option, the subsidiary was determined to be a variable interest entity. Since we do not expect to absorb the majority of the entity s future expected losses or receive the entity s expected residual returns, PMC Commercial Trust is not considered to be the primary beneficiary. Thus, the subsidiary is no longer consolidated in PMC Commercial Trust s financial statements and the equity method is used to account for our investment in the subsidiary effective September 29, 2006. The subsidiary is contractually responsible for the mortgage note and its repayment. The subsidiary recorded the lease as an operating lease. Revenues and expenses of the subsidiary are primarily lease income, interest expense on the mortgage payable, depreciation expense on the real estate investment and amortization of deferred lease costs.

RISK MANAGEMENT

In conducting our business, we are exposed to a range of risks including:

Market risk which is the risk to our earnings or capital resulting from adverse changes in the values of assets resulting from movement in market interest rates;

Credit risk which is the risk of loss due to an individual borrower s unwillingness or inability to pay their obligations;

Operations risk which is the risk of loss resulting from systems failure, inadequate controls, human error, fraud or unforeseen catastrophes;

Liquidity risk which is the potential that we would be unable to meet our obligations as they come due because of an inability to liquidate assets or obtain funding. Liquidity risk also includes the risk of having to sell assets at a loss to generate liquid funds, which is a function of the relative liquidity (market depth) of the asset(s) and general market conditions;

Compliance risk which is the risk of loss, including fines or penalties, from failing to comply with Federal, state or local laws, rules and regulations pertaining to lending and licensed activities;

Legal risk which is the risk of loss, disruption or other negative effect on our operations or condition that arises from unenforceable contracts, lawsuits, adverse judgments, or adverse governmental or regulatory proceedings, or the threat thereof; and

Reputational risk which is the risk that negative publicity regarding our practices whether true or not will cause a decline in our customer base.

Our risk management policies and procedures are established and evaluated under the supervision of our Chief Executive Officer. The policies and procedures are designed to focus on the following:

identifying, assessing and reporting on corporate risk exposures and trends;

establishing, and revising as necessary, policies and procedures;

monitoring and reporting on adherence with risk policies; and

approving new product developments on business initiatives.

We cannot provide assurance that our risk management process or our internal controls will prevent or reduce the risks to which we are exposed. See Risk Factors in Item 1A of this Form 10-K.

IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note 1 of the Consolidated Financial Statements for a full description of recent accounting pronouncements including the respective dates adopted or expected dates of adoption and effect, if any, on our results of operations and financial condition.

RELATED PARTY TRANSACTIONS

Servicing fee income for the years ended December 31, 2006, 2005 and 2004 for loans held by the QSPEs was approximately $676,000, $833,000 and $781,000, respectively. We were not the servicer for the loans receivable held by the QSPEs prior to the merger; therefore, no servicing fees were earned or received by us prior to March 1, 2004.

We received approximately $14.6 million, $15.4 million and $15.1 million in cash distributions from the QSPEs during 2006, 2005 and 2004, respectively.

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We may use funds to repurchase loans from the QSPEs which (1) become charged-off as defined in the transaction documents either through delinquency or initiation of foreclosure or (2) reach maturity. During 2006 and 2005, we repurchased loans with an aggregate principal balance of approximately $2.5 million and $5.1 million, respectively, from the Joint Ventures. We did not repurchase any loans from the QSPEs during 2004.

DIVIDENDS

During 2006, our dividends were declared as follows:

Record Date	Date Paid	Amount Per Share	Type
March 31, 2006	April 10, 2006	$ 0.30	Regular
June 30, 2006	July 10, 2006	0.30	Regular
September 30, 2006	October 10, 2006	0.30	Regular
December 29, 2006	January 8, 2007	0.30	Regular
December 29, 2006	January 8, 2007	0.10	Special
		$ 1.30	

In March 2007, the Board declared a $0.30 per share quarterly dividend to common shareholders of record on March 30, 2007 which will be paid on April 9, 2007.

Our shareholders are entitled to receive dividends when and as declared by our Board. Our Board considers many factors including, but not limited to, expectations for future earnings, REIT taxable income, the interest rate environment, competition, our ability to obtain leverage and our loan portfolio activity in determining dividend policy. The Board also uses REIT taxable income plus tax depreciation in determining the amount of dividends declared. In addition, as a REIT we are required to pay out 90% of 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. We anticipate that as a result of earnings from our core business and gains generated on our property sales, that we will maintain our current regular quarterly dividend of $0.30 per share through the end of 2007.

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

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REIT TAXABLE INCOME

REIT taxable income is a financial measure that is presented quarterly to assist investors in analyzing our performance and is one of the factors utilized by our Board in determining the level of dividends to be paid to our shareholders.

The following reconciles net income to REIT taxable income:

	Years Ended December 31,		
	2006	2005	2004
	(In thousands)		
Net income	$ 15,684	$ 11,297	$ 24,781
Less: taxable REIT subsidiaries net income, net of tax	(1,280)	(1,414)	(145)
Add: book depreciation	231	1,240	1,872
Less: tax depreciation	(508)	(1,483)	(1,935)
Book/tax difference on property sales	171	(350)	135
Book/tax difference on Retained Interests, net	1,973	1,880	3,557
Impairment losses	968	2,210	
Negative goodwill			(11,593)
Book/tax difference on amortization and accretion	(641)	(264)	(221)
Asset valuation	(890)	181	(516)
Other book/tax differences, net	(59)	(9)	317
REIT taxable income	$ 15,649	$ 13,288	$ 16,252
Distributions declared	$ 13,975	$ 13,569	$ 14,140
Basic weighted average common shares outstanding	10,748	10,874	10,134

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

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Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Since our consolidated balance sheet consists of items subject to interest rate risk, we are subject to market risk associated with changes in interest rates as described below. Although management believes that the analysis below is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of our consolidated balance sheet and other business developments that could affect our financial position and net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by these estimates.

LOANS RECEIVABLE

Our loans receivable are recorded at cost and adjusted by net loan origination fees and discounts (which are recognized as adjustments of yield over the life of the loan) and loan loss reserves. Our loans receivable are approximately 86% variable-rate at spreads over LIBOR or the prime rate consistent with the market. Increases or decreases in interest rates will generally not have a material impact on the fair value of our variable-rate loans receivable. If we were required to sell our loans at a time we would not otherwise plan to do so, our losses may be substantial.

Changes in interest rates on our fixed-rate loans receivable do not have an immediate impact on our interest income. Our interest rate risk on our fixed-rate loans receivable is primarily related to loan prepayments and maturities. The average maturity of our loan portfolio is less than its average contractual terms because of prepayments. The average life of mortgage loans receivable tends to increase when the current mortgage rates are substantially higher than rates on existing mortgage loans receivable and, conversely, decrease when the current mortgage rates are substantially lower than rates on existing mortgage loans receivable (due to refinancings of fixed-rate loans).

We had $23.4 million and $18.7 million of fixed-rate loans receivable at December 31, 2006 and 2005, respectively. The estimated fair value of our fixed interest rate loans receivable (approximately $23.9 million at December 31, 2006) is dependent upon several factors including changes in interest rates and the market for the types of loans that we have originated.

At December 31, 2006 and 2005, we had $145.8 million and $138.9 million of variable-rate loans receivable, respectively, and $54.0 million and $54.8 million of variable-rate debt, respectively. On the difference between our variable-rate loans receivable outstanding and our variable-rate debt ($91.8 million and $84.1 million at December 31, 2006 and 2005, respectively) we have interest rate risk. To the extent variable rates decrease our interest income net of interest expense would decrease.

As a result of $16.4 million and $21.7 million at December 31, 2006 and 2005, respectively, of our variable-rate loans receivable having interest rate floors (from 5.25% to 6%), we are deemed to have derivative instruments. However, we are not required to bifurcate these investments; therefore, they are not accounted for as derivatives. To the extent that interest rates decline with respect to our loans that have floors, our interest expense on our variable-rate debt will be reduced by a higher amount than our interest income. We do not use derivatives for speculative purposes.

The sensitivity of our variable-rate loans receivable and debt to changes in interest rates is regularly monitored and analyzed by measuring the characteristics of our assets and liabilities. We assess interest rate risk in terms of the potential effect on interest income net of interest expense in an effort to ensure that we are insulated from any significant adverse effects from changes in interest rates. Based on our analysis of the sensitivity of interest income and interest expense at December 31, 2006 and 2005, if the consolidated balance sheet were to remain constant and no actions were taken to alter the existing interest rate sensitivity, each hypothetical 100 basis point reduction in interest rates would reduce net income by approximately $918,000 and $841,000, respectively, on an annual basis.

NOTES AND DEBENTURES PAYABLE, JUNIOR SUBORDINATED NOTES, CREDIT FACILITIES AND REDEEMABLE PREFERRED STOCK OF SUBSIDIARY (DEBT)

At December 31, 2006 and 2005, approximately $14.5 million (21%) and $32.8 million (37%) of our consolidated debt had fixed rates of interest and therefore was not affected by changes in interest rates. Any amount outstanding on our Revolver or the conduit facility is based on the prime rate and/or LIBOR (or approximates LIBOR) and thus subject to adverse changes in market interest rates. Assuming there were no increases or decreases

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in the balance outstanding under our variable-rate debt at December 31, 2006, each hypothetical 100 basis points increase in interest rates would increase interest expense and therefore decrease net income by approximately $540,000.

Our fixed-rate debt is comprised of SBA debentures and mortgages payable. Our debentures have current prepayment penalties up to 4% of the principal balance. Our $2.6 million of consolidated fixed-rate hotel property mortgages at December 31, 2006 have significant penalties for prepayment.

The following presents the principal amounts, weighted average interest rates and estimated fair values by year of expected maturity to evaluate the expected cash flows and sensitivity to interest rate changes of our outstanding debt at December 31, 2006 and 2005.

Market risk disclosures related to our outstanding debt as of December 31, 2006 were as follows:

	Years Ending December 31,						Carrying	Fair
	2007	2008	2009	2010	2011	Thereafter	Value	Value (1)
	(Dollars in thousands)							
Fixed-rate debt (2)	$ 142	$ 153	$ 2,017	$ 1,998	$ 1,042	$ 9,119	$ 14,471	$ 14,607
Variable-rate debt (LIBOR based) (3)		26,968				27,070	54,038	54,038
Totals	$ 142	$ 27,121	$ 2,017	$ 1,998	$ 1,042	$ 36,189	$ 68,509	$ 68,645

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

(2) *The weighted average interest rate of our fixed-rate debt at December 31, 2006 was 6.6%.*

(3) *The weighted average interest rate of our variable-rate debt at*

December 31, 2006 was 7.5%.

Market risk disclosures related to our outstanding debt as of December 31, 2005 were as follows:

	Years Ending December 31,						Carrying	Fair
	2006	2007	2008	2009	2010	Thereafter	Value	Value (1)
	(Dollars in thousands)							
Fixed-rate debt (2)	$ 6,816	$ 644	$ 704	$ 2,300	$ 4,077	$ 18,220	$ 32,761	$ 32,951
Variable-rate debt (LIBOR and prime based) (3)	143	154	24,371	1,282	1,245	27,659	54,854	54,854
Totals	$ 6,959	$ 798	$ 25,075	$ 3,582	$ 5,322	$ 45,879	$ 87,615	$ 87,805

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

(2) The weighted average interest rate of our fixed-rate debt at December 31, 2005 was 6.5%.

(3) The weighted average interest rate of our variable-rate debt at December 31, 2005 was 6.4%.

RETAINED INTERESTS

Our Retained Interests are valued based on various factors including estimates of appropriate discount rates. Changes in the discount rates used in estimating the fair value of the Retained Interests will impact their carrying value. Any appreciation of our Retained Interests is included on our consolidated balance sheet in beneficiaries equity. Any depreciation of our Retained Interests is either included in the consolidated statements of income as a permanent impairment (if there is a reduction in expected future cash flows) or on our balance sheet in beneficiaries equity as an

unrealized loss. Assuming all other factors (*i.e.,* prepayments, losses, etc.) remained unchanged, if discount rates were 100 basis points and 200 basis points higher than rates estimated at December 31, 2006, the estimated fair value of our Retained Interests at December 31, 2006 would have decreased by approximately $1.6 million and $3.1 million, respectively. Assuming all other factors (*i.e.,* prepayments, losses, etc.) remained unchanged, if discount rates were 100 basis points and 200 basis points higher than rates estimated at December 31, 2005, the estimated fair value of our Retained Interests at December 31, 2005 would have decreased by approximately $2.3 million and $4.5 million, respectively.

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Item 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this Item 8 is hereby incorporated by reference to our Financial Statements beginning on page F-1 of this Form 10-K.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, management has evaluated the effectiveness of our disclosure controls and procedures (as defined under rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of December 31, 2006. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC s rules and forms and include controls and procedures designed to ensure the information required to be disclosed by the Company in such reports is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*. Based on their assessment, management determined that as of December 31, 2006, the Company s internal control over financial reporting was effective based on those criteria.

Management s assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm as stated in their report which appears herein.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. OTHER INFORMATION

None.

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PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this Item 10 with regard to directors and executive officers of the Company and compliance with Section 16(a) of the Exchange Act is hereby incorporated by reference to our definitive proxy statement to be filed with the SEC within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders.

Code of Ethics

We have adopted a Code of Business Conduct and Ethics for trust managers, officers and employees which is available on our website at www.pmctrust.com. Shareholders may request a free copy of the code of Business Conduct and Ethics from:

PMC Commercial Trust
Attention: Chief Financial Officer
17950 Preston Road, Suite 600
Dallas, Texas 75252
(972) 349-3235
www.pmctrust.com

We have also adopted a Code of Ethical Conduct for Senior Financial Officers setting forth a code of ethics applicable to our principal executive officer, principal financial officer and principal accounting officer, which is available on our website at www.pmctrust.com. Shareholders may request a free copy of the Code of Ethical Conduct for Senior Financial Officers from the address and phone number set forth above.

Corporate Governance Guidelines

We have adopted Corporate Governance Guidelines which are available on our website at www.pmctrust.com. Shareholders may request a free copy of the Corporate Governance Guidelines from the address and phone number set forth above under -Code of Ethics.

Item 11. EXECUTIVE COMPENSATION

The information required by this Item 11 regarding executive compensation is hereby incorporated by reference to our definitive proxy statement to be filed with the SEC within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders.

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Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

All of our equity compensation plans were approved by our security holders. Information regarding our equity compensation plans at December 31, 2006 was as follows:

	Column		
	(a)	(b)	(c)
Plan Category	Number of securities to be issued upon exercise of outstanding options	Weighted average exercise price of outstanding options	Number of securities remaining available for future issuances under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	142,511	$ 14.06	414,430

Additional information regarding security ownership of certain beneficial owners and management and related shareholder matters is hereby incorporated by reference to our definitive proxy statement to be filed with the SEC within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item 13 regarding certain relationships and related transactions is hereby incorporated by reference to our definitive proxy statement to be filed with the SEC within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders.

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item 14 regarding principal accountant fees and services is hereby incorporated by reference to our definitive proxy statement to be filed with the SEC within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders.

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report

(1) Financial Statements -

See index to Financial Statements set forth on page F-1 of this Form 10-K.

(2) Financial Statement Schedules -

Schedule II Valuation and Qualifying Accounts
Schedule III Real Estate and Accumulated Depreciation
Schedule IV Mortgage Loans on Real Estate

(3) Exhibits -

See Exhibit Index beginning on page E-1 of this Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on our behalf by the undersigned, hereunto duly authorized.

PMC Commercial Trust
By: /s/ Lance B. Rosemore
Lance B. Rosemore, *President*

Dated March 15, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities and on the dates indicated.

