

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2003

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

(State or other jurisdiction
of incorporation or organization)

75-6446078

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

17950 Preston Road, Suite 600, Dallas, TX 75252

(Address of principal executive offices)

(972) 349-3200

(Registrant's telephone number)

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

Common Shares of beneficial interest, \$.01 par value

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). YES NO

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Common Shares of Beneficial Interest on June 30, 2003 as reported on the American Stock Exchange, was approximately \$81 million. Common Shares of Beneficial Interest held by each officer and trust manager and by each person who owns 10% or more of the outstanding Common Shares of Beneficial Interest have been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 8, 2004, Registrant had outstanding 10,839,891 Common Shares of Beneficial Interest.

DOCUMENTS INCORPORATED BY REFERENCE:

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

PMC COMMERCIAL TRUST

Form 10-K

For the Year Ended December 31, 2003

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Forward-Looking Statements

This Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created thereby. These statements include the plans and objectives of management for future operations, including plans and objectives relating to future growth of our loans receivable and availability of funds. Such forward-looking statements can be identified by the use of forward-looking terminology such as “may,” “will,” “expect,” “intend,” “believe,” “anticipate,” “estimate,” or “continue,” or the negative thereof or other variations or similar words or phrases. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties identified in this Form 10-K, including, without limitation, the risks identified under the caption “Item 1. Business — Risk Factors.” Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Form 10-K will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

PART I

Item 1. BUSINESS

INTRODUCTION

PMC Commercial Trust (“PMC Commercial” and together with its wholly-owned subsidiaries, the “Company”, “our” or “we”) is a real estate investment trust (“REIT”) that primarily originates loans to small businesses collateralized by first liens on the real estate of the related business. In addition, our investments include the ownership of commercial properties in the hospitality industry. Our loans receivable are primarily to borrowers in the limited service hospitality industry. We also originate loans for commercial real estate primarily in the service, retail, multi-family and manufacturing industries.

We generate revenue from the yield earned on our investments, rental income from property ownership and other fee income from our lending activities. Our operations are centralized in Dallas, Texas and include originating, servicing and selling commercial loans. As of December 31, 2003 and 2002, our total assets were approximately \$132.3 million and \$149.7 million, respectively. During the years ended December 31, 2003 and 2002, our total revenues were approximately \$14.6 million and \$15.8 million, respectively and our net income was approximately \$8.2 million and \$9.9 million, respectively.

We seek to maximize shareholder value through long-term growth in dividends paid to our shareholders. As a REIT, we must distribute at least 90% of our REIT taxable income to shareholders. See “Tax Status.” We pay dividends from the funds generated from operations, commonly referred to as “FFO.” Our ability to maintain or increase our FFO is dependent on many factors. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations — Funds From Operations.”

In order to fund new loans or real estate investments, we need to issue new equity, borrow funds or sell loans. Since 1996, our primary source of funds has been structured loan transactions. See “Structured Loan Transactions.”

We operate in two reportable segments: (i) the lending division, which originates loans receivable to small businesses primarily in the hospitality industry and (ii) the property division, which owns hotel properties. See detailed financial information regarding our segments in “Item 8. Consolidated Financial Statements and Supplementary Data.”

MERGER WITH PMC CAPITAL, INC.

PMC Capital, Inc. (“PMC Capital”), our affiliate, was merged (the “Merger”) with and into PMC Commercial, with PMC Commercial continuing as the surviving entity, on February 29, 2004. Pursuant to the Merger, each issued and outstanding share of PMC Capital common stock was converted into 0.37 of a common share of PMC Commercial. As a result, we issued 4,385,800 common shares of beneficial interest on February 29,

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2004 valued at \$13.10 per share, which is the average closing price of our common stock for the three days preceding the date of the announcement, adjusted by declared but unpaid dividends. The Merger was accounted for under the purchase method of accounting as provided by Statement of Financial Accounting Standard ("SFAS") No. 141.

As of the date of the Merger, we own and operate the businesses of PMC Capital and its subsidiaries, along with our existing operations and businesses, under the name "PMC Commercial Trust." We expect that the larger equity market capitalization resulting from the Merger will help create new business flexibility and provide stability to cash flow ultimately adding to our cash available for distribution. As a result of our larger equity base, we believe that our ability to meet our liquidity needs will be enhanced through the possibility of increasing our credit facilities and developing alternative credit facilities such as a warehouse line of credit. A substantial part of PMC Capital's activities were undertaken by its wholly-owned subsidiaries: First Western SBLC, Inc. ("First Western"), PMC Investment Corporation ("PMCIC") and Western Financial Capital Corporation ("Western Financial"). Each of these subsidiaries is now wholly-owned by PMC Commercial.

Unless otherwise stated, all information contained herein represents historical data of PMC Commercial prior to completion of the Merger. For pro forma information, see our Current Report on Form 8-K filed with the Securities and Exchange Commission on March 15, 2004.

LENDING ACTIVITIES

Overview

We are a national lender that focuses our lending activities on businesses in the southeast and southwest regions of the United States. We primarily originate small business loans in the limited service sector of the hospitality industry. With the addition of the lending operations of PMC Capital, we expect to increase our loan originations to the convenience store and gas station, restaurant, service, retail and commercial real estate industries. In addition to first liens on real estate of the related business, our loans receivable are generally personally guaranteed by the principals of the entities obligated on the loans receivable.

We identify loan origination opportunities through personal contacts, internet referrals, attendance at trade shows and meetings, correspondence with local chambers of commerce, direct mailings, advertisements in trade publications and other marketing methods. In addition, we have generated most of our loans through referrals from lawyers, accountants, real estate and loan brokers and existing borrowers. In some instances, we may make payments to non-affiliated individuals who assist in generating loan applications, with such payments generally not exceeding 1% of the principal amount of the originated loan.

Limited Service Hospitality Industry

Our loans in the hospitality industry are generally collateralized by first liens on limited service hospitality properties and are generally made to owner-operated facilities operating under national franchises. We believe that franchise operations offer attractive lending opportunities because such businesses generally employ proven business concepts, have national reservation systems, have consistent product quality, are screened and monitored by franchisors and generally have a higher rate of success when compared to other independently operated hospitality businesses.

Most of our loans are to borrowers operating properties in the limited service sector of the hospitality industry. The limited service sector of the hospitality industry, as a subset of the hospitality industry, does not always react to economic conditions in the same manner as the rest of the hospitality industry. For example, while all sectors of the hospitality industry experienced reductions in occupancy and room rates in 2001 and 2002, the limited service sector of the hospitality industry was not as negatively impacted and, as a consequence, the rebound in the hospitality industry in occupancy and room rates during 2003 primarily affected sectors other than the limited service hotels. Economic conditions that impact the limited service sector of the hospitality industry and, to a lesser degree, the hospitality industry in general, have a significant impact on our loans collateralized by, and investments in, hospitality properties, and our future lending operations.

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. As seen in the past, when gas prices sharply increase, occupancy rates decrease for properties located on interstate highways.

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While occupancy increased slightly for the overall hospitality industry, average room rates showed a slight decline in 2003 based on published industry statistics. The industry's net operating income has been in a downcycle, having been affected by travel warnings and increased travel time due to improved security measures as well as internet bookings which have all negatively impacted revenues. We anticipate that lodging demand will increase in 2004 as the lodging industry follows the economy. Improving economic trends in the lodging industry will generate an increase in competition among lenders, especially those lenders offering alternatives such as fixed rate and "mini-perm" loans.

Loan Originations and Underwriting

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

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

- The components and value of the borrower's collateral (primarily real estate);
- The ease with which the collateral can be liquidated;
- The industry and competitive environment in which the borrower operates;
- The financial strength of the guarantors;
- The existence of any secondary repayment sources; and
- The existence of a franchise relationship.

Upon receipt of a completed loan application, our credit department conducts: (i) a detailed analysis of the loan, which typically includes an appraisal and a valuation by the credit department of the property that will collateralize the loan to assure compliance with loan-to-value percentages, (ii) a site inspection for real estate collateralized loans, (iii) a review of the borrower's business experience, (iv) a review of the borrower's credit history, and (v) an analysis of the borrower's debt-service-coverage and debt-to-equity ratios. All appraisals must be performed by an approved, licensed third party appraiser and based on the market value, replacement cost and cash flow value approaches. We generally utilize nationwide independent appraisal firms and seek local market economic information to the extent available.

Our typical loan is distinguished from those of some of our competitors by the following characteristics:

- *Substantial down payments are required.* We usually require an initial down payment of not less than 20% of the value of the property which is collateral for the loan at the time of such loan. Our experience has shown that the likelihood of full repayment of a loan increases if the owner/operator is required to make an initial and substantial financial commitment to the property which is collateral for the loan.
- *"Cash outs" are typically not permitted.* Generally, we will not make a loan in an amount greater than either the cost of the property which is collateral for the loan or the current appraised value of the property which is collateral for the loan. For example, a hotel property may have been originally constructed for a cost of \$2,000,000, with the owner/operator borrowing \$1,600,000 of that amount. At the time of the borrower's loan refinancing request, the property securing the loan is appraised at \$4,000,000. Some of our competitors might loan from 70% to 90% or more of the new appraised value of the property and permit the owner/operator to receive a cash distribution from the proceeds. Generally, we would not permit this type of "cash-out" distribution.
- *The obligor is personally liable for the loan.* We generally require the principals of the borrower to guarantee the loan.

We are currently originating primarily variable-rate loans. Most of our variable-rate loans are based on LIBOR. While we have originated fixed-rate loans, we do not expect to originate a significant amount of additional fixed-rate loans unless market conditions change. We completed a structured loan sale transaction of \$45.4 million of variable-rate loans on October 7, 2003 which caused our percentage of variable-rate loans receivable to decrease from December 31, 2002 to December 31, 2003. At December 31, 2003, our variable-rate and fixed-rate loans receivable were \$21.2 million (41%) and \$30.3 million (59%) of our loans receivable, respectively. Our variable-rate loans receivable generally require payments of principal and interest, reset on a quarterly basis, to amortize the

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principal over ten to 20 years. Fixed-rate loans receivable generally require level payments of principal and interest calculated to amortize the principal over ten to 25 years.

Loan Activity

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

	Years Ended December 31,				
	2003	2002	2001	2000	1999
			(In thousands)		
Loans receivable, net — beginning of year	\$ 71,992	\$ 78,486	\$ 65,645	\$ 115,265	\$ 119,712
Loans originated	31,320	32,776	51,683	22,508	17,478
Principal collections (1)	(5,655)	(11,637)	(4,965)	(15,135)	(19,650)
Repayments of SBA 504 program loans	(1,963)	(631)	(970)	(973)	(2,542)
Loan transferred to AAL (2)	—	—	—	(1,181)	—
Structured loan sales (3)	(45,456)	(27,286)	(32,662)	(55,675)	—
Other adjustments (4)	346	284	(245)	836	267
Loans receivable, net — end of year	\$ 50,584	\$ 71,992	\$ 78,486	\$ 65,645	\$ 115,265

(1) Includes scheduled principal payments and prepayments.

(2) A loan receivable on which the collateral was foreclosed upon and the asset was classified as an asset acquired in liquidation ("AAL").

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

(4) Includes the change in loan loss reserves and deferred commitment fees.

Quarterly Loan Originations

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

	Years Ended December 31,				
	2003	2002	2001	2000	1999
			(In thousands)		
First Quarter	\$ 9,009	\$ 6,346	\$ 9,761	\$ 301	\$ 7,061
Second Quarter	12,103	6,506	22,567	3,924	3,576
Third Quarter	5,557	10,044	10,097	7,340	3,808
Fourth Quarter	4,651	9,880	9,258	10,943	3,033
Total	\$ 31,320	\$ 32,776	\$ 51,683	\$ 22,508	\$ 17,478

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Information on our loans receivable, loans which have been sold and on which we have retained interests (the “Sold Loans”) and our loans receivable combined with our Sold Loans (the “Aggregate Portfolio”) was as follows:

	December 31, 2003			December 31, 2002		
	Aggregate Portfolio	Sold Loans	Loans Receivable(1)	Aggregate Portfolio	Sold Loans	Loans Receivable(1)
	(Dollars in thousands)					
Portfolio outstanding	\$ 197,487	\$ 146,001	\$ 51,486	\$ 178,567	\$ 105,751	\$ 72,816
Weighted average interest rate	8.2%	8.2%	8.1%	8.7%	9.6%	7.5%
Annualized average yield (2) (3)	8.4%	9.2%	7.2%	10.0%	9.8%	10.3%
Weighted average contractual maturity (in years)	15.2	16.2	12.4	15.4	16.2	14.2
Delinquent and impaired loans (3)	\$ 3,105	\$ 1,357	\$ 1,748	\$ 1,756	\$ —	\$ 1,756
Lodging industry concentration %	96.6%	95.4%	100.0%	94.8%	93.4%	99.7%
Texas concentration % (4)	19.8%	22.5%	12.1%	23.0%	20.7%	26.5%

- (1) Portfolio outstanding before reserves and deferred commitment fees. Includes the principal balance remaining on underlying loans receivable in our 1998 structured loan financing transaction of \$26.0 million and \$30.7 million at December 31, 2003 and 2002, respectively.
- (2) The calculation of annualized average yield divides our interest income, loan fees and prepayment fees earned, less the provision for loan losses, by the average outstanding portfolio.
- (3) Includes loans receivable which are either past due greater than 60 days or the collection of the balance of principal and interest is considered impaired and a loan loss reserve has been established (“Impaired Loans”). The balance does not include the principal balance of loans which have been identified as potential problem loans for which it is expected that a full recovery of the principal balance will be received through either collection efforts or liquidation of collateral (“Special Mention Loans”).
- (4) We also had a concentration of 10.1% of Sold Loans in Arizona, a concentration of 14.6% of Loans Receivable in Virginia and a concentration of 10.8% of Loans Receivable in Florida. No other concentrations greater than 10% existed at December 31, 2003.

Small Business Administration (“SBA”) Programs**Section 504**

We participate as a private lender in the SBA 504 Program. Participation in the SBA 504 Program offers us an opportunity to enhance the collateral status of loans receivable by allowing us to originate loans with lower loan-to-value ratios. The SBA 504 Program assists small businesses in obtaining subordinated, long-term financing by guaranteeing debentures available through certified development companies for the purpose of acquiring land, building, machinery and equipment and for modernizing, renovating or restoring existing facilities and sites. A typical finance structure for an SBA 504 Program project would include a first mortgage covering 50% of the project cost from a private lender, a second mortgage obtained through the SBA 504 Program covering up to 40% of the project cost and a contribution of at least 10% of the project cost by the principals of the small businesses being assisted. We typically require at least 20% of the equity in a project to be contributed by the principals of the borrower. The SBA does not guarantee the first mortgage. Although the total sizes of projects utilizing the SBA 504 Program guarantees are unlimited, the maximum amount of subordinated debt in any individual project generally is \$750,000 (or \$1 million for certain projects). Typical project costs range in size from \$500,000 to \$3 million.

General

The businesses acquired from PMC Capital include several licenses from the SBA. First Western is a licensed small business lending company (“SBLC”) that originates loans through the SBA’s 7(a) Guaranteed Loan Program (“SBA 7(a) Loan Program”). PMCIC is a licensed specialized small business investment company (“SSBIC”) under the Small Business Investment Act of 1958, as amended (“SBIA”). PMCIC uses long-term funds provided by the SBA, together with its own capital, to provide long-term collateralized loans to eligible small

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businesses owned by “disadvantaged” persons, as defined under SBA regulations. Western Financial is a licensed small business investment company (“SBIC”) under the SBIA that provides loans to borrowers whether or not they qualify as “disadvantaged.”

SBICs are intended to stimulate the flow of private equity capital to eligible small businesses. Under present SBA regulations, eligible small businesses include businesses that have a net worth not exceeding \$18 million and have average annual fully taxed net income not exceeding \$6 million for the most recent two fiscal years. According to SBA regulations, SBICs may make long-term loans to small businesses, invest in the equity securities of such businesses, and provide them with consulting and advisory services.

First Western, PMCIC and Western Financial are periodically examined and audited by the SBA to determine compliance with SBA regulations.

SBA 7(a) Loan Program

First Western is licensed to operate as an SBLC. The SBA guarantees 75% of qualified loans over \$150,000 with such individual guarantees not exceeding \$1.0 million. While the eligibility requirements of the SBA 7(a) Loan Program vary by the industry of the borrower and other factors, the general eligibility requirements are that: (i) gross sales of the borrower cannot presently exceed \$6 million, (ii) liquid assets or real estate equity of the borrower and affiliates cannot exceed specified limits, and (iii) the maximum aggregate SBA loan guarantees to a borrower cannot exceed \$1.0 million. Maximum maturities for SBA 7(a) loans are 25 years for real estate and 15 years for the purchase of machinery and equipment. In order to operate as an SBLC, a licensee is required to maintain a minimum net worth (as defined by SBA regulations) of the greater of (i) 10% of the outstanding loans receivable of First Western or (ii) \$1.0 million, as well as certain other regulatory restrictions such as change in control provisions. Effective January 14, 2004, the SBA temporarily changed its policy on origination of loans under the SBA 7(a) Loan Program to limit the maximum amount of a loan to \$750,000 (the “Loan Cap”) for the year ending September 30, 2004 until further notice. The Loan Cap may be amended or discontinued at any time.

PROPERTY OWNERSHIP

At December 31, 2003, we owned 21 limited service hospitality properties (our “Hotel Properties”) that we purchased in 1998 and 1999 through a sale/leaseback agreement with Arlington Hospitality, Inc. (“Arlington”). Arlington, through its wholly-owned subsidiary, is the operator of our properties through a master lease agreement that provides for base rent (currently \$5.3 million per year) and percentage rent of 4% of the gross room revenues generated by the Hotel Properties. The lease agreement runs through June 2008 with two renewal options of five years each and a third option for two years. The first renewal is either at our or Arlington’s option. The second five year renewal and the two year renewal are solely at Arlington’s option. Each renewal requires extension of all of the then owned Hotel Properties. The base rent is adjusted to increase annually based on the consumer price index up to a maximum increase of 2% per year. Arlington operates our Hotel Properties as “Amerihost Inns” which is a brand name franchised by Cendant Corporation, the largest franchisor of leasehold properties.

During the three years ended December 31, 2003, we sold eight hotel properties for \$20.4 million resulting in net gains totaling \$2.3 million. Six of these property sales were completed as a result of an agreement we entered into with Arlington to sell up to eight properties to Arlington prior to June 2004. To the extent the remaining two purchases by Arlington are not completed in the agreed upon time frame, the lease agreement provides for rent increases on all of our remaining Hotel Properties. We may continue to evaluate additional Hotel Property sales.

STRUCTURED LOAN TRANSACTIONS

General

Structured loan sale transactions are our primary method of obtaining funds for new loan originations. In a structured loan sale transaction, we contribute loans receivable to a special purpose entity (“SPE”) in exchange for an ownership interest in that entity and obtains an opinion of counsel that the contribution of the loans receivable to the SPE constitutes a “true sale” of the loans receivable. The SPE issues notes payable (usually through a private placement) to third parties and then distributes a portion of the notes payable proceeds to us. The notes payable are collateralized solely by the assets of the SPE. The terms of the notes payable issued by the SPEs provide that the owners of these SPEs are not liable for any payment on the notes. Accordingly, if the SPEs fail to pay the principal or interest due on the notes, the sole recourse of the holders of the notes is against the assets of the SPEs. We have no obligation to pay the notes, nor do the holders of the notes have any recourse against our assets.

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We account for structured loan sale transactions as sales of our loans receivable and the SPE meets the definition of a qualifying SPE; as a result, neither the loans receivable contributed to the SPE nor the notes payable issued by the SPE are included in our consolidated financial statements. When a structured loan sale transaction is completed: (1) our ownership interests in the SPEs are accounted for as retained interests in transferred assets (“Retained Interests”) and are recorded at the present value of the estimated future cash flows to be received from the SPE and (2) 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, constitutes the gain or loss on sale. Gains or losses on these sales may represent a material portion of our net income in the period in which the transactions occur.

A structured loan financing is similar to a structured loan sale, with the exception that the transaction is not treated as a sale for financial reporting purposes. Therefore, the loans receivable contributed to the SPE and the notes payable issued by the SPE are included in our consolidated financial statements and as a result, the ownership interest in the SPE is not accounted for as a retained interest. Even though the loans receivable and the notes payable are included on our balance sheets from the structured loan financing transaction completed in 1998, we have no obligation to pay the notes, nor do the holders of the notes have any recourse against our assets. The terms of the notes payable issued by the SPE provide that we are not liable for payment on the notes. Accordingly, even though the loans receivable and the notes payable of the SPE are included in our consolidated financial statements, if the SPE fails to pay the principal or interest on the notes, the sole recourse of the holders of the notes is against the loans receivable and any other assets of the SPE.

Our structured loan sale transactions and structured loan financing transactions receive opinions from outside counsel that opine to the legal sale of the loans from PMC Commercial to the SPE formed in connection with the securitization. Each of our completed securitization transactions (both structured loan sale transactions and structured loan financing transactions) provides a clean-up call. A clean-up call is an option which allows the repurchase of the transferred assets when the amount of the outstanding assets falls to a level at which the cost of servicing those assets becomes burdensome. The clean-up call option regarding a loan in an SPE is exercised by the party that contributed the loan to the SPE. As a result of the characteristics underlying the loans receivable not satisfying the requirements of off balance sheet accounting treatment, the 1998 securitization was considered a structured loan financing transaction. We are the servicer of the loans pursuant to the transaction documents and are paid a fee equal to 30 basis points of the principal outstanding per year.

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

Joint Structured Loan Sale Transactions — General

In connection with our structured loan sale transactions, joint ventures were formed as SPEs to hold the loans receivable sold and issue notes payable collateralized by the loans receivable.

As of December 31, 2003, our SPEs consisted of:

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

Each of the Joint Ventures is a partnership between PMC Commercial and PMC Capital. Subsequent to the Merger, we directly or indirectly own 100% of the Joint Ventures.

On October 7, 2003, we completed a structured loan sale transaction of a pool of variable-rate loans receivable. PMC Commercial and PMC Capital contributed loans receivable of \$45.4 million and \$57.8 million, respectively, to the 2003 Joint Venture. The 2003 Joint Venture issued, through a private placement, approximately \$92.9 million of its 2003 Loan-Backed Floating Rate Notes (the “2003 L.P. Notes”) of which approximately \$40.9 million (the “2003 PMCT L.P. Notes”) was allocated to us based on our ownership percentage in the 2003 Joint Venture. The 2003 L.P. Notes, issued at par, have a stated maturity in 2023, bear interest, reset on a quarterly basis,

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at the 90-day LIBOR plus 1.25%, and are collateralized by the loans receivable contributed by us and PMC Capital to the 2003 Joint Venture. We accounted for this transaction as a sale, recorded a gain of \$711,000 and recorded our Retained Interests at an initial amount of \$8,698,000 during 2003. At inception of the 2003 Joint Venture, we owned a 44% limited partnership interest based on our share of the capital.

On April 12, 2002, we completed a structured loan sale transaction of a pool of primarily fixed-rate loans receivable. PMC Commercial and PMC Capital contributed loans receivable of \$27.3 million and \$43.2 million, respectively, to the 2002 Joint Venture. The 2002 Joint Venture issued, through a private placement, approximately \$63.5 million of its 2002 Loan-Backed Fixed Rate Notes (the "2002 L.P. Notes") of which approximately \$24.6 million (the "2002 PMCT L.P. Notes") was allocated to us based on our ownership percentage in the 2002 Joint Venture. The 2002 L.P. Notes, issued at par, have a stated maturity in 2023, bear interest at 6.67% and are collateralized by the loans receivable contributed by us and PMC Capital to the 2002 Joint Venture. We accounted for this transaction as a sale, recorded a gain of \$562,000 and recorded our Retained Interests at an initial amount of \$5,293,000 during 2002. At inception of the 2002 Joint Venture, we owned a 39% limited partnership interest based on our share of the capital.

On June 27, 2001, we completed a structured loan sale transaction of a pool of fixed-rate loans receivable. PMC Commercial and PMC Capital contributed loans receivable of \$32.7 million and \$49.2 million, respectively, to the 2001 Joint Venture. The 2001 Joint Venture issued, through a private placement, approximately \$75.4 million of its 2001 Loan-Backed Fixed Rate Notes (the "2001 L.P. Notes") of which approximately \$30.1 million (the "2001 PMCT L.P. Notes") was allocated to us based on our ownership percentage in the 2001 Joint Venture. The 2001 L.P. Notes, issued at par, have a stated maturity in 2021, bear interest at 6.36% and are collateralized by the loans receivable contributed by us and PMC Capital to the 2001 Joint Venture. We accounted for this transaction as a sale, recorded a gain of \$1,433,000 and recorded our Retained Interests at an initial amount of \$5,871,000 during 2001. At inception of the 2001 Joint Venture, we owned a 40% limited partnership interest based on our share of the capital.

On December 18, 2000, we completed our first structured loan sale transaction with PMC Capital. We completed the structured loan sale of a pool of fixed-rate loans receivable. PMC Commercial and PMC Capital contributed loans receivable of \$55.7 million and \$28.0 million, respectively, to the 2000 Joint Venture. The 2000 Joint Venture issued, through a private placement, approximately \$74.5 million of its 2000 Loan-Backed Fixed Rate Notes (the "2000 L.P. Notes") of which approximately \$49.6 million (the "2000 PMCT L.P. Notes") was allocated to PMC Commercial based on our ownership percentage in the 2000 Joint Venture. The 2000 L.P. Notes, issued at par, have a stated maturity in 2024, bear interest at 7.28% and are collateralized by the loans receivable contributed by us and PMC Capital to the 2000 Joint Venture. We accounted for this transaction as a sale, recorded a gain of \$1,117,000 and recorded our Retained Interests at an initial amount of \$11,174,000 during 2000. At inception of the 2000 Joint Venture, we owned a 66% limited partnership interest based on our share of the capital.

The terms of the 2003 L.P. Notes, the 2002 L.P. Notes, the 2001 L.P. Notes and the 2000 L.P. Notes (the "JV Notes") provide that each of the partners of the respective Joint Ventures is not liable for any payments on the JV Notes. Accordingly, if the Joint Ventures fail to pay the JV Notes, the sole recourse of the holders of the JV Notes is against the assets of the respective Joint Venture. Accordingly, we have no obligation to pay the JV Notes, nor do the holders of the JV Notes have any recourse against our assets.

PMC Commercial owned approximately 68%, 42%, 39% and 44%, respectively, of the 2000 Joint Venture, the 2001 Joint Venture, the 2002 Joint Venture and the 2003 Joint Venture at December 31, 2003, with the remainder owned by PMC Capital. Our ownership of the Joint Ventures was based on our share of the capital of the respective Joint Ventures. Our share of the cash flows from the Joint Ventures was 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.

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Information relating to our structured loan sale transactions was as follows:

	As of December 31, 2003			
	2000 Joint Venture	2001 Joint Venture	2002 Joint Venture	2003 Joint Venture
	<i>(Dollars in thousands)</i>			
Principal amount of loans sold:				
At time of sale	\$ 55,675	\$ 32,662	\$ 27,286	\$ 45,456
At December 31, 2003	\$ 47,111	\$ 28,039	\$ 26,152	\$ 44,699
Structured notes:				
At time of sale	\$ 49,550	\$ 30,063	\$ 24,557	\$ 40,910
At December 31, 2003	\$ 41,707	\$ 25,486	\$ 23,510	\$ 40,310
Weighted average interest rate on loans (1):				
At time of sale	9.63%	9.62%	9.23%	L+4.02%
At December 31, 2003	9.62%	9.59%	9.17%	L+4.02%
Required overcollateralization (3)				
At time of sale	11.0%	8.0%	10.0%	10.0%
At December 31, 2003	11.8%	9.3%	10.4%	10.2%
Interest rate on the SPE notes payable (1)	7.28%	6.36%	6.67%	L+1.25%
Rating of structured notes (4)	"Aaa"	"Aaa"	"Aaa"	"Aaa"
Cash reserve requirement	6.0%	6.0%	6.0%	6.0%

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

(2) The required initial overcollateralization percentage represents the portion of our sold loans receivable retained by the SPEs whose value is included in Retained Interests.

(3) The required overcollateralization percentage at December 31, 2003 was larger than the required overcollateralization percentage at time of sale since all principal payments received on the underlying loans receivable are paid to the noteholders.

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

Retained Interests

Our Retained Interests consist of (i) the required overcollateralization, which is the retention of a portion of each of the sold loans, (ii) the reserve fund, which is required cash balances owned by the SPE and (iii) the interest-only strip receivable, which is the future excess funds to be generated by the SPE after payment of all obligations of the SPE. The Retained Interests are our residual interest in the loans sold by PMC Commercial to the SPE. When we securitize loans receivable, we are required to recognize Retained Interests, which represents our right to receive net future cash flows, at their fair value. Retained Interests are subject to credit, prepayment and interest rate risks. Retained Interests are materially more susceptible to these risks than the notes issued by the SPE. The value of our Retained Interests is determined based on the present value of estimated future cash flows that we will receive from the SPEs. The estimated future cash flows are calculated based on assumptions concerning, among other things, loan losses and prepayment speeds. On a quarterly basis, we measure the fair value of, and record income relating to, the Retained Interests based upon the future anticipated cash flows discounted based on an estimate of market interest rates for investments of this type. Any appreciation of the Retained Interests is included in our balance sheet in beneficiaries' equity. Any depreciation of Retained Interests is either included in our statement of income as either a realized loss (if there is a reduction in expected future cash flows) or on the balance sheet in beneficiaries' equity as an unrealized loss.

We retain a portion of the default and prepayment risk associated with the underlying transferred loans receivable of our Retained Interests. Actual defaults and prepayments, with respect to estimating future cash flows for purposes of valuing our Retained Interests will vary from assumptions, possibly to a material degree, and slower (faster) than anticipated prepayments of principal or lower (higher) than anticipated loan losses will increase (decrease) the fair value of our Retained Interests and related cash flows. See "Risk Factors — There is volatility in the valuation of our Retained Interests." We regularly measure our loan loss, prepayment and other assumptions against the actual performance of the loans receivable sold. Although we believe that assumptions made as to the future cash flows are reasonable, actual rates of loss or prepayments will vary from those assumed and the assumptions may be revised based upon changes in facts or circumstances.

TAX STATUS

We have elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the “Code”). As a REIT, we generally are not subject to Federal income tax (including any applicable alternative minimum tax) to the extent that we distribute at least 90% of our REIT taxable income to shareholders. We may, however, be subject to certain Federal excise taxes and state and local taxes on our income and property. REITs are subject to a number of organizational and operational requirements under the Code.

Subsequent to the Merger, First Western and PMCIC have elected to be treated as taxable REIT subsidiaries, and will cease to be pass-through entities for tax purposes. As a result, First Western and PMCIC earnings will be subject to U.S. Federal income tax.

RISK FACTORS

Management has identified the following important factors that could cause actual results to differ materially from those reflected in forward-looking statements or from our historical results. These factors, which are not all-inclusive, could have a material impact on our asset valuations, results of operations or financial condition. In addition, these factors could impair our ability to maintain dividend distributions at current levels. These factors include those related to both PMC Commercial and PMC Capital.

We have a concentration of investments in the hospitality industry and in certain states, which may negatively impact the market price of our shares.

Substantially all of our revenue is generated from lending to, and leasing of, hospitality properties. Our loans receivable were 100% concentrated in the hospitality industry at December 31, 2003 (91% on a combined basis with PMC Capital). In addition, approximately 95% (93% on a combined basis with PMC Capital) of the loans receivable underlying our Retained Interests were concentrated in the hospitality industry as of December 31, 2003. Any economic factors that negatively impact the hospitality industry, including terrorism, bankruptcies or other political events, could have a material adverse effect on our financial condition and results of operations.

At December 31, 2003, approximately 12% of our loans receivable were collateralized by properties in Texas, 15% were collateralized by loans in Virginia and 11% were collateralized by loans in Florida. On a combined basis with PMC Capital, approximately 19% of combined loans receivable were collateralized by properties in Texas. No other state had a concentration of 10% or greater of our loans receivable or of our combined loans receivable with PMC Capital at December 31, 2003.

In addition, approximately 23% and 10% of the loans receivable underlying our Retained Interests are concentrated in Texas and Arizona, respectively. On a combined basis with PMC Capital, approximately 27% of the loans receivable underlying the combined retained interests in transferred assets are concentrated in Texas.

A decline in economic conditions in any state in which we have a concentration of investments could have a material adverse effect on our financial condition and results of operations.

We are dependent 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 under a master lease agreement. The operating results of our Hotel Properties are subject to a variety of risks which could affect Arlington’s 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 can be 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 the guarantee of the parent of Arlington. In addition, in the event Arlington defaults, we would incur costs including holding costs, legal fees and costs to re-franchise the properties.

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

We will continue to need capital to fund loans. Our ability to continue to grow depends, to a large extent, on our ability to sell our asset-backed securities through structured loan transactions. In certain economic markets the availability of funds may be diminished or the “spread” charged for funds may increase causing us to delay a structured loan transaction. Terrorist attacks or political events could impact the availability and cost of our capital.

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Due to the economic and interest environments, we may experience difficulties in selling our variable-rate loans receivable at an acceptable “spread.” A number of factors could impair our ability, or alter our decision, to complete a structured loan transaction. These factors include, but are not limited to:

- As a result of certain economic conditions, investors in the type of asset-backed securities that we place may increase our cost of capital by widening the “spreads” they require in order to purchase the asset-backed securities or cease acquiring our type of asset-backed security;
- A deterioration in the performance of our loans receivable 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;
- 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 transactions to receive lower ratings than previously issued thereby increasing the cost of capital on our transactions.

Significant changes in any of these criteria may result in us temporarily suspending our structured loan sale program and we may seek other sources of financing.

A reduction in the availability or an increased cost of this source of funds could have a material adverse effect on our financial condition and results of operations since working capital may not be available or available at acceptable “spreads” to fund our current commitments, future loan originations or to acquire real estate.

The intended benefits of the Merger may not be realized, which could have a negative impact on the market price of our common shares after completion of the Merger.

No assurance can be given that anticipated expense reductions or other operating synergies will be realized following the Merger or that unanticipated costs will not arise as a result of the Merger. For example, future operating expenses, such as increased personnel costs, professional fees or credit facility costs, could be higher than anticipated which could have a material adverse effect on our results of operations and financial condition. In addition, the U.S. Federal income taxes incurred following the Merger could be higher than anticipated. If the expected savings are not realized or unexpected costs are incurred, the Merger could have a significant dilutive effect on our per share operating results.

In addition, completion of the Merger poses risks for the ongoing operations of the combined company, including the fact that our portfolio may not perform as well as anticipated due to various factors, including the financial condition of significant borrowers or tenants and changes in macro-economic conditions.

