

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2003**

OR

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

For the transition period from _____ to _____.

Commission File Number 1-13610

PMC COMMERCIAL TRUST

(Exact name of registrant as specified in its charter)

TEXAS

75-6446078

(State or other jurisdiction
of incorporation or organization)

(I.R.S. Employer Identification No.)

18111 Preston Road, Suite 600, Dallas, TX 75252

(972) 349-3200

(Address of principal executive offices)

(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

YES NO

As of August 8, 2003, Registrant had outstanding 6,448,291 Common Shares of Beneficial Interest, par value \$.01 per share.

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PART I

Financial Information

ITEM 1.

Financial Statements

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

	June 30, 2003	December 31, 2002
ASSETS		
Investments:		
Loans receivable, net	\$ 89,614	\$ 71,992
Real estate investments, net	44,283	44,928
Real estate investment held for sale, net	1,877	1,877
Retained interests in transferred assets	22,686	23,532
Restricted investments	3,455	5,614
Cash equivalents	473	41
Asset acquired in liquidation held for sale	333	400
Total investments	162,721	148,384
Other assets:		
Due from affiliates	800	362
Interest receivable	285	243
Deferred borrowing costs, net	231	268
Cash	72	8
Other assets	976	433
Total other assets	2,364	1,314
Total assets	\$ 165,085	\$ 149,698
LIABILITIES AND BENEFICIARIES' EQUITY		
Liabilities:		
Notes payable	\$ 37,188	\$ 41,191
Revolving credit facility	27,400	7,300
Borrower advances	2,566	1,602
Dividends payable	2,450	2,707
Due to affiliates	656	584
Unearned commitment fees	330	447
Interest payable	253	255
Other liabilities	1,950	1,683
Total liabilities	72,793	55,769
<i>Commitments and contingencies</i>		
Beneficiaries' equity:		
Common shares of beneficial interest; authorized 100,000,000 shares of \$0.01 par value; 6,581,141 and 6,579,141 shares issued at June 30, 2003 and December 31, 2002, respectively; 6,448,291 and 6,446,291 shares outstanding at June 30, 2003 and December 31, 2002, respectively	66	66
Additional paid-in capital	94,735	94,707
Net unrealized appreciation of retained interests in transferred assets	3,496	3,783
Cumulative net income	81,699	78,048
Cumulative dividends	(86,419)	(81,390)
	93,577	95,214
Less: Treasury stock; at cost, 132,850 shares	(1,285)	(1,285)
Total beneficiaries' equity	92,292	93,929
Total liabilities and beneficiaries' equity	\$ 165,085	\$ 149,698

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

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

	Six Months Ended June 30,		Three Months Ended June 30,	
	2003	2002	2003	2002
Revenues:				
Interest income	\$ 3,047	\$ 3,446	\$ 1,600	\$ 1,505
Lease income	2,893	2,868	1,461	1,451
Income from retained interests in transferred assets	1,376	1,384	674	717
Other income	99	667	71	464
Total revenues	7,415	8,365	3,806	4,137
Expenses:				
Interest	1,712	1,850	890	867
Depreciation	939	916	469	437
Advisory and servicing fees to affiliate, net	902	898	453	449
General and administrative	188	137	98	93
Impairment loss from asset acquired in liquidation held for sale	67	—	67	—
Professional fees	66	66	45	51
Provision for loan losses	—	65	—	—
Realized losses on retained interests in transferred assets	—	53	—	—
Total expenses	3,874	3,985	2,022	1,897
Income from continuing operations	3,541	4,380	1,784	2,240
Discontinued operations:				
Gain on sale of real estate investments	—	663	—	292
Net earnings	110	207	55	70
	110	870	55	362
Gain on sale of loans receivable	—	562	—	562
Net income	\$ 3,651	\$ 5,812	\$ 1,839	\$ 3,164
Weighted average shares outstanding:				
Basic	6,447	6,442	6,448	6,443
Diluted	6,455	6,458	6,456	6,460
Basic and diluted earnings per share:				
Income from continuing operations and gain on sale	\$ 0.55	\$ 0.77	\$ 0.28	\$ 0.43
Discontinued operations	0.02	0.13	0.01	0.06
Net income	\$ 0.57	\$ 0.90	\$ 0.29	\$ 0.49

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

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

	Six Months Ended June 30,		Three Months Ended June 30,	
	2003	2002	2003	2002
Net income	\$ 3,651	\$ 5,812	\$ 1,839	\$ 3,164
Change in unrealized appreciation (depreciation) of retained interests in transferred assets:				
Net unrealized appreciation (depreciation) arising during period	(33)	1,012	44	927
Less realized gains included in net income	(254)	(175)	(122)	(94)
	(287)	837	(78)	833
Comprehensive income	\$ 3,364	\$ 6,649	\$ 1,761	\$ 3,997

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

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

	Six Months Ended June 30,	
	2003	2002
Cash flows from operating activities:		
Net income	\$ 3,651	\$ 5,812
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	939	974
Investment losses	67	118
Gain on sale of assets	—	(1,225)
Stock-based compensation charge	2	—
Accretion of commitment fees	(137)	(185)
Amortization of borrowing costs	37	46
Loan fees collected, net	204	142
Other operating assets and liabilities	198	(1,295)
Net cash provided by operating activities	4,961	4,387
Cash flows from investing activities:		
Loans funded	(21,112)	(10,808)
Principal collected on loans	3,386	8,305
Proceeds from sales of properties, net	—	3,017
Principal collected on retained interests in transferred assets	558	316
Proceeds from debt issued by SPE	—	24,040
Investment in retained interests in transferred assets	—	(1,474)
Investment in asset acquired in liquidation held for sale	—	(18)
Release of (investment in) restricted investments, net	2,159	(875)
Purchase of furniture, fixtures and equipment	(294)	(149)
Net cash provided by (used in) investing activities	(15,303)	22,354
Cash flows from financing activities:		
Proceeds from issuance of common shares	26	64
Proceeds from (repayment of) revolving line of credit, net	20,100	(8,700)
Payment of principal on notes payable	(4,003)	(4,302)
Payment of dividends	(5,286)	(5,152)
Net cash provided by (used in) financing activities	10,837	(18,090)
Net increase in cash and cash equivalents	495	8,651
Cash and cash equivalents, beginning of year	49	557
Cash and cash equivalents, end of period	\$ 544	\$ 9,208
Supplemental disclosures:		
Interest paid	\$ 1,652	\$ 1,786
Reclassification from retained interests in transferred assets to due from affiliate	\$ 781	\$ —
Loan receivable originated in connection with sale of hotel property	\$ —	\$ 2,044
Loans and interest receivable transferred to SPE, net	\$ —	\$ 2,810

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

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Interim Financial Statements:

The accompanying consolidated balance sheet of PMC Commercial Trust ("PMC Commercial" or together with its wholly-owned subsidiaries, "we," "us" or "our") as of June 30, 2003 and the consolidated statements of income and comprehensive income for the three and six months ended June 30, 2003 and 2002 and cash flows for the six months ended June 30, 2003 and 2002, have not been audited by independent accountants. In the opinion of management, the financial statements reflect all adjustments necessary to fairly present our financial position at June 30, 2003 and our results of operations for the three and six months ended June 30, 2003 and 2002. These adjustments are of a normal recurring nature.

Certain notes and other information have been omitted from the interim financial statements presented in this Quarterly Report on Form 10-Q. Therefore, these financial statements should be read in conjunction with the financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect (i) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and (ii) the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. Our most sensitive estimates involve the valuation of our retained interests in transferred assets and determining loan loss reserves on our loans receivable.

The results for the three and six months ended June 30, 2003 are not necessarily indicative of future financial results.

Note 2. Consolidation:

The consolidated financial statements include the accounts of PMC Commercial and its wholly-owned subsidiaries, including PMC Commercial Trust, Ltd. 1998-1 (the "1998 Partnership"), a Delaware corporation formed in conjunction with our 1998 structured loan financing transaction. All material intercompany balances and transactions have been eliminated.

Our ownership interest in special purpose entities (the "SPEs") created in conjunction with our structured loan sale transactions are accounted for as retained interests in transferred assets ("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").

At June 30, 2003, the SPEs are PMC Joint Venture, L.P. 2000 (the "2000 Joint Venture"), PMC Joint Venture, L.P. 2001 (the "2001 Joint Venture") and PMC Joint Venture, L.P. 2002-1 (the "2002 Joint Venture," and together with the 2000 Joint Venture and the 2001 Joint Venture, the "Joint Ventures") of which we own approximately 68%, 40% and 39%, respectively. PMC Capital, Inc. ("PMC Capital"), our affiliate through common management, owns the remaining interests in the Joint Ventures.

Note 3. Agreement of Plan and Merger:

On March 27, 2003, PMC Commercial entered into an Agreement and Plan of Merger with PMC Capital. Under the terms of the merger agreement, PMC Capital will be merged into PMC Commercial, with PMC Commercial continuing as the surviving entity. Each issued and outstanding share of PMC Capital common stock will be converted into 0.37 of a common share of PMC Commercial. The merger has been recommended by each company's special committee comprised of independent directors and unanimously approved by the Board of Trust Managers (the "Board") of PMC Commercial and the Board of Directors of PMC Capital. In addition, the boards and management of each company have entered into voting agreements pursuant to which they have agreed to vote their shares in favor of the merger and related transactions. Completion of the merger, which is expected to occur on January 1, 2004, but no later than February 29, 2004, is subject to approval by the shareholders of PMC Commercial and PMC Capital, certain governmental consents and customary closing conditions. We have incurred approximately \$706,000 in costs related to the merger as of June 30, 2003 which are included in other assets on our consolidated balance sheet.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4. Stock-Based Compensation Plans:

At June 30, 2003, we have two stock-based compensation plans. Effective January 1, 2003, we adopted the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," prospectively to all awards granted, modified or settled after January 1, 2003. Awards under the plans generally vest immediately.

We granted 5,000 options during the three and six months ended June 30, 2003 and recorded compensation expense of approximately \$2,000. If we had followed SFAS No. 123 for all options granted, we would not have recorded any material compensation expense during the three and six months ended June 30, 2002.

Note 5. Recently Issued Accounting Pronouncements:

FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB 51" ("FIN 46") in January 2003. The primary objectives of FIN 46 are to provide guidance on the identification of entities for which control is achieved through means other than voting rights, Variable Interest Entities ("VIEs"), and how to determine when and which business enterprise should consolidate the VIE ("the primary beneficiary"). This new model for consolidation applies to an entity which either (i) the equity investors, if any, do not have a controlling financial interest or (ii) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. In addition, FIN 46 requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. FIN 46 will not impact our consolidated financial statements since it is not applicable to qualifying SPEs accounted for in accordance with SFAS No. 140.

In April 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." The statement, which is effective for contracts entered into or modified after June 30, 2003 and hedging relationships designated after June 30, 2003, amends and clarifies financial accounting and reporting for derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133. The statement requires that contracts with comparable characteristics be accounted for similarly. Specifically, the statement (i) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative, (ii) clarifies when a derivative contains a financing component, (iii) amends the definition of an underlying to conform it to FASB Interpretation No. 45 and (iv) amends certain other related existing pronouncements. SFAS No. 149 will not impact our consolidated financial statements since we do not have derivatives.

In May 2003, SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" was issued. SFAS No. 150, which is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, will be implemented by reporting the cumulative effect of a change in accounting principle for financial instruments created before the issuance date of the statement and still existing at the beginning of the interim period of adoption. The statement requires that a financial instrument which falls within the scope of the statement to be classified and measured as a liability. The following financial instruments are required to be classified as liabilities: (i) shares that are mandatorily redeemable, (ii) an obligation to repurchase the issuer's equity shares or one indexed to such an obligation and that requires or may require settlement by transferring assets and (iii) the embodiment of an unconditional obligation that the issuer may or may not settle by issuing a variable number of equity shares if, at inception, the monetary value of the obligation is based on certain measurements defined in the statement. SFAS No. 150 will not impact our consolidated financial statements since we do not have any financial instruments with characteristics of both liabilities and equity.

Note 6. Real Estate Investments:

As of June 30, 2003, our real estate investments consisted of 22 limited service hospitality properties (the "Hotel Properties") that we purchased in 1998 and 1999 from Arlington Hospitality, Inc. ("Arlington"), under a sale/leaseback agreement (the "Lease Agreement").

At June 30, 2003, the annual base rent payment for the Hotel Properties was \$5,455,000 plus 4% of gross room revenues (the "Percentage Rent"). In accordance with the terms of the Lease Agreement, we deposit the Percentage Rent into a capital

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

expenditures account for future capital expenditures required to maintain the real estate investments. Funds are released from this account when capital expenditures are incurred.

Our real estate investment held for sale is under contract for approximately \$2.2 million and is expected to close in September 2003. In connection with the sale, we received a non-refundable deposit of \$250,000 which is included in other liabilities on our consolidated balance sheet.

Our real estate investments consisted of the following:

	June 30, 2003		December 31, 2002	
	Real Estate Investments	Real Estate Investment Held for Sale	Real Estate Investments	Real Estate Investment Held for Sale
	(Dollars in thousands)			
Land	\$ 5,347	\$ 263	\$ 5,347	\$ 263
Buildings and improvements	42,231	1,682	42,231	1,682
Furniture, fixtures and equipment	4,975	214	4,681	214
	52,553	2,159	52,259	2,159
Accumulated depreciation	(8,270)	(282)	(7,331)	(282)
	\$ 44,283	\$ 1,877	\$ 44,928	\$ 1,877
Number of Hotel Properties	21	1	21	1

Note 7. Retained Interests:

In our structured loan sale transactions detailed below, we contributed loans receivable to an SPE in exchange for an ownership interest in that entity. The SPE issued notes payable (the "Structured Notes") (usually through a private placement) to third parties ("Structured Noteholders"). The SPE then distributed a substantial portion of the proceeds from the Structured Notes to us. The Structured Notes are collateralized solely by the assets of the SPE which means that should the SPE fail to make payments on the Structured Notes, the Structured Noteholders have no recourse to 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 SPE, the Structured Notes issued by the SPE, and the operating results of the SPE are not included in our consolidated financial statements. The difference between (i) the carrying value of the loans receivable sold and (ii) the relative fair value of the sum of (a) the cash received and (b) the present value of estimated future cash flows from the Retained Interests, constituted the gain or loss on sale. Retained Interests are carried at estimated fair value, with realized gains and losses recorded in net income and unrealized gains and losses recorded in beneficiaries' equity.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Information pertaining to our structured loan sale transactions as of June 30, 2003 was as follows. Balances represent PMC Commercial's share of the Joint Ventures.