Name	Title	Date
/s/ DR. ANDREW S. ROSEMORE	Chairman of the Board of Trust	March 15, 2007
Dr. Andrew S. Rosemore	Managers, Chief Operating Officer and Trust Manager	
/s/ LANCE B. ROSEMORE	President, Chief Executive	March 15, 2007
Lance B. Rosemore	Officer, Secretary and Trust Manager (principal executive officer)	
/s/ BARRY N. BERLIN	Chief Financial Officer (principal	March 15, 2007
Barry N. Berlin	financial and accounting officer)	
/s/ NATHAN COHEN	Trust Manager	March 15, 2007
Nathan Cohen		
/s/ DR. MARTHA GREENBERG	Trust Manager	March 15, 2007
Dr. Martha Greenberg		
/s/ ROY H. GREENBERG	Trust Manager	March 15, 2007
Roy H. Greenberg		
/s/ BARRY A. IMBER	Trust Manager	March 15, 2007
Barry A. Imber		
/s/ IRVING MUNN	Trust Manager	March 15, 2007
Irving Munn		

/s/ DR. IRA SILVER	Trust Manager	March 15, 2007
Dr. Ira Silver		

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PMC COMMERCIAL TRUST A ND SUBSIDIARIES
FORM 10-K
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Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Trust Managers of
PMC Commercial Trust:

We have completed integrated audits of PMC Commercial Trust s consolidated financial statements and of its internal control over financial reporting as of December 31, 2006 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedules

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, comprehensive income, beneficiaries equity, and cash flows present fairly, in all material respects, the financial position of PMC Commercial Trust (the Company) and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15(a)(2) present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal control over financial reporting

Also, in our opinion, management s assessment, included in Management s Report On Internal Control Over Financial Reporting, appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the COSO. The Company s management is responsible for maintaining effective internal control over financial reporting and its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance

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with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Dallas, Texas

March 15, 2007

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

	December 31, 2006	December 31, 2005
ASSETS		
Loans receivable, net	$ 169,181	$ 157,574
Retained interests in transferred assets	55,724	62,991
Real estate investments, net	4,414	8,080
Real estate investments held for sale, net		15,470
Cash and cash equivalents	3,739	3,967
Restricted investments	995	3,532
Mortgage-backed security of affiliate	643	833
Rent and related receivables, net	567	1,489
Deferred tax asset, net	203	349
Other assets	4,938	4,907
Total assets	$ 240,404	$ 259,192
LIABILITIES AND BENEFICIARIES EQUITY		
Liabilities:		
Junior subordinated notes	$ 27,070	$ 27,070
Credit facilities	26,968	24,205
Notes and debentures payable	10,803	32,765
Dividends payable	4,365	3,293
Borrower advances	3,694	4,418
Redeemable preferred stock of subsidiary	3,668	3,575
Accounts payable and accrued expenses	2,578	3,328
Deferred gains on property sales	1,574	345
Due to affiliates, net	683	856
Other liabilities	810	1,420
Total liabilities	82,213	101,275
Commitments and contingencies		
Cumulative preferred stock of subsidiary	900	900
Beneficiaries equity:		
Common shares of beneficial interest; authorized 100,000,000 shares of $0.01 par value; 11,040,153 and 11,028,271 shares issued at December 31, 2006 and 2005, respectively, 10,753,803 and 10,766,021 shares outstanding at December 31, 2006	110	110

and 2005, respectively		
Additional paid-in capital	152,178	152,047
Net unrealized appreciation of retained interests in transferred assets	3,256	4,519
Cumulative net income	137,984	122,300
Cumulative dividends	(133,006)	(119,031)
	160,522	159,945
Less: Treasury stock; at cost, 286,350 shares and 262,250 shares at December 31, 2006 and 2005, respectively	(3,231)	(2,928)
Total beneficiaries equity	157,291	157,017
Total liabilities and beneficiaries equity	$ 240,404	$ 259,192

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

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

	Years Ended December 31,		
	2006	**2005**	**2004**
Revenues:			
Interest income	$ 15,460	$ 11,578	$ 8,162
Income from retained interests in transferred assets	9,390	9,458	8,763
Hotel property revenues	2,113		
Lease income	58	942	1,017
Other income	3,656	3,121	2,974
Total revenues	30,677	25,099	20,916
Expenses:			
Interest	5,435	4,688	3,873
Salaries and related benefits	4,739	4,553	3,557
General and administrative	2,648	2,995	1,882
Hotel property expenses	1,614		
Permanent impairments on retained interests in transferred assets	1,167	467	1,182
Provision for loss on rent and related receivables	925	1,255	
Depreciation	222	281	316
Provision for (reduction of) loan losses, net	103	298	(253)
Advisory and servicing fees to affiliate, net			245
Impairment losses		436	
Total expenses	16,853	14,973	10,802
Gain on early extinguishment of debt	563		
Income before income tax provision, minority interest, discontinued operations and extraordinary item	14,387	10,126	10,114
Income tax provision	(649)	(658)	(116)
Minority interest (preferred stock dividend of subsidiary)	(90)	(90)	(75)
Income from continuing operations	13,648	9,378	9,923
Discontinued operations:			
Gains (losses) on sales of real estate	2,064	2,256	(252)
Impairment losses	(94)	(1,774)	

Net earnings	66	1,437	3,517
	2,036	1,919	3,265
Income before extraordinary item	15,684	11,297	13,188
Extraordinary item:			
Negative goodwill			11,593
Net income	$ 15,684	$ 11,297	$ 24,781
Weighted average shares outstanding:			
Basic	10,748	10,874	10,134
Diluted	10,751	10,879	10,152
Basic and diluted earnings per share:			
Income from continuing operations	$ 1.27	$ 0.86	$ 0.98
Discontinued operations	0.19	0.18	0.32
Extraordinary item			1.14
Net income	$ 1.46	$ 1.04	$ 2.44

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

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

	Years Ended December 31,		
	2006	**2005**	**2004**
Net income	$ 15,684	$ 11,297	$ 24,781
Change in net unrealized appreciation (depreciation) of retained interests in transferred assets:			
Net unrealized appreciation (depreciation) arising during period	(648)	23	2,012
Realized gains included in net income	(615)	(624)	(510)
	(1,263)	(601)	1,502
Comprehensive income	$ 14,421	$ 10,696	$ 26,283

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

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF BENEFICIARIES EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(In thousands, except share and per share data)

	Common Shares of Beneficial Interest Outstanding	Par Value	Additional Paid-in Capital	Net Unrealized Appreciation of Retained Interests in Transferred Assets	Cumulative Net Income	Cumulative Dividends	Treasury Stock	Total Beneficiaries Equity
Balances, January 1, 2004	6,452,791	$ 66	$ 94,792	$ 3,618	$ 86,222	$ (91,322)	$ (1,285)	$ 92,091
Net unrealized appreciation				1,502				1,502
Treasury shares, net	(21,130)						(311)	(311)
Shares issued through exercise of stock options	59,500		378				311	689
Shares issued in connection with merger with PMC Capital, Inc.	4,385,800	44	57,410					57,454
Merger costs			(769)					(769)
Issuance of stock options			7					7
Dividends ($1.40 per share)						(14,140)		(14,140)
Net income					24,781			24,781
Balances, December 31, 2004	10,876,961	110	151,818	5,120	111,003	(105,462)	(1,285)	161,304
Net unrealized depreciation				(601)				(601)
Shares repurchased	(129,400)						(1,643)	(1,643)
Shares issued through exercise of stock options	9,400		123					123
Issuance of share options and restricted shares	9,060		106					106
Dividends ($1.25 per share)						(13,569)		(13,569)
Net income					11,297			11,297

Balances, December 31, 2005	10,766,021	110	152,047	4,519	122,300	(119,031)	(2,928)	157,017
Net unrealized depreciation				(1,263)				(1,263)
Shares repurchased	(24,100)						(303)	(303)
Treasury shares, net	(32,678)						(464)	(464)
Shares issued through exercise of stock options	35,500						464	464
Issuance of share options and restricted shares	9,060		131					131
Dividends ($1.30 per share)						(13,975)		(13,975)
Net income					15,684			15,684
Balances, December 31, 2006	10,753,803	$ 110	$ 152,178	$ 3,256	$ 137,984	$ (133,006)	$ (3,231)	$ 157,291

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

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

	Years Ended December 31,		
	2006	**2005**	**2004**
Cash flows from operating activities:			
Net income	$ 15,684	$ 11,297	$ 24,781
Adjustments to reconcile net income to net cash provided by operating activities:			

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

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies:

Business

PMC Commercial Trust (PMC Commercial or together with its wholly-owned subsidiaries, we, us or our) was organized in 1993 as a Texas real estate investment trust (REIT). Our common shares of beneficial interest (Common Shares) are traded on the American Stock Exchange (symbol PCC). We primarily obtain income from the yield and other related fee income earned on our investments from our lending activities. To date, these investments have principally been in the hospitality industry.

Principles of Consolidation

We consolidate entities that we control as well as variable interest entities (VIEs) for which we are the primary beneficiary. To the extent we do not have a majority voting interest, we use the equity method to account for investments for which we have the ability to exercise significant influence over operating and financial policies. Consolidated net income includes our share of the net earnings of any entity accounted for using the equity method. All material intercompany balances and transactions have been eliminated.

The consolidated financial statements include the accounts of PMC Commercial, First Western SBLC, Inc. (First Western), PMC Investment Corporation (PMCIC), Western Financial Capital Corporation (Western Financial), PMC Commercial Trust, Ltd. 1998-1 (PMCT Trust), PMC Funding Corp. (PMC Funding), PMC Asset Holding, LLC (Asset Holding), PMC Conduit, L.P. (PMC Conduit), PMC Properties, Inc. (PMC Properties) and separate subsidiaries created in conjunction with the purchase of certain hotel properties in 1999.

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

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

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

Loans Receivable, net

We primarily originate loans to small businesses collateralized by first liens on the real estate of the related business. Loans receivable are carried at their unamortized principal balance less net loan origination fees, discounts and loan loss reserves. For loans originated under the Small Business Administration s (SBA) 7(a) Guaranteed Loan Program, when we sell the SBA guaranteed portion of the loans, a portion of the sale proceeds representing the difference in the face amount of the unguaranteed portion of the loans and the value of the loans (the Retained Loan Discount) is determined on a relative fair value basis and is recorded as a reduction in basis of the retained portion of the loan rather than premium income. For purchased loans, we may have discounts representing the difference between the

unamortized principal balance of the loan and its estimated fair value at the date of purchase.

A loan loss reserve is established based on a determination, through an evaluation of the recoverability of individual loans receivable, that significant doubt exists as to the ultimate realization of the loan receivable. The determination of

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

whether significant doubt exists and whether a loan loss reserve is necessary for each loan receivable requires judgment and considers the facts and circumstances existing at the evaluation date. Our evaluation of the adequacy of the reserve is based on a review of our historical loss experience, known and inherent risks in the loan portfolio, 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.

Retained Interests

Retained Interests represent the subordinate interest in QSPEs created in conjunction with structured loan sale transactions. Retained Interests are carried at estimated fair value, with realized gains and permanent impairments included in net income and unrealized gains and losses recorded in beneficiaries equity. The estimated fair value of our Retained Interests is based on estimates of the present value of future cash flows we expect to receive. Estimated future cash flows are based in part upon an estimate of prepayment speeds and loan losses. Prepayment speeds and loan losses are estimated based on the current and anticipated interest rate and competitive environments, the performance of the loan pool and our historical experience with these and similar loans receivable. The discount rates that we utilize are determined for each of the components of the Retained Interests as estimates of market rates based on interest rate levels considering the risks inherent in the transaction. There can be no assurance of the accuracy of these estimates.

Real Estate Investments, net

Real estate investments are initially recorded at cost. Depreciation is provided on the straight-line method based upon estimated useful lives of 35 years for buildings and improvements and seven years for furniture, fixtures and equipment. Upon retirement or sale, the cost and related accumulated depreciation are removed from our books and any resulting gains or losses are included in the consolidated statements of income. Routine maintenance and repairs are charged to expense as incurred. Major replacements, renewals and improvements are capitalized.

We periodically review our real estate investments for impairment. If facts or circumstances support the possibility of impairment, we will prepare a projection of the undiscounted future cash flows without interest charges for the specific property. Impairment exists if the estimate of future cash flows expected to result from the use and ultimate disposition of the specific property is less than the carrying value. If impairment is indicated, an adjustment will be made to the carrying value of the property based on the difference between the current estimated fair value and the depreciated cost of the asset.

Real Estate Investments Held for Sale, net

We consider each individual hotel property to be an identifiable component of our business. In accordance with SFAS No. 144, Accounting for the Impairment of or Disposal of Long-Lived Assets, (SFAS No. 144), we do not consider properties as held for sale until it is probable that the sale will be completed within one year. The determination of held for sale status is assessed based on all available facts and circumstances, including management s intent and ability to eliminate the cash flows of the property from our operations and management s intent and ability not to have significant continuing involvement in the operations of the property.

We discontinue depreciation on properties if they are classified as held for sale. Upon designation of a hotel property as held for sale, we compare the carrying value of the hotel property to its estimated fair value, less costs to sell. We will reclassify the hotel property to real estate investment held for sale in our consolidated balance sheet at the lesser of the carrying value of the property or its estimated fair value, less costs to sell. Any adjustment to the carrying value of a hotel property classified as held for sale is reflected in discontinued operations in our consolidated statements of income. In addition, the operating results of those properties classified as held for sale or that have been sold are included in discontinued operations.

Cash and Cash Equivalents

We generally consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. At various times during the year we maintain cash, cash equivalents and restricted investments in accounts in excess of federally insured limits with various financial institutions. We regularly monitor the financial institutions and do not believe a significant credit risk is associated with the deposits in excess of federally insured

amounts.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Restricted Investments

Restricted investments represent primarily cash reserve accounts required to be held as collateral pursuant to debt facilities and escrow and capital expenditure accounts related to our hotel properties.

Rent and Related Receivables, net

We have claims pertaining to unpaid rent, property taxes, legal fees incurred, termination damages, notes receivable and other charges. Quarterly, we perform an analysis of the anticipated future proceeds related to these claims to determine the collectibility of our investment based on best available information provided to us.

Mortgage-Backed Security of Affiliate

The mortgage-backed security represents our ownership interest in a special purpose entity and is valued consistent with the techniques used to value our Retained Interests.

Deferred Borrowing Costs

Costs incurred in connection with the issuance of debt are being amortized to expense over the life of the related obligation using a method that approximates the effective interest method. Deferred borrowing costs are included in other assets in our consolidated balance sheets.

Borrower Advances

In general, as part of the monitoring process to verify that the borrowers cash equity is utilized for its intended purpose, we receive deposits from our borrowers and release funds upon presentation of appropriate documentation. Funds held on behalf of borrowers are included as a liability on the consolidated balance sheets.

Deferred Gains on Property Sales

We evaluate our hotel property sales individually to determine if they qualify for full accrual gain treatment. If the down payment received was not sufficient to qualify for full gain treatment, we record initial installment gains and defer the remaining gains. The remaining gains are recorded to income as principal is received on the related loans receivable until the required amount of cash proceeds are obtained from the purchasers to qualify for full accrual gain treatment. In addition, upon receipt of updated financial information from the purchaser, if the requirements are met, the transaction would qualify for the full accrual method and the remaining deferred gain would be recognized.

Net Unrealized Appreciation of Retained Interests

Net unrealized appreciation of Retained Interests represents the difference between the cost and estimated fair value of our Retained Interests.

Revenue Recognition

Interest Income

Interest income includes interest earned on loans and our short-term investments and the amortization of net loan origination fees and discounts. Interest income on loans is accrued as earned with the accrual of interest generally suspended when the related loan becomes a non-accrual loan. A loan receivable is generally classified as non-accrual (a Non-Accrual Loan) if (1) it is past due as to payment of principal or interest for a period of more than 60 days, (2) any portion of the loan is classified as doubtful or is charged-off or (3) if the repayment in full of the principal and/or interest is in doubt. Generally, loans are charged-off when management determines that we will be unable to collect any remaining amounts due under the loan agreement, either through liquidation of collateral or other means. Interest income on a Non-Accrual Loan is recognized on either the cash basis or the cost recovery basis.

When originating a loan receivable, we generally charge a commitment fee. These fees, net of costs, are deferred and recognized as an adjustment of yield over the life of the related loan receivable using a method which approximates the effective interest method.

For purchased loans, we may have discounts representing the difference between the unamortized principal balance of the loan and its estimated fair value at the date of purchase. For performing loans, these discounts are recognized as an adjustment of yield over the life of the related loan receivable using a method which approximates the effective interest method.

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The Retained Loan Discount is amortized to interest income over the life of the underlying loan using the effective interest method unless the underlying loan receivable is prepaid or sold.

Income from Retained Interests

The income from our Retained Interests represents the accretion (recognized using the effective interest method) on our Retained Interests which is determined based on estimates of future cash flows and includes any fees collected (*i.e.,* late fees, prepayment fees, etc.) by the QSPEs in excess of anticipated fees. We update our cash flow assumptions on a quarterly basis and any changes to cash flow assumptions impact the yield on our Retained Interests.

Lease Income

Lease income consists of base rent and when applicable, straight-line rental income. We record lease income on a straight-line basis (when applicable) over the estimated lease term to the extent collectibility is reasonably assured.

Hotel Property Revenues

The majority of our hotel property revenues are comprised of room revenue. This revenue is recorded net of any sales or occupancy taxes collected from our guests. All revenues are recorded on an accrual basis, as earned. Appropriate allowances are made for doubtful accounts and are recorded as expense.