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

Several factors may impact the ability of our borrowers to meet their contractual payment obligations or the Hotel Properties to generate sufficient cash flow to support their monthly lease payments. During economic downturns, there may be reductions in business travel and consumers generally take fewer vacations. 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. As seen in the past, when gas prices sharply increase, occupancy rates for properties located on interstate highways decrease. These factors may cause a reduction in revenue per available room (“RevPAR”). If RevPAR for the limited service sector of the hospitality industry were to experience significant sustained reductions, the ability of our borrowers to meet their obligations could be impaired and loan losses could increase and the ability of the operator of our properties, Arlington, to meet its obligations could be impaired.

Economic recessions or downturns could impair our borrowers and harm our operating results. Many of the companies in which we have made or will make loans may be susceptible to economic slowdowns or recessions. Terrorism, bankruptcies or other political events could affect our borrowers. Our non-performing assets are likely to increase during these periods. These conditions could lead to losses in our portfolio and a decrease in our interest income, net income and assets.

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

There is volatility in the valuation of our Retained Interests.

Due to the limited number of entities that conduct transactions with similar assets, the relatively small size of our Retained Interests and the limited number of buyers for such assets, no readily ascertainable market exists for our Retained Interests. Therefore, our determination of the fair value may vary significantly from what a willing buyer would pay for these assets. If we were forced to immediately liquidate some or all of our Retained Interests, the proceeds of such liquidation may be significantly less than the current value of such Retained Interests.

The value of our Retained Interests is determined based on certain assumptions including, but not limited to, anticipated defaults, prepayment speeds and discount rates. We retain a portion of the default and prepayment risk associated with the underlying transferred loans receivable of our Retained Interests. As more fully described below, actual defaults and prepayments with respect to estimating future cash flows for purposes of valuing the Retained Interests may vary from assumptions, possibly to a material degree, and slower (faster) than anticipated prepayments of principal or lower (higher) than anticipated loan losses will increase (decrease) the fair value of our Retained Interests and the related estimated cash flows. The discount rates utilized are determined for each of the assets comprising the Retained Interests based upon an estimate of the inherent risks associated with each asset.

The following is a sensitivity analysis of our Retained Interests as of December 31, 2003 to highlight the volatility that results when prepayments, loan losses and discount rates are different than our assumptions:

Changed Assumption	Value	Asset Change
	(In thousands)	
Losses increase by 50 basis points per annum (1)	\$ 28,632	\$ (2,166)
Losses increase by 100 basis points per annum (1)	\$ 26,547	\$ (4,251)
Rate of prepayment increases by 5% per annum (2)	\$ 29,736	\$ (1,062)
Rate of prepayment increases by 10% per annum (2)	\$ 29,092	\$ (1,706)
Discount rates increase by 100 basis points	\$ 29,446	\$ (1,352)
Discount rates increase by 200 basis points	\$ 28,181	\$ (2,617)

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

(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.

The following sensitivity analysis of the combined retained interests in transferred assets with PMC Capital as of December 31, 2003 highlights the volatility that results when prepayments, losses and discount rates are different than our assumptions:

Changed Assumption	Value	Asset Change
	(In thousands)	
Losses increase by 50 basis points per annum (1)	\$ 70,842	\$ (4,874)
Losses increase by 100 basis points per annum (1)	\$ 66,143	\$ (9,573)
Rate of prepayments increases by 5% per annum (2)	\$ 73,592	\$ (2,124)
Rate of prepayments increases by 10% per annum (2)	\$ 72,169	\$ (3,547)
Discount rates increase by 100 basis points	\$ 72,577	\$ (3,139)
Discount rates increase by 200 basis points	\$ 69,639	\$ (6,077)

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

(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.

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

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

We are leveraged.

We have borrowed funds and intend to obtain additional funds through advances under our revolving credit facility, issuance of mortgage notes payable and/or issuance of notes payable or SBA debentures, if available. As a result, we use leverage to fund our capital needs. Private lenders and, subsequent to the Merger, the SBA have fixed dollar claims on our assets superior to the claims of the holders of our common shares. Leverage magnifies the effect that rising or falling interest rates have on our earnings. Any increase in the interest rate earned by us on investments in excess of the interest rate on the funds obtained from borrowings would cause our net income and earnings per share to increase more than they would without leverage, while any decrease in the interest rate earned by us on investments would cause net income and earnings per share to decline by a greater amount than they would without leverage. Leverage is thus generally considered a speculative investment technique. In order for us to repay indebtedness on a timely basis, we may be required to dispose of assets when we would not otherwise do so and at prices which may be below the net book value of such assets. Dispositions of assets could have a material adverse effect on our financial condition and results of operations.

There are significant risks in lending to small businesses.

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

There is volatility in the valuation of our loans receivable.

There is typically no public market or established trading market for the loans we originate. The illiquid nature of our loans receivable may adversely affect our ability to dispose of such loans receivable at times when it may be advantageous for us to liquidate such investments. Changes to the facts and circumstances of the borrower, the hospitality industry and the economy may require the establishment of additional loan loss reserves.

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

We have an ongoing need for additional capital since earnings are required to be paid as dividends.

We will continue to need capital to fund loans. Historically, we have sold loans receivable as part of structured loan transactions, borrowed from financial institutions and issued equity securities to raise capital. A reduction in the availability of funds from financial institutions or the asset-backed securities market could have a material adverse effect on our financial condition and our results of operations. We must distribute at least 90% of

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our REIT taxable income to our shareholders to maintain our REIT status under the Code. As a result, that income will not be available to fund loan originations or acquire real estate. We expect to be able to borrow from financial institutions and sell loans receivable in the asset-backed securities market.

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

Prepayments generally increase during times of declining interest rates. The proceeds from the prepayments we receive are invested initially in temporary investments and have generally been re-loaned or committed to be re-loaned at lower interest rates than the prepaid loans receivable. The lower interest rates we receive on these new loans receivable have had an adverse effect on our results of operations and depending upon the rate of future prepayments may further impact our results of operations. The impact of the lower lending rates on our net income may be partially offset by the reduced cost of our variable-rate borrowings in a lower interest rate environment. In addition, when loans receivable are repaid prior to their maturity, we often receive prepayment fees.

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

First Western sells the guaranteed portion of most of its originated loans through private placements. These sales are especially sensitive to prepayments. Our Retained Interests in these loan sales consists only of the spread between the interest it collects from the borrower and the interest it pays the purchaser of the guaranteed portion of the loan. Therefore, to the extent the prepayments of these loans exceed estimates, there is a significant impact on the value of the associated Retained Interests.

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

The net income of our lending operations is materially dependent upon the “spread” between the rate at which we borrow funds (historically either short-term at variable rates or a longer term at fixed rates) and the rate at which we loan these funds. During periods of changing interest rates, interest rate mismatches could negatively impact our net income, dividend yield, and the market price of our common shares.

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

As a result of our dependence on variable-rate loans (we are currently originating primarily variable-rate loans and the majority of our commitments are for variable-rate loans), our interest income has been, and will continue to be, reduced. In addition, to the extent that rates remain at these historically low levels, or LIBOR decreases from current levels, interest income on our currently outstanding loans receivable will decline.

Changes in 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 due to loan prepayments and maturities. The average maturity of our loan portfolio is less than their average contractual terms because of prepayments. The average life of mortgage loans receivable tends to increase when the current mortgage rates are substantially higher than rates on existing mortgage loans receivable and, conversely, decrease when the current mortgage rates are substantially lower than rates on existing mortgage loans receivable (due to refinancings of fixed-rate loans receivable at lower rates).

There may be significant fluctuations in our quarterly results.

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

- The completion of a structured loan sale transaction 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 the above factors, quarterly results should not be relied upon as being indicative of performance in future quarters.

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 receivable 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.

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

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

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

If the combined company fails to qualify as a REIT, we may, among other things:

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

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

Ownership limitation may restrict change of control or business combination opportunities.

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

In order to preserve our REIT status, our declaration of trust generally prohibits any shareholder from directly or indirectly owning more than 9.8% of any class or series of our outstanding common shares or preferred shares. The

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ownership limitation could have the effect of discouraging a takeover or other transaction in which holders of our common shares might receive a premium for their shares over the then prevailing market price or which holders might believe to be otherwise in their best interests.

U.S. Federal income tax requirements may restrict our operations which could restrict our ability to take advantage of attractive investment opportunities.

We believe we have operated, and will continue to operate, in a manner that is intended to qualify as a REIT for U.S. Federal income tax purposes. However, the U.S. Federal income tax laws governing REITs are extremely complex, and interpretations of the U.S. Federal income tax laws governing qualification as a REIT are limited. Qualifying as a REIT will require us to meet various tests regarding the nature of our assets and our income, the ownership of our outstanding shares and the amount of distributions we make on an ongoing basis.

At any time, new laws, interpretations, or court decisions may change the federal tax laws regarding, or the U.S. Federal income tax consequences of, qualification as a REIT. In addition, compliance with the REIT qualification tests could restrict our ability to take advantage of attractive investment opportunities in non-qualifying assets, which would negatively affect the cash available for distribution to our shareholders.

Failure to make required distributions would subject us to tax.

In order to qualify as a REIT, an entity generally must distribute to its shareholders, each taxable year, at least 90% of its taxable income, other than any net capital gain and excluding any retained earnings of taxable REIT subsidiaries. To the extent that a REIT satisfies the 90% distribution requirement, but distributes less than 100% of its taxable income, it will be subject to federal corporate income tax on its undistributed income. In addition, the REIT will incur a 4% nondeductible excise tax on the amount, if any, by which its distributions in any calendar year are less than the sum of:

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

We have paid out, and intend to continue to pay out, our REIT taxable income to our shareholders in a manner intended to satisfy the 90% distribution requirement and to avoid both Federal corporate income tax and the 4% excise tax.

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

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

Subject to certain restrictions, a REIT may own up to 100% of the stock of one or more taxable REIT subsidiaries. A taxable REIT subsidiary may earn income that would not be qualifying income if earned directly by the parent REIT. Both the subsidiary and the REIT must jointly elect to treat the subsidiary as a taxable REIT subsidiary. A corporation of which a taxable REIT subsidiary directly or indirectly owns more than 35% of the voting power or value of the stock will automatically be treated as a taxable REIT subsidiary. Overall, no more than 20% of the value of a REIT’s assets may consist of stock or securities of one or more taxable REIT subsidiaries. A taxable REIT subsidiary generally will pay income tax at regular corporate rates on any taxable income that it earns. In addition, the taxable REIT subsidiary rules limit the deductibility of interest paid or accrued by a taxable REIT subsidiary to its parent REIT to assure that the taxable REIT subsidiary is subject to an appropriate level of corporate taxation. The rules also impose a 100% excise tax on certain transactions between a taxable REIT subsidiary and its parent REIT that are not conducted on an arm’s-length basis.

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Subsequent to the Merger, the aggregate value of our taxable REIT subsidiary stock and securities will be less than 20% of the value of our total assets (including our taxable REIT subsidiary stock and securities). Furthermore, we will monitor at all times the value of our investments in taxable REIT subsidiaries for the purpose of ensuring compliance with the rule that no more than 20% of the value of our assets may consist of taxable REIT subsidiary stock and securities (which is applied at the end of each calendar quarter). In addition, we will scrutinize all of our transactions with our taxable REIT subsidiaries for the purpose of ensuring that they are entered into on arm's-length terms in order to avoid incurring the 100% excise tax described above. There can be no assurance, however, that we will be able to comply with the 20% limitation on ownership of taxable REIT subsidiary stock and securities on an ongoing basis so as to maintain REIT status or to avoid application of the 100% excise tax imposed on certain non-arm's-length transactions.

We operate in a highly regulated environment.

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

At any time, U.S. Federal income tax laws governing REITs or the administrative interpretations of those laws may be amended. Any of those new laws or interpretations thereof may take effect retroactively and could adversely affect us. On May 28, 2003, President Bush signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003, which reduced the tax rate on both dividends and long-term capital gains for most non-corporate taxpayers to 15% until 2008. This reduced maximum tax rate generally does not apply to ordinary REIT dividends, which continue to be subject to tax at the higher tax rates applicable to ordinary income (a maximum rate of 35% under the new legislation). However, the new 15% maximum tax rate does apply to certain REIT distributions. This legislation may cause shares in non-REIT corporations to be a more attractive investment to individual investors than shares in REITs and may adversely affect the market price of our common shares.

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

Under various Federal, state and local laws, ordinances and regulations, a current or former owner or operator of real estate may be considered liable for the costs of remediating or removing hazardous substances found on its property, regardless of whether or not the property owner or operator was responsible for its presence. Such liability may be imposed regardless of fault and may be joint and several. We have not been informed by the Environmental Protection Agency or any state or local government authority of any non-compliance likely to be material to our financial statements or results of operations.

We are subject to the Americans with Disabilities Act.

The Americans with Disabilities Act of 1990 ("ADA") requires all public accommodations and commercial facilities to meet federal requirements related to access and use by disabled persons. Compliance with the ADA requirements could require removal of access barriers, and noncompliance could result in imposition of fines by the U.S. Government or an award of damages to private litigants. Although we believe that the properties that we own or finance are substantially in compliance with these requirements, a determination that the properties are not in compliance with the ADA could result in the imposition of fines or an award of damages to private litigants. Pursuant to the master lease agreements relating to the Hotel Properties, costs and fines associated with the ADA are the responsibility of the tenant. However, a substantial expense may affect the borrowers' or tenants' ability to pay their obligations, and consequently, our cash flow and the amounts available for distributions to shareholders may be adversely affected.

EMPLOYEES

We had no salaried employees as of December 31, 2003 since PMC Advisers, Ltd. and its subsidiary (together, the "Investment Manager"), indirect wholly-owned subsidiaries of PMC Capital, provided all personnel required for our operations.

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Subsequent to the Merger, we are self-managed and employ 43 individuals including marketing professionals, investment professionals, operations professionals and administrative staff. In addition, we have employment agreements with certain of our officers. Annual base salary during the terms of the contracts does not exceed \$315,000 for any one individual. Our operations are conducted from our Dallas, Texas office. Management believes the relationship with our employees is good.

COMPETITION

Our primary competition for lending opportunities has come from banks, financial institutions and other lending companies. Many of these competitors have greater financial and managerial resources than us and are able to provide services we are not able to provide (*i.e.*, depository services). As a result of these competitors' greater financial resources, they may be better able to withstand the impact of economic downturns than we are. We believe we compete effectively with such entities on the basis of the variety of our lending programs offered, interest rates, our long-term maturities and payment schedules, the quality of our service, our reputation as a lender, timely credit analysis and greater responsiveness to renewal and refinancing requests from borrowers. In addition, the variety and flexibility of our lending programs enhances our ability to react to current market conditions.

CUSTOMERS

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

Our property division is dependent upon Arlington to operate the Hotel Properties. Lease income from Arlington represents 100% of the revenue in this segment. The loss of Arlington as operator of our properties would have a material adverse effect on us. As a REIT, we would be required to find another operator for our Hotel Properties and lease income could be substantially less than we currently receive. Until such time as a new lease would be entered into, we would incur holding costs, legal fees and costs to re-franchise the properties. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations — Recent Developments."

AVAILABLE INFORMATION

We file annual, quarterly, current and special reports and other information with the Securities and Exchange Commission (the "SEC"). All documents may be located at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549 or you may obtain information on the operation of the Public Reference Room by calling 1-800-SEC-0330. Our SEC filings are also available to the public, free of charge, at our internet site www.pmctrust.com, as soon as reasonably practicable after the reports are filed with, or furnished to, the SEC or at the SEC's internet site at www.sec.gov.

Item 2. PROPERTIES

Subsequent to the Merger, we lease office space for our corporate headquarters in Dallas, Texas under an operating lease which expires in October of 2011.

At December 31, 2003, we owned 21 Hotel Properties. The Hotel Properties are leased to a wholly-owned subsidiary of Arlington pursuant to individual property leases which are subject to the terms of a master lease agreement. Pursuant to the master lease agreement, aggregate base rent is paid to us based on the number of Hotel Properties we own. The master lease and the underlying individual property leases expire in June 2008, but each can be extended by either Arlington or us for one five-year period, and thereafter by Arlington for a five-year period and a subsequent two-year period. If fully extended, the term of the master lease would continue until September 2020. Arlington guarantees the payment of the rent due under the terms of the master lease agreement and the individual property leases. In addition, the master lease requires a deposit of two months base rent (approximately \$850,000 at December 31, 2003). If Arlington defaults under the master lease, we have the right to, among other things, terminate the master lease and litigate to receive damages pursuant to the guarantee as a result of the default. Lease income represented approximately 38% of our total revenues during 2003. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Developments."

The following table describes the location, number of rooms, year built and annual base rent for 2004 relating to each of these properties:

City	State	Rooms in Hotel	Year Built	Annual Base Rent (1)
Eagles Landing	Georgia	60	1995	\$ 241,685
Smyrna	Georgia	60	1996	231,180
Rochelle	Illinois	61	1997	252,190
Macomb	Illinois	60	1995	273,215
Sycamore	Illinois	60	1996	273,215
Plainfield	Indiana	60	1992	252,190
Mt. Pleasant	Iowa	63	1997	231,180
Storm Lake	Iowa	61	1997	220,675
Coopersville	Michigan	60	1996	252,190
Grand Rapids North	Michigan	60	1995	283,720
Grand Rapids South	Michigan	61	1997	283,720
Monroe	Michigan	63	1997	262,700
Port Huron (2)	Michigan	61	1997	262,700
Tupelo	Mississippi	61	1997	241,685
Ashland	Ohio	62	1996	315,250
Marysville	Ohio	79	1990	336,260
Wooster East	Ohio	58	1994	210,170
Wooster North	Ohio	60	1995	210,170
Jackson	Tennessee	61	1998	262,700
McKinney	Texas	61	1997	262,700
Mosinee	Wisconsin	53	1993	178,640
		1,285		\$ 5,338,135

(1) Annual base rent includes a CPI adjustment (1.9% increase) which was effective January 1, 2004.

(2) Represents our real estate investment held for sale at December 31, 2003.

Item 3. LEGAL PROCEEDINGS

In the normal course of business, including our assets acquired in liquidation, 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.

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

The Company's Annual Meeting of Shareholders was originally set for December 30, 2003 and was postponed or adjourned to January 9, 2004 for the solicitation of additional votes. There were 5,957,596 votes for the postponement or adjournment, 291,327 votes against and 117,631 abstentions.

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At the Company's Annual Meeting of Shareholders held on January 9, 2004, the following members were elected to the Board of Trust Managers: Nathan G. Cohen, Martha R. Greenberg, Roy H. Greenberg, Irving Munn, Andrew S. Rosemore, Lance B. Rosemore, and Ira Silver.

The proposal to approve the agreement and plan of merger dated March 27, 2003 and the transactions contemplated by the merger agreement, including the Merger of PMC Capital with and into PMC Commercial, was approved. There were 4,497,152 votes for, 133,664 votes against and 92,688 abstentions.

The proposal to amend our declaration of trust and provide that the holders of company common shares may vote on all matters presented at all meetings of shareholders was approved. There were 4,461,037 votes for, 168,027 votes against and 94,441 abstentions.

The proposal to amend our declaration of trust and provide that the Board of Trust Managers may amend, repeal or adopt new bylaws was approved. There were 4,300,761 votes for, 292,922 votes against and 129,818 abstentions.

The proposal to ratify the appointment of PricewaterhouseCoopers LLP as our independent public accountants was approved. There were 6,207,785 votes for, 54,765 votes against and 104,005 abstentions.

PART II**Item 5. MARKET PRICE OF AND DIVIDENDS ON THE REGISTRANT'S COMMON STOCK AND RELATED SHAREHOLDER MATTERS**

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

Quarter Ended	High	Low	Regular Dividends Per Share	Special Dividends Per Share
December 31, 2003	\$ 15.94	\$ 13.53	\$ 0.380	—
September 30, 2003	\$ 14.09	\$ 13.00	\$ 0.380	—
June 30, 2003	\$ 14.45	\$ 11.25	\$ 0.380	—
March 31, 2003	\$ 13.59	\$ 12.44	\$ 0.400	—
December 31, 2002	\$ 13.67	\$ 11.25	\$ 0.400	\$ 0.020
September 30, 2002	\$ 15.10	\$ 12.80	\$ 0.400	—
June 30, 2002	\$ 15.50	\$ 14.05	\$ 0.400	—
March 31, 2002	\$ 14.75	\$ 12.85	\$ 0.400	—
December 31, 2001	\$ 13.98	\$ 11.80	\$ 0.400	—
September 30, 2001	\$ 15.24	\$ 11.85	\$ 0.380	—
June 30, 2001	\$ 14.95	\$ 11.65	\$ 0.375	—
March 31, 2001	\$ 13.95	\$ 9.00	\$ 0.365	—

On March 8, 2004, there were approximately 1,580 holders of record of Common Shares and the last reported sales price of the Common Shares was \$16.90.

Item 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following is a summary of our Selected Consolidated Financial Data as of and for the five years in the period ended December 31, 2003. The following data should be read in conjunction with our consolidated financial statements and the notes thereto and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” appearing elsewhere in this Form 10-K. The selected financial data presented below has been derived from our consolidated financial statements.

	Years Ended December 31,				
	2003	2002	2001	2000	1999
	(In thousands, except per share information)				
Total revenues	\$ 14,586	\$ 15,752	\$ 16,130	\$ 18,776	\$ 20,998
Total expenses	\$ 7,755	\$ 7,533	\$ 8,128	\$ 11,465	\$ 11,370
Income from continuing operations.	\$ 6,831	\$ 8,219	\$ 8,002	\$ 7,311	\$ 9,628
Discontinued operations	\$ 632	\$ 1,155	\$ 650	\$ 633	\$ 636
Gain on sale of assets	\$ 711	\$ 562	\$ 2,783	\$ 1,421	\$ —
Net income	\$ 8,174	\$ 9,936	\$ 11,435	\$ 9,365	\$ 10,264
Basic weighted average common shares outstanding	6,448	6,444	6,431	6,520	6,530
Basic and diluted earnings per common share:					
Income from continuing operations and gain on sale of assets	\$ 1.17	\$ 1.39	\$ 1.68	\$ 1.34	\$ 1.47
Net income	\$ 1.27	\$ 1.54	\$ 1.78	\$ 1.44	\$ 1.57
Dividends declared, common	\$ 9,932	\$ 10,440	\$ 9,789	\$ 11,367	\$ 12,016
Dividends per common share	\$ 1.54	\$ 1.62	\$ 1.52	\$ 1.75	\$ 1.84

	At December 31,				
	2003	2002	2001	2000	1999
	(In thousands)				
Loans receivable, net	\$ 50,584	\$ 71,992	\$ 78,486	\$ 65,645	\$ 115,265
Real estate investments, net	\$ 41,205	\$ 44,928	\$ 52,718	\$ 65,674	\$ 70,683
Real estate investments, held for sale, net	\$ 2,134	\$ 1,877	\$ —	\$ —	\$ —
Retained interests in transferred assets	\$ 30,798	\$ 23,532	\$ 17,766	\$ 11,203	\$ —
Total assets	\$ 132,292	\$ 149,698	\$ 156,347	\$ 151,399	\$ 197,237
Notes payable and revolving credit facility	\$ 33,380	\$ 48,491	\$ 57,070	\$ 53,235	\$ 97,757
Beneficiaries’ equity	\$ 92,091	\$ 93,929	\$ 92,771	\$ 89,785	\$ 91,932
Total liabilities and beneficiaries’ equity	\$ 132,292	\$ 149,698	\$ 156,347	\$ 151,399	\$ 197,237

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

RECENT DEVELOPMENTS

PMC Capital was merged into PMC Commercial, with PMC Commercial continuing as the surviving entity, on February 29, 2004. Each issued and outstanding share of PMC Capital common stock was converted into 0.37 of a common share of PMC Commercial. As a result, we issued 4,385,800 common shares of beneficial interest on February 29, 2004 valued at \$13.10 per share, which is the average closing price of our common stock for the three days preceding the date of the announcement adjusted by declared but unpaid dividends. The Merger was accounted for under the purchase method of accounting as provided by SFAS No. 141.

We entered into a letter agreement with Arlington, the lessee of our Hotel Properties, on March 12, 2004, pursuant to which we granted Arlington, among other things, reduced cash payments on the base rent due under the master lease for the March and April 2004 payments. The letter agreement terminates on April 30, 2004, at which point Arlington is required to pay the difference between the reduced rent payments made for March and April 2004 and the base rent for those two months provided for in the master lease.

BUSINESS

We are primarily a commercial lender that originates loans to small businesses that are principally collateralized by first liens on the real estate of the related business. We then sell certain of our loans receivable through privately-placed structured loan sale transactions. Historically, we have retained residual interests in all loans receivable sold through our ownership in the related SPEs.

Our revenues and realized gains include the following:

- Interest earned on loans receivable including the effect of commitment fees collected at the inception of the loan;
- Lease payments on our Hotel Properties;
- Earnings on our Retained Interests;
- Interest earned on temporary (short-term) investments;
- Gains relating to structured loan sale transactions;
- Gains relating to sales of our Hotel Properties; and
- Other fees, including late fees, prepayment fees, construction monitoring fees and site visit fees.

Our ability to generate interest income, as well as other revenue sources, is dependent on economic, regulatory and competitive factors that influence interest rates and loan originations, and our ability to secure financing for our investment activities. The amount of other income earned will vary based on volume of loans funded, the timing and amount of financings, the volume of loans receivable which prepay, the mix of loans (construction versus non-construction), the rate and type of loans originated (whether fixed or variable) as well as the general level of interest rates. For a more detailed description of the risks affecting our financial condition and results of operations, see "Risk Factors" in Item 1 of this Form 10-K.

CURRENT OPERATING OVERVIEW AND ECONOMIC FACTORS

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

At December 31, 2003, our variable-rate and fixed-rate loans receivable were \$21.2 million (41%) and \$30.3 million (59%) of our loans receivable, respectively. At December 31, 2003, substantially all of our commitments were for variable-rate loans, and given the current interest rate market, we expect to continue to

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originate primarily variable-rate loans. At December 31, 2003, our total loan commitments and approvals outstanding of \$7.7 million with a weighted average interest rate of 5.6% were primarily with variable interest rates based on spreads over LIBOR ranging from 4.0% to 4.5%.

Prior to 2002 we only originated fixed interest rate loans. During the first half of 2002, we began experiencing decreases in lending opportunities, loans funded and loan commitments compared to the prior year primarily due to competition resulting from the interest rate environment and the economic uncertainty which specifically had an impact on the hospitality sector. As a result of low short-term interest rates, banks have been offering their "mini-perm" short-term loans at rates considerably lower than our long-term fixed-rate loans and often with less down payment requirements. Therefore, we commenced and continue to focus on marketing and selling a variable-rate loan product based on LIBOR which presently provides a lower cost variable interest rate alternative to our borrowers as a result of these market conditions.

As a result of our increasing percentage of variable-rate loans, the continued prolonged low interest rate environment has caused our interest income to be reduced. To the extent that rates remain at or below these historically low levels, we will earn less interest income. Alternatively, when rates rise in the future, the interest we earn on our performing variable-rate loans will increase. In addition, the decreased loan origination volume during 2003 (compared to 2002), resulting from the factors described below, affected our interest income. Interest income will continue to be reduced if (i) principal payments on outstanding loans receivable exceed our loan originations, (ii) interest rates continue to decrease and/or (iii) problem loans increase.

Our net interest margin is dependent upon the difference between the cost of our borrowed funds and the rate at which we invest these funds (the "net interest spread"). A significant reduction in net interest spread may have a material adverse effect on our results of operations and may cause us to re-evaluate our lending focus. Over the past few years the spread has been reduced causing decreased income from continuing operations and there can be no assurance that it will not continue to decrease. We believe that our LIBOR-based loan program allows us to compete more effectively, provides us with a more attractive securitization product and provides us with a net interest spread that is less susceptible to interest rate fluctuations than our fixed-rate transactions.

Most of our loans are to borrowers operating properties in the limited service sector of the hospitality industry. The limited service sector of the hospitality industry, as a subset of the hospitality industry, does not always react to economic conditions in the same manner as the rest of the hospitality industry. For example, while all sectors of the hospitality industry experienced reductions in occupancy and room rates in 2001 and 2002, the limited service sector of the hospitality industry was not as negatively impacted and, as a consequence, the rebound in the hospitality industry in occupancy and room rates during 2003 primarily affected sectors other than the limited service hotels. Economic conditions that impact the limited service sector of the hospitality industry and, to a lesser degree, the hospitality industry in general, have a significant impact on our loans to and investments in hospitality properties, and our future lending operations.

The limited service sector of the hospitality industry was experiencing lower demand during 2001 and 2002 due primarily to geopolitical uncertainties and the sluggish economy. During this period, there was an increase in borrowers with cash flow shortages that caused us to increase our loans identified as "problem assets." In addition, we experienced higher provisions for loan losses in 2003 than our pre-2001 historical losses, although our loan losses continue to be lower than industry standards. These higher loan losses were partially caused by a weakness in the value of the limited service hotel properties that were collateral for our loans. As a result of the market weaknesses in 2001 and 2002, new construction of hospitality properties was significantly reduced and the number of property sales was significantly reduced. In times of economic downturn resulting in fewer properties being sold or constructed, the collateral value underlying our loans receivable could be reduced and, as a result, the equity our borrowers have in their properties could be reduced. To the extent the loan goes into default, the magnitude of the impairment could be greater. In addition, during these periods, the length of time to sell assets acquired in liquidation may increase. Even though lower interest expense helped the industry, we may have to foreclose upon properties and the losses experienced may be greater than those historically incurred. We believe that the current increases in occupancy and room rates experienced by the limited service sector of the hospitality industry and the expectation of additional increases should help to reduce the number of problem assets. It also appears that the resale market for limited service hospitality properties has strengthened.

While occupancy increased slightly for the overall hospitality industry, average room rates showed a slight decline in 2003 based on published industry statistics. The industry's net operating income has been in a downcycle, having been affected by travel warnings and increased travel time due to improved security measures as well as internet bookings which have all negatively impacted revenues. We anticipate that lodging demand will

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increase in 2004 as the lodging industry follows the economy. Improving economic trends in the lodging industry will generate an increase in competition among lenders, especially those lenders offering alternatives such as fixed rate and “mini-perm” loans. As a result, we anticipate an improvement in volume but continued net interest spread pressure.

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. As a result of recent announcements by foreign oil producers, it is widely expected that domestic gasoline prices will be at record high levels in the near future. The current rise in gasoline prices may have an impact on the summer travel season.

As a result of the delayed securitization, competition and economic environment as described above, our fundings during 2003 were lower than 2002 and did not meet our expectations. Furthermore, our outstanding commitments have been significantly reduced from \$40.9 million at December 31, 2002 to \$7.7 million at December 31, 2003. Our fundings were reduced in part due to our lack of funds which resulted from reduced capacity to borrow on our revolving credit facility and the delay in our structured loan sale transaction. We did not complete a structured loan sale transaction that we had initially anticipated to be completed in the first quarter of 2003 until October 2003 as a result of unfavorable market conditions. As a result of our reduced funds, we limited the amount of commitments to originate new loans during the first nine months of 2003. Subsequent to the completion of our structured loan sale transaction, it took more time than expected to re-establish some of our loan demand generators and we were cautious in our underwriting since the economic conditions were still tenuous. As a result, there were only a few commitments generated during the fourth quarter of 2003 and our pipeline for new loan originations continued to be reduced. While this trend has continued into 2004, recently, as the signs of economic recovery appear to be more promising and our renewed marketing efforts have gained momentum, we have seen an increase in activity and we have entered into several commitments to originate new loans.

We also own 21 limited service hospitality properties. As a REIT, we cannot operate these properties. As a result, we are dependent upon Arlington to operate and manage our hotel properties. Arlington’s operating results, including the operations of our hotel properties, are subject to a variety of risks which could affect Arlington’s 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 collect on the guarantee of the parent of Arlington. In addition, in the event Arlington defaults, we may incur costs, including holding costs, legal fees and costs to re-franchise the properties. Arlington is a publicly traded company.

In addition to our lending and property ownership, problems in the asset-backed securities market could impact our ability or alter our decision to complete a structured loan sale transaction on a timely basis or cause us to sell loans receivable on less favorable terms. Based on secondary market trading on our securities and recently announced transactions, the market for small business loan securitizations appears to be improving. However, since we presently do not have a significant amount of securitizable loans available and our outstanding commitments are \$7.7 million (\$23.3 million subsequent to the Merger), we do not anticipate a securitization until the latter part of 2004 at the earliest. See “Item 1. Business — Risk Factors.”

PORTFOLIO INFORMATION

Lending Activities

General

Our lending activities consist primarily of originating loans to borrowers who operate in the hospitality industry. Our net loans receivable were \$50.6 million and \$72.0 million at December 31, 2003 and 2002, respectively. During 2003 and 2002, we originated loans totaling \$31.3 million and \$32.8 million and received principal repayments of \$7.6 million (of which approximately \$2.6 million represented prepayments and \$2.4 million represented balloon maturities) and \$12.3 million (of which approximately \$9.6 million represented prepayments), respectively. When originating a loan, we charge a commitment fee. During 2003 and 2002, we collected commitment fees of \$110,000 and \$575,000, respectively. The commitment fees collected during 2003 were lower than 2002 due to reduced commitments entered into to originate new loans during 2003. A significant portion of borrowers whose loans were funded in 2003 paid their commitment fees in 2002. Commitment fees are collected when the prospective borrower accepts our proposed terms and are deferred and recognized as an adjustment of yield over the life of the related loan receivable.

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At December 31, 2003, approximately \$21.2 million of our loans receivable had a variable interest rate (reset on a quarterly basis) based primarily on LIBOR with a weighted average interest rate of approximately 5.4%. The spread that we charge over LIBOR generally ranges from 4.0% to 4.5%. LIBOR used in determining interest rates during the first quarter of 2004 (set on January 1, 2004) was 1.15%. To the extent LIBOR changes, we will have changes in interest income from our variable-rate loans receivable. In addition, at December 31, 2003, approximately \$30.3 million of our loans receivable had a fixed interest rate with a weighted average interest rate of 10.1%. See Item 7A. "Quantitative and Qualitative Disclosures About Market Risk."

Prepayment Activity

Prepayment activity on our fixed-rate loans receivable has remained at high levels as a result of the continued low interest rate environment (the prime rate, LIBOR and the interest rates on treasury notes decreased substantially during 2002 and remained low in 2003). We believe that we may continue to see prepayment activity at higher levels (particularly in relation to our fixed-rate loans receivable) in 2004. Many of our prepayment fees for our fixed-rate loans receivable are based upon a yield maintenance premium which provides for greater prepayment fees as interest rates decrease. In addition, certain loans receivable have prepayment prohibitions of up to five years.