	2000 Joint Venture	2001 Joint Venture	2002 Joint Venture
		(Dollars in thousands)	
Principal outstanding on sold loans	\$ 47,864	\$ 28,331	\$ 26,505
Structured Notes balance outstanding	\$ 42,473	\$ 26,086	\$ 23,815
Cash in the collection account	\$ 550	\$ 607	\$ 208
Cash in the reserve account	\$ 2,880	\$ 1,724	\$ 1,594
Weighted average interest rate on loans	9.62%	9.59%	9.19%
Interest rate on the Structured Notes	7.28%	6.36%	6.67%
Discount rate assumptions (1)	6.7% to 11.4%	6.7% to 11.4%	7.1% to 11.8%
Constant prepayment rate assumption (2)	9.50%	9.75%	9.75%
Weighted average remaining life of loans (3)	3.97 years	4.88 years	4.97 years
Aggregate losses assumed (4)	2.66%	3.44%	3.42%
Aggregate principal losses to date	—%	—%	—%

- (1) *The discount rates utilized on the components of our Retained Interests (as detailed below) were (i) 6.7% to 7.1% for our required overcollateralization, (ii) 8.4% to 8.8% for our reserve funds and (iii) 11.4% to 11.8% for our interest-only strip receivables.*
- (2) *The prepayment rate was based on the actual performance of the loan pools, adjusted for anticipated principal prepayments considering other similar loans.*
- (3) *The weighted average remaining life of loans 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 0.5% to 0.8%.*

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 SPE over the principal amount of the Structured Notes Payable issued by the SPE, 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 SPE, pursuant to the terms of the transaction documents, as collateral for the Structured Noteholders, a portion of which was contributed by us to the SPE upon formation and a portion which is built up over time by the SPE 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 SPE 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.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Our Retained Interests consisted of the following:

June 30, 2003					
Value					
	OC Piece	Reserve Fund	IO Receivable	Total	Cost
(In thousands)					
2000 Joint Venture	\$ 6,522	\$ 2,340	\$ 1,761	\$ 10,623	\$ 9,020
2001 Joint Venture	3,150	1,374	1,960	6,484	5,270
2002 Joint Venture	3,157	1,243	1,179	5,579	4,900
	<u>\$ 12,829</u>	<u>\$ 4,957</u>	<u>\$ 4,900</u>	<u>\$ 22,686</u>	<u>\$ 19,190</u>

December 31, 2002					
Value					
	OC Piece	Reserve Fund	IO Receivable	Total	Cost
(In thousands)					
2000 Joint Venture	\$ 6,549	\$ 2,464	\$ 2,062	\$ 11,075	\$ 9,312
2001 Joint Venture	3,168	1,391	2,106	6,665	5,373
2002 Joint Venture	3,180	1,261	1,351	5,792	5,064
	<u>\$ 12,897</u>	<u>\$ 5,116</u>	<u>\$ 5,519</u>	<u>\$ 23,532</u>	<u>\$ 19,749</u>

The following sensitivity analysis of our Retained Interests as of June 30, 2003 highlights the volatility that results when prepayments, losses and discount rates are different than our assumptions:

Changed Assumption	Pro-Forma Value	Asset Change
(In thousands)		
Losses increase by 50 basis points per annum (1)	\$ 21,004	(\$1,682)
Losses increase by 100 basis points per annum (1)	\$ 19,386	(\$3,300)
Rate of prepayment increases by 5% per annum (2)	\$ 21,960	(\$726)
Rate of prepayment increases by 10% per annum (2)	\$ 21,455	(\$1,231)
Discount rates increase by 100 basis points	\$ 21,685	(\$1,001)
Discount rates increase by 200 basis points	\$ 20,747	(\$1,939)

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

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

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

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following information summarizes the financial position of the Joint Ventures at June 30, 2003 and December 31, 2002. We owned approximately 68% of the 2000 Joint Venture, 40% of the 2001 Joint Venture and 39% of the 2002 Joint Venture as of June 30, 2003. We owned approximately 66% of the 2000 Joint Venture, 39% of the 2001 Joint Venture and 39% of the 2002 Joint Venture as of December 31, 2002.

Summary of Financial Position (1):

	2000 Joint Venture		2001 Joint Venture		2002 Joint Venture	
	June 30, 2003	December 31, 2002	June 30, 2003	December 31, 2002	June 30, 2003	December 31, 2002
	(In thousands)					
Loans Receivable, Net	\$ 66,734	\$ 70,627	\$ 72,168	\$ 73,220	\$ 67,489	\$ 69,025
Assets Acquired in Liquidation, Net	\$ —	\$ 1,411	\$ —	\$ —	\$ —	\$ —
Total Assets	\$ 73,376	\$ 76,434	\$ 77,864	\$ 81,302	\$ 72,548	\$ 74,322
Notes Payable	\$ 60,187	\$ 62,658	\$ 66,065	\$ 69,146	\$ 60,601	\$ 62,152
Total Liabilities	\$ 60,369	\$ 62,848	\$ 66,240	\$ 69,329	\$ 60,770	\$ 62,325
Partners' Capital	\$ 13,007	\$ 13,586	\$ 11,624	\$ 11,973	\$ 11,778	\$ 11,997

(1) Balances represent 100% of the limited partnership interests in the Joint Ventures.

The following information summarizes the results of operations of the Joint Ventures.

Summary of Operations (1):

	Six Months Ended June 30,					
	2000 Joint Venture		2001 Joint Venture		2002 Joint Venture	
	2003	2002	2003	2002	2003	2002 (2)
	(In thousands)					
Interest Income	\$ 3,329	\$ 3,612	\$ 3,532	\$ 3,756	\$ 3,192	\$ 1,448
Total Revenues	\$ 3,395	\$ 3,848	\$ 3,555	\$ 3,802	\$ 3,256	\$ 1,460
Provision for (Reduction of) Losses	\$ 45	\$ —	\$ (140)	\$ —	\$ —	\$ —
Interest Expense	\$ 2,256	\$ 2,559	\$ 2,121	\$ 2,251	\$ 2,049	\$ 913
Total Expenses	\$ 2,430	\$ 2,687	\$ 2,099	\$ 2,375	\$ 2,161	\$ 991
Net Income	\$ 965	\$ 1,161	\$ 1,456	\$ 1,427	\$ 1,095	\$ 469

(1) Amounts represent 100% of the limited partnership interests in the Joint Ventures.

(2) Represents the period from April 12, 2002 (inception) to June 30, 2002.

Our ownership of the Joint Ventures is based on our share of the capital of the respective Joint Ventures. Our share of the cash flows from the Joint Ventures is allocated based on the cash flows from the underlying loans receivable contributed by us to the respective Joint Venture less allocated costs based on the remaining principal on the underlying loans receivable contributed by us divided by all loans receivable held by the respective Joint Venture.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Our limited partnership allocation of the assets, liabilities and partners' capital of the Joint Ventures was as follows:

	2000 Joint Venture		2001 Joint Venture		2002 Joint Venture	
	June 30, 2003	December 31, 2002	June 30, 2003	December 31, 2002	June 30, 2003	December 31, 2002
	(In thousands)					
Loans Receivable, Net	\$ 47,777	\$ 49,844	\$ 28,331	\$ 28,951	\$ 26,505	\$ 26,825
Total Assets	\$ 51,457	\$ 53,707	\$ 30,754	\$ 31,070	\$ 28,432	\$ 28,838
Total Liabilities	\$ 42,602	\$ 44,707	\$ 26,155	\$ 26,454	\$ 23,881	\$ 24,202
Partners' Capital	\$ 8,855	\$ 9,000	\$ 4,599	\$ 4,616	\$ 4,551	\$ 4,636

Our limited partnership allocation of the net income of the Joint Ventures was as follows:

	Six Months Ended June 30,					
	2000 Joint Venture		2001 Joint Venture		2002 Joint Venture	
	2003	2002	2003	2002	2003	2002 (1)
	(In thousands)					
Net Income	\$ 772	\$ 859	\$ 511	\$ 526	\$ 410	\$ 147

(1) Represents the period from April 12, 2002 (inception) to June 30, 2002.

In accordance with SFAS No. 140, our consolidated financial statements do not include the assets, liabilities, partners' capital, revenues or expenses of the Joint Ventures. As a result, at June 30, 2003 and December 31, 2002 our consolidated balance sheets do not include the \$110.6 million and \$113.6 million of assets, respectively, and \$92.6 million and \$95.4 million of liabilities, respectively, related to our structured loan sale transactions recorded by our SPEs. Our Retained Interests related to these structured loan sale transactions were \$22.7 million and \$23.5 million at June 30, 2003 and December 31, 2002, respectively, including unrealized appreciation of \$3.5 million and \$3.8 million, respectively.

The income from our Retained Interests consists of the yield earned on our Retained Interests which is determined based on estimates of future cash flows (determined by our Board) and includes any fees collected (*i.e.*, late fees, prepayment fees, etc.) by the SPEs in excess of anticipated fees. We update our cash flow assumptions on a quarterly basis and any changes to cash flow assumptions impact the yield on our Retained Interests. The annualized yield on our Retained Interests was as follows:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2003	2002	2003	2002
Annualized Yield	11.7%	13.8%	11.6%	12.7%

PMC Capital is the servicer for all loans receivable held by the Joint Ventures; therefore, no servicing fees were earned or received by us for the three and six months ended June 30, 2003 and 2002.

We received approximately \$1.2 million and \$1.7 million in cash distributions from the Joint Ventures during the six months ended June 30, 2003 and 2002, respectively. During the three months ended June 30, 2003, the asset acquired in liquidation held by the 2000 Joint Venture with an aggregate estimated value of \$1.5 million was transferred to PMC Capital. As a result of this transfer, our previous cash flow deferral related to the 2000 Joint Venture of approximately \$781,000 is due from PMC Capital and is included in due from affiliate on our consolidated balance sheet.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8. Revolving Credit Facility:

We have a revolving credit facility which provides funds to originate loans collateralized by commercial real estate. The revolving credit facility, as amended, provides us with credit availability up to \$40 million. The facility will be reduced to \$30 million upon the earlier of the completion of a structured loan sale transaction or October 28, 2003. The facility matures in May 2004. At June 30, 2003 and December 31, 2002, we had approximately \$27.4 million and \$7.3 million, respectively, outstanding under our revolving credit facility. The weighted average interest rate on our revolving credit facility at June 30, 2003 and December 31, 2002 was 2.9% and 3.1%, respectively. The credit facility requires us to meet certain covenants, the most restrictive of which provides that the ratio of total liabilities to net worth will not exceed 2.0 times. At June 30, 2003, we were in compliance with all covenants of this facility.

Note 9. Beneficiaries' Equity:

The weighted average number of common shares outstanding was approximately 6,448,000 and 6,443,000 for the three months ended June 30, 2003 and 2002, respectively, and approximately 6,447,000 and 6,442,000 for the six months ended June 30, 2003 and 2002, respectively. For purposes of calculating diluted earnings per share, the weighted average shares outstanding were increased by approximately 8,000 and 17,000 shares, respectively, during the three months ended June 30, 2003 and 2002 and by approximately 8,000 and 16,000 shares, respectively, during the six months ended June 30, 2003 and 2002.

Note 10. Dividends Paid and Declared:

On January 13, 2003, we paid a \$0.40 per share quarterly dividend and a \$0.02 special dividend to common shareholders of record on December 31, 2002. On April 14, 2003, we paid a \$0.40 per share quarterly dividend to common shareholders of record on March 31, 2003. The Board declared a \$0.38 per share quarterly dividend to common shareholders of record on June 30, 2003, which was paid on July 14, 2003.

Note 11. Taxable Income:

As a real estate investment trust ("REIT"), we generally will not be subject to corporate level Federal income tax on net income we currently distribute to shareholders. As such, no provision for Federal income taxes has been included in the accompanying consolidated financial statements. If we fail to qualify as a REIT in any taxable year, we will be subject to Federal income taxes at regular corporate rates (including any applicable alternative minimum tax) and may not be able to qualify as a REIT for four subsequent taxable years. We may, however, be subject to certain Federal excise taxes and state and local taxes on our income and property.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table reconciles net income available to common shareholders to taxable income available to common shareholders:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2003	2002	2003	2002
	(In thousands, except per share data)			
Net income available to common shareholders	\$ 3,651	\$ 5,812	\$ 1,839	\$ 3,164
Add: Book depreciation and amortization	939	974	469	456
Less: Tax depreciation and amortization	(866)	(884)	(433)	(442)
Book/tax difference on gains on sales	—	(550)	—	(550)
Book/tax difference on Retained Interests, net	209	246	123	162
Other book/tax differences, net	170	53	97	(37)
Taxable income available to common shareholders	\$ 4,103	\$ 5,651	\$ 2,095	\$ 2,753
Distributions to common shareholders	\$ 5,286	\$ 5,152	\$ 2,579	\$ 2,575
Dividends declared per share	\$ 0.78	\$ 0.80	\$ 0.38	\$ 0.40

Note 12. Discontinued Operations and Asset Acquired in Liquidation Held for Sale:

During July 2003, we sold our asset acquired in liquidation held for sale for net cash proceeds of approximately \$333,000. Accordingly, we reduced our basis in this asset from \$400,000 and recorded an impairment loss of \$67,000 during the three and six months ended June 30, 2003.

Discontinued operations of our Hotel Properties (one Hotel Property and three Hotel Properties during the three and six months ended June 30, 2003 and 2002, respectively) consisted of the following:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2003	2002	2003	2002
	(In thousands)			
Lease income	\$ 118	\$ 282	\$ 59	\$ 94
Advisory fees	(8)	(17)	(4)	(5)
Depreciation	—	(58)	—	(19)
Net earnings	110	207	55	70
Gain on sale of real estate investments	—	663	—	292
Discontinued operations	\$ 110	\$ 870	\$ 55	\$ 362

Note 13. 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. At June 30, 2003, we had approximately \$21.4 million of total loan commitments outstanding. All of these commitments were for variable-rate loans based on LIBOR at spreads over LIBOR ranging from 4.0% to 4.5%. The weighted average interest

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

rate on our loan commitments at June 30, 2003 was 5.3%. 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, the total commitment amounts do not necessarily represent future cash requirements. Pursuant to our investment management agreements, if we do not have funds available for our commitments, these commitments will be referred back to PMC Advisers, as defined below.

Structured Loan Financing Transaction

Our structured loan financing is not treated as a sale for financial reporting purposes. Distributions of the net assets from the 1998 Partnership, pursuant to its trust indenture, are limited and restricted. The reserve requirement (\$1.6 million at June 30, 2003) is calculated as follows: the outstanding principal balance of the 1998 Partnership loans receivable which are delinquent 180 days or more plus the greater of (i) 6% of the current outstanding principal balance of the 1998 Partnership loans receivable or (ii) 2% of our underlying loans receivable of the 1998 Partnership at inception (\$1.4 million). As of June 30, 2003 and December 31, 2002, none of the loans receivable in the 1998 Partnership were delinquent 180 days or more. In April 2003, approximately \$1.7 million was repaid to the noteholders from cash in the reserve fund (*i.e.*, our restricted cash and our structured notes payable were reduced) as a result of a loan, with a principal amount of \$1.7 million which was not repaid at its original maturity. As a consequence, future excess cash flows relating to the 1998 Partnership will be deposited into the reserve fund until the reserve fund is equal to the reserve requirement. Based on current cash flow assumptions, management anticipates that the excess cash flows will be received in future periods. At June 30, 2003, the cash balance in our reserve fund, included in restricted investments on our consolidated balance sheet, was approximately \$330,000.

Structured Loan Sale Transactions

PMC Commercial and PMC Capital have entered into cross indemnification agreements regarding the performance of their respective loans receivable sold to the Joint Ventures. To the extent that poor performance by either PMC Capital's or PMC Commercial's sold loans receivable (the "Underperforming Company") is pervasive enough to cause the other company (the "Performing Company") to not receive cash flow that it otherwise would have received, then the Underperforming Company must make the Performing Company whole. If the cash flow reduction is considered to be temporary, then interest will be paid as compensation to the Performing Company. In general, when a loan is liquidated, it may cause a deferral of cash flow to the Performing Company and, as a result, interest would be charged to the Underperforming Company until the cash flow from the Joint Venture repays the Performing Company. If the reduction of cash flows is deemed permanent, (*i.e.*, to the extent that the Underperforming Company will not be able to satisfy the shortfall with the assets they have contributed to the related structured loan sale transaction), the reduction in cash flows must be paid to the Performing Company by the Underperforming Company. At June 30, 2003, the maximum potential amount of future payments to PMC Capital (undiscounted and without consideration of any proceeds from the collateral underlying the loans receivable) we could be required to make under these cross indemnification agreements was approximately \$34.0 million and the discounted amount was \$23.6 million, which represents the estimated fair value of the Retained Interests reflected on PMC Capital's consolidated balance sheet for the Joint Ventures. Upon completion of a joint structured loan sale transaction and on each subsequent quarterly reporting date, management evaluates the need to recognize a liability associated with these cross indemnification agreements. Based on our present cash flow assumptions, including stress test analyses of increasing the anticipated losses on each of the loan pools, it does not appear that the loans receivable sold by us will cause any permanent cash flow reductions to PMC Capital nor will the loans receivable sold by PMC Capital cause any permanent cash flow reductions to us. Accordingly, we believe that the fair value of our obligations pursuant to the cross indemnification agreements at inception of the Joint Ventures and as of June 30, 2003 and December 31, 2002 was zero; thus, no liability was recorded. If the performance of our sold loans receivable deteriorates, it may be necessary for us to perform under these cross indemnification agreements.