Other Income

Other income consists primarily of servicing income, premium income, prepayment fees and other loan related income. Servicing income is recognized in income when earned. Prepayment fees are recognized in income when loans are prepaid. Late fees and other loan related fees are recognized in income when chargeable, assuming collectibility is reasonably assured. Premium income represents the difference between the relative fair value attributable to the sale of the guaranteed portion of a loan originated under the SBA 7(a) Guaranteed Loan Program and the principal balance (cost) of the loan. The sale price includes the value attributable to any excess servicing spread retained by us plus any cash received.

Income Taxes

We have elected to be taxed as a REIT under the provisions of the Internal Revenue Code of 1986, as amended (the Code). To the extent we qualify for taxation as a REIT, we generally will not be subject to a Federal corporate income tax on our taxable income that is distributed to our shareholders. In order to remain qualified as a REIT under the Code, we must satisfy various requirements in each taxable year, including, among others, limitations on share ownership, asset diversification, sources of income, and the distribution of at least 90% of our taxable income within the specified time in accordance with the Code.

PMC Commercial has wholly-owned taxable REIT subsidiaries which are subject to Federal income taxes. The taxable REIT subsidiaries (TRS s) are PMCIC, First Western, PMC Properties and PMC Funding. The income generated from the taxable REIT subsidiaries is taxed at normal corporate rates. We account for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes which uses the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Earnings per Share

Earnings per share is computed by dividing net income by the weighted-average number of shares outstanding. Diluted earnings per share includes the dilutive effect, if any, of share-based compensation awards.

Distributions to Shareholders

Distributions to shareholders are recorded on the ex-dividend date.

Derivatives

As a result of certain of our variable-rate loans receivable having interest rate floors, we are deemed to have derivative investments. However, in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS No. 133), we are not required to bifurcate these investments; therefore, they are not accounted for as derivatives. We do not use derivatives for speculative purposes.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
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Share-Based Compensation Plans

At December 31, 2006, we have options outstanding under share-based compensation plans described more fully in Note 18. We use the fair value recognition provisions of SFAS No. 123R, Accounting for Stock-Based Compensation, to account for all awards granted, modified or settled.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect (1) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and, (2) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from our estimates. Our most sensitive estimates involve the valuation of our Retained Interests and determination of reserves on our receivables.

Recently Issued Accounting Pronouncements

The FASB issued SFAS No. 155 (SFAS No. 155), Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 in February 2006. SFAS No. 155 (1) permits fair value remeasurement for hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation, (2) clarifies which interest-only strip receivables are not subject to the requirements of SFAS No. 133, (3) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or hybrid financial instruments that contain an embedded derivative requiring bifurcation, (4) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and (5) amends SFAS No. 140 to eliminate the prohibition on a QSPE from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The Statement is effective for all financial instruments acquired or issued after fiscal years beginning after September 15, 2006. We do not expect the adoption of SFAS No. 155 to have a material impact on our consolidated financial statements.

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

The FASB issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, in July 2006. FIN 48 clarifies the accounting and disclosure for uncertainty in income tax positions, as defined, imposes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken in a tax return and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact of FIN 48 on our consolidated financial statements; however, we do not expect the adoption to have a material impact on our consolidated financial statements.

The FASB issued SFAS No. 157 (SFAS No. 157), Fair Value Measurements in September 2006. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability, establishes a fair value hierarchy that prioritizes the information used to develop those assumptions and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the impact of SFAS No. 157 on our consolidated financial statements; however, we do not expect the adoption to have a material impact on our consolidated financial statements.

Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, was issued by the Securities and Exchange Commission (SEC) during September 2006. SAB 108 expresses SEC staff views regarding the process by which misstatements in

financial statements are evaluated for purposes of determining whether financial statement restatement is necessary. SAB 108 is effective for fiscal years ending after November 15, 2006, and early application is encouraged. The adoption of SAB 108 did not have a material impact on our consolidated financial statements.

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Reclassifications

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

Note 2. Variable Interest Entities:

A VIE is an entity for which control is achieved through means other than voting rights. An entity should consolidate a VIE if that entity will absorb a majority of the VIE s expected losses, receive a majority of the VIE s expected residual returns, or both. The following entities have been determined to be VIEs.

PMC Conduit

During 2005, we entered into a $100.0 million conduit warehouse facility (the Conduit Facility). The Conduit Facility operates as a revolving line of credit, collateralized by loans originated by us, which have been or will be sold to PMC Conduit. The transfers of loans to PMC Conduit did not meet the requirements of SFAS No. 140 for sale treatment. PMC Commercial has not guaranteed the repayment of the obligations of the Conduit Facility.

Since PMC Commercial is the primary beneficiary of PMC Conduit it is consolidated in the financial statements of PMC Commercial.

Preferred Trust

During 2005, PMC Commercial issued notes payable (the Junior Subordinated Notes) of approximately $27.1 million due March 30, 2035 to a special purpose subsidiary, PMC Preferred Capital Trust-A, a Delaware statutory trust (the Preferred Trust). The Junior Subordinated Notes, included in our consolidated balance sheets, are subordinated to PMC Commercial s existing debt.

Since PMC Commercial is not considered to be the primary beneficiary of the Preferred Trust, it is not consolidated in PMC Commercial s financial statements. The equity method is used to account for our investment in the Preferred Trust.

PMCT Plainfield, L.P.

On September 29, 2006, we leased a hotel property owned by a separate subsidiary (PMCT Plainfield, L.P.) which was previously consolidated. The hotel property is the primary asset of the subsidiary. The lessee has the option, and is expected to exercise this option, to purchase the property for $1,825,000 at termination of the lease in January 2011 or earlier if certain events occur. Our subsidiary received a substantial non-refundable up-front payment of $452,000. Based on this lease agreement including the fixed price purchase option, the subsidiary was determined to be a variable interest entity.

Since we do not expect to absorb the majority of the entity s future expected losses or receive the entity s expected residual returns, PMC Commercial is not considered to be the primary beneficiary. Thus, the subsidiary is no longer consolidated in PMC Commercial s financial statements and the equity method is used to account for our investment in the subsidiary effective September 29, 2006. The following table summarizes the assets and liabilities of PMCT Plainfield, L.P.:

	September 29, 2006 *(In thousands)*
Real estate investment, net	$ 1,709
Other assets	105
Total assets	$ 1,814
Mortgage payable	$ 1,315

Other liabilities		499
Total liabilities	$	1,814

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Note 3. Merger:

PMC Capital, Inc. (PMC Capital), a regulated investment company related to us through common management, merged with and into PMC Commercial on February 29, 2004. Each issued and outstanding share of PMC Capital, Inc. common stock was converted into 0.37 of a common share of PMC Commercial. As a result, we issued 4,385,800 common shares of beneficial interest on February 29, 2004 valued at $13.10 per share, which was the average closing price of our common shares for the three days preceding the date of the announcement, adjusted by declared but unpaid dividends.

The merger was accounted for using the purchase method of accounting in accordance with SFAS No. 141, Business Combinations as we were not deemed to be under common control. Accordingly, our consolidated results of operations have incorporated PMC Capital s activities on a consolidated basis from the merger date. The cost of the merger was allocated to the assets acquired, liabilities assumed and preferred stock of subsidiary based on management s estimates of their respective fair values at the date of merger. The fair value of the net assets acquired exceeded the cost of the merger, resulting in negative goodwill. The amount of negative goodwill was allocated proportionately to reduce the assigned values of the acquired assets excluding current assets, financial assets and assets held for sale. Substantially all of the assets acquired were considered to be financial assets or assets to be disposed of by sale. Accordingly, we recorded negative goodwill of $11,593,000 during 2004 representing the excess of the fair value of net assets acquired over the cost of the merger.

The cost of the merger was as follows *(dollars in thousands)*:

Fair value of 4,385,800 common shares of beneficial interest	$ 57,454
Transaction costs	1,034
Total	$ 58,488

The following table summarizes the estimated fair values of assets acquired, liabilities assumed and preferred stock of subsidiary as of February 29, 2004 *(in thousands)*:

Loans receivable	$ 55,144
Retained Interests	43,597
Cash and cash equivalents	31,488
Assets acquired in liquidation	1,829
Mortgage-backed security of affiliate	1,164
Deferred tax asset, net	278
Other assets	599
Total fair value of assets acquired	134,099
Notes and debentures payable	54,487
Redeemable preferred stock of subsidiary	3,420
Accounts payable and accrued expenses	2,751
Borrower advances	2,075
Other liabilities	385
Cumulative preferred stock of subsidiary	900
	64,018

Total liabilities assumed and preferred stock of subsidiary	
Fair value of net assets acquired	$ 70,081

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The following unaudited pro forma results of operations are based on our financial statements and the financial statements of PMC Capital and assumed the merger occurred on January 1:

	Year Ended December 31, 2004 *(In thousands, except per share data)*
Total revenues	$ 23,062
Income from continuing operations	$ 10,125
Income before extraordinary item	$ 13,390
Extraordinary item negative goodwill	$ 11,593
Net income	$ 24,983
Earnings per share	$ 2.30

These unaudited pro forma results have been prepared for comparative purposes only. In the opinion of management, all material adjustments necessary to reflect the effects of the merger transaction have been made. This unaudited pro forma information is not necessarily indicative of what the actual results of operations would have been had the merger transaction occurred on the indicated date, nor does it purport to represent our results of operations for future periods.

Note 4. Loans Receivable, net:

Loans receivable, net, consisted of the following:

	At December 31,	
	2006	2005
	(In thousands)	
SBIC commercial mortgage loans	$ 36,243	$ 41,749
SBA 7(a) Guaranteed Loan Program loans	14,749	16,367
Conduit Facility loans (1)	43,612	35,331
Other commercial mortgage loans	75,089	65,121
Total loans receivable	169,693	158,568
Less:		
Deferred commitment fees, net	(449)	(567)
Loan loss reserves	(63)	(427)

Loans receivable, net	$ 169,181	$ 157,574

(1) These loans serve as collateral for our Conduit Facility.

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

	At December 31,					
	2006			2005		
	Loans Receivable, net Amount	%	Weighted Average Interest Rate	Loans Receivable, net Amount	%	Weighted Average Interest Rate
	(Dollars in thousands)					
Variable-rate LIBOR	$ 127,931	75.6%	9.4%	$ 120,645	76.6%	8.3%
Fixed-rate	23,419	13.9%	8.8%	18,651	11.8%	9.4%
Variable-rate prime	17,831	10.5%	10.2%	18,278	11.6%	8.7%
Total	$ 169,181	100.0%	9.4%	$ 157,574	100.0%	8.5%

Our loans receivable were approximately 94% concentrated in the hospitality industry at December 31, 2006. Any economic factors that negatively impact the hospitality industry could have a material adverse effect on our financial condition or results of operations. At December 31, 2006, approximately 22% and 10% of our loans receivable consisted of loans receivable to borrowers in Texas and Ohio, respectively. No other state had a concentration of 10% or greater at December 31, 2006.

The activity in our loan loss reserves was as follows:

	Years Ended December 31,		
	2006	2005	2004
	(In thousands)		
Balance, beginning of year	$ 427	$ 164	$ 675
Provision for loan losses	174	325	422
Reduction of loan losses	(71)	(18)	(675)
Recovery of loans written-off		(9)	
Principal balances written-off	(467)	(35)	(258)
Balance, end of year	$ 63	$ 427	$ 164

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

	At December 31, 2006	At December 31, 2005
	(In thousands)	
Impaired loans requiring reserves	$ 82	$ 1,073
Impaired loans expected to be fully recoverable (1)	1,837	5,056
Total impaired loans	$ 1,919	$ 6,129

	Years Ended December 31, 2006	2005	2004
	(In thousands)		
Average impaired loans	$ 1,235	$ 4,566	$ 5,677
Interest income on impaired loans (2)	$ 72	$ 219	$ 488

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

amounts due based on the original contractual terms of the note.

(2) *Recorded primarily on the cash basis.*

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

Our recorded investment in Non-Accrual Loans at December 31, 2006 and 2005 was approximately $2.1 million and $5.9 million, respectively. We did not have any loans receivable past due 90 days or more which were accruing interest at December 31, 2006 or 2005.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
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Note 5. Real Estate Investments and Rent and Related Receivables, net:

Our real estate investments consisted of the following:

	At December 31,		
	2006	2005	
	Real Estate Investments	Real Estate Investments	Real Estate Investments Held for Sale
	(Dollars in thousands)		
Land	$ 494	$ 1,044	$ 2,041
Buildings and improvements	4,468	7,484	15,110
Furniture, fixtures and equipment	292	271	1,728
	5,254	8,799	18,879
Accumulated depreciation	(840)	(719)	(3,409)
	$ 4,414	$ 8,080	$ 15,470
Number of hotel properties	2	4	9

At December 31, 2006, two of the three hotel properties that we own are included in our consolidated financial statements. The properties were originally part of a sale and leaseback transaction commencing in 1998 with Arlington Hospitality, Inc. (AHI) whereby we purchased 30 properties from AHI and then leased the properties to a wholly-owned subsidiary of AHI, Arlington Inns, Inc. (AII and together with AHI, Arlington). We concurrently entered into a Master Lease Agreement with AHI and AII covering all the properties and entered into a guaranty agreement with AHI whereby AHI guaranteed all obligations of AII under the individual property lease agreements. During June 2005, AII filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code (Bankruptcy). On August 31, 2005, AHI filed for Bankruptcy (the Arlington Bankruptcy). The January through April 2005 lease payments due from AII were paid while the May and June 2005 lease payments due from AII were not paid. AII made rent payments from July 2005 to January 2006 which were recorded as income when earned.

On January 13, 2006, we received rejection notices on 12 individual property leases and as a result, we took possession and operated 13 hotel properties through third party management companies. During 2006, we sold ten hotel properties for approximately $20.6 million and recognized net gains of approximately $1.9 million and deferred gains of approximately $1.2 million. We financed the sale of these properties through origination of loans aggregating approximately $17.1 million with interest rates of LIBOR plus spreads ranging from 3.75% to 4.80% and maturity and amortization periods of 20 years.

At December 31, 2006, our remaining hotel properties had mortgages (which were assumed in the original purchase from AHI) with significant prepayment penalties. Therefore, we do not anticipate selling these properties until the properties market values increase or the prepayment penalties decrease. Until the properties are sold, we will either operate the properties through third party management companies or lease the properties.

On September 29, 2006, we leased a hotel property owned by a separate subsidiary which was previously consolidated. The lessee has the option, and is expected to exercise this option, to purchase the property for $1,825,000 at termination of the lease in January 2011 or earlier if certain events occur. Our subsidiary received a substantial non-refundable up-front payment of $452,000. As a VIE, the subsidiary which owns the hotel property is

no longer consolidated in PMC Commercial s financial statements effective September 29, 2006. The operations relating to this property were included in continuing operations in our consolidated statement of income through September 29, 2006.

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We generated hotel property revenues of approximately $2.1 million consisting primarily of room revenues and $1.6 million in hotel property expenses consisting primarily of operating and general and administrative expenses related to our hotel properties included in continuing operations during 2006.

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

We performed an analysis of our anticipated future proceeds related to the Arlington Bankruptcy to determine the collectibility of our investment in the rent and related receivables based on best available information provided to us through the bankruptcy proceedings. As a result, we established an allowance of approximately $1,255,000 during 2005. We recorded additional allowances of $925,000 during 2006 primarily resulting from reductions in available cash due to unanticipated and unforecasted cash expenditures by Arlington. Accordingly, our net recorded investment was $567,000 as of December 31, 2006. To the extent there is a reduction of the anticipated future proceeds, we would record an additional allowance against these receivables.

Note 6. Retained Interests:

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

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

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Information pertaining to the Originated Structured Loan Sale Transactions was as follows.