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

- The competitive lending environment (*i.e.*, availability of alternative financing);
- The current and anticipated interest rate environment (*i.e.*, if interest rates are expected to rise or fall);
- The market for limited service hospitality property sales; and
- The amount of the prepayment fee and the length of prepayment prohibition.

When our loans receivable are repaid prior to their maturity, we generally receive prepayment fees. Prepayment fees result in one-time increases in our income. The proceeds from the prepayments we receive are invested initially in temporary investments and have generally been re-loaned or committed to be re-loaned at lower interest rates than the prepaid loans receivable. These lower interest rates have had an adverse effect on our interest income and depending upon the rate of future prepayments may further impact our interest income. It is difficult for us to accurately predict the volume or timing of prepayments since the factors listed above are not all-inclusive and changes in one factor are not isolated from changes in another which might magnify or counteract the rate or volume of prepayment activity.

Problem Loans

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

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

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Historically, we have not had a significant amount of Impaired Loans or delinquent loans nor have we had a significant amount of charged-off loans. Our Problem Loans were as follows:

	December 31,	
	2003	2002
	(In thousands)	
Impaired Loans:		
Loans receivable	\$ 1,748	\$ 1,756
Sold loans of SPEs	1,357	—
	<u>\$ 3,105</u>	<u>\$ 1,756</u>
Special Mention Loans:		
Loans receivable	\$ 249	\$ —
Sold loans of SPEs	—	1,362
	<u>\$ 249</u>	<u>\$ 1,362</u>
Percentage impaired loans:		
Loans receivable	3.4%	2.4%
Sold loans of SPEs	0.9%	—
Percentage Special Mention Loans:		
Loans receivable	0.5%	—
Sold loans of SPEs	—	1.3%

Our provision for loan losses as a percentage of our weighted average outstanding loans receivable was 0.40% (40 basis points) and 0.09% (nine basis points) during 2003 and 2002, respectively. At December 31, 2003 and 2002, we had reserves in the amount of \$675,000 and \$365,000, respectively, against loans receivable that we have determined to be potential Impaired Loans.

Retained Interests

At December 31, 2003 and 2002, the estimated fair value of our Retained Interests was \$30.8 million and \$23.5 million, respectively. Retained Interests represents our ownership interest in loans receivable that have been contributed to SPEs and have been recorded as sold. Our Retained Interests consist of (i) the retention of a portion of each of the sold loans (the “required overcollateralization”), (ii) contractually required cash balances owned by the SPE (the “reserve fund”) and (iii) future excess funds to be generated by the SPE after payment of all obligations of the SPE (the “interest-only strip receivable”). Retained Interests are our residual interest in the loans sold by us to the SPE. When we securitize loans receivable, we are required to recognize Retained Interests, which represents our right to receive net future cash flows, at their fair value. Retained Interests are subject to credit, prepayment and interest rate risks. Retained Interests are materially more susceptible to these risks than the notes issued by 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. Prepayment speeds and loan losses are estimated based on the current and anticipated interest rate and competitive environments and our historical experience with these and similar loans receivable. The discount rates utilized are determined for each of the components of Retained Interests as estimates of market rates based on interest rate levels considering the risks inherent in the transaction. Changes in any of our assumptions, or actual results which deviate from our assumptions, may materially affect the value of our Retained Interests.

The net unrealized appreciation on our Retained Interests at December 31, 2003 and 2002 was \$3.6 million and \$3.8 million, respectively. Any appreciation of our Retained Interests is included in the accompanying balance sheet in beneficiaries’ equity. 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.

Assets Acquired in Liquidation

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

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

Property Ownership

Our Hotel Properties are operated by Arlington pursuant to our sale/leaseback agreement.

The following table summarizes statistical data regarding our 21 Hotel Properties (1):

	Years Ended December 31,		
	2003	2002	2001
Occupancy	56.01%	58.80%	58.15%
ADR (2)	\$ 54.60	\$ 55.15	\$ 56.43
RevPAR (3)	\$ 30.58	\$ 32.44	\$ 32.82
Room revenue	\$ 14,274,610	\$ 15,161,248	\$ 15,352,172
Rooms rented	261,499	274,826	272,058
Rooms available	466,866	467,386	467,821

(1) Arlington has provided all data (only includes properties owned as of December 31, 2003).

(2) "ADR" is defined as the average daily room rate.

(3) "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. Room revenue decreased by approximately 6% during 2003. The reduction in revenues was primarily caused by several properties which experienced increased competition from newly constructed properties causing reductions in both occupancy and ADR. Historically, when new competition exists, there is a period of time in which revenues are impacted.

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A summary of financial information for the lessee of our properties, Arlington, (which has been derived from their latest available public filings as of our filing date) as of September 30, 2003 and December 31, 2002, and for the nine months ended September 30, 2003 and the years ended December 31, 2002 and 2001 is as follows:

ARLINGTON HOSPITALITY, INC.

	September 30, 2003	December 31, 2002
(In thousands)		
BALANCE SHEET DATA:		
Investment in hotel assets	\$ 87,006	\$ 103,903
Cash and short term investments	4,079	3,970
Total assets	104,742	119,934
Total liabilities	91,020	102,564
Shareholder's equity	13,722	17,370

	Nine Months Ended September 30,		Years Ended December 31,	
	2003	2002	2002	2001
(In thousands)				
INCOME STATEMENT DATA:				
Total revenue	\$ 57,392	\$ 50,254	\$ 76,531	\$ 77,153
Operating income (loss)	(900)	4,050	1,992	5,547
Net income (loss)	(3,758)	222	(1,710)	755

Arlington is a public entity that files periodic reports with the SEC. Additional information about Arlington, including December 31, 2003 financial information when available, can be obtained from the SEC's website at www.sec.gov.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

Valuation of Loans Receivable

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

Our provision for loan losses was 0.40% (40 basis points) and 0.09% (nine basis points) of our weighted average outstanding loans receivable during 2003 and 2002, respectively. At December 31, 2003 and 2002, we had reserves in the amount of \$675,000 and \$365,000, respectively, against loans receivable that we have determined to

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be potential Impaired Loans. To the extent one or several of our loans experience significant operating difficulties and we are forced to liquidate the loans, future losses may be substantial.

Valuation of Retained Interests

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

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

Significant estimates related to our Retained Interests were as follows at December 31, 2003:

	Constant Prepayment Rate (1)	Aggregate Losses Assumed (2)	Range of Discount Rates
2000 Joint Venture	10.0%	2.98%	7.2% to 11.9%
2001 Joint Venture	10.0%	3.58%	7.2% to 11.9%
2002 Joint Venture	10.0%	3.71%	7.6% to 12.3%
2003 Joint Venture	10.0%	3.18%	7.8% to 12.1%

(1) Based on anticipated principal prepayments considering the loans sold and other similar loans.

(2) As a percentage of the outstanding principal balance of the underlying loans receivable as of December 31, 2003 based upon per annum losses that ranged from 0.5% to 0.9%.

At December 31, 2003, we have identified one sold loan (\$1.4 million) that we consider an Impaired Loan. If we have to liquidate this loan, losses may exceed estimates and the value of our Retained Interests will decline.

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The following is a sensitivity analysis of our Retained Interests as of December 31, 2003 to highlight the volatility that results when prepayments, loan losses and discount rates are different than our assumptions:

<u>Changed Assumption</u>	<u>Value</u>	<u>Asset Change</u>
	(In thousands)	
Losses increase by 50 basis points per annum (1)	\$ 28,632	\$ (2,166)
Losses increase by 100 basis points per annum (1)	\$ 26,547	\$ (4,251)
Rate of prepayment increases by 5% per annum (2)	\$ 29,736	\$ (1,062)
Rate of prepayment increases by 10% per annum (2)	\$ 29,092	\$ (1,706)
Discount rates increase by 100 basis points	\$ 29,446	\$ (1,352)
Discount rates increase by 200 basis points	\$ 28,181	\$ (2,617)

- (1) *If we experience significant losses (i.e., in excess of anticipated losses), the effect on our Retained Interests would first reduce the value of the interest-only strip receivables. To the extent the interest-only strip receivables could not fully absorb the losses, the effect would then be to reduce the value of our reserve funds and then the value of our required overcollateralization.*
- (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. Values based on changes in these assumptions generally cannot be extrapolated since the relationship of the change in assumptions to the change in value may not be linear. The effect of a variation in a particular assumption on the 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.

RESULTS OF OPERATIONS

Year Ended December 31, 2003 Compared to the Year Ended December 31, 2002

Overview

Income from continuing operations decreased by \$1,388,000 (17%) to \$6,831,000 during 2003 from \$8,219,000 during 2002. Net income decreased by \$1,762,000 (18%), to \$8,174,000 during 2003 from \$9,936,000 during 2002. Our basic earnings per share decreased \$0.27 (18%), to \$1.27 per share during 2003 from \$1.54 per share during 2002. The decrease in net income is primarily due to:

- decreased other income of \$825,000 due to reduced prepayments resulting in lower prepayment fee income;
- decreased interest income of \$460,000 due to the sale of loans receivable and an increase in variable-rate lending with lower variable interest rates than our fixed interest rate loans; and
- a decrease in the gain on sale of our real estate investments of \$380,000 as one hotel property was sold during 2003 while two hotel properties were sold during 2002.

Partially offsetting these decreases in net income were:

- decreased interest expense of \$241,000 due primarily to reduced balances outstanding on our structured notes payable from our 1998 structured loan financing; and
- an increase in the gain on sale of our loans receivable of \$149,000 due primarily to a larger volume of loans sold.

Significant changes in revenues and expenses are further described below.

Revenues

The interest income decrease of \$460,000 (7%), to \$5,776,000 during 2003 from \$6,236,000 during 2002 was primarily attributable to (i) the sale of \$45.4 million in loans receivable in a structured loan sale transaction completed in October 2003, (ii) the sale of the majority of our fixed-rate loans receivable in a structured loan sale transaction completed in April 2002, (iii) decreasing variable interest rates and (iv) principal collections including loan maturities and prepayments of our fixed-rate loans which were reinvested in lower yielding variable-rate loans.

Our lease income increased by \$70,000 (1%), to \$5,529,000 during 2003 from \$5,459,000 during 2002 primarily due to a 2% (CPI) increase in base rent during 2003.

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Income from Retained Interests increased \$49,000 (2%), to \$2,942,000 during 2003 compared to \$2,893,000 during 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 increase was primarily the result of an increase in the balance of our Retained Interests due to the completion of our 2003 structured loan sale transaction partially offset by a decrease in the yield on our Retained Interests to 12.3% during 2003 from 13.2% during 2002 resulting primarily from better than anticipated cash flows in 2002.

Other income decreased \$825,000 (71%), to \$339,000 during 2003 compared to \$1,164,000 during 2002 which is primarily attributable to increased prepayment fees received during 2002. Prepayment fees increased sharply in 2002 as a result of the refinancing options at low fixed interest rates made available by mini-perm loans offered by banks. While interest rates remained low and mini-perm bank loans were still available in 2003, many of the borrowers that considered refinancing did so during 2002. As a result of the continued low interest rate environment, we anticipate higher levels of prepayment activity in 2004 than we experienced during 2003.

Interest Expense

Interest expense decreased by \$241,000 (7%), to \$3,204,000 during 2003 from \$3,445,000 during 2002. Interest expense consisted of the following:

	Years Ended December 31,	
	2003	2002
	(In thousands)	
Structured Notes	\$ 1,477	\$ 1,982
Mortgages on Hotel Properties	1,123	1,156
Revolving credit facility	576	296
Other	28	11
	<u>\$ 3,204</u>	<u>\$ 3,445</u>

The decrease was primarily attributable to a decrease in the principal balance of the structured notes payable from our 1998 structured loan financing (\$18.7 million outstanding at December 31, 2003 compared to \$26.0 million outstanding at December 31, 2002). This decrease was partially offset by an increase in the weighted average borrowings outstanding under our revolving credit facility to \$17.3 million during 2003 compared to \$4.2 million during 2002. The weighted average interest rate on our revolving credit facility decreased to 3.1% during 2003 from 3.6% during 2002.

[Table of Contents](#)**Other Expenses**

Fees associated with the advisory agreements with our Investment Manager consisted of the following:

	Years Ended December 31,	
	2003	2002
	(In thousands)	
Investment management fee	\$ 2,047	\$ 1,927
Lease supervision fee	378	401
Total fees incurred	2,425	2,328
Less:		
Management fees included in discontinued operations	(29)	(42)
Fees incurred on behalf of the SPEs	(338)	(298)
Cost of structured loan sale transactions	(102)	(57)
Cost of property sales	(10)	(20)
Fees capitalized as cost of originating loans	(108)	(135)
Advisory and servicing fees to affiliate, net	\$ 1,838	\$ 1,776

Our provision for loan losses increased \$245,000 (377%), to \$310,000 during 2003 from \$65,000 during 2002. During 2003, we increased reserves on a loan on which significant doubt exists as to the ultimate realization of the loan.

Discontinued operations

Our profit from discontinued operations decreased by \$523,000 (45%), to a net profit of \$632,000 during 2003 from a net profit of \$1,155,000 during 2002. The decrease was primarily a result of property sales. Included in discontinued operations are the gains from selling one hotel property in 2003 and two hotel properties in 2002. The gain recognized in 2003 was \$380,000 less than 2002. Results of operations for the two properties sold during 2002, the property sold during 2003 and the property held for sale at December 31, 2003 are included in discontinued operations for 2003 and 2002.

Gain on sale of assets

Gain on sale of loans receivable was \$711,000 and \$562,000 during 2003 and 2002, respectively. The increase in the gain is primarily the result of (i) an increase in the amount of loans sold from \$27.3 million in April 2002 to \$45.4 million during October 2003 and (ii) an increase in the spread earned at the time the transactions were completed to 2.77% for the structured loan sale transaction completed in October 2003 compared to 2.56% for the structured loan sale transaction completed in April 2002. These increases were partially offset by an increase in costs for the 2003 transaction due primarily to the delay in completing the securitization.

Year Ended December 31, 2002 Compared to the Year Ended December 31, 2001**Overview**

Income from continuing operations increased by \$217,000 (3%), to \$8,219,000 during 2002 from \$8,002,000 during 2001. Net income decreased by \$1,499,000 (13%), to \$9,936,000 during 2002 from \$11,435,000 during 2001. Our basic earnings per share decreased \$0.24 (13%), to \$1.54 per share during 2002 from \$1.78 per share during 2001. The decrease in net income is primarily due to:

- decreased interest income of \$1,545,000 due to the sale of loans receivable and an increase in variable-rate lending with lower variable interest rates than our fixed interest rate loans;
- a reduction in the gain on sale of our loans receivable of \$871,000 due to a smaller volume of loans sold and decreased anticipated cash flows due to reduced net interest spread;
- a reduction in the gain on sale of our real estate investments of \$687,000 as a result of the sale of five properties during 2001 compared to two properties sold during 2002; and
- decreased lease income of \$535,000 as a result of the sale of five hotel properties during 2001.

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Partially offsetting these decreases in net income were:

- increased income from our Retained Interests of \$1,078,000 due primarily to the completion of structured loan sale transactions;
- increased other income of \$624,000 due primarily to increased prepayment fees received; and
- decreased interest expense of \$575,000 due to reduced balances outstanding on our structured notes payable from our 1998 structured loan financing and a decrease in the weighted average balance and interest rate on our revolving credit facility.

Significant changes in revenues and expenses are further described below.

Revenues

Interest income decreased by \$1,545,000 (20%), to \$6,236,000 during 2002 from \$7,781,000 during 2001. The decrease was primarily attributable to (i) a decrease in our weighted average loans receivable outstanding of \$3.9 million (5%), to \$69.1 million during 2002 from \$73.0 million during 2001 (due primarily to the sale of \$27.3 million in loans receivable in a structured loan sale transaction completed in April 2002) and (ii) a decrease in our weighted average interest rate to 7.5% at December 31, 2002 from 9.6% at December 31, 2001, primarily resulting from lower variable interest rates and increased variable rate lending. Average quarterly LIBOR decreased by 244 basis points from 2001 to 2002.

Lease income decreased by \$535,000 (9%), to \$5,459,000 during 2002 from \$5,994,000 during 2001. Lease income decreased primarily due to the sale of five hotel properties during 2001.

Income from Retained Interests increased \$1,078,000 (59%), to \$2,893,000 during 2002 compared to \$1,815,000 during 2001. The income from our Retained Interests is comprised of the yield on our Retained Interests. The increase was the result of (i) an increase in the balance of our Retained Interests due to the completion of our structured loan sale transactions and (ii) an increase in the yield on our Retained Interests to 13.2% during 2002 from 12.7% during 2001 resulting from better than anticipated performance and cash flows related to the loans receivable included in our structured loan sale transactions.

Other income increased \$624,000 (116%), to \$1,164,000 during 2002 compared to \$540,000 during 2001. The increase is primarily attributable to increased prepayment fees received during 2002.

Interest Expense

Interest expense decreased by \$575,000 (14%), to \$3,445,000 during 2002 from \$4,020,000 during 2001. Interest expense consisted of the following:

	Years Ended December 31,	
	2002	2001
	(In thousands)	
Structured Notes	\$ 1,982	\$ 2,314
Mortgages on Hotel Properties	1,156	1,175
Revolving credit facility	296	516
Other	11	15
	<u>\$ 3,445</u>	<u>\$ 4,020</u>

The decrease was primarily attributable to (i) a decrease in the principal outstanding on our structured notes payable from our 1998 structured loan financing (\$26.0 million outstanding at December 31, 2002 compared to \$33.8 million outstanding at December 31, 2001), (ii) a decrease in the weighted average borrowings outstanding under the revolving credit facility to \$4.2 million during 2002 compared to \$6.5 million during 2001 and (iii) a decrease in the weighted average interest rate on our revolving credit facility to 3.6% during 2002 from 5.6% during 2001.

[Table of Contents](#)**Other Expenses**

Fees associated with the advisory agreements with our Investment Manager consisted of the following:

	Years Ended December 31,	
	2002	2001
	(In thousands)	
Investment management fee	\$ 1,927	\$ 1,803
Lease supervision fee	401	461
Total fees incurred	2,328	2,264
Less:		
Management fees included in discontinued operations	(42)	(67)
Fees incurred on behalf of the SPEs	(298)	(198)
Cost of structured loan sale transactions	(57)	(60)
Cost of property sales	(20)	(20)
Fees capitalized as cost of originating loans	(135)	(208)
Advisory and servicing fees to affiliate, net	\$ 1,776	\$ 1,711

Provision for loan losses decreased \$135,000 (68%), to \$65,000 during 2002 from \$200,000 during 2001. The reserves established during 2001 were related to two loans that we identified as potential problem loans. At December 31, 2002, no loans were delinquent greater than 31 days; however, we identified a reserve on one loan on which significant doubt existed as to the ultimate realization of the loan. While this loan was current in its payments of both principal and interest, we were aware of information regarding the borrower that indicated that, upon maturity, the borrower would be unable to meet their obligations, and it was expected that a sale of the collateral would result in a net recovery below the principal amount due.

Discontinued operations

Our profit from discontinued operations increased by \$505,000 (78%), to a net profit of \$1,155,000 during 2002 from a net profit of \$650,000 during 2001. During 2002, we sold two of our hotel properties for \$5.2 million resulting in a net gain on sale of \$663,000. In addition, in accordance with SFAS No. 144, results of operations from the hotel properties sold during 2002 are included in discontinued operations for the years ended December 31, 2002 and 2001; however, the corresponding gain on sale and operations of our real estate investments sold during 2001 were not reclassified to discontinued operations.

Included in discontinued operations was the gain on sale of real estate investments of \$1,350,000 during 2001 due to the sale of five of our Hotel Properties for \$13.0 million.

Gain on sale of assets

Gain on sale of loans receivable was \$562,000 and \$1,433,000 during 2002 and 2001, respectively. The decrease in gain is primarily the result of (i) a decrease in the amount of loans sold from \$32.7 million in June 2001 to \$27.3 million during April 2002 and (ii) a decrease in the spread earned at the time the transactions were completed to 2.56% for the structured loan sale transaction completed in April 2002 compared to 3.26% for the structured loan sale transaction completed in June 2001.

CASH FLOW ANALYSIS

We generated \$8,710,000 and \$11,213,000 in cash from operating activities during 2003 and 2002, respectively. The primary source of funds from operating activities is our net income which was \$8,174,000 and \$9,936,000 (a decrease of \$1,762,000) during 2003 and 2002, respectively. Our cash flows from operating activities were also impacted by the change in our current assets and liabilities which decreased by \$945,000 primarily due to a reduction in borrower advances.

Our investing activities reflect a net source of funds of \$17,534,000 and \$7,104,000 during 2003 and 2002, respectively. This increase in source of funds of \$10,430,000 provided by investing activities is primarily due to an increase in net proceeds received from our October 2003 structured loan sale transaction compared to our April 2002

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structured loan sale transaction of \$15,909,000 and an increase in proceeds from restricted investments of \$1,954,000 due primarily to a reduction in funds on deposit at December 31, 2003 compared to 2002 for our 1998 structured loan financing transaction. Partially offsetting the increase was (i) a decrease in principal collected of \$4,650,000, (ii) less proceeds from hotel property sales in 2003 compared to 2002 resulting in a decrease in net proceeds from sale of properties of \$2,193,000 and (iii) merger related costs paid during 2003 of \$670,000.

Our financing activities reflect a net use of funds of \$25,215,000 and \$18,825,000 during 2003 and 2002, respectively. The decrease of \$6,390,000 was due primarily to an increase in payments on our revolving credit facility of \$5,900,000 since we repaid the balance on our revolving credit facility in October 2003 with the proceeds from our 2003 structured loan sale transaction.

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Funds

In general, to meet our liquidity requirements, including origination of new loans, debt principal payment requirements and payment of dividends, we intend to utilize some of the following sources to generate funds:

- Structured loan financings or sales;
- Borrowings under our short-term collateralized revolving credit facility (the “Revolver”);
- Issuance of SBA debentures or senior or medium-term notes;
- Borrowings collateralized by Hotel Properties;
- Sales of Hotel Properties; and/or
- Equity issuance.

Historically, our primary funding source has been the securitization and sale of our loans receivable. See “Structured Loan Sale Transactions.” A reduction in the availability of the above sources of funds could have a material adverse effect on our financial condition and results of operations.

Additional sources of funds include principal and interest collections on existing loans receivable, rent collected on our Hotel Properties and the cash flows from Retained Interests. As a REIT we must distribute to our shareholders at least 90% of our REIT taxable income to maintain our tax status under the Code. Accordingly, to the extent these sources represent taxable income, such amounts have historically been distributed to our shareholders. In 2004, we anticipate that our cash flows from operating activities will be utilized to fund our expected 2004 dividend distributions. Therefore, our cash flows from operating activities are generally not available to fund portfolio growth or for the repayment of principal due on our debt.

During 2003, our loans funded (\$29.7 million) and debt repayments (\$15.1 million) were primarily funded by principal collections on loans receivable of \$7.6 million and proceeds from our structured loan sale transaction of \$39.9 million.

On February 29, 2004, we completed the Merger; therefore, our sources and uses of funds are expected to increase. The assumption of PMC Capital’s liabilities and preferred stock of subsidiary (approximately \$65.7 million at December 31, 2003) include \$35.0 million in notes payable (the “Medium Term Notes”) of which \$15.0 million mature prior to August 2004 and SBA debentures of \$18.5 million with maturities ranging from 2005 to 2013. The Medium Term Notes require us to meet certain covenants, the most restrictive of which require that (i) net loans receivable must exceed 150% of senior funded debt, (ii) loan losses for any twelve-month period must not exceed 3% of net loans receivable and (iii) consolidated earnings plus interest expense must exceed 150% of interest expense.

We received cash of approximately \$5.9 million which was used to pay down our Revolver, \$1.5 million that was used to meet our working capital requirements, and \$24.0 million that was available to fund loan originations of the SBIC subsidiaries acquired as part of the Merger.

The primary use of our funds is to originate loans to small businesses in the limited service hospitality industry. During 2004, we anticipate loan originations will range from \$50 million to \$60 million. We will also use funds for payment of dividends to shareholders, interest, salaries and other general and administrative expenses, loan repurchases from our SPEs and principal payments on borrowings. 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

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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 could leverage up to 75% of their value. Without leverage, it is unlikely that our return on net equity investment would 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.

In addition, the SBICs have \$8.0 million in outstanding commitments from the SBA (\$1.0 million expiring September 2004 and \$7.0 million expiring September 2007) to guarantee future debentures. These debentures have 10-year maturities, are charged interest at a spread over 10-year treasuries and have semi-annual interest-only payments. To the extent funds are needed to originate loans by the SBICs, these pre-approved debentures can be issued.

Upon completion of the Merger, our outstanding commitments to fund new loans were \$23.3 million. 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.

We have \$1.5 million in mortgages payable at an interest rate of 7.5% that mature in June 2004 and \$1.5 million in mortgages payable at an interest rate of 8.0% that mature in October 2004. We anticipate that these mortgages payable will either be "rolled-over" into new mortgages payable with an extended maturity or repaid at maturity. In addition, of the \$35.0 million of Medium Term Notes acquired through the Merger, \$5.0 million (at an interest rate of LIBOR plus 1.3%) mature in April 2004 and \$10.0 million (at an interest rate of LIBOR plus 1.4%) mature in July 2004.

At December 31, 2003, we had availability of \$30 million under our Revolver. On February 29, 2004, the Revolver was increased to provide us with availability of \$40 million. We anticipate meeting our working capital needs, including refinancing the \$15.0 million in Medium Term Notes that mature in 2004, with our Revolver. Under our Revolver, we are charged interest on the balance outstanding under the Revolver at our election of either the prime rate of the lender or 187.5 basis points over the 30, 60 or 90-day LIBOR. The credit facility requires us to meet certain covenants, the most restrictive of which provides for an asset coverage test based on our cash and cash equivalents, loans receivable, Retained Interests and real estate investments as a ratio to our senior debt. The ratio must exceed 1.25 times. The facility matures December 31, 2004.

We are currently evaluating several financing alternatives that will allow us more flexibility to grow our outstanding serviced portfolio and refinance our current maturities as they come due. These alternatives include increasing the size of our Revolver, issuing medium term notes, entering into a conduit warehouse facility, issuance of preferred stock and/or an equity issuance. In addition, we continue to pursue financings secured by mortgages on the unencumbered limited service hospitality properties owned by us. At December 31, 2003 properties with a net book value of approximately \$18.0 million were unencumbered. We expect that these sources of funds and cash on hand will be sufficient to meet our working capital needs. However, there can be no assurance that we will be able to raise funds through these financing sources. If these sources are not available, we may have to originate loans at reduced levels or sell assets.

Structured Loan Sale Transactions

Historically, our primary source of funds has been structured loan sale transactions. We generated net proceeds of \$39.9 million, \$24.0 million, \$29.5 million and \$49.2 million from the completion of our 2003, 2002, 2001 and 2000 structured loan sale transactions, respectively. The proceeds from future structured loan sale transactions are expected to be greater as a result of the Merger. On a combined basis, net proceeds would have been \$90.6 million, \$61.9 million, \$74.0 million and \$73.9 million from the completion of the 2003, 2002, 2001 and 2000 structured loan sale transactions, respectively. It is anticipated that our primary source of working capital during 2004 will again be a structured loan sale transaction.

When our structured loan sale transactions were completed, the transaction documents that the SPE entered into contained Credit Enhancement Provisions that govern the assets and the flow of funds in and out 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 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 first quarter of 2004, as a result of delinquent loans in the 2001 Joint Venture with a principal balance of

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\$2.3 million, a Credit Enhancement Provision was triggered. As a consequence, cash flows of approximately \$600,000 relating to this transaction have been deferred and utilized to fund the increased reserve requirement. We currently anticipate that the increased reserve requirement will be relieved when we exercise our option to repurchase these loans from the 2001 Joint Venture. In the event we do not exercise our option to repurchase these loans, we currently estimate that approximately \$1.7 million of additional cash flows related to this transaction would be deferred and used to fund the increased reserve requirement. Management believes that these funds would be received in future periods. In general, there can be no assurance that amounts deferred under Credit Enhancement Provisions will be received in future periods or that future deferrals or losses will not occur.

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 timing of a structured loan sale transaction also has significant impact on our financial condition and results of operations.

In general, to the extent 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 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 pools of loans receivable on unfavorable terms (reducing our future cash flows) which could result in one or all of the following:

- Increased cost of funds;
- Increased cash reserve requirements;
- Increased subordinated portions of loans receivable; or
- Decreased transaction size.

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

Impact of Inflation

To the extent 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. We primarily originate variable-rate loans and subsequent to the Merger we have \$25.0 million in variable rate debt; therefore, we do not believe inflation will have a significant impact on us in the near future. We have matched our fixed-rate debt with fixed-rate producing assets. Our fixed-rate structured notes are matched with our fixed-rate loans receivable and our fixed-rate mortgages are matched with our properties with a fixed-rate base rent. 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 and Arlington would be negatively impacted and loan losses and lease income could be affected. 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.

SUMMARIZED CONTRACTUAL OBLIGATIONS, COMMITMENTS AND CONTINGENCIES AND OFF BALANCE SHEET ARRANGEMENTS

The following summarizes our contractual obligations at December 31, 2003:

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)	\$ 33,380	\$ 13,165	\$ 11,497	\$ 2,910	\$ 5,808
Revolver (2)	—	—	—	—	—
Advisory agreements (3)	578	578	—	—	—
Total contractual cash obligations	\$ 33,958	\$ 13,743	\$ 11,497	\$ 2,910	\$ 5,808

- (1) Maturities of our 1998 structured notes payable (\$18.7 million at December 31, 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. Our estimate will differ from actual amounts to the extent we experience prepayments and loans losses.
- (2) There were no amounts outstanding under our Revolver at December 31, 2003.
- (3) Represents amounts due to PMC Advisers under our investment management agreement and lease supervision agreement for the fourth quarter of 2003. In connection with the Merger, the investment management agreement and lease supervision agreement with our Investment Manager were terminated on February 29, 2004.

Our commitments at December 31, 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)	7,672	7,672	—	—	—
Total commitments	\$ 7,672	\$ 7,672	\$ —	\$ —	\$ —

- (1) Represents our cross indemnification agreements with PMC Capital related to the Joint Ventures with a maximum exposure at December 31, 2003 of \$49.0 million. As a result of the Merger, we no longer have a commitment.
- (2) Represents our loan commitments outstanding.

Our off balance sheet arrangements consist primarily of structured loan sale transactions which are our primary method of obtaining funds for new loan originations. In a structured loan sale transaction, we contribute loans receivable to an SPE in exchange for an ownership interest in that entity. The SPE issues notes payable (usually through a private placement) to third parties and then distributes a portion of the notes payable proceeds to us. The notes payable are collateralized solely by the assets of the SPE. The terms of the notes payable issued by the SPEs provide that the owners of these SPEs are not liable for any payment on the notes. Accordingly, if the SPEs fail to pay the principal or interest due on the notes, the sole recourse of the holders of the notes is against the assets of the SPEs. We have no obligation to pay the notes, nor do the holders of the notes have any recourse against our assets. We account for structured loan sale transactions as sales of our loans receivable and the SPE meets the definition of a qualifying SPE; as a result, neither the loans receivable contributed to the SPE nor the notes payable issued by the SPE are included in our consolidated financial statements. See "Item 1. Business — Structured Loan Sale Transactions" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies and Estimates — Valuation of Retained Interests."

When our structured loan sale transactions were completed, the transaction documents that the SPE entered into contained Credit Enhancement Provisions that govern the assets and the flow of funds in and out of the SPE formed as part of the structured loan sale transactions. The Credit Enhancement Provisions include specified

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limits on the delinquency, default and loss rates on 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. During the first quarter of 2004, as a result of delinquent loans in the 2001 Joint Venture with a principal balance of \$2.3 million, a Credit Enhancement Provision was triggered. As a consequence, cash flows of approximately \$600,000 relating to this transaction have been deferred and utilized to fund the increased reserve requirement. We currently anticipate that the increased reserve requirement will be relieved when we exercise our option to repurchase these loans from the 2001 Joint Venture. In the event we do not exercise our option to repurchase these loans, we currently estimate that approximately \$1.7 million of additional cash flows related to this transaction would be deferred and used to fund the increased reserve requirement. Management believes that these funds would be received in future periods. In general, there can be no assurance that amounts deferred under Credit Enhancement Provisions will be received in future periods or that future deferrals or losses will not occur.

In addition, we have credit enhancement provisions relating to our structured loan financing transaction completed in 1998. Distributions of the net assets from this transaction, pursuant to its trust indenture, are limited and restricted. The reserve requirement (\$1.5 million at December 31, 2003), is calculated as follows: the outstanding principal balance of the underlying loans receivable which are delinquent 180 days or more plus the greater of (i) 6% of the current outstanding principal balance of the underlying loans receivable or (ii) 2% of the underlying loans receivable at inception (\$1.4 million). As of December 31, 2003 and 2002, none of the loans receivable in the 1998 structured loan financing transaction 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 have been deposited into the reserve fund and continued to be deposited until January 2004 when the reserve fund was equal to the reserve requirement. As of December 31, 2003, the cash balance in our reserve fund, included in restricted investments on our consolidated balance sheet, was approximately \$1,265,000.

For their services in connection with the Merger, our external investment banker received a fee of \$225,000, which was contingent upon consummation of the Merger.

In the normal course of business, including our assets acquired in liquidation, 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.

IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

RELATED PARTY TRANSACTIONS

Our loans receivable were managed by PMC Advisers, Ltd. ("PMC Advisers") (either directly or through its subsidiary), a subsidiary of PMC Capital, pursuant to an Investment Management Agreement (the "IMA") and our properties, including the Hotel Properties, were supervised by PMC Advisers pursuant to a separate agreement (the "Lease Supervision Agreement," and together with the IMA, the "Advisory Agreements"). During 2003 and 2002, pursuant to the IMA, we were charged fees between 0.40% and 1.67% annually, based upon the average principal outstanding of our loans receivable. In addition, PMC Advisers earns fees for its assistance with the issuance of our debt and equity securities. Such compensation includes a consulting fee equal to (i) 12.5% of any offering fees (underwriting or placement fees) incurred by us pursuant to the public offering or private placement of our common shares, and (ii) 50% of any issuance or placement fees incurred by us pursuant to the issuance of our debt securities or preferred shares of beneficial interest. As a result of the acquisition of PMC Capital, the IMA was terminated on February 29, 2004.

In addition, the Lease Supervision Agreement provides for an annual fee of 0.70% of the original cost of the properties to be paid to PMC Advisers for providing services relating to leases on our properties, a fee of \$10,000 upon the sale of each Hotel Property and an annual loan origination fee equal to five basis points of the first \$20

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million in loans receivable funded and 2.5 basis points thereafter. As a result of the acquisition of PMC Capital, the Lease Supervision Agreement was terminated on February 29, 2004.