When our structured loan sale transactions were completed, the transaction documents of the SPE contained provisions (the "Credit Enhancement Provisions") that govern the assets and the inflow and outflow of funds of the SPE 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 SPE. If, at any measurement date, the delinquency, default or loss rate with respect to any SPE were to exceed the specified limits, the Credit Enhancement Provisions would automatically increase the level of credit enhancement requirements for that SPE. During the period in which the specified delinquency, default or loss rate was exceeded, excess cash flow from the SPE, if any, would be used to fund the increased credit enhancement levels instead of being distributed, which would delay or reduce our distribution.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Merger

For their services in connection with the proposed merger of PMC Capital into PMC Commercial, our external investment banker will receive a fee of \$225,000, which is contingent upon consummation of the merger.

PMC Commercial will pay a termination fee of \$870,000 to PMC Capital if the merger agreement is terminated because PMC Commercial (i) breaches any provision of the merger agreement that PMC Capital has not waived and PMC Commercial enters into an agreement to consummate a competing transaction, (ii) withdraws or changes its recommendation that the shareholders approve the merger or (iii) terminates the merger agreement in connection with a superior proposal. In the event that the merger agreement is terminated because of a breach by PMC Commercial that has not been waived by PMC Capital and PMC Commercial has not entered into a competing transaction, no termination fee will be payable but termination expenses of \$750,000 may be payable to PMC Capital.

Advisory Agreements

Our loans receivable are originated and serviced by PMC Advisers, Ltd. and its subsidiary (“PMC Advisers” or the “Investment Manager”), an indirect wholly-owned subsidiary of PMC Capital, pursuant to an Investment Management Agreement (the “IMA”). Property acquisitions are supervised pursuant to a separate agreement with PMC Advisers (the “Lease Supervision Agreement”). Both agreements are renewable on an annual basis.

In the event the IMA agreement with PMC Advisers is terminated or not renewed by us (other than as a result of a material breach by PMC Advisers) or terminated by PMC Advisers (as a result of a material breach by us), we would enter into a non-compete agreement with PMC Capital for a period of seven years from the termination date. A fee would be paid to PMC Advisers each year by us in consideration of the non-compete agreement until the non-compete agreement expires after seven years. Upon termination of the IMA agreement, the fee would be calculated annually as 1% (less loan losses as a percentage of average outstanding invested assets) multiplied by the average invested assets.

In the event the Lease Supervision Agreement with PMC Advisers is terminated or not renewed by us (other than as a result of a material breach by PMC Advisers) or terminated by PMC Advisers (as a result of a material breach by us), PMC Advisers would be entitled to receive the Lease Supervision Fee for a period of five years from the termination date.

Litigation

In the normal course of business, we are subject to various proceedings and claims, the resolution of which will not, in management’s opinion, have a material adverse effect on our financial position or results of operations.

Note 14. Business Segments:

Operating results and other financial data are presented for our principal business segments. These segments are categorized by line of business which also corresponds to how they are operated. The segments include (i) the Lending Division, which originates loans to small businesses primarily in the hospitality industry and (ii) the Property Division which owns our Hotel Properties.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Our business segment data for the six months ended June 30, 2003 and 2002 was as follows:

	For the Six Months Ended June 30,					
	2003			2002		
	Total	Lending Division	Property Division	Total	Lending Division	Property Division
	(In thousands)					
Revenues:						
Interest income — loans and other income	\$ 3,146	\$ 3,146	\$ —	\$ 4,113	\$ 4,113	\$ —
Lease income	2,893	—	2,893	2,868	—	2,868
Income from retained interests in transferred assets	1,376	1,376	—	1,384	1,384	—
Total	7,415	4,522	2,893	8,365	5,497	2,868
Expenses:						
Interest (1)	1,712	812	900	1,850	862	988
Advisory and servicing fees to affiliate, net	902	724	178	898	716	182
Depreciation	939	—	939	916	—	916
Realized losses on retained interests in transferred assets	—	—	—	53	53	—
Impairment loss on asset acquired in liquidation held for sale	67	67	—	—	—	—
Provision for loan losses	—	—	—	65	65	—
Other	254	254	—	203	203	—
Total	3,874	1,857	2,017	3,985	1,899	2,086
Income from continuing operations	3,541	2,665	876	4,380	3,598	782
Discontinued operations:						
Gain on sale of real estate investments	—	—	—	663	—	663
Net earnings	110	—	110	207	—	207
Total	110	—	110	870	—	870
Gain on sale of loans receivable	—	—	—	562	562	—
Net income	\$ 3,651	\$ 2,665	\$ 986	\$ 5,812	\$ 4,160	\$ 1,652
Additions to real estate investments	\$ 294	\$ —	\$ 294	\$ 149	\$ —	\$ 149

(1) Interest expense specifically identifiable to a particular division is allocated to that division. Interest expense which is not specifically allocable is allocated based on the relative total assets of each division.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Our business segment data for the three months ended June 30, 2003 and 2002 was as follows:

	For the Three Months Ended June 30,					
	2003			2002		
	Total	Lending Division	Property Division	Total	Lending Division	Property Division
	(In thousands)					
Revenues:						
Interest income — loans and other income	\$ 1,671	\$ 1,671	\$ —	\$ 1,969	\$ 1,969	\$ —
Lease income	1,462	—	1,462	1,451	—	1,451
Income from retained interests in transferred assets	674	674	—	717	717	—
Total	3,807	2,345	1,462	4,137	2,686	1,451
Expenses:						
Interest (1)	890	361	529	867	403	464
Advisory and servicing fees to affiliate, net	453	364	89	449	356	93
Depreciation	469	—	469	437	—	437
Impairment loss from asset acquired in liquidation held for sale	67	67	—	—	—	—
Other	143	143	—	144	144	—
Total	2,022	935	1,087	1,897	903	994
Income from continuing operations	1,785	1,410	375	2,240	1,783	457
Discontinued operations:						
Gain on sale of real estate investments	—	—	—	292	—	292
Net earnings	54	—	54	70	—	70
Total	54	—	54	362	—	362
Gain on sale of loans receivable	—	—	—	562	562	—
Net income	\$ 1,839	\$ 1,410	\$ 429	\$ 3,164	\$ 2,345	\$ 819
Additions to real estate investments	\$ 248	\$ —	\$ 248	\$ 116	\$ —	\$ 116

(1) Interest expense specifically identifiable to a particular division is allocated to that division. Interest expense which is not specifically allocable is allocated based on the relative total assets of each division.

PART I
Financial Information

ITEM 2.
Management's Discussion and Analysis of Financial Condition
and Results of Operations

This Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created thereby. Such forward-looking statements can be identified by the use of forward-looking terminology such as "may," "will," "expect," "intend," "believe," "anticipate," "estimate," or "continue," or the negative thereof or other variations or similar words or phrases. These statements include the plans and objectives of management for future operations, including plans and objectives relating to future growth of the loan portfolio and availability of funds. The forward-looking statements included herein are based on current expectations and there can be no assurance that these expectations will be attained. For a description of certain factors that could cause our future results to differ materially from those expressed in any such forward-looking statement, see "Factors That May Affect Future Operating Results" included elsewhere in this Form 10-Q and the information contained under the caption "Risk Factors" included in our Annual Report on Form 10-K for the year ended December 31, 2002. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Form 10-Q will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

The following discussion of our financial condition at June 30, 2003 and results of operations for the three and six months ended June 30, 2003 and 2002 should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2002.

AGREEMENT AND PLAN OF MERGER

On March 27, 2003, PMC Commercial Trust ("PMC Commercial") entered into an Agreement and Plan of Merger with PMC Capital, Inc. ("PMC Capital"). Under the terms of the merger agreement, PMC Capital will be merged into PMC Commercial, with PMC Commercial continuing as the surviving entity. Each issued and outstanding share of PMC Capital common stock will be converted into 0.37 of a common share of PMC Commercial. The merger has been recommended by each company's special committee comprised of independent directors and unanimously approved by the Board of Trust Managers of PMC Commercial (the "Board") and the Board of Directors of PMC Capital. In addition, the boards and management of each company have entered into voting agreements pursuant to which they have agreed to vote their shares in favor of the merger and related transactions. Completion of the merger, which is expected to occur on January 1, 2004 but no later than February 29, 2004, is subject to approval by the shareholders of PMC Commercial and PMC Capital, certain governmental consents and customary closing conditions.

BUSINESS

PMC Commercial (and together with its wholly-owned subsidiaries, the "Company," "our," "us" 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. In addition, our investments include the ownership of commercial properties in the hospitality industry. Our loans receivable are primarily to borrowers in the hospitality industry. We also originate loans for commercial real estate primarily in the service, retail, multi-family and manufacturing industries. We generate revenue from the yield earned on our investments, rental income from property ownership and other fee income from our lending activities.

As a REIT, we must distribute at least 90% of our REIT taxable income to shareholders. Our investments are managed pursuant to investment management agreements with PMC Advisers, Ltd. and its subsidiary (together, "PMC Advisers" or the

“Investment Manager”), indirect wholly-owned subsidiaries of PMC Capital, our affiliate. We operate from the headquarters of the Investment Manager in Dallas, Texas, and through its loan production office in Arizona.

CURRENT OPERATING OVERVIEW

Due to geopolitical uncertainty and general economic conditions, we have seen a slowdown in potential lending opportunities and some funding commitments have been terminated. In addition, we did not complete a structured loan sale transaction that we had expected to be completed prior to June 30, 2003. While we believe we could have completed a transaction during the second quarter of 2003, we delayed our transaction since the terms of the transactions available in the market were not considered favorable to us (*i.e.*, the transaction size and cost did not reflect the value of the transaction). As a result, our anticipated fundings during the remainder of 2003 more than likely will not meet our prior expectation. When fundings are reduced, our net interest income does not increase as it would have if these fundings were completed, and may be reduced to the extent principal repayments exceed amounts funded or interest rates decline.

The market for the type of asset-backed securities we originate was relatively inefficient during the first half of 2003 as a result of uncertainties in the marketplace due to the sluggishness of the economy, geopolitical uncertainties and the impact of the ongoing conflict in the Middle East. We are in the process of finalizing a loan pool for our current structured loan sale transaction and anticipate that the transaction will be completed in September 2003, unless additional delays are encountered. We anticipate co-securitizing with PMC Capital approximately \$45.3 million of our variable-rate loans receivable. Changes in market conditions may have an impact on the timing of completion of this transaction. While we have been successful in completing our past structured loan transactions in a timely manner, due to the risky nature of these transactions and the many factors which could cause us to further delay or postpone a transaction, there can be no assurance of a successful outcome.

Since we rely on structured loan sale 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 loans we originate, could have a detrimental effect on our ability to sell loans receivable thereby reducing our ability to originate loans. The delay in completing our current structured loan sale transaction has had a negative impact on our ability to originate loans and our financial condition and results of operations. See “Factors That May Affect Future Operating Results — Asset-Backed Structured Loan Sale Transaction Market.”

As of June 30, 2003, our commitments to fund loans of approximately \$21.4 million were greater than commitments outstanding of \$17.8 million at June 30, 2002 but less than commitments outstanding of \$40.9 million at December 31, 2002. Based on current market conditions, we anticipate that our loan origination volume will range from \$8 million to \$12 million during the remaining half of 2003. However, there can be no assurance of the accuracy of this estimate.

Since the majority of our loans receivable have variable rates of interest, the continuation of the low interest rate environment has had a negative impact on our net income. During late 2002, we expected that interest rates would gradually increase during 2003 and 2004; however, interest rates decreased during the first half of 2003. We expect that short-term interest rates will remain at current levels or possibly decrease during the remainder of 2003.

Interest rate increases generally cause valuation decreases in our retained interests in transferred assets (“Retained Interests”) while interest rate decreases generally cause valuation increases in our Retained Interests. However, these valuation changes have no impact on our cash flow from operations, the cash available for distribution to our shareholders or the determination by the Board of the level of quarterly dividend distributions. See “Quantitative and Qualitative Disclosures About Market Risk.”

PORTFOLIO INFORMATION**Lending Activities***General*

During the six months ended June 30, 2003 and 2002, we originated \$21.1 million and \$12.8 million of loans, respectively. Principal collections on our loans receivable were \$3.4 million (including \$1.4 million of scheduled maturities) and \$8.3 million (including \$6.6 million of prepayments and \$0.6 million of scheduled maturities) during the six months ended June 30, 2003 and 2002, respectively. During the year ended December 31, 2002, we originated \$32.8 million of loans. At June 30, 2003, all of our \$21.4 million of outstanding commitments were for variable-rate LIBOR-based loans at spreads over LIBOR ranging from 4.0% to 4.5%. Given the current low interest rate environment and competitive conditions, we expect to continue to originate variable-rate loans. It is anticipated that new commitments will have an interest rate floor of 6%. The weighted average interest rate on loan commitments at June 30, 2003 was 5.3%. See "Liquidity and Capital Resources."

We sold loans in structured loan sale transactions completed in April 2002, June 2001 and December 2000. Since the cash flows from these sold loans will impact our profitability and our cash available for dividend distributions, information on both our loans receivable retained (the "Retained Portfolio") and combined with the sold loans (the "Aggregate Portfolio") is provided below. Accordingly, at June 30, 2003, our Retained Portfolio does not include \$102.7 million of aggregate principal balance remaining on the loans sold in these structured loan sale transactions. Our Aggregate Portfolio outstanding was \$193.2 million at June 30, 2003. The weighted average contractual interest rate on our Aggregate Portfolio was 8.3%, 8.7% and 9.3% at June 30, 2003, December 31, 2002 and June 30, 2002, respectively.

Information on our Retained Portfolio was as follows:

	As of and For The Period Ended		
	June 30, 2003	December 31, 2002	June 30, 2002
Weighted Average Interest Rate	6.9%	7.5%	8.8%
Annualized Average Yield (1)	7.5%	10.3%	10.9%

(1) In addition to interest income, the yield includes all fees earned and is reduced by the provision for loan losses.

At June 30, 2003, approximately \$59.9 million of our loans receivable had variable interest rates (reset on a quarterly basis) based primarily on LIBOR with a weighted average interest rate of approximately 5.2%. The spread that we charge over LIBOR generally ranges from 3.5% to 4.5%. The LIBOR rate used in determining interest rates to be charged to our borrowers (the "Effective LIBOR") during the third quarter of 2003 (set on July 1, 2003) is 1.11%. In comparison, the effective LIBOR during the second quarter of 2003 (set on April 1, 2003) was 1.29%.

Problem Loans

Senior management closely monitors our Problem Loans which are classified into two categories: Impaired Loans and Special Mention Loans. Our Impaired Loans are loans on which the collection of the balance of principal and interest is considered impaired and a loan loss reserve has been established. Our Special Mention Loans are those loans receivable that are not complying with their contractual terms but we expect a full recovery of the principal balance through either collection efforts or liquidation of collateral. There can be no assurance that Special Mention Loans will not become Impaired Loans in the future if there is a deterioration in the value of the collateral.

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Our Problem Loans were as follows:

	June 30, 2003		December 31, 2002	
	Amount	%	Amount	%
(Dollars in thousands)				
Impaired Loans:				
Loans receivable	\$ 1,739	1.9%	\$ 1,756	2.4%
Sold loans of SPEs	—	—	—	—
	<u>\$ 1,739</u>	<u>1.0%</u>	<u>\$ 1,756</u>	<u>1.0%</u>
Special Mention Loans:				
Loans receivable	\$ —	—	\$ —	—
Sold loans of SPEs	1,365	1.3%	1,362	1.3%
	<u>\$ 1,365</u>	<u>0.7%</u>	<u>\$ 1,362</u>	<u>0.8%</u>

Historically, we have not had a significant amount of Impaired Loans, delinquent loans or charged-off loans. At June 30, 2003, we had reserves in the amount of \$365,000 against loans receivable that we have determined to be Problem Loans.