	2000 Joint Venture	2001 Joint Venture	2002 Joint Venture	2003 Joint Venture
		(Dollars in thousands)		
Transaction date	12/18/00	6/27/01	4/12/02	10/7/03
At inception:				
Principal amount of sold loans	$ 55,675	$ 32,662	$ 27,286	$ 45,456
Structured Notes issued	$ 49,550	$ 30,063	$ 24,557	$ 40,910
Interest rate on the Structured Notes (1)	7.28%	6.36%	6.67%	L+1.25%
Structured Notes rating (2)	Aaa	Aaa	Aaa	Aaa
Weighted average interest rate on loans (1)	9.63%	9.62%	9.23%	L+4.02%
Weighted average remaining life of Retained Interests (3)	5.16 years	5.15 years	5.38 years	4.79 years
Aggregate principal losses assumed (4)	2.37%	2.80%	2.88%	3.03%
Constant prepayment rate assumption	8.0%	9.0%	9.0%	10.0%
Discount rate assumptions	9.3% to 14.0%	8.5% to 13.3%	8.2% to 12.9%	7.8% to 11.6%
Value of Retained Interests	$ 11,174	$ 5,871	$ 5,293	$ 8,698
At December 31, 2006:				
Principal outstanding on sold loans	$ 29,018	$ 9,161	$ 15,510	$ 25,480
Structured Notes balance outstanding	$ 23,597	$ 6,562	$ 12,740	$ 22,182
Cash in the collection account	$ 303	$ 59	$ 112	$ 1,544
Cash in the reserve account	$ 1,710	$ 622	$ 932	$ 1,611
Weighted average interest rate on loans (1)	9.54%	9.70%	9.55%	L+4.02%
Constant prepayment rate assumption (5)	18.00%	18.00%	18.00%	16.00%
Discount rate assumptions (6)	7.7% to 12.4%	7.9% to 12.6%	7.7% to 12.4%	8.2% to 12.5%
Weighted average remaining life of Retained Interests (3)	2.36 years	1.25 years	2.10 years	2.53 years
Aggregate principal losses assumed (4)	1.45%	%	1.42%	1.36%
Aggregate principal losses to date (7)	0.33%	0.56%	%	%

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

(2) Structured Notes issued by the QSPEs were rated by Moody s Investors Service, Inc.

(3) The weighted average remaining life of

Retained Interests was calculated by summing the product of (i) the sum of the principal collections expected in each future period multiplied by (ii) the number of periods until collection, and then dividing that total by (iii) the initial or remaining principal balance, as applicable.

(4) Represents aggregate estimated future losses as a percentage of the principal outstanding based upon per annum losses ranging from 0.0% to 1.0%. To the extent any loans are likely to be liquidated in the next twelve months, estimated losses were assumed to occur during that period. Generally, no losses are assumed for the year ending December 31, 2007 for those structured loan sale transactions with no current potential impaired loans.

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

(6)

Discount rates utilized were (i) 7.7% to 8.2% for our required overcollateralization, (ii) 9.4% to 9.6% for our reserve funds and (iii) 12.4% to 12.6% for our interest-only strip receivables.

(7) *Represents aggregate principal losses incurred to date as a percentage of the principal outstanding at inception. For the 2000 Joint Venture, represents the loss on a loan receivable repurchased by PMC Commercial due to a loan modification and assumption. For the 2001 Joint Venture, represents the loss on a delinquent loan receivable with a charged-off status repurchased by PMC Commercial.*

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Information pertaining to the Acquired Structured Loan Sale Transactions was as follows:

	1998 Partnership	1999 Partnership	2000 Joint Venture	2001 Joint Venture	2002 Joint Venture	2003 Joint Venture
			(Dollars in thousands)			
At February 29, 2004:						
Principal amount of sold loans	$ 21,702	$ 29,800	$ 17,345	$ 37,191	$ 36,102	$ 56,424
Structured Notes balance outstanding	$ 21,221	$ 26,394	$ 15,636	$ 33,324	$ 32,932	$ 50,774
Interest rate on the Structured Notes (1)	P- 1%	6.60%	7.28%	6.36%	6.67%	L+1.25%
Structured Notes rating (2)	Aaa	Aaa	Aaa	Aaa	Aaa	Aaa
Weighted average interest rate on loans (1)	P+1.22%	9.40%	9.20%	9.64%	9.58%	L+4.02%
Weighted average remaining life of Retained Interests (3)	3.17 years	2.95 years	2.96 years	3.89 years	4.04 years	4.63 years
Aggregate principal losses assumed (4)	3.38%	2.32%	4.19%	5.51%	3.51%	3.10%
Constant prepayment rate assumption (5)	12.00%	14.00%	14.00%	11.00%	10.00%	10.00%
Discount rate assumptions	4.0% to 11.9%	7.1% to 11.8%	7.2% to 11.9%	7.2% to 11.9%	7.3% to 12.0%	7.3% to 11.8%
At December 31, 2006:						
Principal outstanding on sold loans	$ 11,795	$ 15,060	$ 8,561	$ 17,931	$ 17,133	$ 38,631
Structured Notes balance outstanding	$ 11,757	$ 11,579	$ 5,860	$ 15,875	$ 12,877	$ 32,954
Cash in the collection account	$ 806	$ 245	$ 79	$ 1,296	$ 211	$ 417
Cash in the reserve account	$ 1,335	$ 1,215	$ 563	$ 1,123	$ 1,037	$ 2,334
Weighted average interest rate of loans (1)	P+0.96%	9.07%	9.00%	9.67%	9.52%	L+4.02%
Discount rate assumptions (6)	9.3% to 12.4%	7.7% to 12.4%	7.7% to 12.4%	7.7% to 12.4%	7.7% to 12.4%	8.2% to 12.4%
Constant prepayment rate assumption (5)	16.00%	18.00%	18.00%	18.00%	18.00%	16.00%
Weighted average remaining life of	2.52 years	2.10 years	2.28 years	1.70 years	2.34 years	2.88 years

Retained Interests (3)						
Aggregate principal losses assumed (4)	1.71%	1.82%	1.39%	1.20%	1.79%	1.48%
Aggregate principal losses to date (7)	%	%	4.28%	1.78%	1.31%	%

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

(2) Structured Notes issued by the QSPEs were rated by Moody s Investors Service, Inc.

(3) The weighted average remaining life of Retained Interests was calculated by summing the product of (i) the sum of the principal collections expected in each future period multiplied by (ii) the number of periods until collection, and then dividing that total by (iii) the remaining principal balance.

(4) Represents aggregate estimated future losses as a percentage of the principal outstanding based upon per annum estimated losses that ranged from 0.0% to 1.5%. To the extent any loans are likely to be liquidated in the next twelve months, estimated losses were assumed to occur during that period.

Generally, no losses are assumed in the year ending December 31, 2007 for those structured loan sale transactions with no current potential impaired loans.

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

(6) *The discount rates utilized on the components of our Retained Interests (as described below) were (i) 7.7% to 9.3% for our required overcollateralization, (ii) 9.4% for our reserve funds and (iii) 12.4% for our interest-only strip receivables.*

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

repurchased by PMC Commercial.

Approximately 94% of the loans sold to the QSPEs were concentrated in the limited service hospitality industry and approximately 24% were to borrowers in Texas. No other state had a concentration of 10% or greater at December 31, 2006.

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At December 31, 2006, one of the loans sold to the QSPEs with a principal balance of approximately $3.5 million, included in our Originated Structured Loan Sale Transactions, was delinquent 60 days as to payment of principal and interest. If we had to liquidate this loan, the loss could exceed estimates and the estimated fair value of our Retained Interests would decline.

First Western has Retained Interests related to the sale of loans originated pursuant to the SBA 7(a) Guaranteed Loan Program. The SBA guaranteed portions of First Western s loans receivable are sold to either dealers in government guaranteed loans receivable or institutional investors (Secondary Market Loan Sales) as the loans are fully funded. On all Secondary Market Loan Sales, we may retain an excess spread between the interest rate paid to us from our borrowers and the rate we pay to the purchaser of the guaranteed portion of the note and servicing costs (Excess Spread). At December 31, 2006, the aggregate principal balance of First Western s serviced loans receivable on which we had an Excess Spread was approximately $39.2 million and the weighted average Excess Spread was approximately 0.6%. In determining the estimated fair value of our Retained Interests related to Secondary Market Loan Sales, our assumptions at December 31, 2006 included a prepayment speed of 20% per annum and a discount rate of 12.4%.

The estimated fair value of our Retained Interests is based upon an estimate of the discounted future cash flows we will receive. In determining the present value of expected future cash flows, estimates are made in determining the amount and timing of those cash flows and the discount rates. The amount and timing of cash flows is generally determined based on estimates of loan losses and anticipated prepayment speeds relating to the loans receivable contributed to the QSPE. Actual loan losses and prepayments may vary significantly from assumptions. The discount rates that we utilize in computing the estimated fair value are based upon estimates of the inherent risks associated with each cash flow stream. Due to the limited number of entities that conduct transactions with similar assets, the relatively small size of our Retained Interests and the limited number of buyers for such assets, no readily ascertainable market exists. Therefore, our estimate of the fair value may or may not vary from what a willing buyer would pay for these assets.

The components of our Retained Interests are as follows:

(1) Our required overcollateralization (the OC Piece). The OC Piece represents the excess of the loans receivable contributed to the QSPE over the principal amount of the Structured Notes issued by the QSPE, which serves as additional collateral for the Structured Noteholders.

(2) The Reserve Fund and the interest earned thereon. The Reserve Fund represents cash that is required to be kept in a liquid cash account by the QSPE pursuant to the terms of the transaction documents, as collateral for the Structured Noteholders, a portion of which was contributed by us to the QSPE upon formation and a portion which is built up over time by the QSPE from the cash flows of the underlying loans receivable.

(3) The interest-only strip receivable (the IO Receivable). The IO Receivable is comprised of the cash flows that are expected to be received by us in the future after payment by the QSPE of (a) all interest and principal due to the Structured Noteholders, (b) all principal and interest on the OC Piece, (c) any required funding of the Reserve Fund and (d) on-going costs of the transaction.

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Our Retained Interests consisted of the following:

	At December 31, 2006				
	Estimated Fair Value				
	OC Piece	Reserve Fund	IO Receivable	Total	Cost
	(In thousands)				
First Western	$	$	$ 652	$ 652	$ 641
1998 Partnership	699	1,094	321	2,114	2,013
1999 Partnership	3,795	973	311	5,079	4,932
2000 Joint Venture	8,763	2,058	728	11,549	10,295
2001 Joint Venture	6,844	1,627	768	9,239	8,788
2002 Joint Venture	7,649	1,700	1,066	10,415	9,751
2003 Joint Venture	10,817	3,316	2,543	16,676	16,048
	$ 38,567	$ 10,768	$ 6,389	$ 55,724	$ 52,468

	At December 31, 2005				
	Estimated Fair Value				
	OC Piece	Reserve Fund	IO Receivable	Total	Cost
	(In thousands)				
First Western	$	$	$ 779	$ 779	$ 741
1998 Partnership	915	1,048	412	2,375	2,306
1999 Partnership	3,885	955	499	5,339	5,240
2000 Joint Venture	8,953	2,231	892	12,076	10,809
2001 Joint Venture	7,227	2,619	2,440	12,286	11,023
2002 Joint Venture	7,890	2,147	1,831	11,868	10,803
2003 Joint Venture	10,878	4,304	3,086	18,268	17,550
	$ 39,748	$ 13,304	$ 9,939	$ 62,991	$ 58,472

The difference between the estimated fair value and cost of our Retained Interests is reflected in our consolidated balance sheets as unrealized appreciation of Retained Interests.

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

Changed Assumption	Estimated Fair Value	Asset Change (1)
	(In thousands)	
Losses increase by 50 basis points per annum (2)	$ 54,157	($1,567)
Losses increase by 100 basis points per annum (2)	$ 52,583	($3,141)
Rate of prepayment increases by 5% per annum (3)	$ 55,136	($ 588)
Rate of prepayment increases by 10% per annum (3)	$ 54,709	($1,015)
Discount rates increase by 100 basis points	$ 54,127	($1,597)
Discount rates increase by 200 basis points	$ 52,595	($3,129)

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

(2) *If we experience significant losses (i.e., in excess of anticipated losses), the effect on our Retained*

Interests would first reduce the value of our IO Receivables. To the extent the IO Receivables could not fully absorb the losses, the effect would then be to reduce the value of our Reserve Funds and then the value of our OC Pieces.

(3) For example, a 16% assumed rate of prepayment would be increased to 21% or 26% based on increases of 5% or 10% per annum, respectively.

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

We monitor the governing pooling and servicing agreements for each of our structured loan sale transactions and believe the servicing-related terms set forth therein are industry standard and consistent with QSPE criteria. However, views about permitted servicing activities involving QSPEs may not be consistent among organizations. As accounting standard setters continue to interpret QSPE criteria under SFAS No. 140, there may be a material resultant impact on our consolidated financial statements.

In accordance with SFAS No. 140, our consolidated financial statements do not include the assets, liabilities, partners capital, revenues or expenses of the QSPEs. As a result, at December 31, 2006 and 2005, our consolidated balance sheets do not include $207.7 million and $276.1 million in assets, respectively, and $156.5 million and $220.8 million in liabilities, respectively, related to these structured loan sale transactions recorded by the QSPEs. At December 31, 2006, the partners capital of our QSPEs was approximately $51.2 million compared to the estimated value of the associated Retained Interests of approximately $55.1 million.

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

	1998 Partnership		1999 Partnership		2000 Joint Venture	
	2006	2005	2006	2005	2006	2005
			(In thousands)			
Loans receivable, net	$ 11,784	$ 15,969	$ 15,060	$ 20,203	$ 37,579	$ 42,263
Total assets	$ 13,978	$ 17,682	$ 16,608	$ 21,947	$ 40,484	$ 48,253
Structured Notes	$ 11,757	$ 15,240	$ 11,579	$ 16,795	$ 29,457	$ 36,697
Total liabilities	$ 11,829	$ 15,314	$ 11,644	$ 16,889	$ 29,546	$ 36,809
Partners capital	$ 2,149	$ 2,368	$ 4,964	$ 5,058	$ 10,938	$ 11,444

	2001 Joint Venture		2002 Joint Venture		2003 Joint Venture	
	2006	2005	2006	2005	2006	2005
			(In thousands)			
Loans receivable, net	$ 27,092	$ 49,175	$ 32,643	$ 42,843	$ 64,111	$ 75,566
Total assets	$ 31,065	$ 52,918	$ 35,257	$ 46,256	$ 70,333	$ 89,017
Structured Notes	$ 22,437	$ 42,731	$ 25,617	$ 35,844	$ 55,137	$ 72,782
Total liabilities	$ 22,497	$ 42,845	$ 25,688	$ 35,944	$ 55,288	$ 72,964
Partners capital	$ 8,568	$ 10,073	$ 9,569	$ 10,312	$ 15,045	$ 16,053

The following information summarizes the results of operations for the QSPEs:

	Years Ended December 31,					
	1998 Partnership			1999 Partnership		
	2006	2005	2004	2006	2005	2004
			(In thousands)			
Interest income	$ 1,329	$ 1,363	$ 1,174	$ 1,620	$ 2,005	$ 2,624

Total revenues	$ 1,414	$ 1,410	$ 1,203	$ 1,816	$ 2,180	$ 2,979
Reduction of losses	$ (14)	$ (10)	$ (206)	$	$	$
Interest expense	$ 924	$ 856	$ 639	$ 904	$ 1,200	$ 1,613
Total expenses	$ 966	$ 914	$ 509	$ 969	$ 1,279	$ 1,710
Net income	$ 448	$ 496	$ 694	$ 847	$ 901	$ 1,269

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	Years Ended December 31,					
	2000 Joint Venture			2001 Joint Venture		
	2006	2005	2004	2006	2005	2004
	(In thousands)					
Interest income	$ 3,920	$ 4,680	$ 5,729	$ 3,783	$ 5,185	$ 5,990
Total revenues	$ 4,128	$ 5,295	$ 6,534	$ 4,390	$ 5,843	$ 6,097
Provision for (reduction of) losses	$ (17)	$ 17	$ 84	$ 182	$ (415)	$ 812
Interest expense	$ 2,343	$ 2,977	$ 3,791	$ 2,066	$ 2,945	$ 3,588
Total expenses	$ 2,460	$ 3,155	$ 4,068	$ 2,376	$ 2,703	$ 4,604
Net income	$ 1,668	$ 2,140	$ 2,466	$ 2,014	$ 3,140	$ 1,493

	Years Ended December 31,					
	2002 Joint Venture			2003 Joint Venture		
	2006	2005	2004	2006	2005	2004
	(In thousands)					
Interest income	$ 3,924	$ 4,681	$ 5,417	$ 6,791	$ 6,408	$ 5,403
Total revenues	$ 4,261	$ 5,070	$ 6,165	$ 7,157	$ 6,603	$ 5,886
Provision for (reduction of) losses	$	$ 204	$ 364	$ (6)	$ 6	$
Interest expense	$ 2,172	$ 2,666	$ 3,380	$ 3,923	$ 3,485	$ 2,403
Total expenses	$ 2,303	$ 3,024	$ 3,927	$ 4,152	$ 3,771	$ 2,722
Net income	$ 1,958	$ 2,046	$ 2,238	$ 3,005	$ 2,832	$ 3,164

The income from our Retained Interests represents the accretion (recognized using the effective interest method) on our Retained Interests which is determined based on estimates of future cash flows and includes any fees collected (*i.e.,* late fees, prepayment fees, etc.) by the QSPEs in excess of anticipated fees. We update our cash flow assumptions on a quarterly basis and any changes to cash flow assumptions impact the yield on our Retained Interests. The yield on our Retained Interests, which is comprised of the income earned less permanent impairments, was 14.1%, 13.8% and 11.5% during 2006, 2005 and 2004, respectively.