Pursuant to the Advisory Agreements, we incurred an aggregate of approximately \$2.4 million, \$2.3 million and \$2.3 million in management fees during 2003, 2002 and 2001, respectively.

DIVIDENDS

During April 2003 we paid \$0.40 per share in dividends to common shareholders of record on March 31, 2003. In July and October 2003, we paid quarterly dividends of \$0.38 per share to common shareholders of record on June 30, 2003 and September 30, 2003, respectively. During December 2003, we declared a \$0.38 per share quarterly dividend to common shareholders of record on December 31, 2003, which was paid during January 2004.

As a condition to completing the Merger, PMC Capital was required to make sufficient distributions to distribute 100% of its taxable income for its taxable period from January 1, 2004 to February 29, 2004 with a similar distribution to be made to our shareholders as adjusted by the 0.37 exchange ratio (the "special dividends"). PMC Capital's declared special dividend was \$0.09 per share; thus, our declared special dividend was \$0.243 per share. These special dividends were paid February 27, 2004 to common shareholders of record on February 23, 2004.

Our Board considers many factors including, but not limited to, expectations for future earnings and funds from operations ("FFO"), taxable income, the interest rate environment, competition, our ability to obtain leverage and our loan portfolio activity in determining dividend policy. In addition, as a REIT we are required to pay out 90% of taxable income. Consequently, the dividend rate on a quarterly basis will not necessarily correlate directly to any singular factor such as quarterly FFO or earnings expectations.

As discussed in "—Recent Developments," we entered into a letter agreement with Arlington on March 12, 2004. If we experience any prolonged interruption in rent payments under the master lease and if we were unable to generate alternative revenues from the Hotel Properties or our lending operations, our income from continuing operations for 2004 would be substantially reduced. Additionally, if our loan originations continue through 2004 at the historically low rate we experienced during 2003 and interest rates continue at their current low historical levels, we may not be able to recognize some of the growth opportunities we previously anticipated. If either, or a combination of these two events were to occur, it would impact our ability to maintain dividends at their current rate.

FUNDS FROM OPERATIONS ("FFO")

FFO (i) does not represent cash flows from operations as defined by GAAP, (ii) is not indicative of cash available to fund all cash flow needs and liquidity, including our ability to make distributions, and (iii) should not be considered as an alternative to net income (as determined in accordance with GAAP) for purposes of evaluating our operating performance. For a complete discussion of our cash flows from operations, see "Cash Flow Analysis." We consider FFO to be an appropriate measure of performance for an equity or hybrid REIT because it provides a relevant basis for comparison among REITs. FFO, as defined by the National Association of Real Estate Investment Trusts (NAREIT), means income (loss) before minority interest determined in accordance with generally accepted accounting principles ("GAAP"), excluding gains (losses) from sales of property, plus real estate depreciation and after adjustments for unconsolidated partnerships and joint ventures. FFO is presented to assist investors in analyzing our performance and is a measure that is presented quarterly to the Board and is utilized in the determination of dividends to be paid to shareholders. Our method of calculating FFO may be different from the methods used by other REITs and, accordingly, may not be directly comparable to such other REITs. Our formulation of FFO set forth below is consistent with the NAREIT White Paper definition of FFO.

Our FFO for the years ended December 31, 2003, 2002 and 2001 was computed as follows:

	Years Ended December 31,		
	2003	2002	2001
Net income	\$ 8,174	\$ 9,936	\$ 11,435
Less gains on sale of assets	(994)	(1,225)	(2,783)
Add depreciation	1,879	1,903	2,101
FFO	<u>\$ 9,059</u>	<u>\$ 10,614</u>	<u>\$ 10,753</u>

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Since our consolidated balance sheet consists of items subject to interest rate risk, we are subject to market risk associated with changes in interest rates as described below. Although management believes that the analysis below is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of our 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

Changes in interest rates on our fixed-rate loans receivable do not have an immediate impact on our interest income. Our interest rate risk on our fixed-rate loans receivable is primarily related to loan prepayments and maturities. The average maturity of our loan portfolio is less than 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).

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. If we were required to sell our loans at a time we would not otherwise do so, our losses may be substantial. At December 31, 2003 and 2002, the fair value of our fixed-rate loans receivable generally approximates the remaining unamortized principal balance of the loans receivable, less any loan loss reserves. Our variable-rate loans receivable are generally at spreads over LIBOR consistent with the market. Increases or decreases in interest rates will generally not have a material impact on the fair value of our variable-rate loans receivable.

At December 31, 2003 and 2002, we had \$21.2 million and \$42.1 million of variable-rate loans receivable, respectively. All of our debt had fixed rates of interest as of December 31, 2003. We had variable rate debt outstanding of \$7.3 million as of December 31, 2002. On the differential between our variable-rate loans receivable outstanding and our variable-rate debt (\$21.2 million and \$34.8 million at December 31, 2003 and 2002, respectively) we have interest rate risk. To the extent variable rates continue to decrease our interest income net of interest expense would decrease.

The sensitivity of our variable-rate loans receivable and debt to changes in interest rates is regularly monitored and analyzed by measuring the characteristics of our assets and liabilities. We assess interest rate risk in terms of the potential effect on interest income net of interest expense in an effort to ensure that we are insulated from any significant adverse effects from changes in interest rates. Based on our analysis of the sensitivity of interest income and interest expense at December 31, 2003 and 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 \$198,000 and \$348,000, respectively.

As a result of certain of our variable-rate loans receivable having interest rate floors, we are deemed to have derivative investments. To the extent that interest rates decline with respect to our loans that have floors, our interest expense on our variable-rate debt will be reduced by a higher amount than our interest income. We do not use derivatives for speculative purposes.

CURRENT AND LONG-TERM DEBT

As of December 31, 2003 and 2002, approximately \$33.4 million (100%) and \$41.2 million (85%) of our consolidated debt had fixed rates of interest and therefore not affected by changes in interest rates. Currently, market rates of interest are below the rates we are obligated to pay on the majority of our fixed-rate debt. Any amount outstanding on our revolving credit facilities is based on the prime rate and/or LIBOR and thus subject to adverse changes in market interest rates. Assuming there were no increases or decreases in the balance outstanding under our Revolver at December 31, 2002, each hypothetical 100 basis points increase in interest rates would increase interest expense and decrease net income by approximately \$73,000.

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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 collections of principal on the underlying loans receivable. Approximately \$6.1 million of our fixed-rate Hotel Property mortgages have significant penalties for prepayment. Approximately \$4.6 million have no prepayment penalties and the remaining \$4.0 million have prepayment penalties of 2% of the prepaid amount.

The following presents 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 December 31, 2003 and 2002.

Market risk disclosures related to our outstanding debt as of December 31, 2003 were as follows:

	Year Ending December 31,						Carrying Value	Fair Value(1)
	2004	2005	2006	2007	2008	Thereafter		
	(Dollars in thousands)							
Fixed-rate debt (2)	\$ 13,165	\$ 3,569	\$ 7,928	\$ 929	\$ 1,981	\$ 5,808	\$ 33,380	\$34,514

(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, 2003 was 6.7%.

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			
	(Dollars 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 market 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. 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 December 31, 2003, the value of our Retained Interests at December 31, 2003 would have decreased by approximately \$1.4 million and \$2.6 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 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

None.

Item 9A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, management has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15 and 15d-15) as of December 31, 2003. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective in timely alerting them to material information as of December 31, 2003.

During the fiscal quarter ended December 31, 2003, there were no changes to the internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Incorporated herein by reference to our definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders.

Code of Ethics

Our Board of Trust Managers is in the process of adopting a Code of Business Conduct and Ethics for trust managers, officers and employees, and once adopted, the Code of Business Conduct and Ethics will be available on our website at www.pmctrust.com. Shareholders will be able to request a free copy of the code of Business Conduct and Ethics from:

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

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

Corporate Governance Guidelines

Our Board of Trust Managers is in the process of adopting Corporate Governance Guidelines. Once adopted, the Corporate Governance Guidelines will be available on our website at www.pmctrust.com. Shareholders will be able to request a free copy of the Corporate Governance Guidelines from the address and phone number set forth above under “-Code of Ethics.”

Item 11. EXECUTIVE COMPENSATION

Incorporated herein by reference to our definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders.

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

We are authorized to grant stock options up to an aggregate of 6% of the total number of Common Shares outstanding at any time as incentive stock options (intended to qualify under Section 422 of the Code) or as options that are not intended to qualify as incentive stock options. All of our equity compensation plans were approved by security holders. Information regarding our equity compensation plans was as follows at December 31, 2003:

Plan Category	Column		
	(a)	(b)	(c)
	Number of securities to be issued upon exercise of outstanding options	Weighted average exercise price of outstanding options	Number of securities remaining available for future issuances under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	<u>150,876</u>	<u>\$12.64</u>	<u>236,291</u>

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

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Incorporated herein by reference to our definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders.

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Incorporated herein by reference to our definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the year covered by this Form 10-K with respect to the Annual Meeting of Shareholders.

PART IV

Item 15. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents filed as part of this report

(1) Financial Statements -

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

(2) Financial Statement Schedules -

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

(3) Exhibits

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

(b) Reports on Form 8-K

On October 10, 2003, we filed a report on Form 8-K pursuant to Item 5 announcing the completion of our structured loan sale transaction on October 7, 2003.

On November 12, 2003, we filed a report on Form 8-K related to our third quarter results. Under the Form 8-K, we furnished (not filed) pursuant to Item 12 our press release announcing our results of operations and financial condition for the three and nine months ended September 30, 2003.

On December 10, 2003, we filed a report on Form 8-K related to our fourth quarter dividend declared. Under the Form 8-K, we furnished (not filed) pursuant to Item 12 our press release announcing our quarterly dividend declared.

SIGNATURES

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

PMC Commercial Trust

By: /s/ Lance B. Rosemore
Lance B. Rosemore,
President

Dated March 15, 2004

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

Name	Title	Date
<u>/s/ DR. ANDREW S. ROSEMORE</u> Dr. Andrew S. Rosemore	Chairman of the Board of Trust Managers, Chief Operating Officer and Trust Manager	March 15, 2004
<u>/s/ LANCE B. ROSEMORE</u> Lance B. Rosemore	President, Chief Executive Officer, Secretary and Trust Manager (principal executive officer)	March 15, 2004
<u>/s/ BARRY N. BERLIN</u> Barry N. Berlin	Chief Financial Officer (principal financial and accounting officer)	March 15, 2004
<u>/s/ IRVING MUNN</u> Irving Munn	Trust Manager	March 15, 2004
<u>/s/ ROY H. GREENBERG</u> Roy H. Greenberg	Trust Manager	March 15, 2004
<u>/s/ NATHAN COHEN</u> Nathan Cohen	Trust Manager	March 15, 2004
<u>/s/ DR. IRA SILVER</u> Dr. Ira Silver	Trust Manager	March 15, 2004
<u>/s/ DR. MARTHA GREENBERG</u> Dr. Martha Greenberg	Trust Manager	March 15, 2004
<u>/s/ BARRY A. IMBER</u> Barry A. Imber	Trust Manager	March 15, 2004
<u>/s/ THOMAS HAMILL</u> Thomas Hamill	Trust Manager	March 15, 2004
<u>/s/ THEODORE J. SAMUEL</u> Theodore J. Samuel	Trust Manager	March 15, 2004

PMC COMMERCIAL TRUST AND SUBSIDIARIES
FORM 10-K

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Report of Independent Auditors

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, comprehensive income, beneficiaries' equity, and cash flows present fairly, in all material respects, the financial position of PMC Commercial Trust and its subsidiaries ("the Company") at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 9 to the consolidated financial statements, effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment of or Disposal of Long-Lived Assets."

PricewaterhouseCoopers LLP

Dallas, Texas
March 15, 2004

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

	December 31,	
	2003	2002
ASSETS		
Investments:		
Loans receivable, net	\$ 50,584	\$ 71,992
Real estate investments, net	41,205	44,928
Real estate investment held for sale, net	2,134	1,877
Retained interests in transferred assets	30,798	23,532
Restricted investments	4,068	5,614
Cash equivalents	1,032	41
Asset acquired in liquidation held for sale	—	400
Total investments	<u>129,821</u>	<u>148,384</u>
Other assets:		
Due from affiliates	506	362
Interest receivable	228	243
Deferred borrowing costs, net	188	268
Cash	46	8
Other assets	1,503	433
Total other assets	<u>2,471</u>	<u>1,314</u>
Total assets	<u>\$ 132,292</u>	<u>\$ 149,698</u>
LIABILITIES AND BENEFICIARIES' EQUITY		
Liabilities:		
Notes payable	\$ 33,380	\$ 41,191
Revolving credit facility	—	7,300
Dividends payable	2,452	2,707
Borrower advances	1,260	1,602
Due to affiliates	578	584
Unearned commitment fees	319	447
Interest payable	190	255
Other liabilities	2,022	1,683
Total liabilities	<u>40,201</u>	<u>55,769</u>
<i>Commitments and contingencies</i>		
Beneficiaries' equity:		
Common shares of beneficial interest; authorized 100,000,000 shares of \$0.01 par value; 6,585,641 and 6,579,141 shares issued at December 31, 2003 and 2002, respectively; 6,452,791 and 6,446,291 shares outstanding at December 31, 2003 and 2002, respectively	66	66
Additional paid-in capital	94,792	94,707
Net unrealized appreciation of retained interests in transferred assets	3,618	3,783
Cumulative net income	86,222	78,048
Cumulative dividends	(91,322)	(81,390)
	93,376	95,214
Less: Treasury stock; at cost, 132,850 shares	(1,285)	(1,285)
Total beneficiaries' equity	<u>92,091</u>	<u>93,929</u>
Total liabilities and beneficiaries' equity	<u>\$ 132,292</u>	<u>\$ 149,698</u>

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)

	Years Ended December 31,		
	2003	2002	2001
Revenues:			
Interest income	\$ 5,776	\$ 6,236	\$ 7,781
Lease income	5,529	5,459	5,994
Income from retained interests in transferred assets	2,942	2,893	1,815
Other income	339	1,164	540
Total revenues	<u>14,586</u>	<u>15,752</u>	<u>16,130</u>
Expenses:			
Interest	3,204	3,445	4,020
Advisory and servicing fees to affiliate, net	1,838	1,776	1,711
Depreciation	1,810	1,755	1,774
General and administrative	361	255	226
Provision for loan losses	310	65	200
Professional fees	165	130	116
Impairment loss on asset acquired in liquidation held for sale	67	54	—
Realized losses on retained interests in transferred assets	—	53	81
Total expenses	<u>7,755</u>	<u>7,533</u>	<u>8,128</u>
Income from continuing operations	<u>6,831</u>	<u>8,219</u>	<u>8,002</u>
Discontinued operations:			
Gain on sale of real estate investments	283	663	—
Net earnings	349	492	650
	<u>632</u>	<u>1,155</u>	<u>650</u>
Gain on sale of assets:			
Gain on sale of real estate investments	—	—	1,350
Gain on sale of loans receivable	711	562	1,433
	<u>711</u>	<u>562</u>	<u>2,783</u>
Net income	<u>\$ 8,174</u>	<u>\$ 9,936</u>	<u>\$ 11,435</u>
Weighted average shares outstanding:			
Basic	6,448	6,444	6,431
Diluted	6,460	6,456	6,443
Basic and diluted earnings per share:			
Income from continuing operations and gain on sale of assets	\$ 1.17	\$ 1.39	\$ 1.68
Discontinued operations	\$ 0.10	\$ 0.18	\$ 0.10
Net income	<u>\$ 1.27</u>	<u>\$ 1.54</u>	<u>\$ 1.78</u>

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

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

	Years Ended December 31,		
	2003	2002	2001
Net income	\$ 8,174	\$ 9,936	\$ 11,435
Change in net unrealized appreciation of retained interests in transferred assets:			
Net unrealized appreciation arising during period	348	2,016	1,435
Less realized gains included in net income	(513)	(418)	(127)
	(165)	1,598	1,308
Comprehensive income	\$ 8,009	\$ 11,534	\$ 12,743

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

PMC COMMERCIAL TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF BENEFICIARIES' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001
(In thousands, except share and per share data)

	Common Shares of Beneficial Interest Outstanding	Par Value	Additional Paid-in Capital	Net Unrealized Appreciation of Retained Interests in Transferred Assets	Cumulative Net Income	Cumulative Dividends	Treasury Stock	Total Beneficiaries' Equity
Balances, January 1, 2001	6,431,646	\$ 65	\$ 94,349	\$ 877	\$ 56,677	\$ (61,161)	\$ (1,022)	\$ 89,785
Net unrealized appreciation	—	—	—	1,308	—	—	—	1,308
Shares repurchased	(40,829)	—	—	—	—	—	(443)	(443)
Shares issued through exercise of stock options	50,474	1	294	—	—	—	180	475
Dividends (\$1.52 per share)	—	—	—	—	—	(9,789)	—	(9,789)
Net income	—	—	—	—	11,435	—	—	11,435
Balances, December 31, 2001	6,441,291	66	94,643	2,185	68,112	(70,950)	(1,285)	92,771
Net unrealized appreciation.	—	—	—	1,598	—	—	—	1,598
Shares issued through exercise of stock options	5,000	—	64	—	—	—	—	64
Dividends (\$1.62 per share)	—	—	—	—	—	(10,440)	—	(10,440)
Net income	—	—	—	—	9,936	—	—	9,936
Balances, December 31, 2002	6,446,291	66	94,707	3,783	78,048	(81,390)	(1,285)	93,929
Net unrealized depreciation	—	—	—	(165)	—	—	—	(165)
Shares issued through exercise of stock options	6,500	—	83	—	—	—	—	83
Issuance of stock options	—	—	2	—	—	—	—	2
Dividends (\$1.54 per share)	—	—	—	—	—	(9,932)	—	(9,932)
Net income	—	—	—	—	8,174	—	—	8,174
Balances, December 31, 2003	<u>6,452,791</u>	<u>\$ 66</u>	<u>\$ 94,792</u>	<u>\$ 3,618</u>	<u>\$ 86,222</u>	<u>\$ (91,322)</u>	<u>\$ (1,285)</u>	<u>\$ 92,091</u>

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

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

	Years Ended December 31,		
	2003	2002	2001
Cash flows from operating activities:			
Net income	\$ 8,174	\$ 9,936	\$ 11,435
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	1,879	1,903	2,101
Realized losses on retained interests in transferred assets	—	53	81
Impairment losses	67	54	—
Gain on sale of assets	(994)	(1,225)	(2,783)
Stock-based compensation charge	2	—	—
Accretion of commitment fees	(308)	(368)	(485)
Amortization of borrowing costs	80	89	58
Provision for loan losses	310	65	200
Commitment fees collected	110	575	521
Construction monitoring fees collected, net	111	10	32
Due to affiliates, net	(189)	(292)	(1,380)
Other operating assets and liabilities	(532)	413	(582)
Net cash provided by operating activities	8,710	11,213	9,198
Cash flows from investing activities:			
Loans funded	(29,651)	(30,732)	(51,683)
Principal collected	7,618	12,268	5,935
Proceeds from sales of properties, net	824	3,017	12,695
Proceeds from structured loan sale transactions, net	39,949	24,040	29,529
Proceeds from retained interests in transferred assets	744	954	633
Investment in retained interests in transferred assets	(2,536)	(1,617)	(1,627)
Purchase of furniture, fixtures, and equipment	(290)	(388)	(490)
Merger related costs	(670)	—	—
Proceeds received from (investment in) asset acquired in liquidation, net	—	(30)	71
Release of (investment in) restricted investments, net	1,546	(408)	1,503
Net cash provided by (used in) investing activities	17,534	7,104	(3,434)
Cash flows from financing activities:			
Proceeds from issuance of common shares	83	64	295
Purchase of treasury stock	—	—	(263)
Proceeds from (payments on) revolving credit facility, net	(7,300)	(1,400)	8,700
Payment of principal on notes payable	(7,811)	(7,179)	(4,865)
Payment of dividends	(10,187)	(10,310)	(9,561)
Net cash used in financing activities	(25,215)	(18,825)	(5,694)
Net increase (decrease) in cash and cash equivalents	1,029	(508)	70
Cash and cash equivalents, beginning of year	49	557	487
Cash and cash equivalents, end of year	\$ 1,078	\$ 49	\$ 557
Supplemental disclosures:			
Loans and interest receivable transferred to SPEs, net	\$ 4,592	\$ 2,810	\$ 2,814
Loans receivable originated in connection with sales of hotel properties	\$ 1,669	\$ 2,044	\$ —
Interest paid	\$ 3,138	\$ 3,218	\$ 3,808
Reclassification from retained interests in transferred assets to due from affiliate	\$ 781	\$ —	\$ —

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

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies:

Business

PMC Commercial Trust (“PMC Commercial” or together with its wholly-owned subsidiaries, “we,” “us” or “our”) was organized in 1993 as a Texas real estate investment trust (“REIT”). Our common shares of beneficial interest (“Common Shares”) are traded on the American Stock Exchange (symbol “PCC”). We obtain income from the yield earned on the investment portfolio, other related fee income from our lending activities and rental income from property ownership. To date, these investments have been principally in the hospitality industry. Our investment advisor at December 31, 2003 was PMC Advisers, Ltd. and its subsidiary (“PMC Advisers” or the “Investment Manager”), an indirect wholly-owned subsidiary of PMC Capital, Inc. (“PMC Capital”), a regulated investment company related to us through common management. On February 29, 2004, PMC Capital was merged with and into PMC Commercial.

Principles of Consolidation

The consolidated financial statements include the accounts of PMC Commercial Trust and its wholly-owned subsidiaries, including PMC Commercial Trust, Ltd. 1998-1, 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 (“SPEs”) created in conjunction with 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 December 31, 2003, the SPEs are PMC Joint Venture, L.P. 2000 (the “2000 Joint Venture”), PMC Joint Venture, L.P. 2001 (the “2001 Joint Venture”), PMC Joint Venture, L.P. 2002-1 (the “2002 Joint Venture”) and PMC Joint Venture, L.P. 2003-1 (the “2003 Joint Venture,” and together with the 2000 Joint Venture, the 2001 Joint Venture and the 2002 Joint Venture, the “Joint Ventures”) of which we own approximately 68%, 42%, 39% and 44%, respectively. PMC Capital owns the remaining interests in the Joint Ventures.

Loans Receivable, net

Loans receivable are carried at their outstanding principal balance less net deferred fee revenue and loan loss reserves. Deferred fee revenue is included as a reduction to the carrying value of loans receivable and consists of non-refundable fees less certain direct loan origination costs which are being recognized over the life of the related loan receivable as an adjustment of the yield. A loan loss reserve is established based on a determination, through an evaluation of the recoverability of individual loans receivable, that significant doubt exists as to the ultimate realization of the loan receivable. The determination of whether significant doubt exists and whether a loan loss reserve is necessary for each loan receivable requires judgment and considers the facts and circumstances existing at the evaluation date. Our evaluation of the adequacy of the reserve is based on a review of our historical loss experience, known and inherent risks in the loan portfolio, adverse circumstances that may affect the ability of the borrower to repay interest and/or principal and, to the extent payment appears impaired, the estimated fair value of the collateral.

Real Estate Investments, net

Real estate investments are recorded at cost. Depreciation is provided on the straight-line method based upon the estimated useful lives of the assets. The buildings and improvements are being depreciated utilizing a 35-year useful life and the furniture, fixtures and equipment are being depreciated over a seven-year useful life. Upon retirement or sale, the cost and related accumulated depreciation are removed from our books and any resulting gains or losses are included in the consolidated statements of income. Under the lease agreements with the lessee of our properties, routine maintenance and repairs are the responsibility of the lessee and are charged to the lessee’s operations as incurred; major replacements, renewals and improvements are capitalized.

Real Estate Investment Held for Sale, net

Our real estate investment held for sale is carried at the lower of cost or estimated fair value less selling costs. When an asset is identified by management as held for sale and the sale of the asset is expected to occur within the next twelve months, the property is classified as held for sale and depreciation is discontinued.

Retained Interests

Retained Interests represent our interest in SPEs created in conjunction with our structured loan sale transactions. Retained Interests are carried at estimated fair value, with realized gains and losses included in net income and unrealized gains and losses recorded in beneficiaries’ equity. The fair value of our Retained Interests is based on

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

estimates of the present value of future cash flows we expect to receive. Estimated future cash flows are based in part upon an estimate of prepayment speeds and loan losses. Prepayment speeds and loan losses are estimated based on the current and anticipated interest rate and competitive environments, the performance of the loan pool and our historical experience with these and similar loans receivable. The discount rates that we utilize are determined for each of the components of the Retained Interests as estimates of market rates based on interest rate levels considering the risks inherent in the transaction. There can be no assurance of the accuracy of these estimates. Any appreciation of our Retained Interests is included in the accompanying balance sheet in beneficiaries' equity. Any depreciation of our Retained Interests is either included in the accompanying statement of income as either 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.

Cash and Cash Equivalents

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

Deferred Borrowing Costs

Costs incurred in connection with the issuance of notes payable are being amortized to interest expense over the life of the related obligation using the effective interest method.

Interest Income

Interest income includes interest earned on loans and our short-term investments. Interest income on loans is accrued as earned with the accrual of interest generally suspended when the related loan becomes a non-accrual loan. Loans receivable are generally classified as non-accrual (a "Non-Accrual Loan") if (i) they are past due as to payment of principal or interest for a period of more than 60 days, (ii) a loan or a portion of a loan is classified as doubtful or is charged-off or (iii) loans receivable that are current or past due less than 60 days if the repayment in full of principal and/or interest is in doubt. Interest income on a Non-Accrual Loan is recognized on the cash basis and we reverse previously recorded interest income which is deemed uncollectible.

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

Lease Income

Lease income represents base and percentage rents on our properties. The fixed lease payments are reported as income in accordance with the terms of the lease agreements. In addition, we receive a fixed percentage of the monthly room revenue of our leased properties which is reported as income when earned.

Income from Retained Interests

The income from our Retained Interests is comprised of the yield earned on our Retained Interests which is determined based on estimates of future cash flows and includes any fees collected (*i.e.*, late fees, prepayment fees, etc.) by the 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.

Borrower Advances

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

Income Taxes

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

Distributions to Shareholders

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

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Impairment of Long-Lived Assets

Long-lived assets to be held and used and to be disposed of are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable or if depreciation periods should be modified.

If facts or circumstances support the possibility of impairment, we will prepare a projection of the undiscounted future cash flows without interest charges of the specific property and determine if the investment in the property is recoverable based on the undiscounted future cash flows. If impairment is indicated, an adjustment will be made to the carrying value of the property based on the difference between the current estimated fair value and the carrying amount of the asset. No impairment was deemed to exist on our real estate investments held and used at December 31, 2003.

We assess the recoverability of our real estate investments held for sale and assets acquired in liquidation held for sale based on estimated sales values. We assess impairment for each asset held for sale based on the estimated sales price less anticipated selling costs.

Derivatives

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

Stock-Based Compensation Plans

At December 31, 2003, we have two stock-based compensation plans, which are described more fully in Note 12. 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.

The following table illustrates the effect on net income and earnings per share if the fair value based method had been applied to all outstanding and unvested awards in each period:

	December 31, 2003		December 31, 2002		December 31, 2001	
	As Reported	Pro Forma	As Reported	Pro Forma	As Reported	Pro Forma
	(In thousands, except per share data)					
SFAS No. 123 Charge	\$ 2	\$ 2	\$ —	\$ 33	\$ —	\$ 40
APB No. 25 Charge	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Net income	\$ 8,174	\$ 8,174	\$ 9,936	\$ 9,903	\$ 11,435	\$ 11,395
Basic earnings per share	\$ 1.27	\$ 1.27	\$ 1.54	\$ 1.54	\$ 1.78	\$ 1.77
Diluted earnings per share	\$ 1.27	\$ 1.27	\$ 1.54	\$ 1.54	\$ 1.78	\$ 1.77

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect (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 reporting period. Actual results could differ from our estimates. Our most sensitive estimates involve valuing our Retained Interests and determining loan loss reserves for loans receivable.

Recently Issued Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB 51" ("FIN 46") in January 2003. In December 2003, FASB issued Interpretation No. 46R which replaced FIN 46 and clarified the application of ARB 51. The primary objectives of FIN 46R are to provide guidance on (i) the identification of entities for which control is achieved through means other than voting rights, Variable Interest Entities ("VIEs"), and (ii) 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 not considered sufficient (based on both quantitative and qualitative considerations) to finance the entity's activities without receiving additional subordinated financial support from other parties, including the entity's own equity investors. In

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

addition, FIN 46R requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. FIN 46R 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, 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 did not impact our consolidated financial statements.

Reclassifications

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

Note 2. Loans Receivable, net:

Loans receivable, net, consisted of the following:

	December 31,	
	2003	2002
	(In thousands)	
Loans receivable	\$ 51,486	\$ 72,816
Less:		
Deferred commitment fees, net	(227)	(459)
Loan loss reserves	(675)	(365)
Loans receivable, net	<u>\$ 50,584</u>	<u>\$ 71,992</u>

At December 31, 2003 and 2002, respectively, approximately \$21.2 million (42%) and \$42.1 million (58%) of our net loans receivable had a variable interest rate (reset on a quarterly basis) based primarily on LIBOR and \$29.4 million (58%) and \$29.9 million (42%) had fixed interest rates, respectively. The weighted average interest rate on our variable-rate loans receivable was approximately 5.4% at both December 31, 2003 and 2002. The weighted average interest rate on our fixed-rate loans receivable was approximately 10.1% and 10.4% at December 31, 2003 and 2002, respectively.

A loan receivable with a balance of approximately \$1.8 million at both December 31, 2003 and 2002 has been identified as a problem loan. Had this impaired loan performed in accordance with its original terms, additional interest income of approximately \$43,000 would have been recognized during 2003. At December 31, 2002, this loan receivable was current as to payments of principal and interest.

Our loans receivable were 100% concentrated in the hospitality industry at December 31, 2003. Any economic factors that negatively impact the hospitality industry could have a material adverse effect on our financial condition or results of operations. At December 31, 2003, approximately 15%, 12% and 11% of our loans receivable consisted of loans receivable to borrowers in Virginia, Texas and Florida, respectively. No other state had a concentration of 10% or greater at December 31, 2003.

Note 3. Real Estate Investments:

Our real estate investments consist of hospitality properties (the "Hotel Properties") we purchased in 1998 and 1999 from Arlington Hospitality, Inc. ("Arlington") under a sale/leaseback agreement (the "Lease Agreement").

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Pursuant to the Lease Agreement, we lease the Hotel Properties to Arlington Inns, Inc., a wholly-owned subsidiary of Arlington, for an initial 10-year period which expires in June 2008, with two renewal options of five years each and a third option for two years which expires in September 2020, and with consumer price index increases up to a maximum of 2% per year. Arlington guarantees the lease payment obligation of Arlington Inns, Inc. Arlington is a public entity that files periodic reports with the Securities and Exchange Commission and additional information about Arlington can be obtained from the SEC's website at www.sec.gov.

The 2004 annual base rent payment for the 21 Hotel Properties is \$5.3 million. In addition to our base rent we receive percentage rent equal to 4% of the gross room revenues of the Hotel Properties (the "Percentage Rent").

Our real estate investments consisted of the following:

	December 31, 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	\$ 5,084	\$ 263	\$ 5,347	\$ 263
Buildings and improvements.	40,151	2,080	42,231	1,682
Furniture, fixtures and equipment	4,744	227	4,681	214
	49,979	2,570	52,259	2,159
Accumulated depreciation	(8,774)	(436)	(7,331)	(282)
	<u>\$ 41,205</u>	<u>\$ 2,134</u>	<u>\$ 44,928</u>	<u>\$ 1,877</u>
Number of Hotel Properties	<u>20</u>	<u>1</u>	<u>21</u>	<u>1</u>

The real estate investment held for sale is under contract for approximately \$2.6 million and is expected to be completed prior to June 2004.

Note 4. Retained Interests in Transferred Assets:

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 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 against us. Upon the completion of our structured loan sale transactions, we recorded the transfer of loans receivable as a sale in accordance with SFAS No. 140. As a result, the loans receivable contributed to the 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.

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Information pertaining to our structured loan sale transactions was as follows. Amounts represent PMC Commercial's share of the respective Joint Ventures.

	2000 Joint Venture	2001 Joint Venture	2002 Joint Venture	2003 Joint Venture
Transaction date	12/18/00	6/27/01	4/12/02	10/7/03
	(Dollars in thousands, except footnotes)			
At inception:				
Principal amount of sold loans	\$ 55,675	\$ 32,662	\$ 27,286	\$ 45,456
Structured Notes issued	\$ 49,550	\$ 30,063	\$ 24,557	\$ 40,910
Interest rate on the Structured Notes	7.28%	6.36%	6.67%	LIBOR + 1.25%
Structured Notes rating (1)	"Aaa"	"Aaa"	"Aaa"	"Aaa"
Weighted average interest rate on loans	9.63%	9.62%	9.23%	LIBOR + 4.02%
Weighted average remaining life (2)	5.16 years	5.15 years	5.38 years	4.79 years
Aggregate principal losses assumed (3)	2.37%	2.80%	2.88%	3.03%
Constant prepayment rate assumption (4)	8.0%	9.0%	9.0%	10.0%
Discount rate assumptions	9.3% to 14.0%	8.5% to 13.3%	8.2% to 12.9%	7.8% to 11.6%
Net gain recorded (5)	\$ 1,117	\$ 1,433	\$ 562	\$ 711
Value of Retained Interests	\$ 11,174	\$ 5,871	\$ 5,293	\$ 8,698
At December 31, 2003:				
Principal outstanding on sold loans (6)	\$ 47,111	\$ 28,039	\$ 26,152	\$ 44,699
Structured Notes balance outstanding	\$ 41,707	\$ 25,486	\$ 23,510	\$ 40,310
Cash in the collection account	\$ 581	\$ 367	\$ 327	\$ 389
Cash in the reserve account	\$ 2,833	\$ 1,687	\$ 1,576	\$ 2,540
Weighted average interest rate on loans	9.62%	9.59%	9.17%	LIBOR + 4.02%
Constant prepayment rate assumption (4)	10.0%	10.0%	10.0%	10.0%
Discount rate assumptions (7)	7.2% to 11.9%	7.2% to 11.9%	7.6% to 12.3%	7.8% to 12.1%
Weighted average remaining life (2)	3.76 years	4.72 years	4.79 years	4.76 years
Aggregate principal losses assumed (3)	2.98%	3.58%	3.71%	3.18%
Aggregate principal losses to date	—%	—%	—%	—%

- (1) Structured Notes issued by the SPEs were rated by Moody's Investors Service, Inc.
- (2) The weighted average remaining life was calculated by summing the product of (i) the sum of the principal collections expected in each future period multiplied by (ii) the number of periods until collection, and then dividing that total by (iii) the initial or remaining principal balance, as applicable.
- (3) Represents aggregate estimated losses as a percentage of the principal outstanding based upon per annum losses ranging from 0.5% to 0.9%.
- (4) The prepayment rate was based on the actual performance of the loan pools, adjusted for anticipated principal prepayments considering similar loans.
- (5) The net gain recorded does not include \$877,000, \$520,000, \$439,000, and \$700,000 for the 2000 Joint Venture, the 2001 Joint Venture, the 2002 Joint Venture and the 2003 Joint Venture, respectively, which was deferred and recorded as unrealized appreciation in our beneficiaries' equity in accordance with SFAS No. 140.
- (6) Approximately 95% concentrated in the hospitality industry, 23% to borrowers in Texas and 10% to borrowers in Arizona. No other state had a concentration of 10% or greater at December 31, 2003.
- (7) Discount rates utilized were (i) 7.2% to 7.8% for our required overcollateralization, (ii) 8.9% to 9.3% for our reserve funds and (iii) 11.9% to 12.3% for our interest-only strip receivables.