Retained Interests

At June 30, 2003 and December 31, 2002, the estimated fair value of our Retained Interests was \$22.7 million and \$23.5 million, respectively. Our Retained Interests consist of (i) the retention of a portion of each of the sold loans, (ii) the contractually required cash balances owned by the SPE and (iii) future excess funds to be generated by the SPE after payment of all obligations of the SPE.

The value of our Retained Interests is based on estimates of the present value of future cash flows we expect to receive from the SPEs. Estimated future cash flows are based in part upon estimates of prepayment speeds and loan losses on the loans receivable transferred to the SPEs. 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 June 30, 2003 and December 31, 2002 was \$3.5 million and \$3.8 million, respectively. Any appreciation of our Retained Interests is included in the accompanying balance sheet in beneficiaries' equity while any depreciation of our Retained Interests is either included in the accompanying statement of income as a realized loss (if there is a reduction in expected future cash flows) or on our balance sheet in beneficiaries' equity as an unrealized loss. 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.

Property Ownership

Our hotel properties are operated by Arlington Hospitality, Inc. (“Arlington”) pursuant to a sale/leaseback agreement. The following table summarizes statistical data provided by Arlington regarding our 22 remaining hotel properties:

	Six Months Ended June 30,			Three Months Ended June 30,		
	2003	2002	% Increase (Decrease)	2003	2002	% Increase (Decrease)
Occupancy	54.95%	58.70%	(6.4%)	59.43%	63.68%	(6.7%)
ADR (1)	\$ 53.27	\$ 54.33	(2.0%)	\$ 54.16	\$ 55.45	(2.3%)
RevPAR (2)	\$ 29.27	\$ 31.89	(8.2%)	\$ 32.18	\$ 35.31	(8.9%)
Revenue	\$ 7,088,807	\$ 7,733,831	(8.3%)	\$ 3,918,776	\$ 4,306,429	(9.0%)
Rooms Rented	133,088	142,359	(6.5%)	72,375	77,665	(6.8%)
Rooms Available	242,203	242,510	(0.1%)	121,780	121,958	(0.1%)

(1) “ADR” is defined as the average daily room rate.

(2) “RevPAR” is defined as room revenue per available room and is determined by dividing room revenue by available rooms for the applicable period.

Our income related to the hotel properties is from lease payments. Our lease is a “triple net” lease; therefore, all expenses of operation including insurance and real estate taxes are the obligation of Arlington. The data provided above is for informational purposes only. All revenues and expenses from operation of the properties belong to Arlington.

A summary of financial information for the lessee of our properties, Arlington, which has been derived from Arlington’s public filings as of March 31, 2003 and December 31, 2002 and for the three months ended March 31, 2003 and 2002, which is the latest available information as of our filing date, is as follows:

ARLINGTON HOSPITALITY, INC.

	March 31, 2003	December 31, 2002
(In thousands)		
BALANCE SHEET DATA:		
Investment in hotel assets	\$ 99,251	\$ 103,903
Cash and short-term investments	4,346	3,970
Total assets	115,831	119,934
Total liabilities	99,817	102,564
Shareholders’ equity	16,014	17,370
(In thousands)		
INCOME STATEMENT DATA:		
Total revenue	\$ 19,158	\$ 17,938
Operating loss	(1,258)	(450)
Net loss	(1,483)	(758)

Arlington is a public entity that files periodic reports with the Securities and Exchange Commission (the “SEC”). Additional information about Arlington, including June 30, 2003 financial information when available, can be obtained from the SEC’s website at www.sec.gov.

RESULTS OF OPERATIONS

Six Months Ended June 30, 2003 Compared to the Six Months Ended June 30, 2002

Overview

Income from continuing operations decreased by \$839,000 (19%), to \$3,541,000 during the six months ended June 30, 2003 from \$4,380,000 during the six months ended June 30, 2002. Net income decreased by \$2,161,000 (37%), to \$3,651,000 during the six months ended June 30, 2003 from \$5,812,000 during the six months ended June 30, 2002. Earnings per share decreased \$0.33 (37%), to \$0.57 per share during the six months ended June 30, 2003 from \$0.90 per share during the six months ended June 30, 2002. The decrease in net income is primarily due to:

- a decrease in the gain on sale of our real estate investments of \$663,000 as there were no hotel properties sold during the six months ended June 30, 2003 while two hotel properties were sold during the six months ended June 30, 2002;
- a decrease in the gain on sale of loans receivable of \$562,000 as there were no loans sold during the six months ended June 30, 2003 while we sold loans in a structured loan sale transaction completed during April 2002;
- a decrease in other income of \$568,000 due to decreased prepayment fees received; and
- a decrease in interest income of \$399,000 due to an increase in variable-rate lending with lower variable interest rates than our fixed-rate loans.

Significant changes in our revenues and expenses are further described below.

Revenues

Interest income decreased by \$399,000 (12%), to \$3,047,000 during the six months ended June 30, 2003 from \$3,446,000 during the six months ended June 30, 2002. The decrease was primarily attributable to a decrease in our weighted average interest rate from 8.8% at June 30, 2002 to 6.9% at June 30, 2003, primarily resulting from lower variable interest rates, increased variable rate lending and the sale of the majority of our fixed-rate loans receivable in our April 2002 structured loan sale transaction. Approximately 67% and 34% of our loans receivable had variable rates of interest as of June 30, 2003 and 2002, respectively. The weighted average of our Effective LIBOR decreased by 61 basis points from the six months ended June 30, 2002 to the six months ended June 30, 2003.

Income from Retained Interests decreased \$8,000 (1%), to \$1,376,000 during the six months ended June 30, 2003 compared to \$1,384,000 during the six months ended June 30, 2002. The income from our Retained Interests consists of the yield on our Retained Interests which is determined based on estimates of future cash flows and includes any fees collected by the SPEs in excess of anticipated fees. The yield on our Retained Interests declined to 11.7% during the six months ended June 30, 2003 from 13.8% during the six months ended June 30, 2002 while the weighted average balance of our Retained Interests increased to \$23.5 million during the six months ended June 30, 2003 compared to \$20.1 million during the six months ended June 30, 2002 due primarily to the completion of our April 2002 structured loan sale transaction.

Other income decreased \$568,000 (85%), to \$99,000 during the six months ended June 30, 2003 compared to \$667,000 during the six months ended June 30, 2002 due to decreased prepayment fees. During the first half of 2002, several loans receivable were prepaid which had significant prepayment penalties.

Interest Expense

Interest expense decreased by \$138,000 (7%), to \$1,712,000 during the six months ended June 30, 2003 from \$1,850,000 during the six months ended June 30, 2002. The decrease was primarily attributable to a decrease in the principal balance of the structured notes payable from our 1998 structured loan financing (\$22.2 million outstanding at June 30, 2003 compared to \$29.7 million outstanding at June 30, 2002). This decrease was partially offset by an increase in the weighted average borrowings outstanding under our revolving credit facility to \$18.0 million during the six months ended June 30, 2003 from \$6.5 million during the six months ended June 30, 2002. The weighted average interest rate on our revolving credit facility decreased to 3.1% during the six months ended June 30, 2003 from 3.8% during the six months ended June 30, 2002.

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Interest expense consisted of the following:

	Six Months Ended June 30,	
	2003	2002
	(In thousands)	
Structured Notes	\$ 803	\$ 1,077
Mortgages on hotel properties	576	568
Revolving credit facility	311	200
Other	22	5
	<u>\$ 1,712</u>	<u>\$ 1,850</u>

Other Expenses

Fees associated with the investment management agreements consisted of the following:

	Six Months Ended June 30,	
	2003	2002
	(In thousands)	
Lease supervision fee	\$ 185	\$ 199
Investment management fee	964	955
Total fees incurred	1,149	1,154
Less:		
Management fees included in discontinued operations	(8)	(17)
Cost of structured loan sale transactions	—	(57)
Fees incurred by the SPEs	(158)	(137)
Fees capitalized as cost of originating loans	(81)	(45)
Advisory and servicing fees to affiliate, net	<u>\$ 902</u>	<u>\$ 898</u>

General and administrative expenses increased \$51,000 (37%) to \$188,000 during the six months ended June 30, 2003 from \$137,000 during the six months ended June 30, 2002. The increase in general and administrative expenses is primarily due to carrying costs related to our asset acquired in liquidation held for sale.

Realized losses on Retained Interests were \$53,000 for the six months ended June 30, 2002 which was the result of a reduction in expected future cash flows resulting from increased prepayments. There were no realized losses on our Retained Interests during the six months ended June 30, 2003.

Impairment loss from asset acquired in liquidation held for sale was \$67,000 for the six months ended June 30, 2003. During July 2003, we sold our asset acquired in liquidation held for sale for net cash proceeds of approximately \$333,000. Accordingly, we reduced our basis in this asset from \$400,000 at December 31, 2002. There was no impairment loss from asset acquired in liquidation held for sale during the six months ended June 30, 2002.

Our provision for loan losses was \$65,000 during the six months ended June 30, 2002. We had no provision for loan losses during the six months ended June 30, 2003. During the twelve-month period ended June 30, 2002, our provision for loan losses was 0.09% (nine basis points) of our weighted average outstanding loans receivable. We had no provision for loan losses during the twelve-month period ended June 30, 2003.

Discontinued operations

Gain on sale of real estate investments was \$663,000 during the six months ended June 30, 2002 due to the sale of two hotel properties for \$5.2 million. No properties were sold during the six months ended June 30, 2003.

Our profit from discontinued operations decreased by \$97,000 (47%), to a net profit of \$110,000 during the six months ended June 30, 2003 from a net profit of \$207,000 during the six months ended June 30, 2002. Results of operations for the two properties sold during 2002 and the property held for sale at June 30, 2003 are included in discontinued operations for the six months ended June 30, 2002.

Three Months Ended June 30, 2003 Compared to the Three Months Ended June 30, 2002

Overview

Income from continuing operations decreased by \$456,000 (20%) to \$1,784,000 during the three months ended June 30, 2003 from \$2,240,000 during the three months ended June 30, 2002. Net income decreased by \$1,325,000 (42%), to \$1,839,000 during the three months ended June 30, 2003 from \$3,164,000 during the three months ended June 30, 2002. Earnings per share decreased \$0.20 (41%), to \$0.29 per share during the three months ended June 30, 2003 from \$0.49 per share during the three months ended June 30, 2002. The decrease in net income is primarily due to:

- a decrease in the gain on sale of our loans receivable of \$562,000 as there were no loans sold during the three months ended June 30, 2003 while we sold loans in a structured loan sale transaction completed during April 2002;
- a decrease in the gain on sale of our real estate investments of \$292,000 as there were no hotel properties sold during the three months ended June 30, 2003 while one hotel property was sold during the three months ended June 30, 2002; and,
- decreased other income of \$393,000 due to decreased prepayment fees received.

Significant changes in our revenues and expenses are further described below.

Revenues

Interest income increased by \$95,000 (6%), to \$1,600,000 during the three months ended June 30, 2003 from \$1,505,000 during the three months ended June 30, 2002. The increase was primarily attributable to an increase in our weighted average loans receivable outstanding of \$29.6 million (51%), to \$87.9 million during the three months ended June 30, 2003 from \$58.3 million during the three months ended June 30, 2002 due primarily to our April 2002 structured loan sale transaction. This increase was partially offset by a decrease in our weighted average interest rate from 8.8% at June 30, 2002 to 6.9% at June 30, 2003 primarily resulting from lower variable interest rates, increased variable rate lending and the sale of the majority of our fixed-rate loans receivable in our April 2002 structured loan sale transaction. Our weighted average Effective LIBOR decreased by 74 basis points from the three months ended June 30, 2002 to the three months ended June 30, 2003.

Income from Retained Interests decreased \$43,000 (6%), to \$674,000 during the three months ended June 30, 2003 compared to \$717,000 during the three months ended June 30, 2002. The income from our Retained Interests consists of the yield on our Retained Interests which is determined based on estimates of future cash flows and includes any fees collected by the SPEs in excess of anticipated fees. The yield on our Retained Interests declined to 11.6% during the three months ended June 30, 2003 from 12.7% during the three months ended June 30, 2002 while the weighted average balance of our Retained Interests increased to \$23.2 million during the three months ended June 30, 2003 from \$22.5 million during the three months ended June 30, 2002 due primarily to the completion of our April 2002 structured loan sale transaction.

Other income decreased \$393,000 (85%), to \$71,000 during the three months ended June 30, 2003 compared to \$464,000 during the three months ended June 30, 2002 due to decreased prepayment fees. During the three months ended June 30, 2002, several loans receivable were prepaid which had significant prepayment penalties.

[Table of Contents](#)**Interest Expense**

Interest expense increased by \$23,000 (3%), to \$890,000 during the three months ended June 30, 2003 from \$867,000 during the three months ended June 30, 2002. The increase was primarily attributable to an increase in the weighted average borrowings outstanding under our revolving credit facility to \$23.5 million during the three months ended June 30, 2003 compared to \$1.3 million during the three months ended June 30, 2002. This increase was partially offset by a decrease in the principal balance of the structured notes payable from our 1998 structured loan financing (\$22.2 million outstanding at June 30, 2003 compared to \$29.7 million outstanding at June 30, 2002). In addition, the weighted average interest rate on our revolving credit facility decreased to 3.0% during the three months ended June 30, 2003 from 4.7% during the three months ended June 30, 2002.

Interest expense consisted of the following:

	Three Months Ended June 30,	
	2003	2002
	(In thousands)	
Structured Notes	\$ 395	\$ 540
Mortgages on hotel properties	283	271
Revolving credit facility	197	54
Other	15	2
	\$ 890	\$ 867

Other Expenses

Fees associated with the investment management agreements consisted of the following:

	Three Months Ended June 30,	
	2003	2002
	(In thousands)	
Lease supervision fee	\$ 92	\$ 98
Investment management fee	488	506
Total fees incurred	580	604
Less:		
Management fees included in discontinued operations	(4)	(5)
Cost of structured loan sale transactions	—	(57)
Fees incurred by the SPEs	(78)	(75)
Fees capitalized as cost of originating loans	(45)	(18)
Advisory and servicing fees to affiliate, net	\$ 453	\$ 449

Impairment loss from asset acquired in liquidation held for sale was \$67,000 for the three months ended June 30, 2003. During July 2003, we sold our asset acquired in liquidation held for sale for net cash proceeds of approximately \$333,000. Accordingly, we reduced our basis in this asset from \$400,000 at March 31, 2003. There was no impairment loss from asset acquired in liquidation held for sale during the three months ended June 30, 2002.

Discontinued operations

Gain on sale of real estate investments was \$292,000 during the three months ended June 30, 2002 due to the sale of a hotel property for \$2.6 million. No properties were sold during the three months ended June 30, 2003.

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Our profit from discontinued operations decreased by \$15,000 (21%), to a net profit of \$55,000 during the three months ended June 30, 2003 from a net profit of \$70,000 during the three months ended June 30, 2002. Results of operations for the two properties sold during 2002 and the property held for sale at June 30, 2003 are included in discontinued operations for the three months ended June 30, 2002.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Analysis

We generated \$4,961,000 and \$4,387,000 from operating activities during the six months ended June 30, 2003 and 2002, respectively. The primary source of funds from operating activities is our net income which was \$3,651,000 and \$5,812,000 (a decrease of \$2,161,000) during the six months ended June 30, 2003 and 2002, respectively. Our cash flows from operating activities are also affected by the change in our current assets and current liabilities which increased by \$1,485,000.