Servicing fee income for the years ended December 31, 2006, 2005 and 2004 for loans held by the QSPEs was approximately $676,000, $833,000 and $781,000, respectively. We have not established a servicing asset or liability related to the loans held by the QSPEs as the servicing fees are considered adequate compensation.

We received approximately $14.6 million, $15.4 million and $15.1 million in cash distributions from the Joint Ventures during 2006, 2005 and 2004, respectively.

During November 2006, PMC Commercial repurchased a loan from the 2001 Joint Venture which had become charged-off as defined in the transaction documents with an outstanding principal balance of approximately $1.5 million. The estimated fair value of the loan receivable included on our consolidated balance sheet was approximately $1.3 million at December 31, 2006.

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Note 7. Restricted Investments:

Restricted investments consisted of the following:

	At December 31,	
	2006	2005
	(In thousands)	
Structured noteholders and Conduit Facility reserve accounts	$ 542	$ 1,927
Structured noteholders and Conduit Facility collection accounts	448	483
Capital expenditures account		1,104
Other	5	18
	$ 995	$ 3,532

The structured noteholders and Conduit Facility reserve and collection accounts represented cash collected that had not yet been remitted to the noteholders or holder and reserve account balances that were required to be held as collateral on behalf of the noteholders or holder. The Conduit Facility reserve account is equal to 2% of borrowings outstanding under the facility. The collection and reserve accounts consist of cash and liquid money market funds. The capital expenditures account represented restricted investments maintained pursuant to our lease agreement with Arlington. Upon lease rejection in January 2006, these funds were no longer restricted.

Note 8. Other Assets:

Other assets consisted of the following:

	At December 31,	
	2006	2005
	(In thousands)	
Deferred borrowing costs, net	$ 1,069	$ 1,340
Interest receivable	1,016	698
Assets acquired in liquidation	975	1,014
Investment in Preferred Trust	820	820
Prepaid expenses and deposits	614	653
Other	444	382
Other assets	$ 4,938	$ 4,907

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Note 9. Debt:

Information on our debt was as follows:

	At December 31,					Weighted Average Coupon Rate at December 31,	
	2006		2005		Current Range of Maturities		
	Face Amount	Carrying Value	Face Amount	Carrying Value		2006	2005
	(In thousands, except footnote)						
Notes and debentures payable:							
Debentures	$ 8,190	$ 8,161	$ 15,500	$ 16,125	2013 to 2015	5.90%	7.10%
Mortgage notes (1)	2,642	2,642	11,473	11,473	2011 to 2017	8.02%	7.45%
Structured notes			5,167	5,167	N/A	N/A	6.37%
	10,832	10,803	32,140	32,765			
Junior Subordinated Notes	27,070	27,070	27,070	27,070	2035	8.62%	7.27%
Credit facilities:							
Conduit Facility	26,968	26,968	24,205	24,205	2008	6.35%	5.26%
Revolving credit facility					2007	N/A	N/A
	26,968	26,968	24,205	24,205			
Redeemable preferred stock of subsidiary	4,000	3,668	4,000	3,575	2009 to 2010	4.00%	4.00%
Debt	$ 68,870	$ 68,509	$ 87,415	$ 87,615			

(1) Debt outstanding at December 31, 2006 does not include a mortgage note with a principal balance of approximately $1.3 million and

a fixed interest rate of 8.5% due January 1, 2011 of an unconsolidated VIE. The mortgage note is included in debt outstanding at December 31, 2005.

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

Years Ending December 31,	Total
	(In thousands)
2007	$ 142
2008	27,121
2009	2,166
2010	2,180
2011	1,042
Thereafter	36,219
	$ 68,870

Debentures

Debentures represent amounts due to the SBA as a result of borrowings made pursuant to the SBIA, have a weighted average cost of funds of 6.0% and semi-annual interest only payments. On September 1, 2006, we prepaid, without penalty, approximately $7.3 million of fixed-rate SBA debentures. The unamortized premiums at the date of repayment of $563,000 were recorded as gain on early extinguishment of debt.

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Mortgage Notes

As of December 31, 2006, we had mortgage notes, each collateralized by a hotel property. During 2006, we sold one hotel property with a mortgage note of approximately $1.5 million and the mortgage was repaid. These mortgages are amortized over 20 years, mature from January 2011 to December 2017 and have restrictive provisions which provide for substantial prepayment penalties. At December 31, 2006 and 2005, approximately $1.4 million and $3.0 million, respectively, of our mortgage notes were guaranteed by PMC Commercial.

Structured Notes

In June 1998, PMC Commercial formed PMCT Trust, a bankruptcy remote partnership that completed a private placement of fixed-rate loan-backed notes. We exercised our option and the structured notes were repaid on December 1, 2006.

Junior Subordinated Notes

In connection with the formation of the Preferred Trust, during 2005, PMC Commercial issued Junior Subordinated Notes which are subordinated to PMC Commercial s existing debt. The Junior Subordinated Notes bear interest at a floating rate which resets on a quarterly basis at the 90-day LIBOR plus 3.25% (computed on a 360-day year). The Junior Subordinated Notes may be redeemed at par at our option beginning on March 30, 2010. Interest payments are due on a quarterly basis.

Conduit Facility

During 2005, we entered into a three-year $100.0 million Conduit Facility expiring February 6, 2008. Interest payments on the advances are payable by PMC Conduit on a monthly basis at a rate approximating 1% over LIBOR and PMC Conduit s principal repayment obligations are expected to be financed through future securitizations of the loans collateralizing advances under the conduit facility. In addition, we are charged an unused fee equal to 12.5 basis points computed based on the daily available balance. During February 2007, the interest rate was modified to a rate approximating 85 basis points over LIBOR. The Conduit Facility allows for advances based on the amount of eligible collateral sold to the Conduit Facility and has minimum requirements. The Conduit Facility has covenants, the most restrictive of which are maximum delinquency ratios for our contributed loans and serviced portfolio, as defined in the transaction documents. In addition, the Conduit Facility has cross default provisions with the revolving credit facility. At December 31, 2006, approximately $43.6 million of our loans were owned by PMC Conduit. We had availability of approximately $7.4 million under the conduit facility at December 31, 2006 without additional sales of loans to PMC Conduit. At December 31, 2006, we were in compliance with the covenants of this facility.

Revolving Credit Facility

PMC Commercial has a revolving credit facility that matures in December 2007 and provides us with credit availability up to $20 million. We are charged interest on the balance outstanding under the revolving credit facility at our election of either the prime rate of the lender less 75 basis points or 162.5 basis points over the 30, 60 or 90-day LIBOR. In addition, we are charged an unused fee equal to 37.5 basis points computed based on our daily available balance. The credit facility requires us to meet certain covenants, the most restrictive of which (1) provides for an asset coverage test based on our cash and cash equivalents, loans receivable, Retained Interests and real estate investments as a ratio to our senior debt and (2) limits our ability to pay out returns of capital as part of our dividends. At December 31, 2006, we were in compliance with the covenants of this facility.

Redeemable Preferred Stock of Subsidiary

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

The 4% Preferred Stock was issued during 1994 ($2.0 million) and 1995 ($2.0 million) and must be redeemed at par no later than 15 years from the date of issuance. In accordance with SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, we classified the 4% Preferred Stock as a liability on our consolidated balance sheet. The 4% Preferred Stock was valued at $3,420,000 on the merger date. Dividends of approximately $160,000 were recognized on the 4% Preferred Stock during both 2006 and 2005 and are included in interest expense in our consolidated statement of income.

Interest Paid

During 2006, 2005 and 2004 interest paid was approximately $5,430,000, $5,378,000, and $4,727,000, respectively.

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Note 10. Cumulative Preferred Stock of Subsidiary:

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

PMCIC is entitled to redeem, in whole or part, the 3% Preferred Stock by paying the par value ($3.0 million) of these securities plus dividends accumulated and unpaid on the date of redemption. While the 3% Preferred Stock may be redeemed, redemption is not mandatory. The 3% Preferred Stock was valued at $900,000 on the merger date. Dividends of approximately $90,000 were recognized on the 3% Preferred Stock during both 2006 and 2005 and are reflected in our consolidated statements of income as minority interest.

Note 11. Earnings Per Share:

The computations of basic earnings per common share are based on our weighted average shares outstanding. The weighted average number of common shares outstanding was approximately 10,748,000, 10,874,000 and 10,134,000 for the years ended December 31, 2006, 2005 and 2004, respectively. For purposes of calculating diluted earnings per share, the weighted average shares outstanding were increased by approximately 3,000, 5,000 and 18,000 shares, respectively, during 2006, 2005 and 2004 for the dilutive effect of stock options.

Not included in the computation of diluted earnings per share were outstanding options to purchase approximately 61,000, 74,000 and 60,000 common shares during 2006, 2005 and 2004, respectively, because the options exercise prices were greater than the average market price of the stock.

Note 12. Dividends Paid and Declared:

During 2006, our dividends were declared as follows:

Record Date	Date Paid	Amount Per Share	Type
March 31, 2006	April 10, 2006	$ 0.30	Regular
June 30, 2006	July 10, 2006	0.30	Regular
September 29, 2006	October 10, 2006	0.30	Regular
December 29, 2006	January 8, 2007	0.30	Regular
December 29, 2006	January 8, 2007	0.10	Special
		$ 1.30	

In March 2007, the Board of Trust Managers declared a $0.30 per share quarterly dividend to common shareholders of record on March 30, 2007 which will be paid on April 9, 2007.

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

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Note 13. Taxable Income:

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

In order to meet our 2006 taxable income distribution requirements, we may make an election under the Code to treat a portion of the distributions declared and paid in 2007 as distributions of 2006 s taxable income.

PMC Commercial has wholly-owned TRS s which are subject to Federal income taxes: PMCIC, First Western, PMC Funding and PMC Properties. The income generated from the TRS s is taxed at normal corporate rates. The measurement of net deferred tax assets is adjusted by a valuation allowance, if, based on our ongoing assessment of future realization, it is more likely than not that they will not be realized.

We calculate our current and deferred tax provisions based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed during the subsequent year. Adjustments based on the final tax returns are generally recorded in the period when the returns are filed.

The following reconciles our net income to REIT taxable income:

	Years Ended December 31,		
	2006	2005	2004
		(In thousands)	
Net income	$ 15,684	$ 11,297	$ 24,781
Less: TRS net income, net of tax	(1,280)	(1,414)	(145)
Add: book depreciation	231	1,240	1,872
Less: tax depreciation	(508)	(1,483)	(1,935)
Book/tax difference on property sales	171	(350)	135
Book/tax difference on Retained Interests, net	1,973	1,880	3,557
Impairment losses	968	2,210	
Negative goodwill			(11,593)
Book/tax difference on amortization and accretion	(641)	(264)	(221)
Asset valuation	(890)	181	(516)
Other book/tax differences, net	(59)	(9)	317
REIT taxable income	$ 15,649	$ 13,288	$ 16,252
Distributions declared	$ 13,975	$ 13,569	$ 14,140

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Dividends per share for dividend reporting purposes were as follows:

	Years Ended December 31,					
	2006		2005		2004	
	Amount Per Share	Percent	Amount Per Share	Percent	Amount Per Share	Percent
Ordinary income	$ 1.244	95.69%	$ 1.194	95.52%	$ 1.400	100.00%
Capital gains	0.056	4.31%	0.056	4.48%		
	$ 1.300	100.00%	$ 1.250	100.00%	$ 1.400	100.00%

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

	Years Ended December 31,		
	2006	2005	2004
	(In thousands)		
Federal:			
Current provision	$ 502	$ 680	$ 152
Deferred provision (benefit)	147	(22)	(36)
Income tax provision	$ 649	$ 658	$ 116

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

	Years Ended December 31,		
	2006	2005	2004
	(In thousands)		
Income before income taxes for TRS s	$ 1,929	$ 2,072	$ 261
Expected Federal income tax provision	$ 676	$ 725	$ 91
Preferred dividend of subsidiary recorded as minority interest	31	31	25
Change in valuation allowance		(112)	
Other adjustments	(58)	14	
Income tax provision	$ 649	$ 658	$ 116

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

	Years Ended December 31,		
	2006	2005	2004
	(In thousands)		
Deferred tax assets:			
Retained Interests	$ 161	$ 97	$ 76
Loans receivable	94	148	105
Servicing asset	69	132	188
Premiums on acquired debentures payable		106	133
Operating loss carryforwards		8	112
Other		12	4
Total gross deferred tax assets	324	503	618
Valuation allowance			112
	324	503	506
Deferred tax liabilities:			
Discounts on acquired redeemable preferred stock of subsidiary and debentures payable	121	154	179
Total gross deferred tax liabilities	121	154	179
Deferred tax asset, net	$ 203	$ 349	$ 327

The net operating loss carryforwards at December 31, 2004 were generated by PMC Funding and were available to offset future taxable income of PMC Funding. At the time of the merger, management believed that we would not realize the benefit of PMC Funding s net operating loss carryforwards and a valuation allowance was established. We realized the full benefit of these net operating loss carryforwards during 2005 and the valuation allowance was reversed.

We paid $845,000 and $467,500 in income taxes during 2006 and 2005, respectively.

Note 14. Other Income:

Other income consisted of the following:

	Years Ended December 31,		
	2006	2005	2004
	(In thousands)		
Prepayment fees	$ 1,653	$ 590	$ 656
Servicing income (1)	1,025	1,222	1,142
Premium income (2)	499	618	526
Other loan related income	403	646	475
Equity in earnings of unconsolidated subsidiaries	76	45	
Debt release income			175

Other income	$ 3,656	$ 3,121	$ 2,974

(1) *We earn fees for servicing all loans held by the QSPEs and First Western s loans sold into the secondary market.*

(2) *Premium income results from the sale of First Western s loans pursuant to Secondary Market Loan Sales.*

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Note 15. Discontinued Operations:

Discontinued operations of our hotel properties (12 hotel properties, 15 hotel properties and 17 hotel properties during 2006, 2005 and 2004, respectively) and assets acquired in liquidation (primarily three limited service hospitality properties during 2005 and 2006) consisted of the following:

	Years Ended December 31,		
	2006	2005	2004
		(In thousands)	
Hotel and Lease Operations:			
Revenues:			
Hotel operating revenues	$ 1,115	$ 624	$
Lease income base and other	145	2,899	4,647
Straight-line rental income		922	516
Lease termination fee income			624
Total revenues	1,260	4,445	5,787
Expenses:			
Hotel operating expenses	1,070	563	
Interest expense (1)	119	598	676
Depreciation	9	959	1,556
Property tax expense		895	
Advisory fees			51
Total expenses	1,198	3,015	2,283
Net earnings, hotel and lease operations	62	1,430	3,504
Assets Acquired in Liquidation Operations:			
Revenues	224	124	15
Expenses	220	117	2
Net earnings, assets acquired in liquidation operations	4	7	13
Total net earnings	66	1,437	3,517
Net gain (loss) on sales of real estate	2,064	2,256	(252)
Impairment losses	(94)	(1,774)	
Discontinued operations	$ 2,036	$ 1,919	$ 3,265

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

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Property sales included in discontinued operations consisted of the following:

	Years Ended December 31,		
	2006 (1)	2005 (1)	2004
	(In thousands, except number of property sales and footnote)		
Properties sold:			
Hotel properties	10	6	2
Assets acquired in liquidation	8	4	7
	18	10	9
Hotel Properties:			
Sales proceeds	$ 20,553	$ 12,804	$ 3,513
Cost of sales	(17,488)	(11,508)	(3,983)
Deferred gains, net	(1,174)		
	1,891	1,296	(470)
Assets Acquired in Liquidation:			
Sales proceeds	4,124	5,978	3,052
Cost of sales	(3,896)	(4,673)	(2,834)
Deferred gains, net	(55)	(345)	
	173	960	218
Net gain (loss) on sales of real estate	$ 2,064	$ 2,256	$ (252)

(1) We financed the sale of certain of these properties through origination of loans aggregating $19,844,000 and $6,969,000 during 2006 and 2005, respectively. As the down payment

received was not sufficient to qualify for full accrual gain treatment on certain of the sales, we recorded initial installment gains and deferred the remaining gains.

Note 16. Dividend Reinvestment and Cash Purchase Plan:

We have a dividend reinvestment and cash purchase plan (the Plan). Participants in the Plan have the option to reinvest all or a portion of dividends received. The purchase price of the Common Shares is 100% of the average of the closing price of the Common Shares as published for the five trading days immediately prior to the dividend record date or prior to the optional cash payment purchase date, whichever is applicable. We use the open market to purchase Common Shares with proceeds from the dividend reinvestment portion of the Plan.