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

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our Retained Interests and the limited number of buyers for such assets, no readily ascertainable market exists. Therefore, our estimate of the fair value may or may not vary from what a willing buyer would pay for these assets.

The components of our Retained Interests are as follows:

- (1) Our required overcollateralization (the "OC Piece"). The OC Piece represents the excess of the loans receivable contributed to the 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.

Our Retained Interests consisted of the following:

	December 31, 2003				
	Estimated Fair Value				Cost
	OC Piece	Reserve Fund	IO Receivable	Total	
	(In thousands)				
2003 Joint Venture	\$ 4,817	\$ 1,930	\$ 2,275	\$ 9,022	\$ 8,224
2002 Joint Venture	3,050	1,208	1,099	5,357	4,850
2001 Joint Venture	3,051	1,317	1,918	6,286	5,230
2000 Joint Venture	6,322	2,290	1,521	10,133	8,876
	<u>\$ 17,240</u>	<u>\$ 6,745</u>	<u>\$ 6,813</u>	<u>\$ 30,798</u>	<u>\$ 27,180</u>

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

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The following sensitivity analysis of our Retained Interests at December 31, 2003 highlights the volatility that results when prepayments, loan losses and discount rates are different than our assumptions:

Changed Assumption	Value	Asset Change
	(In thousands)	
Losses increase by 50 basis points per annum (1)	\$ 28,632	\$ (2,166)
Losses increase by 100 basis points per annum (1)	\$ 26,547	\$ (4,251)
Rate of prepayment increases by 5% per annum (2)	\$ 29,736	\$ (1,062)
Rate of prepayment increases by 10% per annum (2)	\$ 29,092	\$ (1,706)
Discount rates increase by 100 basis points	\$ 29,446	\$ (1,352)
Discount rates increase by 200 basis points	\$ 28,181	\$ (2,617)

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

(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. Values based on changes in these assumptions generally cannot be extrapolated since the relationship of the change in assumptions to the change in fair value is not linear. The effect of a variation in a particular assumption on the 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.

The following information summarizes the financial position of the Joint Ventures at December 31, 2003 and 2002. We owned approximately 68% of the 2000 Joint Venture, 42% of the 2001 Joint Venture, 39% of the 2002 Joint Venture and 44% of the 2003 Joint Venture as of December 31, 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	
	2003	2002	2003	2002
	(In thousands)			
Loans Receivable, Net	\$ 65,608	\$ 70,627	\$ 65,731	\$ 73,220
Asset Acquired in Liquidation, Net	\$ —	\$ 1,411	\$ —	\$ —
Total Assets	\$ 70,683	\$ 76,434	\$ 72,422	\$ 81,302
Notes Payable	\$ 57,634	\$ 62,658	\$ 61,165	\$ 69,146
Total Liabilities	\$ 57,809	\$ 62,848	\$ 61,327	\$ 69,329
Partners' Capital	\$ 12,874	\$ 13,586	\$ 11,095	\$ 11,973

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

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	2002 Joint Venture		2003 Joint Venture
	2003	2002	2003
	(In thousands)		
Loans Receivable, Net	\$ 63,471	\$ 69,025	\$ 101,360
Total Assets	\$ 69,765	\$ 74,322	\$ 108,293
Notes Payable	\$ 57,788	\$ 62,152	\$ 91,408
Total Liabilities	\$ 57,948	\$ 62,325	\$ 91,503
Partners' Capital	\$ 11,817	\$ 11,997	\$ 16,790

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

Results of Operations (1)

	2000 Joint Venture			2001 Joint Venture		
	2003	2002	2001	2003	2002	2001(2)
	(In thousands)					
Interest Income	\$ 6,526	\$ 7,092	\$ 7,936	\$ 6,895	\$ 7,507	\$4,028
Total Revenues	\$ 6,617	\$ 7,351	\$ 8,169	\$ 7,335	\$ 7,815	\$4,222
Interest Expense	\$ 4,379	\$ 4,988	\$ 5,277	\$ 4,144	\$ 4,463	\$2,387
Provision for Losses	\$ 65	\$ 1,514	\$ —	\$ 337	\$ 140	\$ —
Total Expenses	\$ 4,670	\$ 6,752	\$ 5,526	\$ 4,712	\$ 4,849	\$2,507
Net Income	\$ 1,947	\$ 599	\$ 2,643	\$ 2,623	\$ 2,966	\$1,715

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

(2) From June 27, 2001 (inception) to December 31, 2001

	2002 Joint Venture		2003 Joint Venture
	2003	2002(3)	2003(4)
	(In thousands)		
Interest Income	\$ 6,340	\$ 4,850	\$ 1,272
Total Revenues	\$ 6,649	\$ 4,897	\$ 1,274
Interest Expense	\$ 4,013	\$ 2,999	\$ 519
Total Expenses	\$ 4,233	\$ 3,153	\$ 576
Net Income	\$ 2,416	\$ 1,744	\$ 698

(3) From April 12, 2002 (inception) to December 31, 2002

(4) From October 7, 2003 (inception) to December 31, 2003

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Our ownership of the Joint Ventures was based on our share of the capital of the respective Joint Ventures. Our share of the cash flows from the Joint Ventures was 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.

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

	2000 Joint Venture		2001 Joint Venture	
	2003	2002	2003	2002
	(In thousands)			
Loans Receivable, Net	\$ 47,003	\$ 49,844	\$ 28,039	\$ 28,951
Total Assets	\$ 50,637	\$ 53,707	\$ 30,204	\$ 31,070
Total Liabilities	\$ 41,834	\$ 44,707	\$ 25,553	\$ 26,454
Partners' Capital	\$ 8,803	\$ 9,000	\$ 4,651	\$ 4,616

	2002 Joint Venture		2003 Joint Venture
	2003	2002	2003
	(In thousands)		
Loans Receivable, Net	\$ 26,152	\$ 26,825	\$ 44,699
Total Assets	\$ 28,169	\$ 28,838	\$ 47,744
Total Liabilities	\$ 23,575	\$ 24,202	\$ 40,352
Partners' Capital	\$ 4,594	\$ 4,636	\$ 7,392

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

	2000 Joint Venture			2001 Joint Venture		
	2003	2002	2001	2003	2002	2001(1)
	(In thousands)					
Net Income	\$ 1,482	\$ 1,501	\$ 1,887	\$ 1,027	\$ 1,072	\$ 743

	2002 Joint Venture		2003 Joint Venture
	2003	2002(2)	2003(3)
	(In thousands)		
Net Income	\$ 816	\$ 675	\$ 310

- (1) From June 27, 2001 (inception) to December 31, 2001
(2) From April 12, 2002 (inception) to December 31, 2002
(3) From October 7, 2003 (inception) to December 31, 2003

In accordance with SFAS No. 140, our consolidated financial statements do not include the assets, liabilities,

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partners' capital, revenues or expenses of the Joint Ventures. As a result, at December 31, 2003 and 2002, our consolidated balance sheets do not include the \$156.8 million and \$113.6 million in assets, respectively, and \$131.3 million and \$95.4 million in liabilities, respectively, related to these structured loan sale transactions recorded by our SPEs. Our Retained Interests related to these structured loan sale transactions were \$30.8 million and \$23.5 million at December 31, 2003 and 2002, respectively, including unrealized appreciation of \$3.6 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 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 11.7%, 13.2% and 12.7% during 2003, 2002 and 2001, respectively.

PMC Capital is the servicer for all loans receivable held by the Joint Ventures; therefore, no servicing fees were earned or received by us during 2003, 2002 or 2001.

We received approximately \$3.7 million and \$3.8 million in cash distributions from the Joint Ventures during 2003 and 2002, respectively. During 2003, an 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, we had a cash flow deferral of approximately \$781,000. At December 31, 2003, the cash flow deferral remaining of approximately \$465,000 is due from PMC Capital and is included in due from affiliate on our consolidated balance sheet.

Note 5. Restricted Investments:

Restricted investments consisted of the following:

	December 31,	
	2003	2002
	(In thousands)	
Escrow and capital expenditures accounts	\$ 2,170	\$ 1,981
Structured noteholders reserve account	1,265	1,908
Structured noteholders collection account	461	1,625
Other	172	100
	<u>\$ 4,068</u>	<u>\$ 5,614</u>

The escrow and capital expenditures accounts represent restricted investments maintained pursuant to our Lease Agreement. The escrow account includes a deposit equal to two months' base rent. In accordance with the terms of the Lease Agreement, we deposit the Percentage Rent received into a capital expenditures account for future capital expenditures required to maintain the real estate investments. Funds are released from this account when capital expenditures are incurred.

The structured noteholders reserve and collection accounts represent cash collected that has not yet been remitted to the structured noteholders and reserve account balances that are required to be held as collateral on behalf of the structured noteholders. The collection and reserve accounts consist of cash and liquid money market funds.

Note 6. Notes Payable and Revolving Credit Facility:

Structured Notes Payable

In June 1998, we formed a bankruptcy remote partnership that completed a private placement of \$66.1 million of fixed-rate loan-backed notes, (the "Structured Notes"). The Structured Notes mature in May 2019, bear interest at 6.37% per annum and are collateralized by the loans receivable that we contributed to the partnership. At December 31, 2003 and 2002, the principal amount of the underlying loans receivable was \$26.0 million and \$30.7 million, respectively. PMC Commercial has no obligation to pay the Structured Notes nor do the holders of the Structured Notes have any recourse against PMC Commercial's assets. Accordingly, if the partnership fails to pay the Structured Notes, the sole recourse of the holders of the Structured Notes is against the assets of the partnership. The principal amount of the Structured Notes outstanding at December 31, 2003 and 2002 was \$18.7 million and \$26.0 million,

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respectively. Maturities of these notes are dependent upon the timing of the cash flows received from the underlying loans receivable.

Repayment of the Structured Notes, based on scheduled payments of the underlying loans receivable, is as follows:

Year Ending December 31,	Amount
	(In thousands)
2004	\$ 9,725
2005	2,192
2006	5,262
2007	519
2008	495
Thereafter	474
	\$ 18,667

Actual repayments will differ materially from these amounts to the extent we receive prepayments or defaults occur on the underlying loans receivable.

Mortgage Notes Payable

We have entered into seven mortgage notes payable, each collateralized by a Hotel Property. The mortgage notes payable have a weighted average interest rate of 6.6%, mature between 2004 and 2019 and have amortization periods of 20 years. At December 31, 2003 and 2002, the balances outstanding on these obligations were \$8.6 million and \$8.9 million, respectively.

In addition, our subsidiaries have entered into mortgage notes payable related to four Hotel Properties with a weighted average interest rate of approximately 8.0%. These mortgages are amortized over 20 years, mature from 2010 to 2017 and have restrictive provisions which provide for substantial prepayment penalties. At December 31, 2003 and 2002, the balances outstanding on these mortgage notes payable were \$6.1 million and \$6.3 million, respectively, of which \$3.3 million and \$3.4 million, respectively, were guaranteed by PMC Commercial.

Principal payments required on our mortgage notes payable are as follows:

Year Ending December 31,	Amount
	(In thousands)
2004	\$ 3,440
2005	1,377
2006	2,667
2007	410
2008	1,486
Thereafter	5,333
	\$ 14,713

Revolving Credit Facility

We have a revolving credit facility which provides funds to originate loans collateralized by commercial real estate. The revolving credit facility provided us with credit availability up to \$30 million at December 31, 2003. On February 29, 2004, the revolving credit facility was increased to \$40 million. We are charged interest on the balance outstanding under the revolving credit facility at our election of either the prime rate of the lender or 187.5 basis points over the 30, 60 or 90-day LIBOR. At December 31, 2002, we had \$7.3 million outstanding under our revolving credit facility with a weighted average interest rate of 3.1%. The credit facility requires us to meet certain covenants, the most restrictive of which provides for an asset coverage test based on our cash and cash equivalents, loans receivable, Retained Interests and real estate investments as a ratio to our senior debt. The ratio must exceed 1.25 times. The facility matures December 31, 2004. At December 31, 2003 we were in compliance with all covenants of the facility.

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Note 7. Dividends:

In April 2003, we paid a quarterly dividend of \$0.40 per share to common shareholders of record on March 31, 2003. In July and October 2003, we paid quarterly dividends of \$0.38 per share to common shareholders of record on June 30, 2003 and September 30, 2003, respectively. The Board of Trust Managers declared a \$0.38 per share quarterly dividend to common shareholders of record on December 31, 2003, which was paid in January 2004. Dividends declared for the years ended December 31, 2003 and 2002 were \$1.54 per share and \$1.62 per share, respectively.

As a condition to completing the merger, PMC Capital was required to make sufficient distributions to distribute 100% of its taxable income for its taxable period from January 1, 2004 to February 29, 2004 with a similar distribution to be made to our shareholders as adjusted by the 0.37 exchange ratio (the "special dividends"). PMC Capital's declared special dividend was \$0.09 per share; thus, our declared special dividend was \$0.243 per share. These special dividends were paid on February 27, 2004 to common shareholders of record on February 23, 2004.

Note 8. Taxable Income:

As a 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. We may, however, be subject to certain Federal excise taxes and state and local taxes on our income and property. 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 will not be able to qualify as a REIT for four subsequent taxable years.

We may make an election under the Code to treat distributions declared in the current year as distributions of the prior year's taxable income. Upon election, the Code provides that, in certain circumstances, a dividend declared subsequent to the close of an entity's taxable year and prior to the extended due date of the entity's tax return may be considered as having been made in the prior tax year in satisfaction of income distribution requirements. Having met these requirements, we elected on our 2002 tax return to apply approximately \$1.2 million of 2003 distributions to the 2002 tax year.

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

	Years Ended December 31,		
	2003	2002	2001
		(In thousands)	
Net income available to common shareholders	\$ 8,174	\$ 9,936	\$ 11,435
Add: Book depreciation and amortization	1,967	2,121	2,159
Less: Tax depreciation and amortization	(1,927)	(1,987)	(2,147)
Book/tax difference on gains on sales	(650)	(550)	(1,433)
Book/tax difference on Retained Interests, net	672	486	813
Other book/tax differences, net	437	10	365
Taxable income available to common shareholders	<u>\$ 8,673</u>	<u>\$ 10,016</u>	<u>\$ 11,192</u>
Distributions to common shareholders	<u>\$ 9,932</u>	<u>\$ 10,440</u>	<u>\$ 9,789</u>

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Dividends per share for dividend reporting purposes were as follows:

	Years Ended December 31,					
	2003		2002		2001	
	Amount Per Share	Percent	Amount Per Share	Percent	Amount Per Share	Percent
Ordinary income	\$ 1.487	96.53%	\$ 1.517	93.67%	\$ 1.309	86.09%
Capital gains	0.053	3.47%	0.103	6.33%	0.211	13.91%
	<u>\$ 1.540</u>	<u>100.00%</u>	<u>\$ 1.620</u>	<u>100.00%</u>	<u>\$ 1.520</u>	<u>100.00%</u>

Note 9. Discontinued Operations and Impairment Losses:

Effective January 1, 2002, we adopted SFAS No. 144, "Accounting for the Impairment of or Disposal of Long-Lived Assets". In accordance with SFAS No. 144, the operations of our hotel properties either sold during 2002 or 2003 or held for sale at December 31, 2003 have been reflected as discontinued operations in our accompanying statements of income and the prior period financial statements have been reclassified to reflect the operations of these properties as discontinued operations during 2002 and 2001. SFAS No. 144 does not allow for reclassification of prior period gains and operations of properties sold prior to January 1, 2002.

During 2003, we sold one hotel property for approximately \$2.2 million and recognized a gain of approximately \$283,000. During 2002, we sold two hotel properties for approximately \$5.2 million and recognized gains of approximately \$663,000. We provided financing of \$1.7 million for the hotel property sold during 2003 and \$2.0 million for one of the hotel property sales completed during 2002, both with interest rates of LIBOR plus 4%.

Our discontinued operations consisted of the following:

	Years Ended December 31,		
	2003	2002	2001
	(In thousands)		
Lease income	\$ 447	\$ 681	\$ 1,044
Advisory fees	(29)	(42)	(67)
Depreciation	(69)	(147)	(327)
Net earnings	349	492	650
Gain on sale of real estate investments	283	663	—
Discontinued operations	<u>\$ 632</u>	<u>\$ 1,155</u>	<u>\$ 650</u>

We sold our asset acquired in liquidation held for sale for net cash proceeds of approximately \$333,000 during 2003 and recorded impairment losses of \$67,000 and \$54,000 during 2003 and 2002, respectively.

Note 10. Earnings Per Share:

The weighted average number of Common Shares outstanding were 6,448,136, 6,444,371, and 6,431,461 for the years ended December 31, 2003, 2002 and 2001, respectively. For purposes of calculating diluted earnings per share, the weighted average shares outstanding were increased by approximately 11,400, 11,700, and 11,600 shares for the dilutive effect of stock options during 2003, 2002 and 2001, respectively.

For purposes of calculating earnings per share, the gain on sale of assets of \$711,000, \$562,000 and \$2,783,000 for the years ended December 31, 2003, 2002 and 2001, respectively, has been combined with income from continuing operations.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Options to purchase 15,000, 57,600 and 155,600 Common Shares were outstanding during 2003, 2002 and 2001, respectively, but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the Common Shares.

Note 11. Dividend Reinvestment and Cash Purchase Plan:

We have a dividend reinvestment and cash purchase plan (the "Plan"). Participants in the Plan have the option to reinvest all or a portion of dividends received. The purchase price of the Common Shares is 100% of the average of the closing price of the Common Shares as published for the five trading days immediately prior to the dividend record date or prior to the optional cash payment purchase date, whichever is applicable. The optional cash purchase plan was suspended during January 2000. In addition, since January 2000 we have been using the open market to purchase Common Shares with proceeds from the dividend reinvestment portion of the Plan. Accordingly, there were no plan shares issued during 2003, 2002 and 2001.

Note 12. Stock-Based Compensation Plans:

We have two stock-based compensation plans, the 1993 Employee Share Option Plan (the "Employee Plan") and the Trust Manager Share Option Plan (the "Trust Manager Plan"), referred to collectively as the "Stock Option Plans." The Stock Option Plans provide that the exercise price of any stock option may not be less than the fair market value of our Common Stock on the date of grant. We have discretion in determining the vesting terms applicable to stock options granted under the Employee Plan. In general, all options vest immediately. Pursuant to the Employee Plan, we are authorized to grant stock options up to an aggregate of 6% of the total number of Common Shares outstanding at any time (a maximum of approximately 387,000 shares at December 31, 2003) as incentive stock options (intended to qualify under Section 422 of the Code) or as options that are not intended to qualify as incentive stock options.

Effective January 1, 2003, we adopted the fair value recognition provisions of SFAS No. 123 prospectively to all awards granted, modified or settled after January 1, 2003.

Only the trust managers who are not employees of PMC Capital or the Investment Manager (the "Non-employee Trust Managers") are eligible to participate in the Trust Managers Plan. The Trust Managers Plan is a nondiscretionary plan pursuant to which options to purchase 2,000 Common Shares are granted to each Non-employee Trust Manager on the date such trust manager takes office. In addition, options to purchase 1,000 shares are granted on June 1 of each year. Such options will be exercisable at the fair market value of the shares on the date of grant. The options granted under the Trust Managers Plan become exercisable one year after date of grant and expire if not exercised on the earlier of (i) 30 days after the option holder no longer holds office as a Non-employee Trust Manager for any reason or (ii) within five years after date of grant. We issued 5,000 options under the Trust Managers Plan during each of the three years in the period ended December 31, 2003.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of the status of our stock options as of December 31, 2003, 2002 and 2001 and the changes during the years ended on those dates are as follows:

	2003		2002		2001	
	Number of Shares Underlying Options	Weighted Average Exercise Prices	Number of Shares Underlying Options	Weighted Average Exercise Prices	Number of Shares Underlying Options	Weighted Average Exercise Prices
Outstanding, January 1	204,426	\$ 13.86	202,976	\$ 15.28	233,561	\$ 14.81
Granted	5,000	\$ 13.78	54,800	\$ 13.29	52,400	\$ 13.16
Exercised	(6,500)	\$ 12.76	(5,000)	\$ 12.80	(50,474)	\$ 9.40
Forfeited	(8,950)	\$ 14.92	(600)	\$ 18.63	(7,850)	\$ 18.33
Expired	(43,100)	\$ 18.05	(47,750)	\$ 19.78	(24,661)	\$ 16.73
Outstanding, December 31	<u>150,876</u>	<u>\$ 12.64</u>	<u>204,426</u>	<u>\$ 13.86</u>	<u>202,976</u>	<u>\$ 15.28</u>
Exercisable, December 31	<u>145,876</u>	<u>\$ 12.60</u>	<u>199,426</u>	<u>\$ 13.83</u>	<u>197,976</u>	<u>\$ 15.28</u>
Weighted-average fair value of stock options granted during the year	<u>\$ 0.38</u>		<u>\$ 0.60</u>		<u>\$ 0.75</u>	

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for grants in 2003, 2002 and 2001:

	Years Ended December 31,		
	2003	2002	2001
Assumption:			
Expected Term (years)	3.0	3.0	3.0
Risk-Free Interest Rate	1.48%	2.33%	3.88%
Expected Dividend Yield	11.03%	12.20%	11.55%
Expected Volatility	18.50%	22.61%	22.61%

The following table summarizes information about stock options outstanding at December 31, 2003:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/03	Weighted Average Remaining Contract Life	Weighted Average Exercise Price	Number Exercisable at 12/31/03	Weighted Average Exercise Price
\$9.25 to \$10.75	5,076	1.7	\$ 9.84	5,076	\$ 9.84
\$11.1875 to \$11.1875	40,500	0.9	\$11.1875	40,500	\$11.1875
\$13.125 to \$14.90	105,300	3.3	\$13.33	100,300	\$13.31
\$9.25 to \$14.90	<u>150,876</u>	2.6	\$12.64	<u>145,876</u>	\$12.60

Note 13. Fair Values of Financial Instruments:

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

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Years Ended December 31,			
	2003		2002	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(In thousands)			
Assets:				
Loans receivable, net	\$ 50,584	\$ 50,811	\$ 71,992	\$ 72,451
Retained Interests	30,798	30,798	23,532	23,532
Cash and cash equivalents	1,078	1,078	49	49
Restricted investments	4,068	3,782	5,614	5,174
Liabilities:				
Notes payable	33,380	34,514	41,191	43,520
Revolving credit facility	—	—	7,300	7,300

Loans receivable, net: We estimate the fair value of loans receivable to approximate the remaining unamortized principal of the loans receivable, unless there is doubt as to realization of a loan receivable. A valuation reserve is established for a problem loan based on the creditor's payment history, collateral value, guarantor support and other factors. In the absence of a readily ascertainable market value, the estimated value of our loans receivable may differ from the values that would be placed on the loan portfolio if a ready market for the loans receivable existed.

Retained Interests: The assets are reflected in our consolidated financial statements at estimated fair value based on valuation techniques as described in Note 4.

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

Restricted investments: The fair value of the reserve fund associated with the 1998 structured loan financing transaction is estimated by utilizing discounted cash flow techniques based on management's estimates of market rates including risks inherent in the transaction. The carrying amount of the remaining restricted investments is a reasonable estimate of fair value due to the short maturity of these instruments.

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

Revolving credit facility: The carrying amount is a reasonable estimation of fair value as the interest rate on this instrument is a variable rate of interest.

Note 14. Related Party Transactions:

Our loans receivable were originated and serviced by PMC Advisers pursuant to an Investment Management Agreement (the "IMA"). Property acquisitions were supervised pursuant to a separate agreement with PMC Advisers (the "Lease Supervision Agreement" and together with the IMA, the "Advisory Agreements"). We were managed by the same executive officers as PMC Capital and PMC Advisers. Three of our trust managers were directors or officers of PMC Capital.

Pursuant to the IMA we were charged fees between 0.40% and 1.55% annually, based on the average principal outstanding of our loans receivable. In addition, PMC Advisers earns fees for its assistance with the issuance of our debt and equity securities. Such compensation includes a consulting fee equal to (i) 12.5% of any offering fees (underwriting or placement fees) incurred by us pursuant to the public offering or private placement of our common shares, and (ii) 50% of any issuance or placement fees incurred by us pursuant to the issuance of our debt securities or preferred shares of beneficial interest. The IMA also provided for a fee of \$10,000 upon the sale of each Hotel Property and an annual loan origination fee equal to five basis points for the first \$20 million of loans funded and 2.5 basis points thereafter. Subsequent to the merger with PMC Capital, the IMA was terminated.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Lease Supervision Agreement provided for an annual fee of 0.70% of the original cost of the Hotel Properties to be paid to PMC Advisers for providing services relating to the leases on the Hotel Properties. In addition, the Lease Supervision Agreement provided for a fee in connection with the acquisition of properties of 0.75% of the acquisition cost. Subsequent to the merger with PMC Capital, the Lease Supervision Agreement was terminated.

Fees associated with the Advisory Agreements consisted of the following:

	Years Ended December 31,		
	2003	2002	2001
		(In thousands)	
Investment management fee	\$ 2,047	\$ 1,927	\$ 1,803
Lease supervision fee	378	401	461
Total fees incurred	2,425	2,328	2,264
Less:			
Management fees included in discontinued operations	(29)	(42)	(67)
Fees incurred on behalf of the SPEs	(338)	(298)	(198)
Cost of structured loan sale transactions	(102)	(57)	(60)
Cost of property sales	(10)	(20)	(20)
Fees capitalized as cost of originating loans	(108)	(135)	(208)
Advisory and servicing fees to affiliate, net	\$ 1,838	\$ 1,776	\$ 1,711

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 15. Selected Quarterly Financial Data: (unaudited)

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

For the Year Ended December 31, 2003

	Revenues(1)	Income From Continuing Operations(1)	Net Income	Earnings Per Share
(In thousands, except earnings per share and footnotes)				
First Quarter	\$ 3,540	\$ 1,713	\$ 1,812	\$ 0.28
Second Quarter	3,737	1,743	1,839	0.29
Third Quarter	3,939	1,893	2,265(2)	0.35(2)
Fourth Quarter	3,370	1,482	2,258(3)	0.35(2)
	<u>\$ 14,586</u>	<u>\$ 6,831</u>	<u>\$ 8,174</u>	<u>\$ 1.27</u>

For the Year Ended December 31, 2002

	Revenues(1)	Income From Continuing Operations(1)	Net Income	Earnings Per Share
(In thousands, except earnings per share and footnotes)				
First Quarter	\$ 4,156	\$ 2,118	\$ 2,648(4)	\$ 0.41(4)
Second Quarter	4,065	2,172	\$ 3,164(5)	0.49(5)
Third Quarter	3,795	2,065	\$ 2,164	0.34
Fourth Quarter	3,736	1,864	\$ 1,960	0.30
	<u>\$ 15,752</u>	<u>\$ 8,219</u>	<u>\$ 9,936</u>	<u>\$ 1.54</u>

- (1) Certain amounts were previously reported in continuing operations in our quarterly filings on Form 10-Q. Such amounts have been reclassified to discontinued operations in accordance with SFAS No. 144.
- (2) Includes a gain of \$283,000 from the sale of a hotel property.
- (3) Includes a gain of \$711,000 relating to our structured loan sale transaction.
- (4) Includes a gain of \$371,000 from the sale of a hotel property.
- (5) Includes a gain of \$562,000 relating to our structured loan sale transaction and a gain of \$292,000 from the sale of a hotel property.

Note 16. 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 December 31, 2003, we had approximately \$7.7 million of total loan commitments outstanding. The majority of these commitments were for variable-rate loans at spreads over LIBOR ranging from 4.0% to 4.5%. The weighted average interest rate on our loan commitments at December 31, 2003 was 5.6%. 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.

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 (\$1.5 million at December 31, 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 the underlying loans receivable of the 1998 Partnership at inception (\$1.4 million). As of December 31, 2003 and 2002, none of the loans receivable in the 1998 structured loan financing transaction were delinquent 180 days or more. In April 2003, approximately \$1.7 million was repaid to the

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 have been deposited into the reserve fund and continued to be deposited until January 2004 when the reserve fund was equal to the reserve requirement. As of December 31, 2003, the cash balance in our reserve fund, included in restricted investments on our consolidated balance sheet, was approximately \$1,265,000.

Structured Loan Sale Transactions

PMC Commercial and PMC Capital entered into cross indemnification agreements regarding the performance of their respective loans receivable sold to the Joint Ventures. Prior to the merger with PMC Capital, in accordance with the agreements, to the extent that poor performance by either PMC Capital or PMC Commercial's sold loans receivable (the "Underperforming Company") was 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 was required to make the Performing Company whole. If the cash flow reduction was considered temporary, then interest would be paid as compensation to the Performing Company. In general, if a loan was liquidated, it could 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 repaid the Performing Company. If the reduction of cash flows was deemed permanent, (*i.e.*, to the extent that the Underperforming Company would not be able to satisfy the shortfall with the assets they had contributed to the related structured loan sale transaction), the reduction in cash flows would be paid to the Performing Company by the Underperforming Company. At December 31, 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 \$49.0 million and the discounted amount was \$33.0 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. We merged with PMC Capital on February 29, 2004 and the cross indemnification agreements were terminated. Thus, we believe that the fair value of our obligations pursuant to the cross indemnification agreements at inception of the Joint Ventures and as of December 31, 2003 and 2002 was zero and no liability was recorded.

When our structured loan sale transactions were completed, the transaction documents that the SPE entered into contained provisions (the "Credit Enhancement Provisions") that govern the assets and the flow of funds in and out 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 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. During the first quarter of 2004, as a result of delinquent loans in the 2001 Joint Venture with a principal balance of \$2.3 million, a Credit Enhancement Provision was triggered. As a consequence, cash flows of approximately \$600,000 relating to this transaction have been deferred and utilized to fund the increased reserve requirement. We currently anticipate that the increased reserve requirement will be relieved when we exercise our option to repurchase these loans from the 2001 Joint Venture. In the event we do not exercise our option to repurchase these loans, we currently estimate that approximately \$1.7 million of additional cash flows related to this transaction would be deferred and used to fund the increased reserve requirement. Management believes that these funds would be received in future periods. In general, there can be no assurance that amounts deferred under Credit Enhancement Provisions will be received in future periods or that future deferrals or losses will not occur.

Litigation

In the normal course of business, including our assets acquired in liquidation, 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 17. 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 receivable to small businesses primarily in the hospitality industry and (ii) the Property Division which owns the Hotel Properties.

PMC COMMERCIAL TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Year Ended December 31, 2001		
	Total	Lending Division	Property Division
	(In thousands)		
Revenues:			
Interest income — loans and other portfolio income	\$ 8,321	\$ 8,321	\$ —
Lease income	5,994	—	5,994
Income from retained interests in transferred assets	1,815	1,815	—
Total	16,130	10,136	5,994
Expenses:			
Interest (1)	4,020	2,463	1,557
Depreciation	1,774	—	1,774
Advisory and servicing fees to affiliate, net	1,711	1,319	392
Realized losses on retained interests in transferred assets	81	81	—
Provision for loan losses	200	200	—
Other	342	332	10
Total	8,128	4,395	3,733
Income from continuing operations	8,002	5,741	2,261
Discontinued operations:			
Net earnings	650	—	650
Total	650	—	650
Gain on sale of assets:			
Gain on sale of real estate investments	1,350	—	1,350
Gain on sale of loans receivable	1,433	1,433	—
Total	2,783	1,433	1,350
Net income	\$ 11,435	\$ 7,174	\$ 4,261
Additions to real estate investments	\$ 490	\$ —	\$ 490
December 31, 2001			
	(In thousands)		
Total assets	\$ 156,347	\$ 101,480	\$ 54,867

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

Note 18. Subsequent Event:

PMC Capital, our affiliate, was merged into PMC Commercial, with PMC Commercial continuing as the surviving entity, on February 29, 2004. We now own and operate the businesses of PMC Capital and its subsidiaries. We believe that the merger will provide important strategic and financial benefits to us including larger market capitalization, stabilization of cash flow, support for our revenue stream and self-management. Each issued and outstanding share of PMC Capital common stock was converted into 0.37 of a common share of PMC Commercial. As a result, we issued 4,385,800 common shares of beneficial interest on February 29, 2004 valued at \$13.10 per share, which is the average closing price of our common stock for the three days preceding the date of the announcement adjusted by declared but unpaid dividends. As of December 31, 2003, we had incurred transaction costs for the merger of approximately \$1,139,000 which are included in other assets in our accompanying consolidated balance sheet.

The merger was accounted for under the purchase method of accounting as provided by SFAS No. 141. We acquired all assets and assumed all liabilities and preferred stock of PMC Capital at February 29, 2004. Based on our current estimate of value for PMC Capital's assets to be acquired and liabilities and preferred stock of subsidiary to be assumed, no goodwill will result and we will record an extraordinary gain during the first quarter of 2004.