Our investing activities reflect a net use of funds of \$15,303,000 and a net source of funds of \$22,354,000 during the six months ended June 30, 2003 and 2002, respectively. The \$37,657,000 decrease in net cash flows provided during the six months ended June 30, 2003 primarily resulted from the reduction of proceeds from structured loan sale transactions and an increase in loans funded less principal collected. We completed our 2002 structured loan sale transaction and received proceeds of \$24,040,000 during the six months ended June 30, 2002 while no structured loan sale transaction was completed during the six months ended June 30, 2003. During the first half of 2003, our net loans funded were \$17,726,000 which is \$15,223,000 greater than the first half of 2002. The increase was primarily due to increased loans funded of \$10,304,000 and reduced principal payments of \$4,919,000 for the six months ended June 30, 2003 compared to the six months ended June 30, 2002. In addition, (i) we did not sell any hotel properties during the first half of 2003 while we received net proceeds from the sale of two hotel properties of \$3,017,000 during the first half of 2002 and (ii) our investment in Retained Interests decreased by \$1,474,000 due to the completion of our 2002 structured loan sale transaction and the funding of its reserve during the six months ended June 30, 2002. Partially offsetting the above decreases in funds provided from investing activities was an increase in funds provided by our restricted investments of \$3,034,000 related primarily to our 1998 structured loan financing transaction.

Our financing activities reflect a net source of funds of \$10,837,000 and a net use of funds of \$18,090,000 during the six months ended June 30, 2003 and 2002, respectively. The increase in funds from financing activities of \$28,927,000 was primarily due to an increase in proceeds from our revolving credit facility of \$28,800,000. We have increased borrowing on our revolving credit facility due in part to the delay in completing a structured loan sale transaction. See "Factors That May Affect Future Operating Results — Asset-Backed Structured Loan Sale Transaction Market."

Sources and Uses of Funds

Overview

At June 30, 2003, we had \$0.5 million of cash and cash equivalents and availability of \$12.6 million under our revolving credit facility with a borrowing base (the maximum amount that we can have outstanding at any time based on our eligible loans receivable) of \$40.0 million, until the earlier of October 28, 2003 or when our next structured loan sale transaction is completed, when the revolving credit facility will be reduced to \$30 million. Our outstanding commitments to fund loans were \$21.4 million at June 30, 2003. Commitments have fixed expiration dates and require payment of a fee to us. Since some commitments expire without the proposed loan closing, the total committed amounts do not necessarily represent future cash requirements.

During the remaining half of 2003, we anticipate loan originations will range from \$8 million to \$12 million. We expect our loan originations anticipated to occur during the next twelve months, including those on which we have commitments at June 30, 2003, to be funded through (i) advances under our revolving credit facility, (ii) a structured loan sale transaction and (iii) sales of our hotel properties. We are currently in the process of co-securitizing a pool of loans with PMC Capital and expect the transaction to be completed in September 2003, unless additional delays are encountered. See "Factors That May Affect Future Operating Results — Asset-Backed Structured Loan Sale Transaction Market."

Sources of Funds

General

We expect that the sources of funds described below will be adequate to meet our working capital needs. However, there can be no assurance that we will be able to raise funds through these financing sources. If these sources are not available, we may have to originate loans at reduced levels, refer commitments back to PMC Advisers, or sell additional assets. Pursuant to our loan origination agreement with PMC Advisers and PMC Capital, if we do not have available capital to fund outstanding commitments, PMC Advisers will refer such commitments to our affiliates and we will receive no income from those outstanding commitments.

To meet our liquidity requirements, including origination of new loans, we primarily generate funds from the following sources:

- Structured loan sales;
- Borrowings under our short-term collateralized revolving credit facility;
- Borrowings collateralized by our hotel properties; and/or
- Sales of hotel properties.

A reduction in the availability of these sources of funds could have a material adverse effect on our financial condition and results of operations. See “Structured Loan Sale Transactions.”

Additional sources of funds include principal and interest collected on our loans receivable, rent collected on our hotel properties and the cash flows from our Retained Interests. To the extent these sources represent REIT taxable income, such amounts have historically been distributed to our shareholders. As a result, those earnings are generally not available to fund future investments.

Structured Loan Sale Transactions

Our primary source of funds has been structured loan sale transactions. We generated net proceeds of \$24.0 million, \$29.5 million and \$49.2 million from the completion of our 2002, 2001 and 2000 structured loan sale transactions, respectively. It is anticipated that our primary source of working capital during 2003 will again be a structured loan sale transaction. We expected to complete this structured loan sale transaction during the first half of 2003. While we believe we could have completed a transaction during the second quarter of 2003, we delayed our transaction since the terms of the transactions available in the market were not considered favorable to us (*i.e.*, as the transaction size and cost did not reflect the value of the transaction). The market for the type of asset-backed securities that we originate was relatively inefficient during the first half of 2003 as a result of the uncertainties in the marketplace due to sluggishness of the economy, geopolitical concerns and the impact of the ongoing conflict in the Middle East. We anticipate co-securitizing with PMC Capital approximately \$45.3 million of our variable-rate loans receivable, which we expect to complete in September 2003. Changes in market conditions may have an impact on the timing of completion of this transaction. While we have been successful in completing our past structured loan transactions in a timely manner, due to the risky nature of these transactions and the many factors which could cause us to further delay or postpone a transaction, there can be no assurance of a successful outcome. See “Factors That May Affect Future Operating Results — Asset-Backed Structured Loan Sale Transaction Market.”

Since we rely on structured loan sale transactions as our primary source of operating capital to fund new loan receivable 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 delay in completing our current structured loan sale transaction has had a negative impact on our ability to originate loans and our financial condition and results of operations.

Debt

For our short-term working capital needs, at June 30, 2003, we had a \$40 million revolving credit facility (the “Revolver”) which provides funds to originate loans. The facility will be reduced to \$30 million upon the earlier of the completion of a structured loan sale transaction or October 28, 2003. The maximum amount (the “Borrowing Base”) that we

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can have outstanding at any time is based on eligible loans receivable used as collateral. The Borrowing Base available on each eligible loan receivable is the lesser of (a) 60% of the value of the project underlying the loan receivable collateralizing the borrowing or (b) 85% of the amount of the loan receivable outstanding. At June 30, 2003, based on our eligible loans receivable, our Borrowing Base was \$40 million. We are charged interest on the balance outstanding under the Revolver at our election of either the prime rate of the lender or 162.5 basis points over the 30, 60 or 90-day LIBOR. As of June 30, 2003, we had \$27.4 million outstanding under this facility with a weighted average interest rate of 2.9%. The facility matures in May 2004.

With regard to our hotel properties, we continue to pursue financings secured by mortgages on individual properties owned by us. As of June 30, 2003, we had eleven financings secured by mortgages on our hotel properties for an aggregate remaining outstanding principal balance of \$15.0 million at a weighted average interest rate of 7.2%. The related notes have interest rates ranging from 5.4% to 8.5% and maturities ranging from June 2004 to August 2019.

Uses of Funds

General

The primary use of our funds is to originate loans to small businesses in the limited service hospitality industry. We also use funds for payment of dividends to shareholders, management and advisory fees (in lieu of salaries and other administrative overhead), general corporate overhead, and interest and principal payments on borrowed funds. As a REIT, we must distribute to our shareholders at least 90% of our REIT taxable income to maintain our tax status under the Internal Revenue Code of 1986, as amended. As a result, those earnings will not be available to fund future investments. See "Dividends."

To the extent funds are available, management believes that there may be alternative investment opportunities including investment in real estate. While we have historically been a lender to the limited service hospitality industry, we are not necessarily focusing solely on hospitality properties. We believe that there may be attractive acquisition opportunities in either retail shopping centers or commercial office buildings. We are attempting to identify properties that we intend to leverage up to 75% of their value. Without leverage, it is unlikely that our return on net equity investment will provide us with adequate investment returns. There can be no assurance that any properties will be identified or, to the extent identified, will be acquired. To date, no opportunities have been identified.

Loan Originations

At June 30, 2003, our commitments to originate loans were approximately \$21.4 million. We anticipate that our loan origination volume (which averaged approximately \$8.2 million per quarter in 2002) will range from \$8 million to \$12 million during the remainder of 2003.

Impact of Inflation

To the extent that we originate fixed-rate loans while we borrow funds at variable rates, we 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. Currently we are originating variable-rate loans and \$27.4 million of our debt has variable rates of interest; therefore, we do not believe inflation will have a significant impact on us in the near future. To the extent costs of operations rise while economic conditions prevent a matching rise in revenue rates (*i.e.*, room rates, menu prices, gasoline prices, etc.), our borrowers would be negatively impacted and loan losses could result. Accordingly, our borrowers can be impacted by inflation. In addition, in an inflationary environment we could experience pressure to increase our income and our dividend yield to maintain our stock price.

Operators of hotels, including Arlington, can be impacted by inflation. To the extent costs of operations rise while the economy prevents a matching rise in room and other amenity rates, Arlington's results of operations can be negatively impacted and our lease income could be affected.

Summarized Contractual Obligations, Commitments and Contingencies

Our contractual obligations at June 30, 2003 are summarized as follows:

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
	(In thousands)				
Notes payable (1)	\$ 37,188	\$ 4,837	\$ 13,938	\$ 7,673	\$ 10,740
Revolving credit facility (2)	27,400	27,400	—	—	—
Advisory agreements (3)	577	577	—	—	—
Total contractual cash obligations	\$ 65,165	\$ 32,814	\$ 13,938	\$ 7,673	\$ 10,740

- (1) Maturities of our 1998 structured notes payable (\$22.2 million at June 30, 2003) are dependent upon cash flows received from the underlying loans receivable. Our estimate of their repayment is based on scheduled principal payments on the underlying loans receivable. This estimate will differ from actual amounts to the extent we experience prepayments and/or loan losses.
- (2) The Borrowing Base on our revolving credit facility at June 30, 2003 was \$40.0 million.
- (3) Represents amounts due to PMC Advisers under our Investment Management Agreement and Lease Supervision Agreement for the second quarter of 2003.

Our commitments at June 30, 2003 are summarized as follows:

Other Commitments	Total Amounts Committed	Amount of Commitment Expiration Per Period			
		Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
	(In thousands)				
Indemnification (1)	\$ —	\$ —	\$ —	\$ —	\$ —
Other commitments (2)	21,392	21,392	—	—	—
Total commitments	\$ 21,392	\$ 21,392	\$ —	\$ —	\$ —

- (1) Represents our cross indemnification agreements with PMC Capital related to the special purpose entities created in conjunction with our structured loan sale transactions completed in 2002, 2001 and 2000 with a maximum exposure at June 30, 2003 of \$34.0 million. We valued our obligations pursuant to these cross indemnification agreements at zero.
- (2) Represents loan commitments outstanding.

See Note 13 to the accompanying consolidated financial statements for a detailed discussion of commitments and contingencies.

FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS

Asset-Backed Structured Loan Sale Transaction Market: A number of factors could impair our ability, or alter our decision, to complete a structured loan sale 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” 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 either our loans receivable or the loans receivable of PMC Capital may deter potential investors from purchasing our asset-backed securities;
- A deterioration in the operations 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;

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- A reduction in the performance of the loans receivable of our prior transactions or of similar transactions (for example, higher than expected loan losses or delinquencies) may deter potential investors from purchasing our asset-backed securities; and
- A change in the underlying criteria utilized by the rating agencies may cause our transactions to receive lower ratings than previously issued thereby increasing the cost of capital on our transaction.

In the event a structured loan sale transaction is delayed or unable to be completed, we will either have to increase our capacity under our Revolver, enter into new debt agreements, cease or reduce originating new loans until a structured loan sale transaction is completed, or sell additional assets, potentially on unfavorable terms. In addition, we may choose to sell the pool of loans receivable on unfavorable terms (reducing our future cash flows) including:

- Increased interest rate spreads required by investors;
- Increased cash reserve requirements;
- Increased subordinated portions of loans receivable; or
- Decreased transaction size.

Loan Origination Trend: We primarily originate variable-rate loans based on LIBOR which presently provides a lower cost variable interest rate alternative to our borrowers than our fixed-rate loan products. As a result of the uncertainties in the marketplace due to the sluggishness of the economy and the impact of the ongoing conflict in the Middle East, fewer hospitality properties are being marketed to be sold or refinanced; therefore, fewer property sales are requiring financing. In addition, we did not complete a structured loan sale transaction that we expected to be completed prior to June 30, 2003. Our commitments at June 30, 2003 were less than commitments at December 31, 2002. We expect that our commitments will continue to decrease until the market for limited service hospitality properties improves and a structured loan sale transaction is completed.

Dependency on Third Party Management of our Hotel Properties: As a REIT, we cannot operate our hotel properties. As a result, we are dependent upon Arlington to operate and manage our hotel properties. The operating results of our hotel properties are subject to a variety of risks which could affect their ability to generate sufficient cash flow to support the payment obligations under the master lease agreement. In the event Arlington defaults on the master lease agreement, there is no assurance that we would be able to find a new operator for our hotel properties, negotiate to receive the same amount of lease income or that we would be able to collect on Arlington's guarantee. In addition, in the event Arlington defaults, we may incur costs, including holding costs, legal fees and costs to re-franchise the properties.

Hospitality Industry Factors: Reductions in business and discretionary travel continue to cause a moderation in demand for hotel rooms and a slowdown in construction of hospitality properties (including limited service hospitality properties). These reductions were primarily caused by (i) traveler concerns about the safety and convenience of air travel, (ii) a general reluctance to be away from home and (iii) a downturn in corporate profits, investments and transactions which led to aggressive business travel reductions. Although the Federal Reserve lowered interest rates during the last three years to aid in stimulating the economy and to provide liquidity, consumer and business confidence declined. This lack of confidence, which continued into the beginning of 2003, caused a significant strain on the travel and hotel industries as well as numerous other industries. Political uncertainties impeded a rebound in consumer and investor confidence and spending. However, the limited service segment of the hospitality industry has been less impacted and has continued to outperform the luxury and upscale sectors which experienced the weakest performance.

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. Most of the limited service hospitality properties collateralizing our loans receivable are located on interstate highways. Historically, when gas prices sharply increase, occupancy rates decrease for properties located on interstate highways.

FLUCTUATIONS IN QUARTERLY RESULTS

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

- The completion of a structured loan sale in a particular period;
- 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 these factors, quarterly results should not be relied upon as being indicative of performance in future quarters.

In addition, to the extent a structured loan sale transaction is completed, (i) our interest income on loans receivable in future periods will be reduced until the proceeds received are reinvested in new loan originations, (ii) interest expense will be reduced if we repay outstanding debt with the proceeds and (iii) we will earn income from our ownership of a retained interest in the loans sold. Until the proceeds are fully reinvested, the net impact of a structured loan sale transaction on future operating periods should be a reduction in interest income, net of interest expense.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Information regarding recently issued accounting pronouncements is included in Note 5 to the accompanying consolidated financial statements.

SARBANES-OXLEY ACT OF 2002

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the "Act") which imposes a wide variety of regulatory requirements on publicly-held companies. These requirements include, but are not limited to:

- requires certification by the chief executive officer and chief financial officer that periodic financial statements filed with the SEC present fairly the operations and financial condition of the Company;
- prohibits making loans to corporate executives;
- establishes a reporting obligation with respect to disclosure controls and procedures requiring the chief executive officer and chief financial officer to certify in periodic reports filed with the SEC that they are responsible for establishing and maintaining disclosure controls and procedures for the Company and if there were significant changes in internal controls subsequent to the date of their evaluation;
- requires that annual reports (beginning December 31, 2004) contain an internal control report stating management's responsibility for establishing and maintaining adequate internal controls and procedures for financial reporting and management's conclusions regarding the effectiveness of internal controls and procedures for financial reporting attested to and reported on by the external auditor; and
- reduces the mandatory period for principal stockholders or senior executives to disclose changes in ownership of securities to two business days after changes are executed.

The Act required us to evaluate our current policies and procedures to ensure our compliance with current laws and regulations. We will continue to monitor our compliance with all future regulations that are adopted and will take any necessary actions to maintain compliance.