Note 17. Profit Sharing Plan:

We have a profit sharing plan available to our full-time employees after one year of employment. Vesting increases ratably to 100% after the sixth year of employment. Pursuant to our profit sharing plan, approximately $244,000, $244,000 and $183,000 was expensed during 2006, 2005 and 2004, respectively. Contributions to the profit sharing plan are at the discretion of our Board of Trust Managers.

Note 18. Share-Based Compensation Plans:

At December 31, 2006, we have options outstanding under share-based compensation plans: the 2005 Equity Incentive Plan, the 1993 Employee Share Option Plan and the Trust Manager Share Option Plan. The 1993 Employee Share Option Plan and the Trust Manager Share Option Plan expired in December 2003; thus, no additional options will be issued under these plans.

We use the fair value recognition provisions of SFAS No. 123R, Accounting for Stock-Based Compensation, to account for all awards granted, modified or settled.

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The 2005 Equity Incentive Plan was approved by our shareholders on June 11, 2005 and permits the grant of options to our employees, executive officers and Board of Trust Managers and restricted shares to our executive officers and Board of Trust Managers for up to 500,000 Common Shares. We believe that these awards better align the interests of our employees, executive officers and Board of Trust Managers with those of our shareholders. Option awards are granted with an exercise price equal to the market price of our Common Shares at the date of grant and vest immediately upon grant with five-year contractual terms.

The Trust Manager Share Option Plan was a nondiscretionary plan pursuant to which options to purchase 2,000 Common Shares were granted to certain trust managers on the date such trust manager took office. In addition, options to purchase 1,000 shares were granted on June 1 of each year through December 31, 2003. Such options were exercisable at the fair market value of the shares on the date of grant. The options granted under the Trust Manager Share Option Plan became exercisable one year after date of grant and expired if not exercised on the earlier of (1) 30 days after the option holder no longer held office for any reason or (2) within five years after date of grant. Due to expiration of the Trust Manager Share Option Plan, we did not grant any options under the Trust Manager Share Option Plan after 2003.

A summary of the status of our stock options as of December 31, 2006, 2005 and 2004 and the changes during the years ended on those dates are as follows:

	2006		2005		2004	
	Number of Shares Underlying Options	Weighted Average Exercise Prices	Number of Shares Underlying Options	Weighted Average Exercise Prices	Number of Shares Underlying Options	Weighted Average Exercise Prices
Outstanding, January 1	170,113	$ 14.78	164,260	$ 15.86	150,876	$ 12.64
Granted	33,250	$ 12.72	36,700	$ 14.54		
Acquired in the merger					88,483	$ 19.19
Exercised	(35,500)	$ 13.06	(9,400)	$ 13.13	(59,500)	$ 11.58
Forfeited	(2,064)	$ 15.29	(5,652)	$ 20.14	(92)	$ 12.97
Expired	(23,288)	$ 18.79	(15,795)	$ 24.49	(15,507)	$ 19.97
Outstanding, December 31	142,511	$ 14.06	170,113	$ 14.78	164,260	$ 15.86
Exercisable, December 31	142,511	$ 14.06	170,113	$ 14.78	164,260	$ 15.86
Weighted-average fair value of stock options granted during the year	$ 0.59		$ 0.69			

The market price of our stock at December 31, 2006 is greater than certain of our stock option exercise prices (approximately 86,000 shares). The intrinsic value of these stock options outstanding or exercisable at December 31, 2006 was approximately $129,000.

Upon notification of intent to exercise stock options, our policy is to first verify that the options are exercisable, then to contact our transfer agent instructing them to issue new shares and then to collect the cash proceeds. We received approximately $123,000 and $378,000 in cash proceeds related to the cash exercise of stock options during 2005 and 2004, respectively. There were no cash exercises of stock options during 2006. In addition, during 2006 and 2004 we

issued 2,822 and 6,620 Common Shares, respectively to our executive officers in exchange for 35,500 and 27,750 stock options, respectively, utilizing stock-for-stock exercise provisions of our option plans.

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The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Years Ended December 31,	
	2006	2005
Assumption:		
Expected Term (years)	3.0	3.0
Risk-Free Interest Rate	4.96%	3.74%
Expected Dividend Yield	9.43%	9.16%
Expected Volatility	16.24%	16.63%
Forfeiture Rate	5.00%	5.00%

The expected term of the options represents the period of time that the options are expected to be outstanding and was determined based on our historical data. The risk-free rate was based on the 3-year treasury rate corresponding to the expected term of the options. We used historical information to determine our expected volatility, dividend yield and forfeiture rates. We recorded compensation expense of approximately $19,000 and $23,000 during 2006 and 2005, respectively, related to these option grants. No options were granted during the year ended December 31, 2004.

We issued an aggregate of 9,060 restricted shares to executive officers and our Board of Trust Managers on both June 10, 2006 and June 11, 2005 at the then current market price of the shares of $12.72 and $14.54, respectively. The restricted share awards vest based on two years of continuous service with one-third of the shares vesting immediately upon issuance of the shares and one-third vesting at the end of each of the next two years. Restricted share awards provide for accelerated vesting if there is a change in control (as defined in the plan). There were no forfeitures of restricted shares during 2006 or 2005. Compensation expense is being recognized over the vesting period. We recorded compensation expense of approximately $112,000 and $83,000 during 2006 and 2005, respectively, related to our restricted share issuances. At December 31, 2006, there was approximately $52,000 of total unrecognized compensation expense related to the unvested restricted shares which will be recognized over the next one to two years.

We assumed unearned share compensation in the merger representing the intrinsic value of unvested options assumed that vest as the employees provide future services. Compensation expense was recognized over the vesting period. We recorded compensation expense of approximately $7,000 during 2004 related to these unvested options.

The following table summarizes information about stock options outstanding at December 31, 2006:

	Options Outstanding and Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contract Life (in years)	Weighted Average Exercise Price
$ 12.72 to $14.54	119,943	2.85	$ 13.44
$ 14.90	4,000	0.67	$ 14.90
$ 17.95	18,568	0.70	$ 17.95
$ 12.72 to $17.95	142,511	2.51	$ 14.06

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Note 19. Supplemental Disclosure of Cash Flow Information:

Our non-cash investing activities were as follows:

	Years Ended December 31,		
	2006	2005	2004
		(In thousands)	
Reclassification from loans receivable to assets acquired in liquidation	$ 3,730	$ 5,657	$ 2,115
Loans receivable originated in connection with sales of hotel properties	$ 17,084	$ 4,770	$
Loans receivable originated in connection with the sale of assets acquired in liquidation	$ 2,760	$ 3,725	$ 1,800
Loan receivable established through due to affiliates, net	$	$ 415	$ 2,126
Reduction of due to affiliate and Retained Interests	$	$ 2,126	$
Note receivable and deferred liability recorded upon sale of hotel property	$	$ 197	$ 443

See Note 3 for information on assets acquired and liabilities assumed in connection with the merger with PMC Capital. See Note 2 for information on the deconsolidation of the assets and liabilities of PMCT Plainfield, L.P.

Note 20. Fair Values of Financial Instruments:

The estimates of fair value as required by SFAS No. 107, Disclosures about Fair Value of Financial Instruments differ from the carrying amounts of the financial assets and liabilities primarily as a result of the effects of discounting future cash flows. Considerable judgment is required to interpret market data and develop estimates of fair value. Accordingly, the estimates presented below may not be indicative of the amounts we could realize in a current market exchange.

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

	Years Ended December 31,			
	2006		2005	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(In thousands)			
Assets:				
Loans receivable, net	$ 169,181	$ 170,044	$ 157,574	$ 158,579
Retained Interests	55,724	55,724	62,991	62,991
Cash and cash equivalents	3,739	3,739	3,967	3,967
Restricted investments	995	995	3,532	3,336
Mortgage-backed security of affiliate	643	643	833	833
Liabilities:				
Notes and debentures payable	10,803	10,847	32,765	27,092
Redeemable preferred stock of subsidiary	3,668	3,760	3,575	3,575
Credit facilities	26,968	26,968	24,205	24,205
Junior Subordinated Notes	27,070	27,070	27,070	27,070

Loans receivable, net: We generally estimate the fair value of variable-rate loans to approximate the remaining unamortized principal of the loan less any purchase or other discounts, unless there is doubt as to realization of the loan. In addition, we generally estimate the fair value of fixed-rate loans based on a net present value calculation utilizing current market interest rates and anticipated principal collections. A valuation reserve is established for a problem loan based on the creditor s payment history, collateral value, guarantor support and other factors. In the absence of a readily ascertainable market value, the estimated value of our loans receivable may differ from the values that would be placed on the portfolio if a ready market for the loans receivable existed.

Retained Interests and mortgage-backed security of affiliate: The assets are reflected in our consolidated financial statements at estimated fair value based on valuation techniques as described in Note 6.

Cash and cash equivalents: The carrying amount is a reasonable estimation of fair value due to the short maturity of these instruments.

Restricted investments: The carrying amounts of the reserve fund associated with the Conduit Facility and the remaining restricted investments are considered to be a reasonable estimate of fair value due to the relatively short maturity of these funds.

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

Redeemable preferred stock of subsidiary: The estimated fair value is based on a present value calculation based on prices of the same or similar instruments after considering risk, current interest rates and remaining maturities.

Credit facilities and Junior Subordinated Notes: The carrying amount is a reasonable estimation of fair value as the interest rates on these instruments are variable.

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Note 21. Selected Quarterly Financial Data: ***(unaudited)***

The following represents our selected quarterly financial data which, in the opinion of management, reflects adjustments (comprising only normal recurring adjustments) necessary for fair presentation.

	Year Ended December 31, 2006			
	Revenues (1)	Income From Continuing Operations (1)	Net Income	Earnings Per Share
	(In thousands, except earnings per share and footnotes)			
First Quarter	$ 7,301	$ 3,224	$ 5,041(2)	$ 0.47
Second Quarter	8,163	3,490	3,650	0.34
Third Quarter	8,324	3,945	3,976(3)	0.37
Fourth Quarter	6,889	2,989	3,017	0.28
	$ 30,677	$ 13,648	$ 15,684	$ 1.46

	Year Ended December 31, 2005			
	Revenues (1)	Income From Continuing Operations (1)	Net Income	Earnings Per Share
	(In thousands, except earnings per share and footnotes)			
First Quarter	$ 6,270	$ 3,151	$ 4,116	$ 0.38
Second Quarter	5,913	1,893	2,233(4)	0.20
Third Quarter	6,337	1,442	2,004(5)	0.19
Fourth Quarter	6,579	2,892	2,944	0.27
	$ 25,099	$ 9,378	$ 11,297	$ 1.04

(1) Certain amounts were previously reported in continuing operations in our quarterly filings on Form 10-Q. Such amounts have been reclassified to discontinued operations in accordance with

SFAS No. 144.

(2) *Includes gains of $1,877,000 from the sale of six hotel properties and three assets acquired in liquidation.*

(3) *Includes a gain on extinguishment of debt of $563,000.*

(4) *Includes gains of $978,000 from the sale of two hotel properties*

(5) *Includes gains of $1,038,000 from the sale of two assets acquired in liquidation and two hotel properties.*

Note 22. Commitments and Contingencies:

Loan Commitments

Commitments to extend credit are agreements to lend to a customer provided the terms established in the contract are met. Our outstanding loan commitments and approvals to fund new loans were approximately $32.6 million at December 31, 2006, of which approximately $2.6 million were for prime-based loans to be originated by First Western, the government guaranteed portion of which (approximately 75% of each individual loan) will be sold pursuant to Secondary Market Loan Sales.

At December 31, 2006, the majority of our commitments and approvals were for variable-rate loans based on the prime rate or the 90-day LIBOR at spreads over the prime rate generally ranging from 1.50% to 2.75% and over LIBOR generally ranging from 3.00% to 4.25%. The weighted average interest rate on our loan commitments and approvals at December 31, 2006 was approximately 9.1%. Commitments generally have fixed expiration dates and require payment of a fee to us. Since some commitments are expected to expire without being drawn upon, total commitment amounts do not necessarily represent future cash requirements.

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Operating Lease

We lease office space in Dallas, Texas under a lease which expires in October 2011. Future minimum lease payments under this lease are as follows:

	Amount *(In thousands)*
2007	$ 179
2008	191
2009	203
2010	214
2011	186
	$ 973

Rent expense, which is being recorded on a straight-line basis, amounted to approximately $186,000, $165,000 and $133,000 during 2006, 2005 and 2004, respectively.

Employment Agreements

We have employment agreements with our executive officers for three-year terms expiring June 30, 2009. Annually, the agreements are renewed for new three-year terms unless prior to the end of the first year, either the Company or the executive officer provides notice to the other party of its intention not to extend the employment period beyond the current term. In the event of a change in responsibilities, as defined, during the employment period, the agreements provide for severance compensation to the executive officer in an amount equal to 2.99 times annual compensation paid to the executive officer as defined in the agreements.

Structured Loan Sale Transactions

The transaction documents of the QSPEs contain provisions (the Credit Enhancement Provisions) that govern the assets and the inflow and outflow of funds of the QSPE formed as part of the structured loan sale transactions. The Credit Enhancement Provisions include specified limits on the delinquency, default and loss rates on the loans receivable included in each QSPE. If, at any measurement date, the delinquency, default or loss rate with respect to any QSPE were to exceed the specified limits, the Credit Enhancement Provisions would automatically increase the level of credit enhancement requirements for that QSPE. During the period in which the specified delinquency, default or loss rate was exceeded, excess cash flow from the QSPE, if any, which would otherwise be distributable to us, would be used to fund the increased credit enhancement levels up to the principal amount of such loans and would delay or reduce our distribution. In general, there can be no assurance that amounts deferred under Credit Enhancement Provisions would be received in future periods or that future deferrals or losses will not occur.

Environmental

PMC Funding has a recorded liability of approximately $300,000 at December 31, 2006 related to a loan with collateral that has environmental remediation obligations which are the primary responsibility of our borrower. Under purchase accounting, the liability was assumed and the loan was acquired by PMC Commercial in the merger with PMC Capital, Inc. The loan was originated in connection with the sale of the underlying collateral by PMC Funding to the borrower. The sale was financed by PMC Capital through a loan with a current outstanding principal balance of approximately $475,000 which is in default. As a result, we filed a lawsuit in the State of Georgia to appoint a receiver to operate the property and determine if current environmental remediation plans are being followed. The Court has refused to appoint a receiver at the present time. The borrower has filed a counterclaim alleging, among other things, breach of contract and non-default under the loan documents. We do not believe there is any merit to the counterclaim and intend to vigorously pursue all remedies available to us under the law.

During 2005, we were informed by the Georgia Department of Natural Resources that the current remediation plan for the property has certain aspects that require revision. While our borrower has the primary responsibility for the environmental remediation, to the extent we elect to foreclose, we currently believe that the estimated fair value of the collateral underlying the loan exceeds the current outstanding principal balance on the loan. At the present time, we have been unable to quantify additional costs, if any, of the potential changes in remediation methods requested by the State of Georgia; however, these costs could be material and may exceed the value of the collateral net of the recorded liability and the current outstanding principal balance of the loan.

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Litigation

We have significant outstanding claims against Arlington s bankruptcy estate. Arlington has objected to our claims and initiated a complaint in the bankruptcy seeking, among other things, the return of payments Arlington made pursuant to the leases and the Master Lease Agreement. Although the value of our claims against Arlington is significantly higher than Arlington s claims against us, there is no assurance that we will collect our claims from Arlington nor is there any assurance we will not be required to make payments to the bankruptcy estate in connection with Arlington s initiated claim.

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

Other

If the SBA establishes that a loss on an SBA guaranteed loan is attributable to significant technical deficiencies in the manner in which the loan was originated, funded or serviced by First Western, the SBA may seek recovery of funds 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.

Pursuant to SBA rules and regulations, distributions from our consolidated subsidiaries, First Western, PMCIC and Western Financial are limited. In order to operate as a small business lending company, a licensee is required to maintain a minimum net worth (as defined by SBA regulations) of the greater of (1) 10% of the outstanding loans receivable of our SBLC or (2) $1.0 million, as well as certain other regulatory restrictions such as change in control provisions. At December 31, 2006, dividends available for distribution were approximately $2.1 million.

Note 23. Business Segments:

Operating results and other financial data are presented for our reportable business segments. These segments are categorized by line of business which also corresponds to how they are operated. The segments include (1) the Lending Division, which originates loans receivable to small businesses primarily in the hospitality industry and (2) the Property Division which owns and operates certain of our hotel properties. The operations of our lending division are reviewed by our chief operating decision makers in assessing its performance, to make business decisions and to allocate resources. We do not differentiate between subsidiaries or loan programs for this purpose.