***Report of Independent Auditors on
Financial Statement Schedules***

To the Board of Trust Managers of
PMC Commercial Trust:

Our audits of the consolidated financial statements referred to in our report dated March 15, 2004 appearing on page F-2 of the 2003 Form 10-K also included an audit of the financial statement schedules listed in Item 15(a)(2) of this Form 10-K. In our opinion, these financial statement schedules present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PricewaterhouseCoopers LLP

Dallas, Texas
March 15, 2004

Schedule II
PMC COMMERCIAL TRUST AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS
AS OF DECEMBER 31, 2003
(In thousands)

Description	Balance at beginning of period	Additions		Balance at end of period
		Charged to costs and expenses	Charged to other accounts	
Year ended December 31, 2001				
Loan Loss Reserves	\$ 100	\$ 200	\$ —	\$ 300
Year ended December 31, 2002				
Loan Loss Reserves	\$ 300	\$ 65	\$ —	\$ 365
Year ended December 31, 2003				
Loan Loss Reserves	\$ 365	\$ 310	\$ —	\$ 675

Schedule III
PMC COMMERCIAL TRUST AND SUBSIDIARIES
REAL ESTATE AND ACCUMULATED DEPRECIATION
AS OF DECEMBER 31, 2003
(In thousands)

Description of Property	Encumbrances	Initial Cost			Cost Capitalized Subsequent To Acquisition			Gross Amounts at Which Carried at Close of Period (1)			Total
		Land	Building and Improvements	Furniture and Fixtures	Land	Building and Improvements	Furniture and Fixtures	Land	Building and Improvements	Furniture and Fixtures	
The following are all hotel properties operating as Amerihost Inns											
Ashland, OH	\$ —	\$ 215	\$ 2,626	\$ 185	\$ —	\$ 5	\$ 46	\$ 215	\$ 2,631	\$ 231	\$ 3,077
Coopersville, MI	1,339	242	1,999	180	—	4	66	242	2,003	246	2,491
Eagles Landing, GA	—	325	1,815	180	—	4	19	325	1,819	199	2,343
Grand Rapids-N, MI	1,543	221	2,323	180	—	5	43	221	2,328	223	2,772
Grand Rapids-S, MI	1,471	368	2,173	183	—	4	49	368	2,177	232	2,777
Jackson, TN	—	403	1,936	183	—	4	36	403	1,940	219	2,562
McKinney, TX	—	273	2,066	183	—	4	37	273	2,070	220	2,563
Monroe, MI	—	273	2,060	189	—	4	100	273	2,064	289	2,626
Mosinee, WI	1,088	140	1,416	159	—	3	48	140	1,419	207	1,766
Mt. Pleasant, IA	980	179	1,851	189	—	4	76	179	1,855	265	2,299
Port Huron, MI	—	263	2,076	183	—	4	45	263	2,080	228	2,571
Rochelle, IL	881	221	2,017	183	—	4	57	221	2,021	240	2,482
Smyrna, GA	—	290	1,749	180	—	4	75	290	1,753	255	2,298
Storm Lake, IA	1,336	220	1,716	183	—	3	16	220	1,719	199	2,138
Tupelo, MS	—	236	1,901	183	—	4	33	236	1,905	216	2,357
Wooster — E, OH	—	171	1,673	174	—	3	51	171	1,676	225	2,072
Wooster — N, OH	—	263	1,575	229	—	7	40	263	1,582	269	2,114
Macomb, IL	1,650	194	2,277	180	—	4	69	194	2,281	249	2,724
Sycamore, IL	1,607	250	2,220	180	—	4	65	250	2,224	245	2,719
Marysville, OH	1,354	300	2,712	237	—	6	61	300	2,718	298	3,316
Plainfield, IN	1,464	300	1,962	180	—	4	36	300	1,966	216	2,482
	<u>\$ 14,713</u>	<u>\$ 5,347</u>	<u>\$ 42,143</u>	<u>\$ 3,903</u>	<u>\$ —</u>	<u>\$ 88</u>	<u>\$ 1,068</u>	<u>\$ 5,347</u>	<u>\$ 42,231</u>	<u>\$ 4,971</u>	<u>\$52,549</u>

(1) The aggregate cost of our real estate for Federal income tax purposes was \$52,549,000 (unaudited).

Schedule III
PMC COMMERCIAL TRUST AND SUBSIDIARIES
REAL ESTATE AND ACCUMULATED DEPRECIATION
AS OF DECEMBER 31, 2003
(In thousands)

Description of Property The following are all hotel properties operating as Amerihost Inns	Accumulated Depreciation - Building and Improvements; Furniture and Fixtures	Date of Construction	Date of Acquisition	Life upon Which Depreciation in Statement Is Computed
Ashland, OH	\$ 536	8/9/1996	6/30/1998	7 - 35 years
Coopersville, MI	454	1/9/1996	6/30/1998	7 - 35 years
Eagles Landing, GA	417	8/8/1995	6/30/1998	7 - 35 years
Grand Rapids-N, MI	487	7/5/1995	6/30/1998	7 - 35 years
Grand Rapids-S, MI	473	6/11/1997	6/30/1998	7 - 35 years
Jackson, TN	440	4/1/1998	6/30/1998	7 - 35 years
McKinney, TX	452	1/6/1997	6/30/1998	7 - 35 years
Monroe, MI	488	9/19/1997	6/30/1998	7 - 35 years
Mosinee, WI	357	4/30/1993	6/30/1998	7 - 35 years
Mt. Pleasant, IA	442	7/2/1997	6/30/1998	7 - 35 years
Port Huron, MI	436	7/1/1997	6/30/1998	7 - 35 years
Rochelle, IL	447	3/7/1997	6/30/1998	7 - 35 years
Smyrna, GA	414	1/8/1996	6/30/1998	7 - 35 years
Storm Lake, IA	405	3/13/1997	6/30/1998	7 - 35 years
Tupelo, MS	430	7/25/1997	6/30/1998	7 - 35 years
Wooster — E, OH	400	1/18/1994	6/30/1998	7 - 35 years
Wooster — N, OH	403	10/21/1995	6/30/1998	7 - 35 years
Macomb, IL	425	5/1/1995	3/23/1999	7 - 35 years
Sycamore, IL	416	5/31/1996	3/23/1999	7 - 35 years
Marysville, OH	514	6/1/1990	3/5/1999	7 - 35 years
Plainfield, IN	374	9/1/1992	3/5/1999	7 - 35 years
	<u>\$ 9,210</u>			

Schedule III
PMC COMMERCIAL TRUST AND SUBSIDIARIES
REAL ESTATE AND ACCUMULATED DEPRECIATION
AS OF DECEMBER 31, 2003
(In thousands)

Gross amount carried:

	Totals
Balance at December 31, 2000	\$ 70,941
Additions during period:	
Acquisitions through foreclosure	\$ —
Other Acquisitions	—
Improvements, etc.	490
Other (describe)	—
	\$ 490
Deductions during period:	
Cost of real estate sold	\$ (12,436)
Other (describe)	—
	\$ (12,436)
Balance at December 31, 2001	\$ 58,995
Additions during period:	
Acquisitions through foreclosure	\$ —
Other Acquisitions	—
Improvements, etc.	388
Other (describe)	—
	\$ 388
Deductions during period:	
Cost of real estate sold	\$ (4,965)
Real estate held for sale	(2,159)
	\$ (7,124)
Balance at December 31, 2002	\$ 52,259
Additions during period:	
Acquisitions through foreclosure	\$ —
Other Acquisitions	—
Improvements, etc.	290
Other (describe)	—
	\$ 290
Deductions during period:	
Cost of real estate sold	\$ —
Real estate held for sale	(2,570)
	\$ (2,570)
Balance at December 31, 2003	\$ 49,979

Accumulated Depreciation:

Balance at December 31, 2000	\$ 5,267
Additions during period:	
Depreciation expense during the period	2,101
Accumulated Depreciation:	
Assets sold or written-off during the period	(1,091)
Balance at December 31, 2001	\$ 6,277
Additions during period:	
Depreciation expense during the period	1,903
Accumulated Depreciation:	
Real estate held for sale	(282)
Assets sold or written-off during the period	(567)
Balance at December 31, 2002	\$ 7,331
Additions during period:	
Depreciation expense during the period	1,879
Accumulated Depreciation:	
Real estate held for sale	(436)
Assets sold or written-off during the period	—
Balance at December 31, 2003	\$ 8,774

Schedule IV
PMC COMMERCIAL TRUST AND SUBSIDIARIES
MORTGAGE LOANS ON REAL ESTATE
AS OF DECEMBER 31, 2003
(In thousands, except footnotes)

Description of Property	Interest Rate		Final Maturity Date	Periodic Payment Terms	Prior Liens	Face Amount of Mortgages (1)	Carrying Amount of Mortgages	Principal Amount of Loans Subject to Delinquent Principal or Interest	
	Variable	Fixed							
100% of our mortgages are commercial first mortgages on limited service hospitality properties									
Mortgages 3% or greater:									
Richmond, VA	5.65%		4/25/2023	(2)	\$ —	\$ 3,379	\$ 3,355	\$ —	
Davenport, IA	5.15%		5/12/2023	(3)	—	3,057	3,036	—	
Orlando, FL	8.25%		1/1/2024	(4)	—	2,900	2,909	—	
Emporia, VA	5.15%		12/16/2023	(5)	—	2,591	2,600	—	
Stroudsburg, PA		10.80%	9/1/2017	(6)	—	2,201	2,183	—	
Kingman, AZ	5.40%		12/31/2023	(7)	—	2,171	2,180	—	
Arlington, TX		10.63%	4/5/2004	(8)	—	1,748	1,073(8)	1,748	
Dunkirk, NY	5.15%		4/9/2023	(9)	—	1,710	1,700	—	
LaGrange, GA	5.15%		9/12/2023	(10)	—	1,662	1,662	—	
Pikesville, MD		9.85%	4/23/2005	(11)	—	1,622	1,616	—	
Grand Prairie, TX		10.90%	4/18/2006	(12)	—	1,619	1,606	—	
Emporia, VA	5.15%		2/28/2023	(13)	—	1,561	1,556	—	
Runnemede, NJ		10.90%	9/11/2006	(12)	—	1,533	1,520	—	
States 3% or greater (14):									
	Number of Loans	Size of Loans (In thousands)		Interest Rate	Final Maturity Date	Prior Liens	Face Amount of Mortgages (1)	Carrying Amount of Mortgages	Principal Amount of Loans Subject to Delinquent Principal or Interest
		From	To						
Texas	3	\$ 200	\$ 1,000	10.50%	2/01/04--12/02/17	—	1,811	1,798	—
	1	(15)	(15)	10.99%	9/13/2006	—	1,060	1,053	—
Florida	2	\$ 600	\$ 1,000	8.25%	01/23/04--04/30/06	—	1,236	1,232	—
	1	(15)	(15)	5.40%	3/30/2024	—	1,420	1,429	—
Arizona	1	(15)	(15)	5.40%	12/31/2003	—	660	660	—
	2	\$ 1,000	\$ 1,500	5.40%	9/06/04--1/20/23	—	2,188	2,167	—
Maryland	2	\$ 700	\$ 1,300	9.60% to 10.25%	2/20/17--4/07/18	—	1,996	1,988	—
New York	1	(15)	(15)	8.85%	12/1/2006	—	50	50	—
Ohio	1	(15)	(15)	11.37%	8/12/2004	—	180	179	—
	2	\$ 1,200	\$ 1,500	9.00% to 11.37%	8/12/04--06/02/18	—	2,286	2,276	—
Mississippi	2	\$ 1,000	\$ 1,200	9.25% to 10.75%	10/02/06--4/14/18	—	2,218	2,204	—
Other	4	\$ 100	\$ 1,000	10.75% to 10.90%	12/01/05--07/31/12	—	2,274	2,258	—
	5	\$ 1,000	\$ 1,600	5.40% to 5.65%	9.60% to 10.75%	—	6,353	6,294	—
						\$ —	\$ 51,486	\$ 50,584	\$ —

Footnotes:

- (1) *The aggregate cost of our mortgages for Federal income tax purposes was \$51,486,000 (unaudited).*
- (2) *Payments based on variable interest rate, adjusting quarterly until maturity. Prepayment charge for first five years is 5% of the principal prepaid. Prepayment charge for the second five years is 3% of the principal prepaid. Thereafter, no prepayment charge.*
- (3) *Payments based on variable interest rate, adjusting quarterly until maturity. Prepayment is prohibited for first five years; thereafter 10% of prepaid principal.*
- (4) *Payments based on variable interest rate, adjusting quarterly until maturity. Prepayment is prohibited until certificate of occupancy is issued; from then and continuing and including the date which is five years from the date the second lien note is paid in full, 10% charge on prepaid principal; no prepayment charge thereafter.*
- (5) *Payments based on variable interest rate, adjusting quarterly until maturity. Prepayment charge is 5% for six years from December 31, 2003; no prepayment penalty at expiration of six years.*
- (6) *Payments are equal until September 1, 2007. At that date, interest rate may be changed at our discretion. Prepayment charge is based on a Yield Maintenance Premium.*
- (7) *Payments based on variable interest rate, adjusting quarterly until maturity. Prepayment charge is 5% for five years from December 2, 2003; 3% for the next five years from that date and no prepayment charge after ten years from December 2, 2003.*
- (8) *An impaired loan with a face amount of \$1,748,000 and a valuation reserve of \$675,000.*
- (9) *Payments based on variable interest rate, adjusting quarterly until maturity. Prepayment charge for first five years is 5% of the principal prepaid. Prepayment charge for the second five years is 1.5% of the principal prepaid. Thereafter, no prepayment charge.*
- (10) *Payments based on variable interest rate, adjusting quarterly until maturity. No prepayment charge for first year; years two through six 10% of the principal prepaid; years seven through twenty prepayment charge is 2% of the prepaid principal.*
- (11) *Payments based on fixed interest rate. Prepayment charge is greater of ninety-five days of interest or Yield Maintenance Premium.*
- (12) *Payments based on fixed interest rate. Prepayment charge is greater of 2% of prepaid principal or Yield Maintenance Premium.*
- (13) *Payments based on variable interest rate, adjusting quarterly until maturity. Prepayment charge for first five years is 5% of the principal prepaid. No prepayment charge thereafter.*
- (14) *For those loans which were individually less than 3% of our portfolio, we have grouped the outstanding balance by state.*
- (15) *Range not presented as represents only one loan.*

Schedule IV
PMC COMMERCIAL TRUST AND SUBSIDIARIES
MORTGAGE LOANS ON REAL ESTATE
AS OF DECEMBER 31, 2003
(In thousands)

		Totals
Balance at December 31, 2000		\$ 65,645
Additions during period:		
New mortgage loans	\$ 51,683	
Other — accretion of commitment fees	427	52,110
Deductions during period:		
Collections of principal	\$ (5,935)	
Foreclosures	—	
Cost of mortgages sold	(32,662)	
Amortization of premium	—	
Loan loss reserve	(200)	
Other — deferral for collection of commitment fees, net of costs	(473)	\$ (39,270)
Balance at December 31, 2001		\$ 78,485
Additions during period:		
New mortgage loans	\$ 32,776	
Other — accretion of commitment fees	455	33,231
Deductions during period:		
Collections of principal	\$ (12,268)	
Foreclosures	—	
Cost of mortgages sold	(27,216)	
Amortization of premium	—	
Loan loss reserve	(65)	
Other — deferral for collection of commitment fees, net of costs	(175)	\$ (39,724)
Balance at December 31, 2002		\$ 71,992
Additions during period:		
New mortgage loans	\$ 31,320	
Other — accretion of commitment fees	362	31,682
Deductions during period:		
Collections of principal	\$ (7,618)	
Foreclosures	—	
Cost of mortgages sold	(45,032)	
Amortization of premium	—	
Loan loss reserve	(310)	
Other — deferral for collection of commitment fees, net of costs	(130)	\$ (53,090)
Balance at December 31, 2003		\$ 50,584

EXHIBIT INDEX

Exhibit Number	Description
2.1	Agreement of Purchase and Sale, dated as of May 21, 1998, by and among Registrant and the various corporations identified on Exhibit A thereto (which includes as Exhibit D thereto, the form of the Master Agreement relating to the leasing of the properties), including Amerihost Properties, Inc. and Amerihost Inns, Inc. (previously filed with the Commission as Exhibit 2.2 to the Registrant's Form 8-K dated June 5, 1998 and incorporated herein by reference).
2.2	Agreement and Plan of Merger by and between PMC Commercial Trust and PMC Capital, Inc. dated March 27, 2003 (previously filed with Commission as Annex A to the Registrant's Form S-4 dated November 10, 2003 and incorporated herein by reference).
2.3	Amendment No. 1 to Agreement and Plan of Merger between PMC Commercial Trust and PMC Capital, Inc. dated August 1, 2003 (incorporated by reference to Exhibit 2.5 from Registrant's Form 10-Q filed on August 12, 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).
*3.1(c)	Amendment No. 3 to Declaration of Trust dated February 10, 2004.
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.
4.1	Instruments defining the rights of security holders. The instruments filed in response to items 3.1 and 3.2 are incorporated in this item by reference. 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.
10.2	1993 Employee Share Option Plan. Previously filed as an exhibit to our Registration Statement on Form S-11 filed with

Exhibit Number	Description
	the Commission on June 25, 1993, as amended (Registration No. 33-65910), and incorporated herein by reference.
10.3	1993 Trust Manager Share Option Plan. 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.
10.11	Trust Indenture between PMC Joint Venture, L.P. 2000 and BNY Midwest Trust Company, dated as of December 15, 2000 (incorporated by reference to Exhibit 2.1 from Registrant's Form 8-K filed on March 13, 2001).
10.12	Servicing Agreement by and among BNY Midwest Trust Company, PMC Joint Venture, L.P. 2000 and PMC Capital and PMC Commercial Trust, dated as of December 15, 2000 (incorporated by reference to Exhibit 2.2 from Registrant's Form 8-K filed on March 13, 2001).
10.13	Servicing Agreement by and among BNY Midwest Trust Company as Trustee and Supervisory Servicer, PMC Joint Venture, L.P. 2001, as Issuer and PMC Capital, Inc. and PMC Commercial Trust, as Servicers (incorporated by reference to Exhibit 10.1 from Registrant's Form 10-Q for the quarterly period ended June 30, 2001).
10.14	Trust Indenture by and among BNY Midwest Trust Company as Trustee and PMC Joint Venture, L.P. 2001, as Issuer (incorporated by reference to Exhibit 10.2 from Registrant's Form 10-Q for the quarterly period ended June 30, 2001).
10.15	Amended and Restated Master Agreement, dated as of January 24, 2001, by and among PMC Commercial Trust, and certain of its subsidiaries, and Amerihost Properties, Inc., doing business as Arlington Hospitality, Inc. (incorporated by reference to Exhibit 2.3 from Registrant's Form 8-K filed on March 13, 2001).
10.20	Trust Indenture between PMC Joint Venture, L.P. 2002-1 and BNY Midwest Trust Company, dated April 3, 2002 (incorporated by reference to Exhibit 2.1 from Registrant's Form 8-K filed on April 19, 2002).
10.21	Servicing Agreement by and among BNY Midwest Trust Company, PMC Joint Venture, L.P. 2002-1, PMC Capital, Inc. and PMC Commercial Trust, dated April 3, 2002 (incorporated by reference to Exhibit 2.2 from Registrant's Form 8-K filed on April 19, 2002).
10.26	Investment Management Agreement between PMC Capital, Inc., PMC Commercial Trust and PMC Advisers, Ltd. dated July 1, 2003 (incorporated by reference from Registrant's Form 10-Q filed August 12, 2003).
10.27	Trust Indenture between PMC Joint Venture, L.P. 2003-1 and The Bank of New York, as Trustee, dated September 16, 2003

Exhibit Number	Description
	(incorporated by reference from Registrant's Form 8-K filed October 10, 2003).
10.28	Servicing Agreement by and among The Bank of New York as Trustee and Supervisory Servicer, PMC Joint Venture, L.P. 2003-1 as Issuer and PMC Capital, Inc. and PMC Commercial Trust as Servicers, dated September 16, 2003 (incorporated by reference from Registrant's Form 8-K filed October 10, 2003).
*10.29	Revolving Credit Agreement dated February 29, 2004 between PMC Commercial and Bank One, Texas, N.A.
*10.30	Employment contract with Lance B. Rosemore dated September 17, 2003.
*10.31	Employment contract with Andrew S. Rosemore dated September 17, 2003.
*10.32	Employment contract with Barry N. Berlin dated September 17, 2003.
*10.33	Employment contract with Jan F. Salit dated September 17, 2003.
*10.34	Employment contract with Cheryl T. Murray dated July 1, 2001.
*10.35	Assumption, Waiver and Amendment Agreement dated February 27, 2004 between PMC Capital, Inc., PMC Commercial Trust, Security Life of Denver Insurance Company and ING USA Annuity and Life Insurance Company.
10.36	Senior Note dated April 19, 1995 for \$5,000,000 with Security Life of Denver Insurance Company (incorporated by reference to Exhibit 4.27 from PMC Capital, Inc.'s (Commission File Number 1-09589) Form 10-K for the year ended December 31, 1995).
10.37	Senior Note dated July 19, 1999 for \$10,000,000 with Equitable Life Insurance Company of Iowa (incorporated by reference to Exhibit 4.32 from PMC Capital, Inc.'s (Commission File Number 1-09589) Form 10-K for the year ended December 31, 1999).
10.38	Senior Note dated July 19, 2000 for \$10,000,000 with Security Life of Denver (incorporated by reference to Exhibit 4.33 from PMC Capital, Inc.'s (Commission File Number 1-09589) Form 10-K for the year ended December 31, 2000).
10.39	Senior Note dated July 19, 2001 for \$10,000,000 with Security Life of Denver (incorporated by reference to Exhibit 4.36 from PMC Capital, Inc.'s (Commission File Number 1-09589) Form 10-K for the year ended December 31, 2001).

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Exhibit Number	Description
*14.1	Code of Ethical Conduct for Senior Financial Officers — Chief Executive Officer
*14.2	Code of Ethical Conduct for Senior Financial Officers — Chief Financial Officer
*21.1	Subsidiaries of the Registrant
*23.1	Consent of PricewaterhouseCoopers LLP
*31.1	Section 302 Officer Certification — Chief Executive Officer
*31.2	Section 302 Officer Certification — Chief Financial Officer
**32.1	Section 906 Officer Certification — Chief Executive Officer
**32.2	Section 906 Officer Certification — Chief Financial Officer

* *Filed herewith.*

** *Submitted herewith.*

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

ARTICLES OF AMENDMENT
TO THE
DECLARATION OF TRUST
OF
PMC COMMERCIAL TRUST

Pursuant to the provisions of Section 22.40 of the Texas Real Estate Investment Trust Act (the "Texas REIT Act"), the undersigned Texas real estate investment trust (the "Trust") adopts the following Articles of Amendment to its Declaration of trust.

1. The name of the Trust is PMC Commercial Trust.

2. The date on which the Declaration of Trust of the Trust was filed with the Secretary of State of Texas is June 4, 1993 and the file number assigned by the Secretary of State is 8268 0000000 1809.

3. Paragraph (f) of Article Eight of the Trust's Declaration of Trust is hereby amended in its entirety to read as follows:

"ARTICLE EIGHT

"(f) Except as otherwise specifically required by law or this Declaration of Trust or as specifically provided in any resolution or resolutions of the Trust Managers providing for the issuance of any particular series of Preferred Shares, the Common Shares shall have the exclusive right to vote on all matters (as to which common shareholders shall be entitled to vote pursuant to applicable law) at all meetings of the shareholders of the Trust. Subject to the provisions of the Texas REIT Act and this Declaration of Trust that may require a greater voting requirement, any matter to be voted upon by holders of the Common Shares shall be approved if the matter receives the affirmative vote of the holders of at least a majority of the Common Shares that are represented in person or by proxy at a meeting of shareholders at which a quorum is present."

4. The Declaration of Trust is hereby amended by the addition of Article Twenty-Six:

"ARTICLE TWENTY-SIX

Except as otherwise provided herein, the Trust's Bylaws may be amended or repealed or new Bylaws may be adopted from time to time by resolution adopted by the Trust Managers."

5. The foregoing amendments were recommended by the Board of Trust Managers and approved by the shareholders of the Trust effective January 9, 2004.

6. The amendments were approved in accordance with Section 20.20 the Texas REIT Act or as otherwise provided in the Declaration of Trust or Bylaws.

7. The number of shares of the Trust issued and outstanding at the time of adoption of these amendments was: 6,449,291 shares of common stock, par value \$0.01 per share ("Common Stock"). The holders of 6,366,558 shares of Common Stock were present in person or by proxy at the Annual Meeting of Shareholders held on January 9, 2004.

8. The number of shares voting in favor of or against the proposal to amend paragraph (f) of Article Eight of the Declaration of Trust as set forth herein was as follows:

Stock -----	For ---	Against -----	Percentage Approval -----
Common Stock	4,461,037	168,027	69

9. The number of shares voting in favor of or against the proposal to amend the Declaration of Trust by adding Article Twenty-Six as set forth herein was as follows:

Stock -----	For ---	Against -----	Percentage Approval -----
Common Stock	4,300,761	292,922	67

[The next page is the signature page.]

IN WITNESS WHEREOF, these Articles of Amendment to the Declaration of Trust of the Trust have been executed this 10th day of February, 2004.

PMC COMMERCIAL TRUST

By: /s/ Lance B. Rosemore

Lance B. Rosemore, Chief Executive Officer

=====

CREDIT AGREEMENT
among
PMC COMMERCIAL TRUST,
as Borrower

BANK ONE, NA,
as Administrative Agent

and

THE LENDERS NAMED HEREIN,
as Lenders

FEBRUARY 29, 2004

\$40,000,000 SENIOR UNSECURED
REVOLVING CREDIT FACILITY

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CREDIT AGREEMENT

THIS CREDIT AGREEMENT is entered into as of February 29, 2004, among PMC COMMERCIAL TRUST, a real estate investment trust organized under the laws of the State of Texas ("Borrower"), certain Lenders (defined below) and BANK ONE, NA, a national banking association with its main office in Chicago, Illinois, as Administrative Agent (defined below) for itself and the other Lenders.

PRELIMINARY STATEMENT:

A. Borrower is a commercial lender that originates loans to small business enterprises, primarily collateralized by first liens on the real estate of the related business. Borrower's lending function consists primarily of making loans to borrowers who operate in the lodging industry.

B. Borrower and Bank One (defined below) have previously entered into that certain Revolving Credit Agreement (as renewed, extended or amended, the "Previous Agreement") dated as of November 29, 1999, whereby Bank One provided a revolving credit facility to Borrower for the purpose of financing Borrower's mortgage loan origination business.

C. PMC Capital, Inc., a Florida corporation ("PMC Capital") and Bank One have previously entered into that certain Revolving Credit Agreement (as renewed, extended or amended, the "PMC Capital Agreement") dated as of March 22, 2000, whereby Bank One provided a revolving credit facility to Borrower for the purpose of financing PMC Capital's commercial loan origination business.

D. Pursuant to that certain definitive Agreement and Plan of Merger dated as of March 27, 2003, Borrower and PMC Capital will be merged and Borrower will be the surviving entity.

E. Borrower has requested that Bank One extend credit to Borrower not to exceed a total principal amount of \$40,000,000 to be used by the Borrower to finance Borrower's mortgage and commercial loan origination or for general corporate purposes.

F. Upon the effectiveness of the merger of the Borrower and PMC Capital contemplated by the Merger Agreement (the "Merger"), the Previous Agreement and the PMC Capital Agreement will be terminated and this agreement will become effective.

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

SECTION 1. DEFINITIONS AND TERMS.

1.1 Definitions. As used in the Credit Documents:

"Administrative Agent" means Bank One, NA (or its successors appointed under Section 12), acting as administrative, managing and syndication agent for Lenders under the Credit Documents.

"Affiliate" of a Person means any other Person who directly or indirectly controls, is controlled by, or is under common control with that Person. For purposes of this definition (a) "control," "controlled by," and "under common control with" mean possession, directly or indirectly, of power to direct or cause the direction of management or policies (whether through ownership of voting securities or other interests, by contract or otherwise) and (b) the Companies are "Affiliates" of each other.

"Amerihost Properties" means any of the 30 hotel/motel properties acquired by Borrower in connection with a sale/leaseback transaction dated May 21, 1998, between Borrower and Amerihost Properties, Inc., which are still owned by Borrower at the applicable date of determination.

"Applicable Margin" means, for any day, the margin of interest under or over the Base Rate or the LIBOR Rate, as the case may be, that is applicable when the Base Rate or LIBOR Rate, as applicable, is determined under this agreement, which margin of interest shall be as follows:

TYPE OF BORROWING	APPLICABLE MARGIN
Base Rate	- 0.5000%
LIBOR Rate	1.8750%

"Asset Coverage Ratio" means, at any time the ratio of (i) the sum of (A) unencumbered cash and cash equivalents of Borrower and First Western, plus (B) eighty-five percent (85%) of the aggregate outstanding principal balance of whole unencumbered Performing Commercial Loans then owned by Borrower or First Western, plus (C) fifty percent (50%) of the retained interest consisting of interest only strip and excess collateralized portions only, plus (D) fifty percent (50%) of the most recent appraised value of the unencumbered Amerihost Properties to (ii) the outstanding principal amount of all Funded Debt (other than Mortgages related to the Amerihost Properties and preferred stock of PMC Investment Corporation) for which either Borrower or First Western is obligated.

"Asset Securitization" means any transaction or series of transactions that may be entered into by any Company pursuant to which such Company or any of its Subsidiaries may sell, convey or otherwise transfer any of their assets to a Special Purpose Entity, and pursuant to which the Special Purpose Entity will, in turn, pay to such Company a portion of the proceeds of a secured loan or debt offering to public or private investors (with such secured loan or debt offering being, among other things, non-recourse to Borrower).

"Assignment" means any assignment described in Section 13.3.

"Bank One" means Bank One, NA., in its individual capacity as a Lender, and its successors and assigns.

"Base Rate" means, for any day, the greater of (a) an annual interest rate equal from day to day to the floating annual interest rate established by Administrative Agent from time to time as its base rate of interest, which may not be the lowest or best interest rate charged by

Administrative Agent on loans similar to the Borrowings and (b) the sum of the Federal Funds Rate plus 0.5%.

"Base Rate Borrowing" means a Borrowing bearing interest at the sum of the Base Rate plus the Applicable Margin for Base Rate Borrowings.

"Borrower" is defined in the preamble to this agreement.

"Borrowing" means any amount disbursed (a) by one or more Lenders to or on behalf of Borrower under the Credit Documents, either as an original disbursement of funds or a renewal, extension, modification or continuation of an amount outstanding, or (b) by any Lender in accordance with, and to satisfy a Company's obligations under, any Credit Document.

"Borrowing Date" is defined in Section 2.3(a).

"Borrowing Request" means a request, subject to Section 2.3(a), substantially in the form of Exhibit B and otherwise in form and scope acceptable to Administrative Agent.

"Business Day" means (a) for purposes of any LIBOR Rate Borrowing, a day when commercial banks are open for international business in London, England, and (b) for all other purposes, any day other than Saturday, Sunday and any other day that most commercial banks in Texas are closed.

"Capital Lease" means any capital lease or sublease which should be capitalized on a balance sheet in accordance with GAAP.

"Cash Flow" shall mean for the Companies, for the applicable period, an amount equal to (a) EBITDA, less (b) Distributions, plus (c) principal amounts repaid to Borrower with respect to Mortgage Loans and Commercial Loans, less (d) Interest Expense, less (e) payments of principal made by Borrower with respect to its Debt other than the Obligation; provided that in the case of any Debt with bullet payments due during such period, Cash Flow shall be calculated based on payments that would be due during such period pursuant to a hypothetical 15-year amortization of such bullet payments.

"CERCLA" means the Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. Sections 9601 et seq.

"Change of Control" means the acquisition by any Person, or two or more Persons acting in concert, of beneficial ownership (within the meaning of Rule 13d-3 of the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended) of 20% or more of the outstanding shares of beneficial interest of Borrower having voting rights.

"Charge-Off Ratio" means a fraction, expressed as a percentage, the numerator of which is the sum of the total amounts charged off by Borrower with respect to its Mortgage Loans (less any such amounts subsequently recovered) during the applicable period of determination, and the denominator of which is the aggregate average principal balance of all of Borrower's Mortgage Loans for such period.

"Closing Date" means the date upon which this agreement has been executed by Borrower, Lenders and Administrative Agent and all conditions precedent specified in Section 5.1 have been satisfied or waived.

"Code" means the Internal Revenue Code of 1986.

"Commercial Loan Obligor" means each Person who is obligated or liable for the payment or performance of all or any portion of a Commercial Loan.

"Commercial Loans" means loans made by any Company to any Person (other than an Affiliate of the Companies) for business or commercial purposes and not for family consumer or household use, which loans are secured by real property or personal property.

"Commitment" means an amount (subject to reduction or cancellation as herein provided) equal to \$40,000,000.

"Commitment Usage" means, at the time of any determination thereof, the aggregate Principal Debt.

"Commitment Percentage" means, for any Lender, the proportion (stated as a percentage) that its Commitment bears to the total Commitments of all Lenders.

"Committed Sum" means, for any Lender, the amount (subject to reduction or cancellation as provided in this Agreement) stated beside its name on Schedule 2, as such amount may be adjusted pursuant to permitted assignments of such Lender's Rights as reflected from time to time on the most recently amended Schedule 2, if any, delivered by Administrative Agent pursuant to this agreement.

"Companies" means at any time, Borrower and each of its subsidiaries (other than any Special Purpose Entities).

"Compliance Certificate" means a certificate substantially in the form of Exhibit D, and otherwise in form and scope satisfactory to Administrative Agent, and signed by a Responsible Officer of Borrower.

"Consequential Loss" means any loss, expense or reduction in yield (but not any Applicable Margin) that any Lender reasonably incurs because (a) Borrower fails or refuses (for any reason whatsoever other than a default by Administrative Agent or a Lender claiming that loss, expense or reduction in yield) to take any Borrowing that it has requested under this agreement or (b) Borrower prepays or pays any Borrowing or converts any Borrowing to a Borrowing of another Type, in each case, other than on the last day of the applicable Interest Period.

"Consolidated Companies" means, at any time, Borrower and each of its Subsidiaries (including any Special Purpose Entities that, according to GAAP, are required to be shown on Borrower's consolidated Financials).

"Construction Loan" means any Mortgage Loan with respect to which the loan funds are used to finance the construction, renovation or improvement of one or more Projects (provided that such Mortgage Loan will no longer constitute a Construction Loan once the construction, renovation or improvement of such Project or Projects is completed, if the Mortgage Loan is structured so as to convert automatically to a permanent loan upon completion of the construction period).

"Conversion Notice" means a notice and request from Borrower to Administrative Agent, subject to Section 3.10, substantially in the form of Exhibit C, and otherwise in form and scope satisfactory to Administrative Agent.

"Credit Documents" means (a) this agreement, certificates and reports delivered under this agreement, and exhibits and schedules to this agreement, (b) all agreements, documents, and instruments in favor of Administrative Agent or Lenders (or Administrative Agent on behalf of Lenders) ever delivered under this agreement or otherwise delivered in connection with all or any part of the Obligation (other than Assignments), and (c) all renewals, extensions, modifications and restatements of, and amendments and supplements to, any of the foregoing, which are made in accordance with the provisions of the respective Credit Documents.