DIVIDENDS

On January 13, 2003, we paid a \$0.40 per share quarterly dividend and a \$0.02 per share special dividend to common shareholders of record on December 31, 2002. On April 14, 2003, we paid a \$0.40 per share quarterly dividend to common shareholders of record on March 31, 2003. The Board declared a \$0.38 per share dividend to common shareholders of record on June 30, 2003 which was paid on July 14, 2003. This dividend reduction was the result of reduced earnings and continued low interest rates. Our Board may amend the level of quarterly dividends as warranted by actual and/or anticipated earnings.

ITEM 3.

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 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 variable-rate loans receivable are generally at spreads over LIBOR consistent with the market. Increases or decreases in interest rates will not generally have a material impact on the fair value of our variable-rate loans receivable. At June 30, 2003 and December 31, 2002, we had \$59.9 million and \$42.1 million of variable-rate loans receivable, respectively, and \$27.4 million and \$7.3 million of variable-rate debt, respectively. We have interest rate risk on the differential between our variable-rate loans receivable outstanding and our variable-rate debt (\$32.5 million and \$34.8 million at June 30, 2003 and December 31, 2002, respectively). To the extent variable rates continue to decrease, our interest income net of interest expense would decrease. Since our variable-rate loans receivable exceed our variable-rate debt, reductions in variable interest rates will negatively impact our results of operations.

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 June 30, 2003, 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 \$325,000 on an annual basis. In comparison, based on our analysis of the sensitivity of interest income and interest expense at December 31, 2002, 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 \$348,000.

Changes in market interest rates on our fixed-rate loans receivable do not have an immediate impact on interest income. Our interest rate risk on our fixed-rate loans receivable is primarily related to 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).

Our loans receivable are recorded at cost and adjusted by deferred commitment fees (recognized as an adjustment of yield over the life of the loan) and loan loss reserves. The fair value of our fixed interest rate loans receivable is dependent upon several factors including changes in interest rates and the market for the types of loans that we have originated. At June 30, 2003 and December 31, 2002, the fair value of our fixed-rate loans receivable generally approximates the remaining unamortized principal balance of the loans receivable, less any valuation reserves.

NOTES PAYABLE AND REVOLVING CREDIT FACILITY

Since our fixed-rate debt has coupon rates that are currently higher (in general) than market rates, the fair value of these financial instruments is higher than their cost thus decreasing our net worth. The majority of this debt is the structured notes payable from our 1998 structured loan financing which cannot be repaid other than through assets of the 1998 structured loan financing including collections of principal on the underlying loans receivable. Of our fixed-rate hotel property mortgages, \$6.2 million have significant penalties for prepayment, \$4.7 million have no prepayment penalties and the remaining \$4.1 million have prepayment penalties of 2% of the prepaid amount.

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The following tables present the principal amounts, weighted average interest rates and fair values required by year of expected maturity to evaluate the expected cash flows and sensitivity to interest rate changes of our outstanding debt at June 30, 2003 and December 31, 2002.

Market risk disclosures related to our outstanding debt as of June 30, 2003 were as follows:

	Twelve Month Period Ending June 30,					Thereafter	Carrying Value	Fair Value (1)
	2004	2005	2006	2007	2008			
					(In thousands)			
Fixed-rate debt (2)	\$ 4,837	\$ 6,862	\$ 7,076	\$ 6,614	\$ 1,059	\$ 10,740	\$ 37,188	\$ 39,190
Variable-rate debt (primarily LIBOR-based) (3)	27,400	—	—	—	—	—	27,400	27,400
Totals	\$ 32,237	\$ 6,862	\$ 7,076	\$ 6,614	\$ 1,059	\$ 10,740	\$ 64,588	\$ 66,590

- (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 June 30, 2003 was 6.7%.
- (3) The weighted average interest rate of our variable-rate debt at June 30, 2003 was 2.9%.

Market risk disclosures related to our outstanding debt as of December 31, 2002 were as follows:

	Year Ending December 31,					Thereafter	Carrying Value	Fair Value (1)
	2003	2004	2005	2006	2007			
					(In thousands)			
Fixed-rate debt (2)	\$ 1,691	\$ 7,103	\$ 2,768	\$ 2,006	\$ 2,215	\$ 25,408	\$ 41,191	\$ 43,520
Variable-rate debt (primarily LIBOR-based) (3)	7,300	—	—	—	—	—	7,300	7,300
Totals	\$ 8,991	\$ 7,103	\$ 2,768	\$ 2,006	\$ 2,215	\$ 25,408	\$ 48,491	\$ 50,820

- (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, 2002 was 6.9%.
- (3) The weighted average interest rate of our variable-rate debt at December 31, 2002 was 3.1%.

RETAINED INTERESTS

We have an investment in Retained Interests that is valued based on various factors including estimates of appropriate discount rates. Changes in the discount rates used in determining the fair value of the Retained Interests will impact their carrying value. Any appreciation of our Retained Interests is included in the accompanying balance sheet in beneficiaries' equity while any depreciation of our Retained Interests is either included in the accompanying statement of income as a realized loss (if there is a reduction in expected future cash flows) or on our balance sheet in beneficiaries' equity as an unrealized loss. 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 June 30, 2003, the value of our Retained Interests at June 30, 2003 would have decreased by approximately \$1.0 million and \$1.9 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, 2002, the value of our Retained Interests at December 31, 2002 would have decreased by approximately \$1.1 million and \$2.0 million, respectively.

ITEM 4.
Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15 (e)) as of June 30, 2003. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our current disclosure controls and procedures are effective in timely notifying them of material information relating to us (including our consolidated subsidiaries) required to be disclosed in the reports we file or submit under the Exchange Act.

There have been no significant changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2003 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II
Other Information

ITEM 6. Exhibits and Reports on Form 8-K

A. Exhibits

- *2.5 Amendment No. 1 to Agreement and Plan of Merger between PMC Commercial Trust and PMC Capital, Inc. dated August 1, 2003.
- 3.1 Declaration of Trust. Previously filed as an exhibit to our Registration Statement on Form S-11 filed with the Commission on June 25, 1993, as amended (Registration No. 33-65910), and incorporated herein by reference.
- 3.1(a) Amendment No. 1 to Declaration of Trust. Previously filed as an exhibit to our Registration Statement on Form S-11 filed with the Commission on June 25, 1993, as amended (Registration No. 33-65910), and incorporated herein by reference.
- 3.1(b) Amendment No. 2 to Declaration of Trust (incorporated by reference from Registrant's Form 10-K for the year ended December 31, 1993).
- 3.2 Bylaws. Previously filed as an exhibit to our Registration Statement on Form S-11 filed with the Commission on June 25, 1993, as amended (Registration No. 33-65910), and incorporated herein by reference.
- *10.25 Fifth Amendment to Credit Agreement dated June 30, 2003 between PMC Commercial Trust and Bank One, N.A.
- *10.26 Investment Management Agreement between PMC Capital, Inc., PMC Commercial Trust and PMC Advisers, Ltd. dated July 1, 2003.
- *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.

** Submitted herewith.

B. Reports on Form 8-K

On May 15, 2003, we filed a report on Form 8-K pursuant to Item 12 related to the disclosure of our results of operations and financial condition for the three months ended March 31, 2003.

On June 30, 2003, we filed a report on Form 8-K pursuant to Item 12 announcing our quarterly dividend declared and a delay in the completion of our proposed securitization.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PMC Commercial Trust

Date: 8/12/03

/s/ Lance B. Rosemore

Lance B. Rosemore
President and Chief Executive Officer

Date: 8/12/03

/s/ Barry N. Berlin

Barry N. Berlin
Chief Financial Officer
(Principal Accounting Officer)

FIRST AMENDMENT TO AGREEMENT AND PLAN OF MERGER

This First Amendment to the Agreement and Plan of Merger (the "Amendment") is made and entered into as of this 1st day of August, 2003, by and between PMC Commercial Trust, a Texas real estate investment trust ("Trust"), and PMC Capital, Inc., a Florida corporation that has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended ("Capital").

RECITALS:

WHEREAS, Trust and Capital entered into that certain Agreement and Plan of Merger dated as of March 27, 2003 (as amended or modified from time to time, the "Agreement");

WHEREAS, the Agreement entitles either Trust or Capital to terminate the Agreement if the Merger (as defined in the Agreement) is not consummated by December 31, 2003; and

WHEREAS, Trust and Capital desire to amend the Agreement to extend such termination date from December 31, 2003 to February 29, 2004.

NOW, THEREFORE, in consideration of the foregoing premises, the mutual promises and agreements hereinafter set forth, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Trust and Capital hereby agree as follows:

1. Definitions. All capitalized terms used in this Amendment shall have the meanings given to them in the Agreement, unless otherwise specifically defined herein.

2. Amendment to Section 11.1(e). Effective as of the date hereof, Section 11.1(e) of the Agreement is hereby amended to read in its entirety as follows:

(e) by either Trust or Capital, if the Merger shall not have been consummated before February 29, 2004; provided, however, that a party that has willfully and materially breached a representation, warranty or covenant of such party set forth in this Agreement shall not be entitled to exercise its right to terminate under this Section 11.1(e);

3. Effect. The terms and provisions set forth in this Amendment shall modify and supersede all inconsistent terms and provisions set forth in the Agreement and except as expressly modified and superseded by this Amendment, all of the terms, provisions and conditions of the Agreement are ratified and confirmed and shall remain in full force and effect.

4. Counterparts. This Amendment may be executed in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same agreement.

5. Applicable Law. This Amendment shall be governed by the laws of the State of Texas, without regard to the principles of conflicts of law thereof.

6. Entire Agreement. This Amendment and the Agreement contain the entire agreement and understanding among the parties hereto with respect to the subject matter hereof and supersede all prior agreements and understandings relating to the subject matter hereof.

7. Severability. If any provision of this Amendment shall be held invalid or unenforceable by any court of competent jurisdiction, such holding shall not invalidate or render unenforceable any other provision hereof.

IN WITNESS WHEREOF, the undersigned have caused this Amendment to be effective as of the date first above written.

PMC COMMERCIAL TRUST,
a Texas real estate investment trust

By: /s/ Andrew S. Rosemore

Andrew S. Rosemore
Executive Vice President and
Chief Operating Officer

PMC CAPITAL, INC.,
a Florida corporation

By: /s/ Lance B. Rosemore

Lance B. Rosemore
Chief Executive Officer

FIFTH AMENDMENT TO CREDIT AGREEMENT

THIS FIFTH AMENDMENT TO CREDIT AGREEMENT (this "Amendment") is entered into as of June 30, 2003, among PMC COMMERCIAL TRUST, a real estate investment trust organized under the laws of the State of Texas ("Borrower"), certain Lenders, and BANK ONE, NA, a national banking association with its main office in Chicago, Illinois, successor by merger to Bank One, Texas, N.A. ("Administrative Agent").

PRELIMINARY STATEMENT:

Borrower, Administrative Agent and Lenders are party to that certain Credit Agreement (as renewed, extended, amended and restated, the "Credit Agreement") dated as of November 29, 1999, pursuant to which the Lenders have made and may hereafter make loans to Borrower. The parties hereto have agreed to amend the Credit Agreement in order to provide for a temporary increase in the amount of the Commitment.

Accordingly, for adequate and sufficient consideration, the receipt of which is hereby acknowledged, Borrower, Administrative Agent and Lenders agree as follows:

1. Defined Terms; References. Unless otherwise stated in this Amendment (a) terms defined in the Credit Agreement have the same meanings when used in this Amendment and (b) references to "Sections," "Schedules" and "Exhibits" are to sections, schedules and exhibits to the Credit Agreement.

2. Amendments.

(a) The defined term "Commitment" in Section 1.1 of the Credit Agreement is amended in its entirety as follows:

"Commitment" means an amount (subject to reduction or cancellation as herein provided) equal to (a) \$40,000,000 for the period between June 30, 2003, and the Commitment Reduction Date, and (b) \$30,000,000 at any time thereafter. For purposes of this paragraph, the term "Commitment Reduction Date" means the earlier of (i) the closing date of the first Asset Securitization to be completed after June 30, 2003, and (ii) October 28, 2003.

(b) Schedule 2 to the Credit Agreement is hereby amended in its entirety as set forth on Annex A attached hereto.

3. Conditions Precedent. Notwithstanding any contrary provisions, the foregoing paragraphs in this Amendment are not effective unless and until (a) the representations and warranties in this Amendment are true and correct, (b) Lender receives counterparts of this Amendment executed by each party named below, and (c) Borrower executes and delivers to Bank One, NA, a renewal and replacement Revolving Note in the stated principal amount of \$40,000,000.

4. Ratifications. This Amendment modifies and supersedes all inconsistent terms and provisions of the Credit Documents, and except as expressly modified and superseded by this Amendment, the Credit Documents are ratified and confirmed and continue in full force and effect. Borrower, Administrative Agent and Lenders agree that the Credit Documents, as amended by this Amendment, continue to be legal, valid, binding and enforceable in accordance with their respective terms. Without limiting the generality of the foregoing, Borrower hereby ratifies and confirms that all Liens heretofore granted to Administrative Agent on behalf of the Lenders were intended to, do, and continue to secure the full payment and performance of the Obligation. Borrower agrees to perform such acts and duly authorize, execute, acknowledge, deliver, file and record such additional assignments, security agreements, modifications or amendments to any of the foregoing, and such other agreements, documents, and instruments as Administrative Agent or Lenders may reasonably request in order to perfect and protect those Liens and preserve and protect the rights of Administrative Agent and Lenders in respect of all present and future Collateral.

5. Representations and Warranties. Borrower hereby represents and warrants to Administrative Agent and Lenders that (a) this Amendment and any Credit Documents to be delivered under this Amendment have been duly executed and delivered by Borrower, (b) no action of, or filing with, any Governmental Authority is required to authorize, or is otherwise required in connection with, the execution, delivery, and performance by Borrower of this Amendment and any Credit Document to be delivered under this Amendment, (c) this Amendment and any Credit Documents to be delivered under this Amendment are valid and binding upon Borrower and are enforceable against Borrower in accordance with their respective terms, except as limited by any applicable Debtor Relief Laws, (d) the execution, delivery and performance by Borrower of this Amendment and any Credit Documents to be delivered under this Amendment do not require the consent of any other Person and do not and will not constitute a violation of any Governmental Requirements, agreements or understandings to which Borrower is a party or by which Borrower is bound, (e) the representations and warranties contained in the Credit Agreement, as amended by this Amendment, and any other Credit Document are true and correct in all material respects as of the date of this Amendment, and (f) as of the date of this Amendment, no Event of Default or Potential Default exists or is imminent.

6. References. All references in the Credit Documents to the "Credit Agreement" refer to the Credit Agreement as amended by this Amendment. This Amendment is a "Credit Document" referred to in the Credit Agreement and the provisions relating to Credit Documents in the Credit Agreement are incorporated by reference, the same as if set forth verbatim in this Amendment.

7. Counterparts. This Amendment may be executed in any number of counterparts with the same effect as if all signatories had signed the same document.

8. Parties Bound. This Amendment binds and inures to the benefit of Borrower, Administrative Agent and each Lender, and, subject to Section 14 of the Credit Agreement, their respective successors and assigns.

9. Entirety. THIS AMENDMENT, THE CREDIT AGREEMENT AS AMENDED BY THIS AMENDMENT, AND THE OTHER CREDIT DOCUMENTS

REPRESENT THE FINAL AGREEMENT BETWEEN THE PARTIES FOR THE TRANSACTIONS THEREIN,
AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT
ORAL AGREEMENTS BETWEEN THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS
BETWEEN THE PARTIES.

EXECUTED as of the date first stated above.