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Our business segment data is as follows:

	Years Ended December 31,					
	2006			2005		
	Total	Lending Division	Property Division	Total	Lending Division	Property Division
	(In thousands)					
Revenues:						
Interest income loans and other income	$ 19,116	$ 19,110	$ 6	$ 14,699	$ 14,699	$
Lease income and other property income	2,171		2,171	942		942
Income from Retained Interests	9,390	9,390		9,458	9,458	
Total	30,677	28,500	2,177	25,099	24,157	942
Expenses:						
Interest	5,435	5,132	303	4,688	4,343	345
Depreciation	222	10	212	281	3	278
Salaries and related benefits (1)	4,739	4,502	237	4,553	4,098	455
Hotel property expenses	1,614		1,614			
General and administrative	2,648	2,444	204	2,995	2,393	602
Impairments and provisions	2,195	1,270	925	2,456	765	1,691
Total	16,853	13,358	3,495	14,973	11,602	3,371
Gain on early extinguishment of debt	563	563				
Income (loss) before income tax provision, minority interest, and discontinued operations	14,387	15,705	(1,318)	10,126	12,555	(2,429)
Income tax provision	(649)	(638)	(11)	(658)	(658)	
Minority interest (preferred stock dividend of subsidiary)	(90)	(90)		(90)	(90)	
Income (loss) from continuing operations	13,648	14,977	(1,329)	9,378	11,807	(2,429)

Discontinued operations:						
Net gain on sales of real estate	2,064	157	1,907	2,256	960	1,296
Impairment losses	(94)	(51)	(43)	(1,774)		(1,774)
Net earnings	66	4	62	1,437	7	1,430
Total discontinued operations	2,036	110	1,926	1,919	967	952
Net income (loss)	$ 15,684	$ 15,087	$ 597	$ 11,297	$ 12,774	$ (1,477)

(1) Salaries and related benefits were allocated to the property division based on management s estimate of time spent for oversight.

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	Year Ended December 31, 2004		
	Total	Lending Division	Property Division
		(In thousands)	
Revenues:			
Interest income loans and other income	$ 11,136	$ 11,136	$
Lease income	1,017		1,017
Income from Retained Interests	8,763	8,763	
Total	20,916	19,899	1,017
Expenses:			
Interest	3,873	3,512	361
Depreciation	316	2	314
Salaries and related benefits (1)	3,557	3,201	356
Advisory and servicing fees to affiliate, net	245	236	9
General and administrative	1,882	1,868	14
Permanent impairments on Retained Interests	1,182	1,182	
Reduction of loan losses	(253)	(253)	
Total	10,802	9,748	1,054
Income (loss) before income tax provision, minority interest discontinued operations and extraordinary item	10,114	10,151	(37)
Income tax provision	(116)	(116)	
Minority interest (preferred stock dividend of subsidiary)	(75)	(75)	
Income (loss) from continuing operations	9,923	9,960	(37)
Discontinued operations:			
Net gain (loss) on sales of real estate	(252)	218	(470)
Net earnings	3,517	13	3,504
Total discontinued operations	3,265	231	3,034
Income before extraordinary item	13,188	10,191	2,997
Extraordinary item:			
Negative goodwill	11,593	11,593	

Net income	$ 24,781	$ 21,784	$ 2,997

(1) Salaries and related benefits were allocated to the property division based on management s estimate of time spent for oversight.

Total assets were allocated as follows:

	Years Ended December 31,		
	2006	2005	2004
	(In thousands)		
Lending Division	$ 235,040	$ 232,603	$ 214,252
Property Division	5,364	26,589	39,588
	$ 240,404	$ 259,192	$ 253,840

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PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Additions to furniture, fixtures and equipment were as follows:

	Years Ended December 31,		
	2006	2005	2004
	(In thousands)		
Lending Division	$ 38	$	$ 10
Property Division	65	366	595
	$ 103	$ 366	$ 605

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Schedule II
PMC COMMERCIAL TRUST AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS
(In thousands, except footnotes)

		Additions			
Description	**Balance at beginning of period**	**Charged to costs and expenses**	**Charged to other accounts**	**Deductions**	**Balance at end of period**
Year ended December 31, 2004:					
				(258)***(1)*** (675)***(2)***	
Loan Loss Reserves	$ 675	$ 422	$	$ (933)	$ 164
Deferred Tax Asset Valuation Allowance	$	$	$ 171***(3)***	$	$ 171
Year ended December 31, 2005:					
				(35)***(1)*** (18)***(4)*** (9)***(5)***	
Loan Loss Reserves	$ 164	$ 325	$	$ (62)	$ 427
Deferred Tax Asset Valuation Allowance	$ 171	$	$	$ (171)***(6)***	$
Rent and Related Receivables Reserve	$	$ 1,255***(7)***	$	$	$ 1,255
Year ended December 31, 2006:					
				(467)***(1)*** (71)***(4)***	
Loan Loss Reserves	$ 427	$ 174	$	$ (538)	$ 63
	$ 1,255	$ 925***(7)***	$	$	$ 2,180

Rent and Related Receivables
Reserve

(1) *Principal written-off.*

(2) *During 2004, $675,000 of previously recorded loan loss reserves was reversed due to the reduction in the expected loss on a loan collateralized by a limited service hospitality property due to repayment in full of all principal on the loan.*

(3) *We acquired net operating losses in the merger with PMC Capital, Inc. which were fully reserved at acquisition.*

(4) *During 2005 and 2006, previously recorded loan loss reserves were reversed due to reductions in expected losses on loans.*

(5) *Represents recovery of loans previously written-off.*

(6) *At the time of the merger in 2004, management believed that the benefit of the net operating loss carryforwards from one of our taxable REIT subsidiaries would not be realized and a valuation allowance was established. However, as a result of operations during 2005, we realized the full benefit of these net operating loss carryforwards and the valuation allowance was reversed.*

(7) *During 2005 and 2006, we established reserves against our rent and related receivables from Arlington based on best available information provided to us through the Arlington bankruptcy proceedings.*

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Schedule III
PMC COMMERCIAL TRUST AND SUBSIDIARIES
REAL ESTATE AND ACCUMULATED DEPRECIATION
AS OF DECEMBER 31, 2006
(In thousands, except footnotes)

		Initial Cost			Cost Capitalized Subsequent To Acquisition			Recorded Impairment (2)			Gross Amounts at Which Carried at Close of Period (1)			
Description of Property	**Encumbrances**	**Land**	**Building and Improvements**	**Furniture and Fixtures**	**Land**	**Building and Improvements**	**Furniture and Fixtures**	**Land**	**Building and Improvements**	**Furniture and Fixtures**	**Land**	**Building and Improvements**	**Furniture and Fixtures**	**Total**
The following are hotel properties operating as Amerihost Inns														
Macomb, IL	$ 1,439	$ 194	$ 2,277	$ 180	$	$ 4	$ 94	$	$	$	$ 194	$ 2,281	$ 274	$ 2,749
Plainfield, IN	1,300	300	1,962	180		4	97		(508)	(262)	300	1,458	15	1,773
Marysville, OH	1,203	300	2,712	237		6	129		(531)	(348)	300	2,187	18	2,505
	3,942	794	6,951	597		14	320		(1,039)	(610)	794	5,926	307	7,027
Less property held by unconsolidated entity:														
Plainfield, IN	(1,300)	(300)	(1,962)	(180)		(4)	(97)		508	262	(300)	(1,458)	(15)	(1,773)
	$ 2,642	$ 494	$ 4,989	$ 417	$	$ 10	$ 223	$	$ (531)	$ (348)	$ 494	$ 4,468	$ 292	$ 5,254

(1) The aggregate cost of our real estate for Federal income tax purposes was $8,675,000 (unaudited).

(2) Impairments were recorded during the year ended December 31, 2005.

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Schedule III
PMC COMMERCIAL TRUST AND SUBSIDIARIES
REAL ESTATE AND ACCUMULATED DEPRECIATION
AS OF DECEMBER 31, 2006
(In thousands)

Description of Property The following are all hotel properties operating as Amerihost Inns	**Accumulated Depreciation - Building and Improvements; Furniture and Fixtures**	**Date of Construction**	**Date of Acquisition**	**Life on Which Depreciation in Latest Income Statement is Computed**
Macomb, IL	$ 724	5/1/1995	3/23/1999	7 - 35 years
Plainfield, IN	64	9/1/1992	3/5/1999	7 - 35 years
Marysville, OH	116	6/1/1990	3/5/1999	7 - 35 years
	904			
Less property held by unconsolidated entity:				
Plainfield, IN	(64)			
	$ 840			

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Schedule III
PMC COMMERCIAL TRUST AND SUBSIDIARIES
REAL ESTATE AND ACCUMULATED DEPRECIATION
AS OF DECEMBER 31, 2006
(In thousands, except footnotes)
Gross amount carried:

		Totals
Balance at December 31, 2003		$ 52,549
Additions during period:		
Acquisitions through foreclosure	$	
Other Acquisitions		
Improvements, etc.	595	
Other (describe)		$ 595
Deductions during period:		
Cost of real estate sold	$ (4,913)	
Other (describe)		$ (4,913)
Balance at December 31, 2004		$ 48,231
Additions during period:		
Acquisitions through foreclosure	$	
Other Acquisitions		
Improvements, etc	366	
Other (describe)		$ 366
Deductions during period:		
Cost of real estate sold	$ (13,656)	
Other (1)	(7,263)	$ (20,919)
Balance at December 31, 2005 (2)		$ 27,678
Additions during period:		
Acquisitions through foreclosure	$	

Other Acquisitions		
Improvements, etc.	65	
Other (describe)		$ 65
Deductions during period:		
Cost of real estate sold	$ (20,673)	
Other (1)(3)	(1,816)	$ (22,489)
Balance at December 31, 2006		$ 5,254

(1) Impairment recorded.
(2) Includes properties held for sale with a cost of $18,879,000 and accumulated depreciation of $3,409,000.
(3) We deconsolidated an entity which owns a property on September 29, 2006 due to a new lease agreement with a significant down payment and a purchase agreement.

Accumulated Depreciation:

Balance at December 31, 2003	$ 9,210
Additions during period:	
Depreciation expense during the period	1,870
Accumulated Depreciation:	
Real estate held for sale	
Assets sold or written-off during the period	(931)

Balance at December 31, 2004	$ 10,149
Additions during period:	
Depreciation expense during the period	1,236
Accumulated Depreciation:	
Real estate held for sale	
Assets sold or written-off during the period	(7,257)
Balance at December 31, 2005 (2)	$ 4,128
Additions during period:	
Depreciation expense during the period	221
Accumulated Depreciation:	
Real estate held for sale	
Reduction due to deconsolidation of entity during the period (3)	(64)
Assets sold or written-off during the period	(3,445)
Balance at December 31, 2006	$ 840

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Schedule IV
PMC COMMERCIAL TRUST AND SUBSIDIARIES
MORTGAGE LOANS ON REAL ESTATE
AS OF DECEMBER 31, 2006
(Dollars in thousands, except footnotes)

Conventional Loans States 2% or greater *(1) (2)*:

Geographic Dispersion of Collateral	Number of Loans	Size of Loans From	Size of Loans To	Interest Rate Variable	Interest Rate Fixed	Final Maturity Date	Carrying Amount of Mortgages	Principal amount of loans subject to delinquent principal or "interest"
Texas	12	$ 0	$1,000	9.12% to 9.87%	10.50%	11/30/06--2/25/24	$ 6,289	$
Texas	9	$1,000	$2,000	8.62% to 9.37%	NA	3/04/07--8/13/26	13,831	
Texas	3	$2,000	$3,000	8.62%	8.35%	11/29/26--12/04/26	7,985	
Texas	1	$3,000	$4,000	NA	8.35%	11/29/26	3,473	
Ohio	1	$ 0	$1,000	NA	9.00%	3/02/18	940	
Ohio	6	$1,000	$2,000	9.12% to 10.12%	8.28%	12/29/06--5/30/26	8,789	
Ohio	2	$2,000	$3,000	9.37%	8.28%	2/05/24--10/30/26	5,396	
Michigan	4	$1,000	$2,000	9.12% to 9.37%	NA	8/26/25--5/30/26	6,156	
Michigan	2	$3,000	$4,000	8.87%	NA	11/02/26	7,323	
Florida	1	$ 0	$1,000	9.25%	NA	11/01/25	220	
Florida	2	$1,000	$2,000	NA	9.50%	3/02/07--10/01/26	2,911	
Florida	1	$2,000	$3,000	NA	8.24%	1/01/24	2,767	
Florida	1	$3,000	$4,000	9.25%	NA	11/01/25	3,190	
Arizona	2	$ 0	$1,000	9.37% to 9.62%	NA	5/01/23--7/29/25	1,691	
Arizona	1	$1,000	$2,000	9.87%	NA	9/29/24	1,297	
Arizona	1	$2,000	$3,000	9.62%	NA	12/21/25	2,500	
Arizona	1	$3,000	$4,000	9.37%	NA	10/13/25	3,056	
Alabama	1	$ 0	$1,000	NA	9.50%	10/27/18	542	
Alabama	1	$1,000	$2,000	9.62%	NA	12/02/24	1,104	
Alabama	1	$2,000	$3,000	9.37%	NA	3/01/26	2,891	
Alabama	1	$3,000	$4,000	9.37%	NA	10/01/26	3,016	
Virginia	1	$ 0	$1,000	9.37%	NA	1/13/26	299	
Virginia	3	$1,000	$2,000	9.37%	NA	2/28/23--10/04/24	4,033	
Virginia	1	$3,000	$4,000	9.62%	NA	6/29/24	3,062	
California	2	$ 0	$1,000	NA	8.5% to 11.25%	6/29/07--10/01/09	870	
California	2	$1,000	$2,000	9.11% to 9.62%	NA	9/18/23--12/13/26	3,822	
California	1	$2,000	$3,000	9.75%	NA	12/12/26	2,315	
Oregon	2	$ 0	$1,000		NA	9/08/25--9/15/25	1,305	

				8.87% to 9.12%				
Oregon	2	$1,000	$2,000	9.62%	9.40%	3/20/18--1/14/25	2,399	
Oregon	1	$2,000	$3,000	9.62%	NA	9/08/25	2,416	
New Mexico	1	$ 0	$1,000	9.62%	NA	3/10/23	811	
New Mexico	2	$1,000	$2,000	9.62% to 9.87%	NA	3/04/24--5/17/24	2,584	
New Mexico	1	$2,000	$3,000	9.37%	NA	4/15/25	2,430	
Iowa	1	$1,000	$2,000	9.12%	NA	5/30/26	1,840	
Iowa	1	$2,000	$3,000	9.37%	NA	5/12/23	2,811	
Louisiana	1	$1,000	$2,000	9.25%	NA	4/16/23	1,585	
Louisiana	1	$2,000	$3,000	9.12%	NA	11/03/25	2,986	
New York	1	$ 0	$1,000	11.62%	NA	9/19/13	345	
New York	3	$1,000	$2,000	8.87% to 9.75%	NA	4/09/23--3/01/24	4,182	
Tennessee	3	$1,000	$2,000	9.03% to 9.87%	NA	8/01/22--11/08/25	3,813	
Georgia*(3)*	2	$ 0	$1,000	9.87%	8.50%	11/01/04--10/10/16	1,290	473
Georgia	1	$2,000	$3,000	9.81%	NA	12/22/24	2,253	
Missouri	2	$1,000	$2,000	9.37%	NA	12/15/25--3/07/26	3,341	
Mississippi	1	$1,000	$2,000	NA	9.25%	4/14/18	1,025	
Mississippi	1	$2,000	$3,000	9.87%	NA	9/29/23	2,190	
Other	7	$ 0	$1,000	9.62% to 10.37%	9.5% to 10.25%	11/01/04--10/01/26	2,182	
Other *(4)*	10	$1,000	$2,000	9.22% to 10.00%	9.5% to 9.77%	2/27/18--3/15/26	12,839	1,545
	108						$154,395*(5)*	$2,018

Footnotes:

(1) As of December 31, 2006, there were no individual mortgage loans that were 3% of the total loans outstanding. Approximately 95% of our loans are collateralized by limited service hotels.

(2) There are nine loans which are

secured by second liens on properties which are subordinated to our first liens on the respective properties.