"Current Financials," unless otherwise specified:

(a) means either (i) the Companies' consolidated Financials for the year ended December 31, 2003, or (ii) at any time after annual Financials are first delivered under Section 7.1(a), the Companies' annual Financials then most recently delivered to Administrative Agent under Section 7.1(a), together with the Companies' quarterly Financials then most recently delivered to Administrative Agent under Section 7.1(b); but

(b) does not include the results of operation and cash flows for any Company for the time period before it becomes a member of Borrower's consolidated group.

"Debt" means, with respect to any Person on any date of determination (without duplication), (a) all obligations for borrowed money, (b) all obligations evidenced by bonds, debentures, notes or similar instruments, (c) all obligations to pay the deferred purchase price of property or services, except trade accounts payable arising in the ordinary course of business, which are paid when due in accordance with ordinary-course payment terms or which are being contested in good faith in appropriate proceedings, (d) all obligations arising under acceptance facilities or facilities for the discount or sale of accounts or loans receivable, (e) all direct or contingent obligations in respect of letters of credit, (f) Capital Lease obligations, (g) liabilities secured (or for which the holder of any obligations or liabilities has an existing Right, contingent or otherwise, to be so secured) by any Lien existing on property owned or acquired by that Person and (h) all guaranties, endorsements and other contingent obligations for liabilities, obligations or the maintenance of the financial condition of others, including obligations to repurchase or purchase properties or to maintain or cause to maintain any financial condition.

"Debtor Relief Laws" means the Bankruptcy Code of the United States of America and all other applicable laws providing for liquidation, conservatorship, bankruptcy, moratorium,

rearrangement, receivership, insolvency, reorganization, or suspension of payments or similar Governmental Requirements affecting creditors' Rights.

"Default Rate" means, for any day, an annual interest rate equal to the lesser of either (a) the Base Rate on such day plus 3.0% or (b) the Maximum Rate.

"Delinquent Loans" means, at any time, the sum of (i) the aggregate unpaid principal amount of Commercial Loans and Mortgage Loans owned by any Company or Special Purpose Entity which are 31 or more days delinquent (whether under the initial payment plan or a modified payment plan established pursuant to a workout), plus (ii) assets acquired in satisfaction of debt, including any assets acquired through foreclosure, by deed-in-lieu of foreclosure, liquidation or other similar actions, plus (iii) Commercial Loans and Mortgage Loans then subject to any legal suit, arbitration proceeding or other similar action or proceeding.

"Distribution" means, with respect to any shares of any beneficial interests, capital stock or other equity securities issued by a Person (a) the retirement, redemption, purchase, repurchase or other acquisition for value of those securities, (b) the declaration or payment of any dividend on or with respect to those securities, (c) any loan or advance by that Person to, or other investment by that Person in, the holder of any of those securities and (d) any other payment by that Person with respect to those securities.

"EBITDA" means, with respect to any Person and for any period (without duplication) an amount equal to (a) Net Income, plus (b) to the extent deducted in calculating Net Income, the sum of (i) Interest Expense, plus (ii) Tax expense, plus (iii) depreciation and amortization from its continuing operations, minus (c) to the extent included in calculating Net Income, any gains that are extraordinary items.

"Employee Plan" means any employee pension benefit plan (a) covered by Title IV of ERISA and established or maintained by Borrower or any ERISA Affiliate (other than a Multiemployer Plan) or (b) established or maintained by Borrower or any ERISA Affiliate or to which Borrower or any ERISA Affiliate contributes, under the Governmental Requirements of any foreign country.

"Environmental Investigation" means any health, safety or environmental site assessment, investigation, study, review, audit, compliance audit or compliance review conducted at any time or from time to time (whether at the request of Administrative Agent or any Lender, upon the order or request of any Governmental Authority, or at the voluntary instigation of any Company or Affiliate of any Company or otherwise) concerning any Real Property or the business operations or activities of any Company or Affiliate of any Company, including, without limitation, (a) air, soil, groundwater or surface-water sampling and monitoring, (b) repair, cleanup, remediation, or detoxification, (c) preparation and implementation of any closure, remedial, spill, emergency or other plans, and (d) any health, safety or environmental compliance audit or review.

"Environmental Law" means any applicable Governmental Requirement that relates to (a) the condition of air, ground or surface water, soil, or other environmental media, (b) the environment or natural resources, (c) safety or health, (d) the regulation of any contaminants,

wastes, and Hazardous Substances, including, without limitation, CERCLA, OSHA, the Hazardous Materials Transportation Act (49 U.S.C. Section 1801 et seq.), the Resource Conservation and Recovery Act (42 U.S.C. Section 6901 et seq.), the Clean Water Act (33 U.S.C. Section 1251 et seq.), the Clean Air Act (42 U.S.C. Section 7401 et seq.), the Toxic Substances Control Act (15 U.S.C. Section 2601 et seq.), the Federal Insecticide, Fungicide and Rodenticide Act (7 U.S.C. Section 136 et seq.), the Emergency Planning and Community Right-to-Know Act (42 U.S.C. Section 11001 et seq.), the Safe Drinking Water Act (42 U.S.C. Section 201 and Section 300f et seq.), the Rivers and Harbors Act (33 U.S.C. Section 401 et seq.), the Oil Pollution Act (33 U.S.C. Section 2701 et seq.), state and local Governmental Requirements, and any future Governmental Requirements which may be enacted or adopted, in each case, now existing or hereafter adopted, which are analogous to any of the preceding referenced requirements, or (e) the Release or threatened Release of Hazardous Substances.

"Environmental Liability" means any liability, loss, fine, penalty, charge, lien, damage, cost or expense of any kind to the extent that it results directly or indirectly, in whole or in part, (a) from the violation of any Environmental Law, (b) from the Release or threatened Release of any Hazardous Substance, (c) from removal, remediation, or other actions in response to the Release or threatened Release of any Hazardous Substance, (d) from actual or threatened damages to natural resources, (e) from the imposition of injunctive relief or other orders, (f) from personal injury, death, or property damage which occurs as a result of any Company's use, storage, handling, or Release or threatened Release of a Hazardous Substance, or (g) from any Environmental Investigation performed at, on, or for any Real Property.

"Environmental Lien" means any Lien imposed as a result of the operation of any Environmental Law.

"Environmental Permit" means any permit or license from any Person defined in clause (a) of the definition of Governmental Authority that is required under any Environmental Law for the lawful conduct of any business, process or other activity.

"Equity Issuance" means the issuance by Borrower of any shares of any class of beneficial interests, stock, warrants, options or other equity interests, whether pursuant to a public offering or otherwise, but does not include (a) any present and future shares of beneficial interests, stock, options or warrants issued to employees or trust managers of Borrower or (b) any present and future shares of beneficial interests, stock, options or warrants issued in respect of any dividend reinvestment plan established and maintained by Borrower.

"ERISA" means the Employee Retirement Income Security Act of 1974.

"ERISA Affiliate" means any Person that, for purposes of Title IV of ERISA, is a member of Borrower's controlled group or is under common control with Borrower within the meaning of Section 414 of the Code (which provisions are deemed by this agreement to apply to Foreign Persons).

"Event of Default" is defined in Section 10.

"Existing Debt" is defined in Section 8.2(a).

"Existing Liens" is defined in Section 8.3(b).

"Federal Funds Rate" means, for any day, the annual rate (rounded upwards, if necessary, to the nearest 0.01%) determined by Administrative Agent (which determination is conclusive and binding, absent manifest error) to be equal to (a) the weighted average of the rates on overnight federal-funds transactions with member banks of the Federal Reserve System arranged by federal-funds brokers on that day, as published by the Federal Reserve Bank of New York on the next Business Day or (b) if the rates referred to in the preceding clause (a) are not published for any day, the average of the quotations at approximately 10:00 a.m. received by Administrative Agent from three federal-funds brokers of recognized standing selected by Administrative Agent in its sole discretion.

"Financial Contract" of a Person means (i) any exchange-traded or over-the-counter futures, forward, swap or option contract or other financial instrument with similar characteristics, or (ii) any Rate Management Transaction.

"Financials" of a Person means balance sheets, profit and loss statements, reconciliations of capital and surplus, and statements of cash flow prepared (a) according to GAAP (subject to year-end audit adjustments with respect to interim Financials) and (b) except as stated in Section 1.4, in comparative form to prior year-end figures or corresponding periods of the preceding fiscal year or other relevant period, as applicable.

"First Western" means First Western SBLC, Inc.

"Foreign" means, in respect of any Person, a Person organized under the Governmental Requirements of a jurisdiction other than, or domiciled outside of, the United States of America or one of its states, territories, commonwealths, or possessions.

"Funded Debt" means, at any time and without duplication, the sum of (a) the balance of any obligation for borrowed money that is required by GAAP to be shown as a liability, plus (b) total net rentals (net of any interest, Taxes, or other expenses included in those rentals) payable under Capital Leases. For purposes of this agreement, "Funded Debt" shall not include any Debt incurred by a Special Purpose Entity in connection with an Asset Securitization, so long as such Debt is non-recourse to Borrower in all respects.

"Funds from Operations" means net income determined in accordance with GAAP, plus, to the extent deducted in calculating such net income, depreciation and amortization expense.

"GAAP" means generally accepted accounting principles of the Accounting Principles Board of the American Institute of Certified Public Accountants and the Financial Accounting Standards Board that are applicable from time to time.

"Governmental Authority" means any (a) local, state, territorial, federal or Foreign judicial, executive, regulatory, administrative, legislative or governmental agency, board, bureau, commission, department or other instrumentality, (b) private arbitration board or panel or (c) central bank.

"Governmental Requirements" means all applicable statutes, laws, treaties, ordinances, rules, regulations, orders, writs, injunctions, decrees, judgments, opinions and interpretations of any Governmental Authority.

"Hazardous Substance" means (a) any substance that is reasonably expected to require removal, remediation, or other response under any Environmental Law, (b) any substance that is designated, defined or classified as a hazardous waste, hazardous material, pollutant, contaminant, explosive, corrosive, flammable, infectious, carcinogenic, mutagenic, radioactive, dangerous, or toxic or hazardous substance under any Environmental Law, including, without limitation, any hazardous substance within the meaning of Section 101(14) of CERCLA, (c) petroleum, oil, gasoline, natural gas, fuel oil, motor oil, waste oil, diesel fuel, jet fuel, and other petroleum hydrocarbons, (d) asbestos and asbestos-containing materials in any form, (e) polychlorinated biphenyls, (f) urea formaldehyde foam, or (g) any substance the presence of which on any Real Property either (i) poses or threatens to pose a hazard to the health or safety of persons or to the environment, or (ii) could reasonably be expected to constitute a health or safety hazard to persons or the environment if emanated or migrated from the Real Property.

"Interest Expense" means, with respect to any Person and for any period (without duplication), all interest on that Person's Debts, whether paid in cash or accrued as a liability and payable in cash during any subsequent period (including, without limitation, the interest component of Capital Leases), as determined by GAAP.

"Interest Period" is determined in accordance with Section 3.9.

"Investment" means, in respect of any Person, any loan, advance, extension of credit or capital contribution to that Person, any investment in that Person, or any purchase or commitment to purchase any equity securities or Debt issued by that Person or substantially all of the assets or a division or other business unit of that Person.

"Lender Lien" means any present or future first-priority Lien securing the Obligation and assigned, conveyed, or granted to or created in favor of Administrative Agent for the benefit of Lenders.

"Lenders" means the financial institutions (including, without limitation, Administrative Agent in respect of its share of Borrowings) named on Schedule 2 or on the most recently amended Schedule 2, if any, delivered by Administrative Agent under this agreement, and, subject to this agreement, their respective successors and assigns (but not any Participant who is not otherwise a party to this agreement).

"LIBOR Rate" means, for a LIBOR Rate Borrowing and for the relevant Interest Period, the annual interest rate (rounded upward, if necessary, to the nearest 0.01%) equal to the quotient obtained by dividing (a) the rate that deposits in United States dollars are offered to Administrative Agent in the London interbank market at approximately 11:00 a.m. London, England time two Business Days before the first day of that Interest Period as shown on the display designated as "British Bankers Assoc. Interest Settlement Rates" on the Telerate System ("Telerate"), Page 3750 or Page 3740, or such other page or pages as may replace such pages on Telerate for the purpose of displaying such rate (provided that if such rate is not available on Telerate then such offered rate shall be otherwise independently determined by Administrative Agent from an alternate, substantially similar independent service available to Administrative Agent or shall be calculated by Administrative Agent by a substantially similar methodology as that theretofore used to determine such offered rate in Telerate) in an amount comparable to that

LIBOR Rate Borrowing and having a maturity approximately equal to that Interest Period by (b) one minus the Reserve Requirement (expressed as a decimal) applicable to the relevant Interest Period.

"LIBOR Rate Borrowing" means a Borrowing bearing interest at the sum of the LIBOR Rate plus the Applicable Margin for LIBOR Rate Borrowings.

"Lien" means any lien, mortgage, security interest, pledge, assignment, charge, title retention agreement or encumbrance of any kind and any other arrangement for a creditor's claim to be satisfied from assets or proceeds prior to the claims of other creditors or the owners (other than title of the lessor under an operating lease).

"Litigation" means any action, proceeding, investigation or hearing by or before any Governmental Authority.

"Loan Obligor" means any Mortgage Loan Obligor and/or Commercial Loan Obligor.

"Material Adverse Event" means any circumstance or event that, individually or collectively, is reasonably expected to result (at any time before the Commitment is fully canceled or terminated and the Obligation is fully paid and performed) in any (a) material impairment of (i) the ability of Borrower or any other Company to perform any of its payment or other material obligations under any Credit Document or (ii) the ability of Administrative Agent or any Lender to enforce any of those obligations or Rights under the Credit Documents, (b) material and adverse effect on the business, management or financial condition of Borrower or of the Companies as a whole, as represented to Lenders in the Current Financials, or (c) Event of Default or Potential Default.

"Maximum Amount" and "Maximum Rate" respectively mean, for a Lender, the maximum non-usurious amount and the maximum non-usurious rate of interest that, under applicable Governmental Requirements of the State of Texas or federal laws of the United States of America (as applicable), that Lender is permitted to contract for, charge, take, reserve or receive on the Obligation.

"Merger" is defined in the preamble to this agreement.

"Mortgage" means a mortgage, deed of trust or trust deed that grants a perfected first-priority Lien (or a second- or third-priority Lien in the case of Second-Lien Loans and Third-Lien Loans, respectively) on a Project.

"Mortgage Loan" means a commercial mortgage loan (i.e. not for family, consumer or household use) that is evidenced by a valid promissory note and is secured by a Mortgage.

"Mortgage Loan Documents" means, with respect to each Mortgage Loan, the documents designated as such on Schedule 5.2.

"Mortgage Loan Obligor" means each Person who is obligated or liable for the payment or performance of all or any portion of a Mortgage Loan.

"Mortgage Loans in Liquidation" means those Mortgage Loans with respect to which the Mortgage Loan Obligor has failed to respond to Borrower's demand and acceleration letters, and to which Borrower has determined that the best course of action is to liquidate the Mortgage Loan in order to foreclose on the collateral securing the same and has commenced such foreclosure action.

"Mortgage Loans in Litigation" means those Mortgage Loans with respect to which the Mortgage Loan Obligors have ceased making regularly scheduled payments and are not responding to Borrower's collection efforts, thereby requiring legal action to collect the Mortgage Loan. If the Mortgage Loan Obligor brings the loan current in accordance with the original terms thereof, the Mortgage Loan may be returned to the status of an Eligible Mortgage Loan. If, however, the terms of such Mortgage Loan are restructured, the Mortgage Loan will be converted to a Workout Loan (i.e. no longer a Mortgage Loan in Litigation). Furthermore, should an alternative repayment agreement be established, the Mortgage Loan in Litigation will be considered a Workout Loan (i.e. no longer a Mortgage Loan in Litigation).

"Multiemployer Plan" means a multiemployer plan as defined in Sections 3(37) or 4001(a)(3) of ERISA or Section 414(f) of the Code (or any similar type of plan established or regulated under the Governmental Requirements of any foreign country) to which Borrower or any ERISA Affiliate is making, or has made, or is accruing, or has accrued, an obligation to make contributions.

"Net Income" of any Person means that Person's profit or loss determined in accordance with GAAP.

"Net Proceeds" means the net proceeds, whether received in cash or otherwise, received before, on or after the date of consummation of a subject transaction, by any Company from such transaction, after payment of (a) all usual and customary brokerage commissions and all other reasonable fees and expenses related to such transaction (including, without limitation, reasonable attorney's fees and closing costs), and (b) any Debt (other than the Obligation) relating to the assets being sold which must be repaid in connection with such subject transaction.

"Net Worth" means, for any Person, total beneficiaries' or stockholders' equity, as applicable, as determined in accordance with GAAP.

"Non-Performing Loans" means (a) all of Borrower's Delinquent Loans, (b) all of Borrower's Mortgage Loans with respect to which a default has occurred as to the payment of any installment of principal or interest or another monetary default has occurred under any Mortgage Loan Document related thereto and such default has not been cured for more than sixty (60) days or, in the case of Workout Loans, for more than thirty (30) days, (c) all of Borrower's Mortgage Loans in Litigation, (d) all of Borrower's Mortgage Loans in Liquidation, and (e) all of Borrower's Mortgage Loans with respect to which any Mortgage Loan Obligor has not paid its Debts as they mature or has made a general assignment for the benefit of creditors or with respect to whom proceedings in bankruptcy or for reorganization or liquidation under the bankruptcy code or under any other state or federal law for the relief of debtors has been commenced by or against such Mortgage Loan Obligor and shall not have been discharged

within thirty (30) days of the commencement thereof or for whom (or for whose assets) a receiver, trustee or custodian shall have been appointed or who may die, be dissolved or who may involuntarily suspend the transaction of its business.

"Notes" means, at the time of any determination thereof, all outstanding and unpaid Revolving Notes.

"Obligation" means (a) all present and future Debts, liabilities and obligations of any Company to Administrative Agent, or any Lender and related to any Credit Document, whether principal, interest, fees, costs, attorneys' fees or otherwise, (b) all present and future Rate Management Obligations, (c) any of the foregoing amounts that would become due but for the operation of 11 U.S.C. Section 502 and 503 or any other provision of Title 11 of the United States Code, (d) all present and future pre- and post-maturity interest on any of the foregoing, including all post-petition interest if any Company voluntarily or involuntarily files for protection under any Debtor Relief Law, and (e) renewals, extensions, rearrangements and modifications of any character whatsoever of any the foregoing.

"Organizational Documents" means, for any Person, the documents for its formation and organization, which, for example, (a) for a corporation are its corporate charter and bylaws, (b) for a partnership are its certificate of partnership (if applicable) and partnership agreement, (c) for a limited liability company are its certificate of formation or organization and its operating agreement, regulations or the like and (d) for a trust is the trust agreement, declaration of trust, indenture or bylaws under which it is created.

"OSHA" means the Occupational Safety and Health Act of 1970, 29 U.S.C. Section 651 et seq.

"Participant" is defined in Section 13.2(a).

"PBGC" means the Pension Benefit Guaranty Corporation.

"Performing Commercial Loan" means a Commercial Loan with respect to which (i) no payment of principal or interest is 31 days or more past due (whether under the initial payment plan or a modified payment plan established pursuant to a workout), and (ii) there is no claim of fraud in connection with the origination of such Commercial Loan.

"Permitted Asset Sale" means (a) any sale of assets which are obsolete or are no longer in use and which are not significant to the continuation of the Companies' business, (b) upon prior written notice to Administrative Agent, any sale and disposition from any Company to any other Company provided, in all respects, such sale and disposition is in the ordinary course of business on current market terms, is otherwise subject to Section 8.5, and provided further, if such sale and disposition is made in connection with an Asset Securitization, a prepayment on the Obligation is made in accordance with Section 3.2(c), and (c) any other sales and dispositions approved in advance by Administrative Agent.

"Permitted Debt" is defined in Section 8.2.

"Permitted Investments" is defined in Section 8.7.

"Permitted Liens" is defined in Section 8.3.

"Permitted Project Liens" means, with respect to any Project or other collateral, (a) Liens for Taxes and/or assessments which are being contested by the applicable Mortgage Loan Obligor, (i) in accordance with the applicable Mortgage and (ii) by appropriate legal proceedings conducted in good faith and with due diligence if, but only if, such proceedings suspend the collection of all amounts secured by such Lien and neither the Project nor any rent or other income therefrom or collateral securing the Mortgage Loan or any part thereof or interest therein shall be in any danger of being sold, forfeited, lost or interfered with, and the Mortgage Loan Obligor provides security satisfactory to Borrower for the payment of all amounts secured by any such Lien and any and all losses, costs and expenses that may be incurred in connection therewith, (b) Liens relating to leased equipment (e.g., signs, vending machines, etc.) located on the premises of a Project, so long as such Liens cover only such leased equipment, and (c) Liens which secure Debt that is fully subordinated as to right of payment and to the payment of the Mortgage Loan, and without limiting the foregoing, no payments may be made on such other Debt except for regularly scheduled payments of principal and interest, which may be made if no default or event which, with the giving of notice or the passage of time or both, would constitute a default then exists under the Mortgage Loan. If the making of such principal or interest payments will not result in default or potential default and such Debt is subject to an agreement by the holder thereof, that if such holder receives any payment with respect to such other Debt, other than the principal and interest installments permitted above, such payments will be held in trust for the benefit of Borrower and will be paid to Borrower for application upon the Mortgage Loan, such other Debt shall permit the Mortgage Loan to be renewed, extended and modified without the consent of the holder thereof and without impairing the subordination of such other Debt to payment of the Mortgage Loan. The Liens securing such other Debt shall be made expressly subordinate and inferior to all Liens securing the Mortgage Loan, and such subordination agreement shall be recorded in the real property records of the state and county where the Project which secures the Mortgage Loan is located.

"Person" means any individual, entity or Governmental Authority.

"PMC Capital" is defined in the preamble to this Agreement.

"Potential Default" means any event, occurrence or circumstance the existence of which, upon any required notice, time lapse, or both, could become an Event of Default.

"Principal Debt" means, at any time, the unpaid principal balance of all Borrowings.

"Projects" means the commercial real estate projects owned from time to time by Loan Obligors which are subject to perfected Liens which secure Mortgage Loans or Commercial Loans owned by Borrower. The term "Project" means and includes the land and all appurtenances, servitudes, easements, rights, privileges, prescriptions and advantages belonging or in any way appertaining to the land and all buildings, fixtures, improvements, equipment and other property, whether real, personal or mixed, located upon the land or used or intended to be used in connection with the land or buildings, fixtures or improvements thereon.

"Pro Rata" and "Pro Rata Part" mean, at any time and for any Lender, the proportion (stated as a percentage) that the Principal Debt owed to it bears to the total Principal Debt owed to all Lenders.

"Purchaser" is defined in Section 13.3.

"Qualifying Real Estate" means any real estate which produces income from rental of improvements, other than (a) raw land, (b) single tenant retail properties, or (c) industrial properties.

"Rate Management Obligations" of a Person means any and all obligations of such Person, whether absolute or contingent and howsoever and whensoever created, arising, evidenced or acquired (including all renewals, extensions and modifications thereof and substitutions therefor) under (i) any and all Rate Management Transactions, and (ii) any and all cancellations, buy backs, reversals, terminations or assignments of any Rate Management Transactions.

"Rate Management Transaction" means any transaction (including an agreement with respect thereto) now existing or hereafter entered into between Borrower and any Lender or any Affiliate thereof which is a rate swap, basis swap, forward rate transaction, commodity swap, commodity option, equity or equity index swap, equity or equity index option, bond option, interest rate option, foreign exchange transaction, cap transaction, floor transaction, collar transaction, forward transaction, currency swap transaction, cross-currency rate swap transaction, currency option or any other similar transaction (including any option with respect to any of these transactions) or any combination thereof, whether linked to one or more interest rates, foreign currencies, commodity prices, equity prices or other financial measures.

"REIT" means a "real estate investment trust" as defined in the Code.

"Real Estate Purchase Limitations" means the limitation on the dollar amount that Borrower may pay for the purchase of Qualifying Real Estate, which shall be (a) \$10,000,000 (inclusive of costs and related improvements) in the aggregate for all items of Qualifying Real Estate purchased by Borrower on or after August 16, 1999, and (b) \$3,000,000 (inclusive of costs and related improvements) for any one item of Qualifying Real Estate.

"Real Property" means any land, buildings, fixtures and other improvements to land now or in the future directly or indirectly owned by any Company, leased to or otherwise operated by any Company or subleased by any Company to any other Person.

"Regulation D" means Regulation D of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor thereto or other regulation or official interpretation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

"Regulation U" means Regulation U of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor or other regulation or official interpretation of said Board of Governors relating to the extension of credit by banks for the

purpose of purchasing or carrying margin stocks applicable to member banks of the Federal Reserve System.

"Release" means any "release" as defined under any Environmental Law.

"Renegotiated Loan" means any Mortgage Loan with respect to which the applicable Mortgage Loan Obligor has had insufficient cash flow or negative economic events which have diminished its ability to make timely or complete payments and Borrower has given its concurrence to an alternative schedule of repayment.

"Reportable Event" means a reportable event as defined in Section 4043 of ERISA and the regulations issued under such section, with respect to an Employee Plan, excluding, however, such events as to which the PBGC has by regulation waived the requirement of Section 4043(a) of ERISA that it be notified within 30 days of the occurrence of such event, provided, however, that a failure to meet the minimum funding standard of Section 412 of the Code and of Section 302 of ERISA shall be a Reportable Event regardless of any such waiver of the notice requirement in accordance with either Section 4043(a) of ERISA or Section 412(d) of the Code.

"Representatives" means, with respect to a Person, its representatives, officers, directors, employees, accountants, attorneys, insurers, shareholders and agents.

"Required Lenders" means any combination of one or more Lenders holding (directly or indirectly) at least either (i) 66 2/3% of the total Commitments while there is no Principal Debt, or (ii) 66 2/3% of the Principal Debt while there is any Principal Debt.

"Reserve Requirement" means, for any LIBOR Rate Borrowing and for the relevant Interest Period, the total reserve requirements (including all basic, supplemental, emergency, special, marginal and other reserves required by applicable Governmental Requirements, including, without limitation, Regulation D) applicable to eurocurrency fundings or liabilities, as of the first day of that Interest Period, in amount and maturity of such Borrowing.

"Responsible Officer" means Borrower's chairman, president, chief executive officer, chief financial officer, executive vice president or, with respect to non-financial matters, its general counsel.

"Revolving Facility" means the revolving line of credit facility described in Section 2.1.

"Revolving Note" means one of the promissory notes executed by Borrower in favor of a Lender pursuant to this Agreement, substantially in the form of Exhibit A and otherwise in form and scope acceptable to Administrative Agent and that Lender.

"Rights" means rights, remedies, powers, privileges and benefits.

"Second-Lien Loan" means a Mortgage Loan secured by a Mortgage granting a second-priority Lien on a Project, subject only to the first-priority Lien on the same project in favor of Borrower.

"Segmented Loan" means any Mortgage Loan which has been segmented into parts for securitization purposes.

"Solvent" means, as to any Person, that (a) the aggregate fair market value of such Person's assets exceeds its liabilities (whether contingent, subordinated, unmatured, unliquidated, or otherwise), (b) such Person has sufficient cash flow to enable it to pay its debts as they mature and (c) such Person does not have unreasonably small capital to conduct its businesses.

"Special Purpose Entity" means a special purpose Wholly-owned Subsidiary of Borrower, created in connection with the transactions contemplated by an Asset Securitization, which engages in no activities, has no material liabilities, and owns no other assets, other than those incidental to such Asset Securitization.

"Stated Termination Date" means May 31, 2004.

"Structured Financing" means a financing arrangement whereby (a) the obligor is a Special Purpose Entity, (b) Borrower has no obligation to pay the indebtedness or any other obligations arising thereunder, and (c) the obligees thereunder have no recourse against any of the Companies (other than the Special Purpose Entity involved in the financing) or their assets.

"Subsidiary" of any Person means any other Person of which (a) more than 50% (in number of votes) of the stock (or equivalent interests) is owned of record or beneficially, directly or indirectly, by that Person or (b) such Person serves as a general partner or in a similar capacity. Unless otherwise specified or the context otherwise requires, "Subsidiary" refers to a Subsidiary of Borrower.

"Taxes" means, for any Person, taxes, assessments or other governmental charges or levies imposed upon it, its income or any of its properties, franchises or assets.

"Termination Date" means the earlier of (a) the Stated Termination Date or (b) the effective date that the Lenders' commitments to lend under this agreement are fully canceled or terminated.

"Third-Lien Loan" means a Mortgage Loan secured by a Mortgage granting a third-priority Lien on a Project, subject only to the first- and second-priority Liens on the same project in favor of Borrower.

"Total Liabilities" means, at any time and for the Consolidated Companies, all liabilities properly reflected on the Consolidated Companies' consolidated balance sheet in accordance with GAAP.

"Type" means any type of Borrowing determined with respect to the applicable interest option.

"UCC" means the Uniform Commercial Code as enacted in Texas or other applicable jurisdictions.

"Wholly-owned" when used in connection with any Subsidiary shall mean a Subsidiary of which all of the issued and outstanding shares of stock (or equivalent interests) are owned by Borrower or one or more of its Wholly-owned Subsidiaries.

"Workout Loans" means (a) those Mortgage Loans with respect to which the Mortgage Loan Obligors have had insufficient cash flow and/or negative economic events which have diminished their ability to make timely and/or complete payments and Borrower has given its concurrence to an alternative schedule of repayment, and (b) those Mortgage Loans previously classified as Loans in Litigation which have been brought current by the Mortgage Loan Obligors. Workout Loans will be maintained in this category for a minimum of six (6) months and will be designated as performing (and therefore no longer a Workout Loan) if, based upon payment history under the revised plan (or existing payment plan with respect to Mortgage Loans previously classified as Mortgage Loans in Litigation which have been brought current), financial information when available, and Borrower's professional opinion of each situation, it appears that it is no longer a problem loan.

1.2 Time References. Unless otherwise specified, in the Credit Documents (a) time references (e.g., 10:00 a.m.) are to time in Dallas, Texas, and (b) in calculating a period from one date to another, the word "from" means "from and including" and the word "to" or "until" means "to but excluding."

1.3 Other References. Unless otherwise specified, in the Credit Documents (a) where appropriate, the singular includes the plural and vice versa, and words of any gender include each other gender, (b) heading and caption references may not be construed in interpreting provisions, (c) monetary references are to currency of the United States of America, (d) section, paragraph, annex, schedule, exhibit and similar references are to the particular Credit Document in which they are used, (e) references to "teletype," "telefax," "facsimile," "fax" or similar terms are to facsimile or teletype transmissions, (f) references to "including" mean including without limiting the generality of any description preceding that word, (g) the rule of construction that references to general items, following references to specific items are limited to the same type or character of those specific items is not applicable in the Credit Documents, (h) references to any Person include that Person's heirs, personal representatives, successors, trustees, receivers and permitted assigns, (i) references to any Governmental Requirement include every amendment or supplement to it, rule and regulation adopted under it, and successor or replacement for it and (j) references to any Credit Document or other document include every renewal and extension of it, amendment, modification and supplement to it, and replacement or substitution for it, as each is made in accordance with the applicable provisions of such Credit Document.

1.4 Accounting Principles. Unless otherwise specified, in the Credit Documents (a) GAAP determines all accounting and financial terms and compliance with financial covenants, (b) GAAP in effect on the date of this agreement determines compliance with financial covenants, (c) all accounting principles applied in a current period must be comparable in all material respects to those applied during the preceding comparable period and (d) while the Financials for the Companies are on a consolidated basis, (i) all accounting and financial terms and compliance with reporting covenants must be on a consolidated basis, as applicable and (ii) compliance with financial covenants must be on a consolidated basis.

SECTION 2.

COMMITMENT.

2.1 Revolving Facility. Subject to and in reliance upon the terms, conditions, representations and warranties in the Credit Documents, each Lender severally and not jointly agrees to lend to Borrower such Lender's Commitment Percentage of one or more Borrowings under the Revolving Facility not to exceed such Lender's Committed Sum, which, subject to the Credit Documents, Borrower may borrow, repay and reborrow under this agreement, provided that (a) each such Borrowing must occur on a Business Day and no later than the Business Day immediately preceding the Termination Date, (b) each such Borrowing shall be in an amount not less than \$500,000 or a greater integral multiple of \$100,000, and (c) on any date of determination, the Commitment Usage shall never exceed the Commitment.

2.2 Borrowing Procedure. The following procedures apply to all Borrowings:

(a) Borrowing Request. Borrower may request a Borrowing only by making or delivering a Borrowing Request to Administrative Agent, which is irrevocable and binding on Borrower, stating the Type, amount and, if applicable, Interest Period for each Borrowing and which must be received by Administrative Agent no later than (i) 10:00 a.m. on the second Business Day before the date on which funds are requested (the "Borrowing Date") for any LIBOR Rate Borrowing or (ii) 10:00 a.m. on the Borrowing Date for any Base Rate Borrowing. Administrative Agent shall promptly notify each Lender of any Borrowing Request.

(b) Funding. Each Lender shall remit its Commitment Percentage of each requested Borrowing to Administrative Agent's principal office in Dallas, Texas, in funds that are available for immediate use by Administrative Agent by 2:00 p.m. on the applicable Borrowing Date. Subject to receipt of those funds, Administrative Agent shall (unless to its actual knowledge any of the applicable conditions precedent have not been satisfied by Borrower or waived by the requisite Lenders under Section 14.10) make those funds available to Borrower by (at Borrower's option) (i) wiring the funds to or for the account of Borrower at the direction of Borrower or (ii) depositing the funds in Borrower's account with Administrative Agent.

(c) Funding Assumed. Absent contrary written notice from a Lender, Administrative Agent may assume that each Lender has made its Commitment Percentage of the requested Borrowing available to Administrative Agent on the applicable Borrowing Date, and Administrative Agent may, in reliance upon such assumption (but shall not be required to), make available to Borrower a corresponding amount. If a Lender fails to make its Commitment Percentage of any requested Borrowing available to Administrative Agent on the applicable Borrowing Date, Administrative Agent may recover the applicable amount on demand, (i) from that Lender together with interest, commencing on the Borrowing Date and ending on (but excluding) the date Administrative Agent recovers the amount from that Lender, at an annual interest rate equal to the Federal Funds Rate, or (ii) if that Lender fails to pay its amount upon demand, then from Borrower. No Lender is responsible for the failure of any other Lender to make its Commitment Percentage of any Borrowing; however,

failure of any Lender to make its Commitment Percentage of any Borrowing does not excuse any other Lender from making its Commitment Percentage of any Borrowing.

2.3 Borrowing Requests. Each Borrowing Request constitutes a representation and warranty by Borrower that as of the Borrowing Date, all of the conditions precedent for that Borrowing in Section 6 have been satisfied.