BANK ONE, NA,
as Administrative Agent and a Lender

By: /s/ Bradley C. Peters, Vice President

Bradley C. Peters, Vice President

PMC COMMERCIAL TRUST,
as Borrower

By: /s/ Barry N. Berlin

Name: Barry N. Berlin

Title: Chief Financial Officer

INVESTMENT MANAGEMENT AGREEMENT

This Investment Management Agreement (the "AGREEMENT") dated this 1st day of July, 2003 by and among PMC Commercial Trust, a Texas real estate investment trust (the "COMPANY"), PMC Asset Management, Inc., a Texas corporation ("PMC ASSET" or the "INVESTMENT MANAGER"), a wholly-owned subsidiary of PMC Advisers, Ltd. ("PMC ADVISERS"), and PMC Capital, Inc. ("PMC CAPITAL").

1. CERTAIN DEFINITIONS

As used in this Agreement, the following terms have the meanings set forth below:

"Affiliate" shall mean a Person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, the first mentioned Person.

"Average Annual Value of All Invested Assets" shall mean the book value of the Invested Assets determined in accordance with GAAP on the first day of the year and on the last day of each quarter of such year divided by five.

"Average Annual Value of All Invested Assets at Date of Termination" shall mean the book value of the Invested Assets at Date of Termination determined in accordance with GAAP on the first day of the year and on the last day of each quarter of such year divided by five.

"Average Common Equity Capital" shall mean the Common Equity Capital on the first day of the year and on the last day of each quarter of such year, divided by five.

"Average Quarterly Value of All Assets" shall mean the book value of total assets of the Company or any Person wholly-owned (directly or indirectly) by the Company determined in accordance with GAAP on the first day of the quarter and on the last day of the quarter, divided by two.

"Average Quarterly Value of All Invested Assets" shall mean the book value of Invested Assets determined in accordance with GAAP on the first day of the quarter and on the last day of the quarter, divided by two.

"Code" shall mean the Internal Revenue Code of 1986, as amended.

"Common Equity Capital" shall mean the sum of the stated capital plus the additional paid-in capital for the Common Shares.

"Common Shares" shall mean the Company's common shares of beneficial interest, par value \$.01 per share.

"GAAP" shall mean generally accepted accounting principles.

"Independent Trust Managers" shall mean the trust managers of the Company who are not affiliated with PMC Capital or its subsidiaries.

"Invested Assets" shall have the meaning set forth in Section 2 of this Agreement.

"Invested Assets at Date of Termination" shall mean Primary Investments and Other Investments and any Primary Investments or Other Investments that arise from loan commitments, letters of intent or other agreements, in any case, as in existence on the Termination Date, as set forth on a schedule to be prepared by the Company and delivered to PMC Capital not later than 45 days from such date of termination, which schedule shall be annually updated by the Company and delivered to PMC Capital not later than 90 days following the end of each of the Company's fiscal years during which the Non-Compete Agreement (as defined in Section 10 of this Agreement) is in effect.

"Other Investments" shall have the meaning set forth in Section 2 of this Agreement.

"Person" shall mean an individual, corporation, partnership, association, trust or any unincorporated organization or other entity.

"Primary Investments" shall have the meaning set forth in Section 2 of this Agreement.

"Return on Average Common Equity Capital" means the net income of the Company determined in accordance with GAAP, less preferred dividends, if any, divided by the Average Common Equity Capital.

"Termination Date" shall mean the date on which this Agreement no longer has any force and effect, whether as a result of being terminated in accordance with the provisions of Section 10 hereof (following the expiration of the 60-day notice period provided for therein) or as a result of non-renewal (at the expiration of the term hereof) for whatever reason.

2. PURPOSE OF THE COMPANY

The Company intends primarily to originate business loans (a) to small business enterprises that exceed the net worth, asset, income, number of employees or other limitations applicable to the Small Business Administration ("SBA") programs utilized by PMC Capital, (b) in excess of \$1,333,000 to small business enterprises without regard to SBA eligibility requirements, (c) for which PMC Capital does not have available funds to make such loans or (d) that cannot be originated by PMC Capital or its subsidiaries as a result of industry concentration limitations. All such loans (collectively, the "Primary Investments") will be secured by first liens on real estate and subject to the Company's underwriting criteria. In addition, the Company may (i) purchase from the Resolution Trust Company, the Federal Deposit Insurance Corporation and other sellers loans on which payments are current at the time of the Company's commitment to purchase and which meet the

Company's underwriting criteria, (ii) invest in other commercial loans secured by real estate and (iii) invest in real estate (collectively, the "OTHER INVESTMENTS").

Concurrently with the execution of this Agreement, the Company, PMC Asset, and PMC Capital shall enter into a Loan Origination Agreement in the form of Exhibit A hereto (the "LOAN ORIGINATION AGREEMENT") pursuant to which PMC Asset shall determine the allocation of the loan origination opportunities to either the Company or PMC Capital.

The Company's primary investment objective is to obtain current income from interest payments and other related fee income from Primary Investments originated by it and Other Investments acquired by it and, in each case, owned by the Company or by any Person wholly-owned (directly or indirectly) by the Company (collectively, the "INVESTED ASSETS") for distribution to its shareholders. The Company will invest in Invested Assets selected by the Investment Manager in accordance with underwriting criteria established by the trust managers with the intention of creating a portfolio of investments intended to preserve the capital base of the Company and generate income for distribution to the Company's shareholders. The Company's investments are anticipated to be held primarily to maturity.

3. THE INVESTMENT MANAGER

PMC Asset shall act as the investment adviser to the Company and is registered with the applicable governmental authorities of the State of Texas. The Company hereto engages the services of PMC Asset as the Company's Investment Manager.

4. OBLIGATIONS OF THE INVESTMENT MANAGER

As the Investment Manager, PMC Asset will:

(a) advise the Company as to the acquisition and disposition of Invested Assets and temporary investments (collectively, "INVESTMENTS") in accordance with the Company's underwriting criteria and investment policies;

(b) provide the Company with office space and services to the extent required by the Company's trust managers, officers and employees;

(c) maintain the Company's books of account and other records and files;

(d) report to the Company's trust managers, or to any committee or officer of the Company acting pursuant to the authority of the trust managers, at such times and in such detail as the trust managers deem appropriate in order to enable the Company to determine that its investment policies are being observed and implemented;

(e) undertake its obligations pursuant hereto and any other activities undertaken by PMC Asset on the Company's behalf subject to any directives of the Company's trust

managers or any duly constituted committee or officer of the Company acting pursuant to authority of the Company's trust managers;

(f) subject to the Company's investment policies and any specific directives from the Company's trust managers, to effect acquisitions and dispositions for the Company's account in the Investment Manager's discretion and to arrange for the documents representing acquired Investments to be delivered to the Company's custodian;

(g) on a continuing basis, monitor, manage and service the Company's Investments; and

(h) arrange debt and equity financing for the Company, subject to policies adopted by the Company's trust managers.

5. EXPENSES TO BE PAID BY THE INVESTMENT MANAGER

The Investment Manager will pay for its own account all expenses incurred by it in rendering the services hereunder without regard to the compensation received by the Investment Manager from the Company hereunder. Without limiting the generality of the foregoing, the Investment Manager shall bear the following expenses incurred in connection with the performance of its duties under this Agreement:

(a) employment expenses of the personnel employed by the Investment Manager (other than fees paid and reimbursement of expenses made to independent managers, independent contractors, mortgage services, consultants, managers, local property managers or agents employed by or on behalf of the Company including such persons or entities which may be Affiliates of the Investment Manager when acting in any such capacity, all of which shall be the responsibility of the Company), including but not limited to, salaries, wages, payroll taxes and the costs of employee benefit plans;

(b) rent, telephone, utilities, office furniture, equipment and machinery (including computers, to the extent utilized) and other office expenses of the Investment Manager, except to the extent such expenses relate solely to an office maintained by the Company separate from the office of the Investment Manager; and

(c) miscellaneous administrative expenses incurred in supervising, monitoring and inspecting real property and such other investments of the Company or relating to the performance by the Investment Manager of its obligations hereunder.

Notwithstanding the foregoing, any share options granted by the Company to directors, officers and key employees of the Investment Manager shall not be an expense to be borne by the Investment Manager pursuant to this Section 5.

6. EXPENSES TO BE PAID BY THE COMPANY

Except as expressly otherwise provided in this Agreement, the Company will pay any expenses incurred by the Company and will reimburse the Investment Manager promptly, against the Investment Manager's voucher, for any such expenses paid by the Investment Manager for the Company's account. Without limiting the generality of the foregoing, such expenses shall include:

(a) all expenses of the Company's organization and of any offering and sale by the Company of its shares;

(b) expenses of the Company operations, except as otherwise provided in Section 5 above;

(c) financing costs and debt service with respect to indebtedness of the Company;

(d) taxes on income and taxes and assessments on real property, if any, and all other taxes applicable to the Company;

(e) legal, auditing, accounting, underwriting, brokerage, listing, reporting, registration and other fees, and printing, engraving and other expenses and taxes incurred in connection with the issuance, distribution, transfer, trading, registration and stock exchange listing of the Company's securities, whether such expenses are directly incurred by the Company or are allocated to the Company by the Investment Manager either pursuant to this Agreement or as otherwise agreed to by the Board of Trust Managers of the Company from time to time;

(f) expenses of organizing, revising, amending, converting, modifying or terminating the Company;

(g) fees and expenses paid to trust managers and officers who are not employees or Affiliates of the Investment Manager, independent advisors, independent contractors, mortgage services, consultants, managers, local property managers or management firms, accountants, attorneys and other agents employed by or on behalf of the Company and out-of-pocket expenses of trust managers of the Company;

(h) expenses directly connected with the acquisition, disposition and ownership of Invested Assets, including real estate interests or other property (including the costs of foreclosure, insurance premiums, legal services, brokerage and sales commissions, maintenance, repair, improvement and local management of property), other than expenses with respect thereto of employees of the Investment Manager to the extent that such expenses are to be borne by the Investment Manager pursuant to Section 5 above, and any expenses allocated to the Company by the Investment Manager as agreed to by the Board of Trust Managers of the Company from time to time;

(i) all insurance costs incurred in connection with the Company (including officer and trust manager liability insurance, if any);

(j) expenses connected with payments of dividends or interest or contributions in cash or any other form made or caused to be made by the trust managers to holders of securities of the Company;

(k) all expenses connected with communications to holders of securities of the Company and other bookkeeping and clerical work necessary to maintaining relations with holders of securities, including the cost of printing and mailing certificates for securities and proxy solicitation materials and reports to holders of the Company securities;

(l) transfer agent's, registrar's and indenture trustee's fees and charges;

(m) legal, accounting and auditing fees and expenses; and

(n) expenses relating to any office or office facilities maintained by the Company separate from the office of the Investment Manager.

If the Company uses the services of attorneys or paraprofessionals on the staff of the Investment Manager in lieu of outside counsel for purposes other than the performance of the services to be performed by the Investment Manager hereunder, the Company will reimburse the Investment Manager for such services at hourly rates calculated to cover the cost of such services, as well as for incidental disbursements.

7. RECEIPT OF FEES

All fees that may be paid to the Investment Manager by any person in connection with any investment transaction in which the Company participates or proposes to participate shall be paid over or credited to the Company at the time such investment transaction is consummated. The Investment Manager may, on the other hand, retain for its own account any fees paid to it by any such person for any services rendered to such person which is not related to any such investment transaction. For this purpose, any fees paid for services rendered by attorneys on the staff of the Investment Manager in connection with any such investment transaction shall be treated as transaction costs and shall not be deemed to be fees paid to the Investment Manager in connection with any investment transaction. The Investment Manager will report to the Company's trust managers not less often than quarterly all fees received by the Investment Manager from any source whatever and whether, in its opinion, any such fee is one that the Investment Manager is entitled to retain under the provisions of this Section 7. In the event that any trust manager should disagree, the matter shall be conclusively resolved by a majority of the trust managers of the Company, including a majority of the Independent Trust Managers.

8. COMPENSATION OF THE INVESTMENT MANAGER

As the Investment Manager's sole and exclusive compensation for its services to be rendered pursuant to the terms set out above, the Company will, during the term of this Agreement, pay to the Investment Manager the following fees, beginning as of the date of this Agreement:

- I. Quarterly in arrears, a fee ("BASE FEE") consisting of a quarterly servicing and advisory fee equal to the sum of (a) the product of 0.3875% (1.55% on an annual basis) multiplied by the lesser of (i) the Average Quarterly Value of Common Equity Capital or (ii) the Average Quarterly Value of All Invested Assets and (b) the product of 0.10% (0.40% on an annual basis) and the difference between the Average Quarterly Value of All Invested Assets and the Average Quarterly Value of Common Equity Capital. Notwithstanding the foregoing or any other provision contained herein, the Base Fee payable to the Investment Manager hereunder shall be reduced for each quarter during the term of this Agreement by an amount equal to the amount of servicing or supervisory servicing fees, if any, required to be paid for such quarter by the Company to any third party which is unaffiliated with the Company or the Investment Manager for the servicing of any Invested Assets. For purposes of calculating the Base Fee, the Average Quarterly Value of Common Equity Capital shall not be increased by the proceeds received from any public offering of Common Shares by the Company (other than pursuant to the Company's dividend reinvestment plan or any employee/trust manager benefit plan) during the 180 calendar day period immediately following such public offering.
- II. Quarterly in arrears, a consulting fee equal to the sum of (a) the product of 50% multiplied by the amount of fees contractually due to any third party assisting in the placement of any of the Company's debt securities or preferred shares of beneficial interest and (b) the product of 12.5% multiplied by the amount of any fees contractually due any third party assisting in the placement or underwriting of any private or public offering of Common Shares (the "OFFERING FEE"). If the Offering Fee is less than 5.5%, the consulting fee shall be increased by an amount equal to the product of (i) 50% of the difference between 5.5% and the actual Offering Fee multiplied by (ii) the gross proceeds of the offering.
- III. Quarterly in arrears, an origination fee (the "ORIGINATION FEE") equal to the product of 0.005 (2%) multiplied by the first \$20 million in loans funded during a one year period. Thereafter, the origination fee shall be equal to the product of 0.0025 (3%) multiplied by the dollar amount of loans funded for the remainder of that one year period.
- IV. A fee in the amount of ten thousand dollars (\$10,000) due and payable upon the sale of any Amerihost property.

9. INDEMNIFICATION OF THE INVESTMENT MANAGER

The Company confirms that in performing services hereunder the Investment Manager (including its directors, officers and employees) will be an agent of the Company for the purpose of the indemnification provisions of the Company's Declaration of Trust, as amended, and Bylaws, subject, however, to the same limitations as though the Investment Manager were a director or officer of the Company. The Investment Manager shall not be liable to the Company, its shareholders or its creditors except for violations of law or for conduct which would preclude the Investment Manager from being indemnified under such provisions.

10. TERM OF THE AGREEMENT; TERMINATION

The term of this Agreement shall commence as of the first day of July 2002 and shall remain in effect and is renewable annually thereafter by the Company, if (a) a majority of the Independent Trust Managers determines that (i) the Investment Manager's performance has been satisfactory and (ii) the terms of this Agreement are appropriate with respect to the Company's performance and then existing economic conditions and (b) a majority of the independent directors of the Investment Manager approve the renewal of this Agreement.

Notwithstanding any other provision of this Agreement to the contrary, this Agreement, or any extension thereof, may be terminated by either party thereto upon at least sixty (60) days' notice to the other party specifying the effective date of such termination, pursuant to a majority vote of the Independent Trust Managers or upon the vote of the holders of more than two-thirds of the outstanding shares of the Company, or, in the case of a termination by the Investment Manager, by a majority vote of the independent directors of the Investment Manager.