(3) *Includes one loan with a maturity date of November 1, 2004 which is impaired and currently in default.*

(4) *Includes one impaired loan with a face value of $1,545,000 and a discount of $182,000.*

(5) *For Federal income tax purposes, the cost basis of our mortgage loans on real estate was approximately $155,350,000 (unaudited).*

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Schedule IV
PMC COMMERCIAL TRUST AND SUBSIDIARIES
MORTGAGE LOANS ON REAL ESTATE
AS OF DECEMBER 31, 2006
(Dollars in thousands, except footnotes)

SBA 7(a) Loans States 2% or greater*(1)*:

	Number of Loans	Size of Loans From	To	Interest Rate*(2)*	Final Maturity Date	Carrying Amount of Mortgages	Principal amount of loans subject to delinquent principal or "interest"
Texas *(3)*	46	$ 0	$ 500	9.25% to 11.0%	12/24/09-4/21/31	$ 4,639	$
Texas *(4)*	5	$ 0	$ 500	8.25% to 11.0%	4/18/01-1/01/21	103	79
Texas *(5)*	1	$ 1,000	$ 1,500	10.50%	12/18/26	1,308	
Georgia	6	$ 0	$ 500	9.25% to 11.0%	11/20/08-7/22/30	1,144	
Georgia *(4)*	1	$ 500	$ 1,000	9.25%	6/29/24	533	
Ohio	8	$ 0	$ 500	9.25% to 10.75%	5/11/13-3/31/30	1,123	
Oklahoma	6	$ 0	$ 500	9.75% to 11.0%	5/27/24-8/25/30	813	
Kansas	6	$ 0	$ 500	10.0% to 11.0%	3/17/18-9/01/26	700	
New Mexico	1	$ 0	$ 500	11.00%	8/30/24	214	
New Mexico *(4)*	1	$ 0	$ 500	8.25%	5/11/25	384	
Missouri	4	$ 0	$ 500	10.25% to 11.0%	2/20/11-12/14/29	486	
Florida *(6)*	6	$ 0	$ 500	10.00% to 11.0%	12/14/08-3/18/18	426	
South Carolina	2	$ 0	$ 500	10.25%	10/02/17-5/30/31	360	
Arkansas	3	$ 0	$ 500	10.25% to 11.00%	10/25/11-7/30/26	353	
California	4	$ 0	$ 500	9.25% to 11.0%	2/28/09-8/03/21	349	
Indiana	3	$ 0	$ 500	10.25% to 10.50%	11/19/19-3/17/25	303	
Michigan	4	$ 0	$ 500	9.25% to 10.75%	9/15/12-10/21/16	291	
Other	12	$ 0	$ 500	10.0% to 11.0%	11/01/08-9/29/25	1,257	

119	$	14,786*(7)*	$	79

Footnotes:

(1) Includes approximately $558,000 of loans not secured by real estate and $360,000 of loans secured by second liens on properties which are subordinated to our first liens on the respective properties.

(2) Interest rates are variable at spreads over the prime rate unless otherwise noted.

(3) Includes an impaired loan with a face value of $79,000 and a valuation reserve of $56,000 and a discount of $23,000.

(4) Fixed rate loans

(5) Loan funded, guaranteed portion of loan sold into secondary market in January 2007

(6) Includes an impaired loan with a face value of $32,000 and a valuation reserve of $7,000.

(7) For Federal income tax purposes, the

cost basis of our loans on real estate was approximately $14,808,000 (unaudited).

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Schedule IV
PMC COMMERCIAL TRUST AND SUBSIDIARIES
MORTGAGE LOANS ON REAL ESTATE
AS OF DECEMBER 31, 2006
(In thousands, except footnotes)

Balance at December 31, 2003		$ 50,534
Additions during period:		
New mortgage loans	53,659	
Mortgage loans acquired in merger with PMC Capital, Inc.	55,144	
Other loan deemed to be repurchased from securitization	2,126	
Other reduction of bad debt expense	253	
Other accretion of loan fees and discounts	379	111,561
Deductions during period:		
Collections of principal	(24,817)	
Foreclosures	(2,115)	
Cost of mortgages sold, net	(6,577)	
Amortization of premium		
Other deferral for collection of commitment fees, net of costs	(352)	(33,861)
Balance at December 31, 2004		$ 128,234
Additions during period:		
New mortgage loans *(1)*	58,852	
Loan receivable established through due to affiliate, net	415	
Other accretion of loan fees and discounts	384	59,651
Deductions during period:		
Collections of principal	(16,006)	
Foreclosures	(5,657)	
Cost of mortgages sold, net	(8,198)	

Amortization of premium		
Other bad debt expense	(298)	
Other deferral for collection of commitment fees, net of costs	(152)	(30,311)
Balance at December 31, 2005		$ 157,574
Additions during period:		
New mortgage loans *(2)(3)*	71,530	
Other accretion of loan fees and discounts	440	71,970
Deductions during period:		
Collections of principal	(49,582)	
Foreclosures	(3,730)	
Cost of mortgages sold, net	(6,694)	
Amortization of premium		
Other purchased discount	(182)	
Other bad debt expense	(103)	
Other deferral for collection of commitment fees, net of costs	(72)	(60,363)
Balance at December 31, 2006		$ 169,181

Footnotes:

(1) Includes three loans of approximately $4,770,000 which were originated in connection with the sales of hotel properties and two loans of approximately $3,725,000 which were originated in connection with sales of assets acquired in liquidation which did not require cash expenditures.

(2) Includes ten loans of approximately $17,084,000 which were originated in connection with the sales of hotel properties and two loans of approximately $2,760,000 which were originated in connection with sales of assets acquired in liquidation which did not require cash expenditures.

(3) Includes two loans receivable totalling approximately $2,540,000 repurchased from affiliates.

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EXHIBIT INDEX

Exhibit Number	Description
2.1	Agreement of Purchase and Sale, dated as of May 21, 1998, by and among Registrant and the various corporations identified on Exhibit A thereto (which includes as Exhibit D thereto, the form of the Master Agreement relating to the leasing of the properties), including Amerihost Properties, Inc. and Amerihost Inns, Inc. (incorporated by reference to Exhibit 2.2 to the Registrant s Current Report on Form 8-K dated June 5, 1998).
2.2	Agreement and Plan of Merger by and between PMC Commercial Trust and PMC Capital, Inc. dated March 27, 2003 (incorporated by reference to Annex A to the Registrant s Registration Statement on Form S-4 dated November 10, 2003).
2.3	Amendment No. 1 to Agreement and Plan of Merger between PMC Commercial Trust and PMC Capital, Inc. dated August 1, 2003 (incorporated by reference to Exhibit 2.5 to the Registrant s Quarterly Report on Form 10-Q filed on August 12, 2003).
3.1	Declaration of Trust (incorporated by reference to the exhibits to the Registrant s Registration Statement on Form S-11 filed with the Commission on June 25, 1993, as amended (Registration No. 33-65910)).
3.1(a)	Amendment No. 1 to Declaration of Trust (incorporated by reference to the exhibits to the Registrant s Registration Statement on Form S-11 filed with the Commission on June 25, 1993, as amended (Registration No. 33-65910)).
3.1(b)	Amendment No. 2 to Declaration of Trust (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 1993).
3.1(c)	Amendment No. 3 to Declaration of Trust dated February 10, 2004 (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2003).
3.2	Bylaws (incorporated by reference to the exhibits to the Registrant s Registration Statement on Form S-11 filed with the Commission on June 25, 1993, as amended (Registration No. 33-65910)).
4.1	Instruments defining the rights of security holders. The instruments filed in response to items 3.1 and 3.2 are incorporated in this item by reference.
4.2	Debenture dated March 4, 2005 for $4,000,000 loan with SBA (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005).

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Exhibit Number	Description
4.3	Debenture dated September 9, 2003 for $2,190,000 loan with SBA (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005).
4.4	Debenture dated September 9, 2003 for $2,000,000 loan with SBA (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005).
10.1	1993 Employee Share Option Plan (incorporated by reference to the exhibits to the Registrant s Registration Statement on Form S-11 filed with the Commission on June 25, 1993, as amended (Registration No. 33-65910)).
10.2	1993 Trust Manager Share Option Plan (incorporated by reference to the exhibits to the Registrant s Registration Statement on Form S-11 filed with the Commission on June 25, 1993, as amended (Registration No. 33-65910)).
10.3	2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005).
10.4	Trust Indenture between PMC Joint Venture, L.P. 2000 and BNY Midwest Trust Company, dated as of December 15, 2000 (incorporated by reference to Exhibit 2.1 to the Registrant s Current Report on Form 8-K filed on March 13, 2001).
10.5	Servicing Agreement by and among BNY Midwest Trust Company, PMC Joint Venture, L.P. 2000 and PMC Capital, Inc. and PMC Commercial Trust, dated as of December 15, 2000 (incorporated by reference to Exhibit 2.2 to the Registrant s Current Report on Form 8-K filed on March 13, 2001).
10.6	Servicing Agreement by and among BNY Midwest Trust Company as Trustee and Supervisory Servicer, PMC Joint Venture, L.P. 2001, as Issuer and PMC Capital, Inc. and PMC Commercial Trust, as Servicers (incorporated by reference to Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2001).
10.7	Trust Indenture by and among BNY Midwest Trust Company as Trustee and PMC Joint Venture, L.P. 2001, as Issuer (incorporated by reference to Exhibit 10.2 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2001).
10.8	Amended and Restated Master Agreement, dated as of January 24, 2001, by and among PMC Commercial Trust, and certain of its subsidiaries, and Amerihost Properties, Inc., doing business as Arlington Hospitality, Inc. (incorporated by reference to Exhibit 2.3 to the Registrant s Current Report on Form 8-K filed on March 13, 2001).

Exhibit Number	Description
10.9	Third Amendment to Amended and Restated Master Agreement dated October 4, 2004 among PMC Commercial Trust and Arlington Hospitality, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed on October 8, 2004).
10.10	Trust Indenture between PMC Joint Venture, L.P. 2002-1 and BNY Midwest Trust Company, dated April 3, 2002 (incorporated by reference to Exhibit 2.1 to the Registrant s Current Report on Form 8-K filed on April 19, 2002).
10.11	Servicing Agreement by and among BNY Midwest Trust Company, PMC Joint Venture, L.P. 2002-1, PMC Capital, Inc. and PMC Commercial Trust, dated April 3, 2002 (incorporated by reference to Exhibit 2.2 to the Registrant s Current Report on Form 8-K filed on April 19, 2002).
10.12	Servicing Agreement by and among Harris Trust Savings Bank, as Trustee and Supervisory Servicer, PMC Capital L.P. 1998-1, as Issuer, and PMC Capital, Inc. as Servicer (incorporated by reference to Exhibit 10.12 to PMC Capital, Inc. s Annual Report on Form 10-K for the fiscal year ended December 31, 1998).
10.13	Servicing Agreement by and among Harris Trust Savings Bank, as Trustee and Supervisory Servicer, PMC Capital L.P. 1999-1, as Issuer, and PMC Capital, Inc. as Servicer (incorporated by reference to Exhibit 10.1 to PMC Capital, Inc. s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1999).
10.14	Trust Indenture between PMC Joint Venture, L.P. 2003-1 and The Bank of New York, as Trustee, dated September 16, 2003 (incorporated by reference to the Registrant s Current Report on Form 8-K filed October 10, 2003).
10.15	Servicing Agreement by and among The Bank of New York as Trustee and Supervisory Servicer, PMC Joint Venture, L.P. 2003-1 as Issuer and PMC Capital, Inc. and PMC Commercial Trust as Servicers, dated September 16, 2003 (incorporated by reference to the Registrant s Current Report on Form 8-K filed October 10, 2003).
10.16	Revolving Credit Agreement dated February 29, 2004 between PMC Commercial and Bank One, Texas, N.A. (incorporated by reference to the Registrant s Annual Report on Form 10-K filed March 15, 2004).
10.17	Employment contract with Lance B. Rosemore dated June 12, 2006 (incorporated by reference to Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006).
10.18	Employment contract with Andrew S. Rosemore dated June 12, 2006 (incorporated by reference to Exhibit 10.2 to the

Exhibit Number	Description
	Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006).
10.19	Employment contract with Barry N. Berlin dated June 12, 2006 (incorporated by reference to Exhibit 10.4 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006).
10.20	Employment contract with Jan F. Salit dated June 12, 2006 (incorporated by reference to Exhibit 10.3 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006).
10.21	Employment agreement with Ron Dekelbaum dated April 28, 2005 (incorporated by reference to Exhibit 10.6 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005).
10.22	Purchase Agreement among PMC Commercial Trust, PMC Preferred Capital Trust-A and Taberna Preferred Funding I, Ltd. dated March 15, 2005 (incorporated by reference to Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005).
10.23	Junior Subordinated Indenture between PMC Commercial Trust and JPMorgan Chase Bank, National Association as Trustee dated March 15, 2005 (incorporated by reference to Exhibit 10.2 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005).
10.24	Amended and Restated Trust Agreement among PMC Commercial Trust, JPMorgan Chase Bank, National Association, Chase Bank USA, National Association and The Administrative Trustees Named Herein dated March 15, 2005 (incorporated by reference to Exhibit 10.3 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005).
10.25	Preferred Securities Certificate (incorporated by reference to Exhibit 10.4 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005).
10.26	Floating Rate Junior Subordinated Note due 2035 (incorporated by reference to Exhibit 10.5 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005).
10.27	First Amendment to employment agreement with Ron Dekelbaum dated January 12, 2006 (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005).
10.28	Amendment No. 1 to Revolving Credit Facility dated March 15, 2004 between PMC Commercial Trust and Bank One, Texas, N.A. (incorporated by reference to the Registrant s

Exhibit Number	Description
	Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2004).
10.29	Servicing Agreement by and among PMC Conduit, L.P. as Borrower, PMC Commercial Trust as Servicer and JPMorgan Chase Bank, National Association as Agent dated February 7, 2005 (incorporated by reference to Exhibit 10.2 to the Registrant s Current Report on Form 8-K filed February 11, 2005).
10.30	Purchase and Contribution Agreement by and between PMC Commercial Trust as Seller and PMC Conduit, L.P. as Purchaser dated February 7, 2005 (incorporated by reference to Exhibit 10.3 to the Registrant s Current Report on Form 8-K filed February 11, 2005).
10.31	Credit and Security Agreement by and among PMC Conduit, L.P. as Borrower, PMC Conduit, LLC, PMC Commercial Trust as Servicer, Jupiter Securitization Corporation as the Conduit Lender, The Alternate Lenders From Time to Time Party Hereto and JPMorgan Chase Bank, National Association as Agent dated February 7, 2005 (incorporated by reference to Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed February 11, 2005).
10.32	Second Amendment to Credit Agreement between PMC Commercial Trust and JPMorgan Chase Bank, N.A. dated December 29, 2004 (incorporated by reference to Exhibit 10.44 to the Registrant s Annual Report on Form 10-K filed March 16, 2005).
10.33	Third Amendment to Credit Agreement between PMC Commercial Trust and JPMorgan Chase Bank, N.A. dated February 7, 2005 (incorporated by reference to Exhibit 10.45 to the Registrant s Annual Report on Form 10-K filed March 16, 2005).
10.34	Fourth Amendment to Credit Agreement between PMC Commercial Trust and JPMorgan Chase Bank, N.A. dated December 28, 2005 (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005).
10.35	Form of Indemnification Agreement (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005).
10.36	Amendment No. 1 to Credit and Security Agreement between PMC Conduit, L.P. as borrower, PMC Conduit, LLC, PMC Commercial Trust as servicer, the conduits and financial institutions from time to time party to the Credit Agreement and JPMorgan Chase Bank, National Association , as agent for the lenders dated February 6, 2006 (incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005).

Exhibit Number	Description
10.37	Second amendment to employment agreement with Ron Dekelbaum dated July 6, 2006 (incorporated by reference to Exhibit 10.5 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006).
10.38	Fifth amendment to Credit Agreement between PMC Commercial Trust and JPMorgan Chase Bank, N.A. dated November 7, 2006 (incorporated by reference to Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2006).
*10.39	Amendment No. 2 to Credit and Security Agreement between PMC Conduit, L.P. as borrower, PMC Conduit, LLC, PMC Commercial Trust as servicer, the conduits and financial institutions from time to time party to the Credit Agreement and JPMorgan Chase Bank, National Association, as agent for the lenders dated February 5, 2007
*21.1	Subsidiaries of the Registrant
*23.1	Consent of PricewaterhouseCoopers LLP
*31.1	Section 302 Officer Certification Chief Executive Officer
*31.2	Section 302 Officer Certification Chief Financial Officer
**32.1	Section 906 Officer Certification Chief Executive Officer
**32.2	Section 906 Officer Certification Chief Financial Officer

* Filed herewith.

** Furnished herewith.

The Registrant agrees to furnish to the Securities and Exchange Commission upon request a copy of any instrument with respect to long-term debt not filed herewith as to which the total amount of securities authorized thereunder does not exceed 10 percent of the total assets of the Registrant and its subsidiaries on a consolidated basis.