In the event this Agreement is terminated or not renewed by (i) the Company, other than as a result of a material breach of the terms of this Agreement by the Investment Manager, or (ii) the Investment Manager as a result of a material breach of the terms of this Agreement by the Company, PMC Capital shall enter into a non-compete agreement, substantially in the form attached hereto as Exhibit B, which shall have a term of seven (7) years following the Termination Date (the "NON-COMPETE AGREEMENT"). The payment to be made by the Company to PMC Capital as consideration for the Non-Compete Agreement entered into as a result of in the occurrence of any event set forth in clause (i) or (ii) in the preceding sentence shall be an amount equal to the product of the Non-Compete Percentage (as hereinafter defined) multiplied by the Average Annual Value of All Invested Assets at Date of Termination, calculated and payable on an annual basis and prorated on the basis of a 360-day year for any portion of a calendar year during which the Non-Compete Agreement is in effect. In the event this Agreement is terminated or not renewed by (x) the Company as a result of a material breach of the terms of this Agreement by the Investment Manager or (y) the Investment Manager, other than as a result of a material breach of the terms of this Agreement by the Company, PMC Capital shall enter into the Non-Compete Agreement either on the terms and conditions provided herein and in Exhibit B hereto or, at the Company's option, such other terms as may be mutually agreeable to PMC Capital and the Company. The "Non-Compete Percentage" shall be equal to 1% less the amount of the percentage, determined by dividing the dollar

amount of loan losses on the Invested Assets at Date of Termination in any year (or portion thereof) during which the Non-Compete Agreement is in effect (as determined based on the audited financial statements of the Company for that year), by the Average Annual Value of All Invested Assets at Date of Termination for such year, in excess of 1%. In no event will the annual fee payable pursuant to the Non-Compete Agreement be reduced below zero. Notwithstanding anything contained in this Section 10 to the contrary, in the event that, following the Termination Date, the Company has foreclosed on an outstanding loan and has liquidated the collateral relating thereto and otherwise exhausted all remedies available to it to collect any remaining deficiency on such obligation, the Company shall, upon written request of the Investment Manager, transfer to the Investment Manager all files related to such loan. If the Investment Manager is successful in collecting any additional amount of the deficiency it may retain 1% of such additional amount and shall return the remainder to the Company.

11. ASSIGNMENT, AMENDMENTS AND WAIVERS

The Company may terminate this Agreement at any time in the event of its assignment by the Investment Manager except an assignment to a corporation, association, trust or other successor organization which may take over the property and carry on the affairs of the Investment Manager, provided that following such assignment the Persons who controlled the operations of the Investment Manager on the date such Investment Manager became an advisor to the Company shall control the operation of the successor organization, including the performance of its duties under this Agreement, and they shall be bound by the same restrictions by which they were bound prior to such assignment; however, if at any time subsequent to such an assignment such Persons shall cease to control the operations of the successor organization, the Company may thereupon terminate this Agreement. Such an assignment or any other assignment of this Agreement by the Investment Manager shall bind the assignee hereunder in the same manner as the Investment Manager is bound hereunder. This Agreement shall not be assignable by the Company without the prior written consent of the Investment Manager, except in the case of any assignment by the Company to a Person which is the successor to the Company, in which case such successor shall be bound hereby and by the terms of said assignment in the same manner and to the same extent as the Company is bound hereby. Any successor organization that is a permitted assignee under this Section 11, whether a successor to the Investment Manager or to the Company, shall be obligated to execute such agreements, certificates or other documents as the nonassigning party shall reasonably request to evidence that such successor organization is bound hereby.

This Agreement may not be amended, supplemented or discharged, and none of its provisions may be modified, except expressly by an instrument in writing signed by the party to be charged, provided that, in the case of the Company, such amendment, supplement, discharge or modification must be approved by a majority vote of the Independent Trust Managers or by a vote of the holders of more than two-thirds of the outstanding shares of the Company and, in the case of the Investment Manager, such amendment, supplement, discharge or modification must be approved by a majority vote of the independent directors of the Investment Manager. Any term or provision of this Agreement may be waived, but only in writing by the party which is entitled to the benefit of that provision. No waiver by any party of any default with respect to any provision, condition or requirement hereof shall be deemed to be a continuing waiver in the future thereof or a waiver of any other provision, condition or

requirement hereof; nor shall any delay or omission of any party to exercise any right hereunder in any manner impair the exercise of any such right accruing to it thereafter.

12. OTHER ACTIVITIES OF INVESTMENT MANAGER

Nothing herein shall prevent the Investment Manager or its Affiliates from engaging in other activities or businesses or from acting as advisor to any other Person (including other real estate investment trusts) or from managing other investments including those of investors or investments advised, sponsored or organized by the Investment Manager even though such Person has investment policies and objectives similar to those of the Company; provided, however, that the Investment Manager shall notify the Company in writing in the event that it does so act (or intends to so act) as an advisor to another real estate investment trust. The Investment Manager may also render such services to joint ventures and partnerships in which the Company is a co-venturer or partner and to the other entities in such joint ventures and partnerships. Except with respect to loan origination opportunities allocated pursuant to the Loan Origination Agreement, the Investment Manager shall be free from any obligation to present to the Company any particular investment opportunity which comes to the Investment Manager. In addition, nothing herein shall prevent any shareholder or Affiliate of the Investment Manager from engaging in any other business or from rendering services of any kind to any other corporation, partnership or other entity (including competitive business activities).

Directors, officers, employees and agents of the Investment Manager or of its Affiliates may serve as trust managers, officers, employees, agents, nominees or signatories of the Company. When executing documents or otherwise acting in such capacities for the Company, such persons shall use their respective titles in the Company. Such persons shall receive from the Company no compensation for their services to the Company in such capacities.

13. BANK ACCOUNTS

The Investment Manager shall establish and maintain one or more bank accounts in its own name or, at the direction of the trust managers, in the name of the Company, and shall collect and deposit into such account or accounts and disburse therefrom any monies on behalf of the Company, provided that no funds in any such account shall be commingled with any funds of the Investment Manager or any other Person. The Investment Manager shall from time to time render an appropriate accounting of such collections and payments to the trust managers and to the auditors of the Company.

14. PROTECTION OF INVESTMENTS

The Investment Manager shall use its efforts, in cooperation with the legal counsel to the Company, as deemed appropriate in the Investment Manager's reasonable discretion, (a) to verify title to or procure title insurance in respect of any property in which the Company makes or proposes

to make any investment; (b) to verify that any mortgage securing any Investment of the Company shall be a valid lien upon the mortgaged property according to its terms; that any insurance or guaranty issued by the Federal Housing Authority, the Veterans Administration or any similar agency of the United States or Canada, or any subdivision thereof, or any private mortgage insurance company, upon which the trust managers rely, is valid and in full force and effect and enforceable according to its terms; and that any commitments to provide permanent financing on property with respect to which the Company is furnishing interim loans are satisfactory; and (c) to carry on the policies from time to time specified by the trust managers with regard to the protection of the Company's Investments.

15. RECORDS

The Investment Manager shall maintain appropriate books of account and records relating to services performed pursuant hereto, which books of account and records shall be available for inspection by representatives of the Company upon reasonable notice during normal business hours.

16. REIT QUALIFICATION

Anything else in this Agreement to the contrary notwithstanding, the Investment Manager shall not take any action (including, without limitation, furnishing or rendering services to tenants of property or managing real property), which action, in its judgment made in good faith, or in the judgment of the trust managers as transmitted to the Investment Manager in writing, would (a) adversely affect the status of the Company as a real estate investment trust as defined and limited in the Code or which would make the Company subject to the Investment Company Act of 1940, as amended, if not in the best interest of the Company's shareholders or (b) violate any law, rule, regulation or statement of policy of any government body or agency having jurisdiction over the Company or over its securities, or (c) otherwise not be permitted by the Declaration of Trust, as amended, or Bylaws of the Company, except if such action shall be ordered by the trust managers, in which event the Investment Manager shall promptly notify the trust managers of the Investment Manager's judgment that such action or omission to act would adversely affect such status or violate any such law, rule or regulation or the Declaration of Trust, as amended, or Bylaws of the Company and shall refrain from taking such action pending further clarification or instructions from the trust managers. In addition, the Investment Manager shall take such affirmative steps which, in its good faith judgment, or in the judgment of the trust managers as transmitted to the Investment Manager in writing, would prevent or cure any action described in (a), (b) or (c) above.

17. SELF-DEALING

Neither the Investment Manager nor any Affiliate of the Investment Manager shall sell any property or assets to the Company or purchase any property or assets from the Company, directly or indirectly, except as approved by a majority of the Independent Trust Managers, provided that any Person wholly-owned (directly or indirectly) by the Company may sell property or assets to the Company or purchase assets from the Company without such approval. In addition, except as approved by a majority of the Independent Trust Managers, neither the Investment Manager nor any

Affiliate of the Investment Manager shall receive any commission or other remuneration, directly or indirectly, in connection with the activities of the Company (except as expressly provided herein) or any joint venture or partnership in which the Company is a party, unless such joint venture or partnership is wholly-owned (directly or indirectly) by the Company. Except for compensation received by the Investment Manager pursuant to Section 8 hereof, all commissions or other remuneration received by the Investment Manager or an Affiliate of the Investment Manager and not approved by the Independent Trust Managers under this Section 17 shall be reported to the Company annually within ninety (90) days following the end of the Company's fiscal year.

18. NO PARTNERSHIP OR JOINT VENTURE

The Company and the Investment Manager are not partners or joint venturers with each other and neither the terms of this Agreement nor the fact that the Company and the Investment Manager have joint interest in any one or more investments shall be construed so as to make them such partners or joint venturers or impose any liability as such on either of them.

19. FIDELITY BOND

The Investment Manager shall not be required to obtain or maintain a fidelity bond in connection with the performance of its services hereunder.

20. JURISDICTION

This Agreement shall be governed by the laws of Texas.

21. LIMITATION OF LIABILITY

The Declaration of Trust establishing the Company (the "DECLARATION"), a copy of which is duly filed with the County Clerk for Dallas County, Texas, provides that the name "PMC Commercial Trust" refers to the trust managers under the Declaration collectively as trust managers, but not individually or personally; and that no trust manager, officer, shareholder, employee or agent of the Company or its subsidiaries shall be held to any personal liability, jointly or severally, for any obligation of, or claim against, the Company or its subsidiaries. All persons dealing with the Company, in any way, shall look only to the assets of the Company for the payment of any sum or the performance of any obligations. Notwithstanding the foregoing, the Investment Manager hereby acknowledges and agrees that it shall look only to the assets of the Company for the payment of any sum or performance of any obligations due by or from the Company pursuant to the terms and provisions hereof. Furthermore, except as otherwise expressly provided herein, in no event shall the Company (original or successor) ever be liable to the Investment Manager for any indirect or consequential damages suffered by the Investment Manager from whatever cause.

22. SURVIVAL OF OBLIGATIONS

The obligations of the Company, PMC Capital and the Investment Manager set forth in Section 10 hereof shall survive any termination or non-renewal of this Agreement for a period of seven (7) years following the Termination Date.

IN WITNESS WHEREOF, the parties have executed this Agreement effective as of the date first above written.

PMC COMMERCIAL TRUST

By: /s/ Lance B. Rosemore

Lance B. Rosemore
President

PMC ASSET MANAGEMENT, INC.

By: /s/ Lance B. Rosemore

Lance B. Rosemore
President

PMC CAPITAL, INC.

By: /s/ Lance B. Rosemore

Lance B. Rosemore
President

LOAN ORIGINATION AGREEMENT

This Loan Origination Agreement dated as of July 1, 2003 (this "AGREEMENT") is made and entered into by and among PMC Commercial Trust, a Texas real estate investment trust (the "COMPANY"), PMC Asset Management, Inc., a Texas corporation (the "INVESTMENT MANAGER") and a wholly-owned subsidiary of PMC Advisers, Ltd. a Texas limited partnership ("PMC ADVISERS"), and PMC Capital, Inc., a Florida corporation ("PMC CAPITAL").

WHEREAS, management of PMC Capital believes that loan origination opportunities exist for loans that generally conform to the lending criteria and customer profile of PMC Capital's lending business, but that involve borrowers that exceed SBA eligibility requirements or that exceed the lending capacity of PMC Capital to fund; and

WHEREAS, the Company was organized as a result of the decision of the board of directors of PMC Capital that the amount of capital required to fund the types of investments contemplated by a Company is not available to PMC Capital without significant dilution to existing shareholders of PMC Capital or substantial leverage, if at all; and

WHEREAS, the board of directors of PMC Capital determined that the creation of the Company as a separate entity to originate such loans was appropriate; and

WHEREAS, the board of directors of PMC Capital also determined that the shareholders of PMC Capital would benefit by establishing the Investment Manager as an indirect wholly owned subsidiary of PMC Capital in order to more fully utilize the in-house staff and facilities of PMC Capital while providing the shareholders of PMC Capital the benefit of the advisory fees to be paid to the Investment Manager; and

WHEREAS, the Company, the Investment Manger and PMC Capital desire to define a system which will determine whether the Company or PMC Capital shall have the right to make any proposed loan, as such opportunities arise from time to time;

NOW, THEREFORE, in consideration of the mutual agreements and covenants herein contained, the parties hereto agree as follows:

SECTION 1. DEFINITIONS

Defined terms in this Agreement shall include in the singular number the plural and in the plural number the singular.

"Industry Concentration Limits" shall mean the limitations on loans made within a particular industry applicable to PMC Capital or its subsidiaries, which are a part of PMC Capital's fundamental policies enumerated in its SEC filing as such may be amended from time to time.

"SBA" shall mean the United States Small Business Administration.

"SBIC" shall have the meaning ascribed to such term in the Underwritten Offering.

"Underwritten Offering" shall mean the initial public offering of the Company pursuant to the Company's registration statement on Form S-11, number 33-65010 as filed with the Securities and Exchange Commission.

SECTION 2. DETERMINATION OF LOAN OPPORTUNITIES

The Company, the Investment Manager and PMC Capital hereby agree that upon completion of the Underwritten Offering, to the extent that the Company has funds available to make a proposed loan, no loans will be made by PMC Capital other than (i) loans in an original principal amount not exceeding \$1,333,000 made pursuant to the SBA Section 7(a) or SBIC loan programs utilized by PMC Capital's subsidiaries and (ii) bridge loans to be refinanced by SBA Section 7(a) or SBIC loans upon approval of the SBA loan application. The criteria to be used by the Investment Manager for determination of how loan origination opportunities are allocated between the Company and PMC Capital is further illustrated in the flowchart attached hereto as Annex A.

SECTION 3. MISCELLANEOUS

3.1 Governing Law; Submission to Jurisdiction. This Agreement and the rights and obligations of the parties hereunder shall be construed in accordance with and be governed by the laws of the State of Texas.

3.2 Waivers and Amendments. None of the terms or provisions of this Agreement may be waived, amended, supplemented or otherwise modified except by a written instrument executed by the Company, the Investment Manager and PMC Capital.

3.3 Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the Company, the Investment Manger and PMC Capital and any of their respective successors and assigns, except that no party may assign this Agreement without prior written consent of the other parties.

IN WITNESS HEREOF, each party hereto has caused its duly authorized officer to execute and deliver this Agreement as of the date first above written.

PMC COMMERCIAL TRUST

By: /s/ Lance B. Rosemore

Lance B. Rosemore
President

PMC ASSET MANAGEMENT, INC.

By: /s/ Lance B. Rosemore

Lance B. Rosemore
President

PMC CAPITAL, INC.

By: /s/ Lance B. Rosemore

Lance B. Rosemore
President

CERTIFICATION

I, Lance B. Rosemore, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of PMC Commercial Trust;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: 8/12/03

/s/ Lance B. Rosemore

Lance B. Rosemore
Chief Executive Officer

CERTIFICATION

I, Barry N. Berlin, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of PMC Commercial Trust;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: 8/12/03

/s/ Barry N. Berlin

Barry N. Berlin
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of PMC Commercial Trust (the "Company") on Form 10-Q for the period ended June 30, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Lance B. Rosemore, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Lance B. Rosemore
Lance B. Rosemore
Chief Executive Officer
August 12, 2003

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934.

A signed original of this statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of PMC Commercial Trust (the "Company") on Form 10-Q for the period ended June 30, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Barry N. Berlin, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Barry N. Berlin
Barry N. Berlin
Chief Financial Officer
August 12, 2003

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934.

A signed original of this statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.