2.4 Reduction or Termination of Commitment by Borrower. Without premium or penalty, and upon giving not less than three Business Days prior written and irrevocable notice to Administrative Agent, Borrower may terminate in whole or in part the unused portion of the Commitment; provided that: (a) each partial termination shall be in an amount of not less than \$5,000,000 or a greater integral multiple of \$2,500,000; (b) the amount of the Commitment may not be reduced below the Commitment Usage at such time; and (c) each reduction shall be allocated among the Lenders in accordance with their respective Commitment Percentages. Promptly after receipt of such notice of termination or reduction, Administrative Agent shall notify each Lender of the proposed cancellation or reduction. Such termination or partial reduction of the Commitment shall be effective on the Business Day specified in Borrower's notice (which date must be at least three Business Days after Borrower's delivery of such notice). In the event that the Commitment is reduced to zero at a time when there is no outstanding Principal Debt, this agreement shall be terminated (except for any indemnification or expense reimbursement provisions in this Agreement which survive the termination of this Agreement) and all commitment fees and other fees then earned and unpaid hereunder and all other amounts constituting part of the Obligation then due and owing shall be immediately due and payable, without notice or demand by Administrative Agent or any Lender.

SECTION 3. TERMS OF PAYMENT.

3.1 Notes and Payments.

(a) Notes. The Principal Debt shall be evidenced by the Revolving Notes, one payable to each Lender in the maximum stated principal amount of its Committed Sum as of the Closing Date.

(b) Payment. Borrower must make each payment and prepayment on the Obligation to Administrative Agent's principal office in Dallas, Texas in immediately available funds by 1:00 p.m. on the day due; otherwise, but subject to Section 3.8, those funds continue to accrue interest as if they were received on the next Business Day. Administrative Agent shall promptly pay to each Lender the part of any payment or prepayment to which that Lender is entitled under this agreement on the same day Administrative Agent is deemed to receive the funds from Borrower.

(c) Payment Assumed. Unless Administrative Agent has received notice from Borrower prior to the date on which any payment is due under this agreement, that Borrower will not make that payment in full, Administrative Agent may assume that Borrower has made the full payment due and Administrative Agent may, in reliance upon that assumption, cause to be distributed to each Lender on that date the amount then due to each Lender. If and to the extent Borrower does not make the full payment due to

Administrative Agent, each Lender shall repay Administrative Agent on demand the amount distributed to that Lender by Administrative Agent, together with interest for each day from the date that Lender received payment from Administrative Agent until the date that Lender repays Administrative Agent (unless such repayment is made on the same day as such distribution), at an interest rate equal to the Federal Funds Rate.

3.2 Interest and Principal Payments.

(a) Interest. Interest on each LIBOR Rate Borrowing shall be due and payable as it accrues on the last day of its respective Interest Period and on the Termination Date; provided that if any Interest Period is a period greater than three months, then accrued interest shall also be due and payable on the date three months after the commencement of such Interest Period. Interest on each Base Rate Borrowing shall be due and payable as it accrues on the last day of each month (commencing on the first of those dates that follows the Closing Date), and on the Termination Date.

(b) Principal. The Principal Debt under the Revolving Facility is due and payable on the Termination Date. After giving Administrative Agent advance written notice of the intent to prepay, Borrower may voluntarily prepay all or any part of the Principal Debt from time to time and at any time, in whole or in part, without premium or penalty; provided that: (i) such notice must be received by Administrative Agent by 10:00 a.m. on (A) the third Business Day preceding the date of prepayment of a LIBOR Rate Borrowing, and (B) one Business Day preceding the date of prepayment of a Base Rate Borrowing; (ii) each such partial prepayment must be in a minimum amount of at least \$500,000 or a greater integral multiple of \$100,000 thereof (if a LIBOR Rate Borrowing or a Base Rate Borrowing); (iii) all accrued interest on the Obligation must also be paid in full, to the date of such prepayment; and (iv) Borrower shall pay any related Consequential Loss within ten (10) days after demand therefor. Each notice of prepayment shall specify the prepayment date, the facility or the subfacility hereunder being prepaid, the Type of Borrowing(s) and amount(s) of such Borrowing(s) to be prepaid and shall constitute a binding obligation of Borrower to make a prepayment on the date stated therein.

(c) Mandatory Prepayments. Borrower shall make mandatory prepayments on the Obligation to Administrative Agent in the following amounts (without duplication):

(i) On any date of determination, if the Commitment Usage exceeds the Commitment then in effect, then Borrower shall make a mandatory prepayment of the Principal Debt under the Revolving Facility in at least the amount of any such excess, together with (A) all accrued and unpaid interest on the principal amount so prepaid and (B) any Consequential Loss arising as a result thereof.

(ii) 100% of the Net Proceeds from any sale (subject in all respects to Section 8.10) of assets by Borrower, other than any sale of assets which are obsolete or are no longer in use and which are not significant to the continuation of Borrower's business;

(iii) 100% of the Net Proceeds received by the Companies in connection with any Structured Financing or Asset Securitization; and

(iv) 100% of the Net Proceeds from any Debt incurred as permitted by Section 8.2(a)(iv).

Mandatory prepayments made pursuant to clauses (ii) - (iv) above (together with any related Consequential Loss) are payable on the same Business Day on which the proceeds of such sale, securitization or issuance are received by Borrower, and must be made together with (A) all accrued and unpaid interest on the principal amount so prepaid and (B) any Consequential Loss arising as a result thereof. If the amount of any mandatory prepayment required hereunder is greater than the then-outstanding Obligation, any such excess may be retained by Borrower.

3.3 Interest Options. Except that the LIBOR Rate may not be selected when an Event of Default or Potential Default exists, and except as otherwise provided in this agreement, Borrowings bear interest at an annual rate equal to the lesser of (a) the Base Rate plus the Applicable Margin or the LIBOR Rate plus the Applicable Margin (in each case as designated or deemed designated by Borrower), as the case may be and (b) the Maximum Rate. Each change in the Base Rate, LIBOR Rate or Maximum Rate is effective, without notice to Borrower or any other Person, upon the effective date of change. If Borrower does not designate the Type for a requested Borrowing, then the requested Borrowing shall be deemed to be a LIBOR Rate Borrowing with an Interest Period of one month (unless the LIBOR Rate is unavailable because of the conditions described in Sections 3.15 or 3.17, in which case the requested Borrowing will be deemed a Base Rate Borrowing).

3.4 Quotation of Rates. Borrower may call Administrative Agent before delivering a Borrowing Request to receive an indication of the interest rates then in effect, but the indicated rates do not bind Administrative Agent or Lenders or affect the interest rate that is actually in effect when Borrower makes a Borrowing Request or on the Borrowing Date.

3.5 Default Rate. All past-due Principal Debt and, unless prohibited by applicable Government Requirements, past-due interest accruing on the Principal Debt shall, at Administrative Agent's option, bear interest on the amount thereof from time to time outstanding from the date due (stated or by acceleration) at the Default Rate until paid, regardless of whether payment is made before or after entry of a judgment.

3.6 Interest Recapture. If the designated interest rate applicable to any Borrowing exceeds the Maximum Rate, the interest rate on that Borrowing is limited to the Maximum Rate, but any subsequent reductions in the designated rate shall not reduce the interest rate thereon below the Maximum Rate until the total amount of accrued interest equals the amount of interest that would have accrued if that designated rate had always been in effect. If at maturity (stated or by acceleration), or at final payment of the Notes, the total interest paid or accrued is less than the interest that would have accrued if the designated rates had always been in effect, then, at that time and to the extent not prohibited by applicable Governmental Requirements, Borrower shall pay an amount equal to the difference between (a) the lesser of the amount of interest that would have accrued if the designated rates had always been in effect and the amount of interest

that would have accrued if the Maximum Rate had always been in effect, and (b) the amount of interest actually paid or accrued on the Notes.

3.7 Interest Calculations. Interest on all Borrowings will be calculated on the basis of actual number of days (including the first day but excluding the last day) elapsed but computed as if each calendar year consisted of (a) 360 days in the case of LIBOR Borrowings or Base Rate Borrowings calculated with reference to the Federal Funds Rate (unless such calculation would result in the interest on the Borrowings exceeding the Maximum Rate in which event such interest shall be calculated on the basis of a year of 365 or 366 days, as the case may be) and (b) 365 or 366 days, as the case may be, in the case of Base Rate Borrowings calculated with reference to Administrative Agent's base rate of interest. All interest rate determinations and calculations by Administrative Agent are conclusive and binding absent manifest error.

3.8 Maximum Rate. It is the intent of Administrative Agent, Lenders and Borrower in the execution and performance of the Credit Documents to remain in strict compliance with applicable Governmental Requirements from time to time in effect, including applicable laws limiting the amount or rate of interest. Administrative Agent, Lenders and Borrower stipulate and agree that none of the terms and provisions contained in the Credit Documents shall ever be construed to create a contract to pay for the use, forbearance or detention of money with interest at a rate or in an amount in excess of the Maximum Rate or Maximum Amount. For purposes of the Credit Documents, "interest" shall include the aggregate of all charges which constitute interest under applicable Governmental Requirements that are contracted for, charged, reserved, received or paid under the Credit Documents. Borrower shall never be required to pay unearned interest and shall never be required to pay interest at a rate or in an amount in excess of the Maximum Rate or Maximum Amount, and the provisions of this section shall control over all other provisions of the Credit Documents, and of any other instrument pertaining to or securing the Obligation, which may be in actual or apparent conflict herewith. If the Obligation is prepaid, or if the maturity of the Obligation is accelerated for any reason, or if under any contingency the effective rate or amount of interest which would otherwise be payable under the Credit Documents would exceed the Maximum Rate or Maximum Amount, or in the event any Lender or any holder of the Notes shall charge, contract for, take, reserve or receive monies that are deemed to constitute interest which would, in the absence of this provision, increase the effective rate or amount of interest payable under the Credit Documents to a rate or amount in excess of that permitted to be charged, contracted for, taken, reserved or received under applicable Governmental Requirements then in effect, then the principal amount of the Obligation or the amount of interest which would otherwise be payable under the Notes or both shall be reduced to the amount allowed under applicable Governmental Requirements as now or hereinafter construed by the courts having jurisdiction, and all such moneys so charged, contracted for, taken, reserved or received that are deemed to constitute interest in excess of the Maximum Rate shall immediately be returned to or credited to the account of Borrower upon such determination. Administrative Agent, Lenders and Borrower further stipulate and agree that, without limitation of the foregoing, all calculations of the rate or amount of interest contracted for, charged, taken, reserved or received under the Credit Documents which are made for the purpose of determining whether such rate or amount exceeds the Maximum Rate or Maximum Amount, shall be made to the extent not prohibited by applicable Governmental Requirements, by amortizing, prorating, allocating and spreading during the period of the full stated term of the Notes, all interest at any time contracted for, charged, taken, reserved or

received from Borrower or otherwise by Lenders or any other holder of the Notes. If the Governmental Requirements of the State of Texas are applicable for purposes of determining the "Maximum Rate" or the "Maximum Amount," then those terms mean the indicated rate ceiling from time to time in effect under Chapter 303 of the Texas Finance Code, as amended.

3.9 Interest Periods. When Borrower requests any LIBOR Rate Borrowing, Borrower may elect the applicable interest period (each an "Interest Period"), which may be, at Borrower's option, one, three or six months, subject to the following conditions: (a) the initial Interest Period for a LIBOR Rate Borrowing commences on the applicable Borrowing Date or conversion date, and each subsequent Interest Period applicable to any Borrowing commences on the day when the next preceding applicable Interest Period expires; (b) if any Interest Period for a LIBOR Rate Borrowing begins on a day for which no numerically corresponding Business Day in the calendar month at the end of the Interest Period exists, then the Interest Period ends on the last Business Day of that calendar month; (c) if Borrower is required to pay any portion of a LIBOR Rate Borrowing before the end of its Interest Period in order to comply with the payment provisions of the Credit Documents, Borrower shall also pay any related Consequential Loss; (d) no Interest Period for any portion of Principal Debt may extend beyond the scheduled repayment date for that portion of Principal Debt; and (e) no more than four Interest Periods may be in effect at one time.

3.10 Conversions. Subject to the dollar limits of Section 2.1 and provided that Borrower may not convert to or select a new Interest Period for a LIBOR Rate Borrowing at any time when an Event of Default exists, Borrower may (a) convert a LIBOR Rate Borrowing on the last day of the applicable Interest Period to a Base Rate Borrowing, (b) convert a Base Rate Borrowing at any time to a LIBOR Rate Borrowing and (c) elect a new Interest Period for a LIBOR Rate Borrowing. That election may be made by telephonic request to Administrative Agent no later than 10:00 a.m. on the second Business Day before the conversion date or the last day of the Interest Period, as the case may be (for conversion to a LIBOR Rate Borrowing or election of a new Interest Period), and no later than 10:00 a.m. on the last day of the Interest Period (for conversion to a Base Rate Borrowing). Borrower shall provide a Conversion Notice to Administrative Agent no later than two days after the date of the conversion or election. Absent Borrower's telephonic request for conversion or election of a new Interest Period or if an Event of Default exists, then, a LIBOR Rate Borrowing shall be deemed converted to a Base Rate Borrowing effective when the applicable Interest Period expires.

3.11 Order of Application.

(a) No Event of Default. Payments and prepayments of the Obligation shall be applied in the order and manner specified in this agreement; provided, however, if no order is otherwise specified in this agreement and no Event of Default or Potential Default has occurred and is continuing, payments and prepayments of the Obligation shall be applied first to fees, second to accrued interest then due and payable on the Principal Debt, and then to the remaining Obligation in the order and manner as Borrower may direct.

(b) Event of Default or No Direction. If an Event of Default or Potential Default has occurred and is continuing (or if Borrower fails to give direction as permitted

under Section 3.11(a)), any payment or prepayment (including proceeds from the exercise of any Rights) shall be applied in the following order: (i) to all fees and expenses for which Administrative Agent or Lenders have not been paid or reimbursed in accordance with the Credit Documents (and if such payment or prepayment is less than all unpaid or unreimbursed fees and expenses, then the payment or prepayment shall be paid against unpaid and unreimbursed fees and expenses in the order of incurrence or due date); (ii) to accrued interest on the Principal Debt; (iii) to the remaining Principal Debt in such order as Required Lenders may elect (provided that Required Lenders will apply such proceeds in an order that will minimize any Consequential Loss); and (iv) to the remaining Obligation in the order and manner Required Lenders deem appropriate.

(c) Pro Rata. Each payment or prepayment shall be distributed to each Lender in accordance with its Pro Rata Part of that payment or prepayment.

3.12 Sharing of Payments, Etc. If any Lender obtains any payment or prepayment with respect to the Obligation (whether voluntary, involuntary, or otherwise, including, without limitation, as a result of exercising its Rights under Section 3.13) that exceeds the part of that payment or prepayment that it is then entitled to receive under the Credit Documents, then that Lender shall purchase from the other Lenders participations that will cause the purchasing Lender to share the excess payment or prepayment ratably with each other Lender. If all or any portion of any excess payment or prepayment is subsequently recovered from the purchasing Lender, then the purchase shall be rescinded and the purchase price restored to the extent of the recovery. Borrower agrees that any Lender purchasing a participation from another Lender under this section may, to the fullest extent permitted by applicable Governmental Requirements, exercise all of its Rights of payment (including the Right of offset) with respect to that participation as fully as if that Lender were the direct creditor of Borrower in the amount of that participation.

3.13 Offset. If an Event of Default exists, to the extent not prohibited by applicable Governmental Requirements, each Lender may exercise (for the benefit of all Lenders in accordance with Section 3.12) the Rights of offset and banker's lien against each and every account and other property, or any interest therein, that any Company may now or hereafter have with, or which is now or hereafter in the possession of, that Lender to the extent of the full amount of the Obligation owed (directly or participated) to it, provided, however, no such right of offset or banker's lien may be exercised against any account of any Special Purpose Entity.

3.14 Booking Borrowings. To the extent permitted by applicable Governmental Requirements, any Lender may make, carry, or transfer its Borrowings at, to, or for the account of any of its branch offices or the office or branch of any of its Affiliates. However, no Affiliate or branch is entitled to receive any greater payment under Section 3.16 than the transferor Lender would have been entitled to receive with respect to those Borrowings, and a transfer may not be made if, as a direct result of it, Section 3.15 or 3.17 would apply to any of the Obligation. If any of the conditions of Sections 3.16 or 3.17 ever apply to a Lender, that Lender shall, to the extent possible, carry or transfer its Borrowings at, to, or for the account of any of its branch offices or the office or branch of any of its Affiliates so long as the transfer is consistent with the other provisions of this section, does not create any burden or adverse circumstance for that Lender

that would not otherwise exist, and eliminates or ameliorates the conditions of Sections 3.16 or 3.17, as applicable.

3.15 Basis Unavailable or Inadequate for LIBOR Rate. If on or before any date when a LIBOR Rate is to be determined for a Borrowing, Administrative Agent or any Lender determines (and Required Lenders agree with that determination) that the basis for determining the applicable rate is not available or that the resulting rate does not accurately reflect the cost to Lenders of making or converting Borrowings at that rate for the applicable Interest Period, then Administrative Agent shall promptly notify Borrower and Lenders of that determination (which is conclusive and binding on Borrower absent manifest error), and the applicable Borrowing shall bear interest at the sum of the Base Rate plus the Applicable Margin. Until Administrative Agent notifies Borrower that those circumstances giving rise to such notice no longer exist, Lenders' commitments under this agreement to make, or to convert to, LIBOR Rate Borrowings, as the case may be, shall be suspended.

3.16 Additional Costs. Each Lender severally and not jointly agrees to notify Administrative Agent, the other Lenders, and Borrower within 180 days after it has actual knowledge that any circumstances exist that would give rise to any payment obligation by Borrower under clauses (a) through (c) below. Although no Lender shall have any liability to Administrative Agent, any other Lender, or any Company for its failure to give that notice, Borrower is not obligated to pay any amounts under those clauses that arise, accrue or are imposed more than 180 days before that notice to the extent that notice is applicable to those amounts. To demand payment under this section, any such Lender must generally be making similar demand for similar additional costs under credit agreements to which it is party that contain similar provisions to this section.

(a) Reserves. With respect to any LIBOR Rate Borrowing (i) if any change in any present Governmental Requirement, any change in the interpretation or application of any present Governmental Requirement, or any future Governmental Requirement imposes, modifies or deems applicable (or if compliance by any Lender with any requirement of any Governmental Authority results in) any requirement that any reserves (including, without limitation, any marginal, emergency, supplemental, or special reserves) be maintained (other than any reserve included in the Reserve Requirement) and if (ii) those reserves reduce any sums receivable by that Lender under this agreement or increase the costs incurred by Lender in advancing or maintaining any portion of any LIBOR Rate Borrowing, then (iii) that Lender (through Administrative Agent) shall deliver to Borrower a certificate setting forth in reasonable detail the calculation of the amount necessary to compensate it for its reduction or increase (which certificate is conclusive and binding absent manifest error), and (iv) Borrower shall pay that amount to that Lender within five Business Days after demand. The provisions of and undertakings and indemnifications in this clause (a) survive the satisfaction and payment of the Obligation and termination of this agreement.

(b) Capital Adequacy. With respect to any Borrowing, if any change in any present Governmental Requirement, any change in the interpretation or application of any present Governmental Requirement, or any future Governmental Requirement regarding capital adequacy, or if compliance by Administrative Agent or any Lender with any

request, directive or requirement imposed in the future by any Governmental Authority regarding capital adequacy, or if any change in its written policies or in the risk category of this transaction, in any of the foregoing events or circumstances, reduces the rate of return on its capital as a consequence of its obligations under this agreement to a level below that which it otherwise could have achieved (taking into consideration its policies with respect to capital adequacy) by an amount deemed by it to be material (and it may, in determining the amount, utilize reasonable assumptions and allocations of costs and expenses and use any reasonable averaging or attribution method), then (unless the effect is already reflected in the rate of interest then applicable under this agreement) Administrative Agent or that Lender (through Administrative Agent) shall notify Borrower and deliver to Borrower a certificate setting forth in reasonable detail the calculation of the amount necessary to compensate it (which certificate is conclusive and binding absent manifest error), and Borrower shall pay that amount to Administrative Agent or that Lender within five Business Days after demand. The provisions of and undertakings and indemnification in this clause (b) shall survive the satisfaction and payment of the Obligation and termination of this agreement.

(c) Taxes. Any Taxes payable by Administrative Agent or any Lender or ruled by a Governmental Authority to be payable by Administrative Agent or any Lender in respect of this agreement or any other Credit Document shall, if permitted by applicable Governmental Requirements, be paid by Borrower, together with interest and penalties, if any, except for Taxes payable on or measured by the overall net income of Administrative Agent or that Lender (or any other Person with whom Administrative Agent or that Lender files a consolidated, combined, unitary, or similar Tax return) and except for interest and penalties incurred as a result of the gross negligence or willful misconduct of Administrative Agent or that Lender. Administrative Agent or that Lender (through Administrative Agent) shall notify Borrower and deliver to Borrower a certificate setting forth in reasonable detail the calculation of the amount of Taxes payable, which certificate is conclusive and binding (absent manifest error), and Borrower shall pay that amount to Administrative Agent for its account or the account of that Lender, as the case may be, within ten Business Days after demand. If Administrative Agent or that Lender subsequently receives a refund of the Taxes paid to it by Borrower, then the recipient shall promptly pay the refund to Borrower.

3.17 Change in Governmental Requirements. If any Governmental Requirement makes it unlawful for any Lender to make or maintain LIBOR Rate Borrowings, then that Lender shall promptly notify Borrower and Administrative Agent, and (a) as to undisbursed funds, that requested Borrowing shall be made as a Base Rate Borrowing and (b) as to any outstanding Borrowing (i) if maintaining the Borrowing until the last day of the applicable Interest Period is unlawful, the Borrowing shall be converted to a Base Rate Borrowing as of the date of notice, in which event Borrower will be required to pay any related Consequential Loss or (ii) if not prohibited by applicable Governmental Requirements, the Borrowing shall be converted to a Base Rate Borrowing as of the last day of the applicable Interest Period or (iii) if any conversion will not resolve the unlawfulness, Borrower shall promptly prepay the Borrowing, without penalty but with related Consequential Loss.

3.18 Consequential Loss. Borrower shall indemnify each Lender against, and pay to it upon demand, any Consequential Loss of that Lender. When any Lender demands that Borrower pay any Consequential Loss, that Lender shall deliver to Borrower and Administrative Agent a certificate setting forth in reasonable detail the basis for imposing Consequential Loss and the calculation of the amount, which calculation is conclusive and binding absent manifest error. The provisions of and undertakings and indemnification in this Section survive the satisfaction and payment of the Obligation and termination of this agreement.

3.19 Foreign Lenders, Participants, and Purchasers. Each Lender, Participant (by accepting a participation interest under this agreement), and Purchaser (by executing an Assignment) that is not organized under the Governmental Requirements of the United States of America or one of its states (a) represents to Administrative Agent and Borrower that (i) no Taxes are required to be withheld by Administrative Agent or Borrower with respect to any payments to be made to it in respect of the Obligation and (ii) it has furnished to Administrative Agent and Borrower two duly completed copies of either U.S. Internal Revenue Service Form 4224, Form 1001, Form W-8, or any other form acceptable to Administrative Agent and Borrower that entitles it to a complete exemption from U.S. federal withholding Tax on all interest or fee payments under the Credit Documents, and (b) covenants to (i) provide Administrative Agent and Borrower a new Form 4224, Form 1001, Form W-8, or other form acceptable to Administrative Agent and Borrower upon the expiration or obsolescence according to applicable Governmental Requirements of any previously delivered form, duly executed and completed by it, entitling it to a complete exemption from U.S. federal withholding Tax on all interest and fee payments under the Credit Documents, and (ii) comply from time to time with all applicable Governmental Requirements with regard to the withholding Tax exemption. If any of the foregoing is not true at any time or the applicable forms are not provided, then Borrower and Administrative Agent (without duplication) may deduct and withhold from interest and fee payments under the Credit Documents any Tax at the maximum rate under the Code or other applicable Governmental Requirement, and amounts so deducted and withheld shall be treated as paid to that Lender, Participant, or Purchaser, as the case may be, for all purposes under the Credit Documents.

SECTION 4. FEES.

4.1 Treatment of Fees. Except as otherwise provided by applicable Governmental Requirements, the fees described in this Section 4 (a) do not constitute compensation for the use, detention, or forbearance of money, (b) are in addition to, and not in lieu of, interest and expenses otherwise described in this agreement, (c) shall be payable in accordance with Section 3, (d) shall be non-refundable, (e) shall, to the fullest extent permitted by applicable Governmental Requirements, bear interest, if not paid when due, at the Default Rate, and (f) shall be calculated on the basis of actual number of days (including the first day but excluding the last day) elapsed, but computed as if each calendar year consisted of 360 days, unless such computation would result in interest being computed in excess of the Maximum Rate in which event such computation shall be made on the basis of a year of 365 or 366 days, as the case may be.

4.2 Fees of Administrative Agent. Borrower shall pay to Administrative Agent, for its own account, fees in such amounts and upon such payment terms as may be separately agreed upon by Administrative Agent and Borrower in writing.

4.3 Upfront Fees. On the Closing Date, Borrower shall pay to each initial Lender upfront fees in amounts separately agreed to between Borrower and each such Lender.

4.4 Commitment Fee. Following the Closing Date, Borrower shall pay to Administrative Agent, for the ratable account of Lenders, a commitment fee, payable in installments in arrears, on each March 31, June 30, September 30, and December 31 and on the Termination Date, commencing March 31, 2004. Each installment shall be in an amount equal to 0.375% multiplied by the amount by which (a) the average daily Commitment exceeds (b) the average daily Commitment Usage, in each case during the period from and including the last payment date (or from the Closing Date for the payment due March 31, 2004) to and excluding the payment date for such installment, provided that each such installment shall be calculated in accordance with Section 4.1(f). Solely for the purposes of this Section 4.4, "ratable" shall mean, for any period of calculation, with respect to any Lender, that proportion which (x) the average daily unused Committed Sum of such Lender during such period bears to (y) the amount of the average daily unused Commitment during such period.

4.5 Facility Fee. On the Termination Date, the Borrower shall pay to Administrative Agent a facility fee of Twenty Thousand Dollars (\$20,000).

SECTION 5. CONDITIONS PRECEDENT.

5.1 Initial Advances. The obligation of Lenders to make the initial advances under this agreement is subject to the condition precedent that, on or before the date of such advance, Administrative Agent and Lenders have received, there shall have been performed and there shall exist, the documents, actions and other matters set forth below, each in form, scope and substance, and (as applicable) dated as of a date, satisfactory to Administrative Agent and Lenders:

- (a) Credit Agreement. This agreement duly executed by Borrower, Administrative Agent and each initial Lender;
- (b) Revolving Notes. The Revolving Notes duly executed and delivered by Borrower;
- (c) Resolutions. Resolutions of Borrower approving the execution, delivery and performance of this agreement, the Revolving Notes and the other Credit Documents to which it is a party and the transactions contemplated herein and therein, duly adopted by Borrower's Board of Trust Managers and accompanied by a certificate of the Secretary or Assistant Secretary of Borrower stating that the resolutions are true and correct, have not been altered or repealed and are in full force and effect;
- (d) Incumbency Certificates. Signed certificates of the Secretary or Assistant Secretary of Borrower certifying the names of the officers of Borrower authorized to sign each of the Credit Documents to which it is a party and the other documents or

certificates to be delivered pursuant to the Credit Documents by Borrower, together with the true signatures of each such officer. Administrative Agent and Lenders may conclusively rely on each such certificate until they receive, and have had a reasonable opportunity to act upon, a further certificate of the Secretary or Assistant Secretary of Borrower canceling or amending the prior certificate and submitting the signatures of the officers named in the further certificate;

(e) Declaration of Trust. A copy of the Declaration of Trust of Borrower, and all amendments thereto, certified by the Secretary or Assistant Secretary of Borrower as being true, correct and complete as of the date of such certification;

(f) Bylaws. A copy of the Bylaws of Borrower, and all amendments thereto, certified by the Secretary or Assistant Secretary of Borrower as being true, correct and complete as of the date of such certification;

(g) Payments to Administrative Agent. The payment to Administrative Agent of: (i) all fees to be received by Administrative Agent pursuant to this agreement or any other Credit Document, and (ii) all third-party costs incurred in connection with this agreement, including all reasonable attorneys' fees, costs and out-of-pocket expenses of Administrative Agent's counsel incurred or estimated to have been incurred through the Closing Date in connection with the preparation, execution and delivery of the Credit Documents and the consummation of the transactions contemplated thereby;

(h) Opinion of Counsel. A favorable opinion addressed to Administrative Agent and Lenders, in form and substance satisfactory to Administrative Agent, from outside legal counsel to Borrower;

(i) Merger Completed. Administrative Agent shall have (i) received and reviewed copies of all of the documentation related to the Merger and such other information related to the Merger as it may request and (ii) received evidence, in form and substance satisfactory to it, that the Merger has been consummated; and

(j) Additional Information. Such other documents, instruments, reports, opinions and information as reasonably required by Administrative Agent, any Lender and their respective counsel.

5.2 All Borrowings. The obligation of Lenders to extend Borrowings under this agreement (including the initial advances) is subject to the following conditions precedent:

(a) No Default or Potential Default. As of the date of the making of the Borrowing, there exists no Event of Default or Potential Default;

(b) Compliance with Credit Agreement. Each Company has performed and complied with all agreements and conditions contained in this agreement and each other Credit Document that are required to be performed or complied with by it before or at the date of the Borrowing;

(c) No Material Adverse Event. As of the date of making the Borrowing, no Material Adverse Event has occurred and is continuing;

(d) Representations and Warranties. The representations and warranties contained in Section 6 and the other Credit Documents are true in all respects on the date of, and after giving effect to, the Borrowing, with the same force and effect as though made on and as of that date;

(e) Borrowing Request. Administrative Agent has timely received from Borrower a properly completed Borrowing Request, executed by a Responsible Officer of Borrower; and

SECTION 6. REPRESENTATIONS AND WARRANTIES. Borrower represents and warrants to Administrative Agent and Lenders as follows:

6.1 Purpose and Regulation U.

(a) Subject to the other provisions in the Credit Documents, including, without limitation, clause (b) below, the proceeds of all Borrowings will be used either (i) to refinance any amounts outstanding under the Previous Agreement, (ii) to finance Borrower's Mortgage Loan origination, (iii) to finance Borrower's Commercial Loan origination or (iv) for general corporate purposes.

(b) The proceeds of the Revolving Facility will be used by Borrower solely for the purposes specified in Section 6.1(a). None of such proceeds will be used for the purpose of purchasing or carrying any "margin stock" as defined in Regulation U, or for the purpose of reducing or retiring any indebtedness which was originally incurred to purchase or carry a margin stock or for any other purpose which might constitute this transaction a "purpose credit" within the meaning of such Regulation U. No Company is engaged in the business of extending credit for the purpose of purchasing or carrying margin stocks. No Company, nor any Person acting on behalf of any Company, has taken or will take any action that might cause the Notes or any of the other Credit Documents, including this Credit Agreement, to violate Regulation U or any other regulations of the Board of Governors of the Federal Reserve System or to violate Section 7 of the Securities Exchange Act of 1934, as amended, or any rule or regulation thereunder, in each case as now in effect or as the same may hereinafter be in effect.

(c) No portion of any advance or loan made hereunder shall be used directly or indirectly to purchase ineligible securities, as defined by applicable regulations of the Federal Reserve Board, underwritten by any affiliate of Banc One Corporation or any affiliate of any other Lender during the underwriting period and for 30 days thereafter.

6.2 Corporate Existence, Good Standing, Authority and Locations.

Borrower is a real estate investment trust duly organized, validly existing and in good standing under the laws of the State of Texas. Except where the failure to qualify would not result in a Material Adverse Event, Borrower is duly qualified to transact business and is in good standing in each jurisdiction where the nature and extent of its business and properties require due qualification and good standing (and each of such jurisdictions is identified in Schedule 6.3). Borrower possesses all

requisite authority and power to conduct its business as is now being conducted and as proposed to be conducted (including under the Credit Documents) and to own and operate its assets as now owned and operated and as proposed to be owned and operated (including under the Credit Documents). Borrower's chief executive office and other principal offices are described on Schedule 6.3. The present location of Borrower's books and records concerning accounts and accounts receivable is at its chief executive office.

6.3 Subsidiaries and Names. Schedule 6.3 describes (a) each Company, (b) every name or trade name used by each Company during the four-month period before the date of this agreement (or during the period such Company has been a Subsidiary, if shorter) and (c) every change of each Company's name during the four-month period before the date of this agreement. All of the outstanding shares of beneficial interests, capital stock or similar voting interests of each Company are (i) duly authorized, validly issued, fully paid and nonassessable, (ii) owned of record and beneficially as described in Schedule 6.3, free and clear of any Liens, and (iii) not subject to any warrant, option or other acquisition Right of any Person or subject to any voting, ownership or transfer restriction except (1) restrictions imposed by securities laws and general corporate laws and (2) restrictions expressly noted in the certificates evidencing such shares.

6.4 Authorization and Contravention. The execution and delivery by Borrower of each Credit Document to which it is a party and the performance by it of its obligations under those Credit Documents (a) are within its trust power, (b) have been duly authorized by all necessary trust action, (c) require no consent of, action by, or filing with, any Governmental Authority (except any action or filing that has been taken or made or consent that has been received, and is completed and in final form and full force and effect, on or before the Closing Date), (d) do not violate any provision of its Organizational Documents, (e) do not violate any provision of any Governmental Requirement applicable to it or result in any breach of, or default under, any material agreement of the Companies, or (f) result in, or requires the imposition of, any Liens on any property of any Company, other than in favor of Administrative Agent for Lenders.

6.5 Binding Effect. Upon execution by Borrower of each Credit Document to which it is a party, each such Credit Document will constitute a legal and binding obligation of Borrower, enforceable against Borrower in accordance with that Credit Document's terms, except as that enforceability may be limited by Debtor Relief Laws and general principles of equity.

6.6 Financials. The Current Financials were prepared in accordance with GAAP and present fairly, in all material respects, the Companies' consolidated (if applicable) financial condition, results of operations and cash flows as of, and for the portion of the fiscal year ending on, their dates (subject only to normal year-end adjustments for interim statements). Except for transactions directly related to, or specifically contemplated or expressly permitted by, the Credit Documents, no material adverse changes have occurred in the Companies' consolidated (if applicable) financial condition from that shown in the Current Financials.

6.7 Solvency. On each Borrowing Date, Borrower is, and after giving effect to the requested Borrowing will be, Solvent.

6.8 Litigation.

(a) Except as shown on Schedule 6.8, no Company is subject to, or aware of the threat of, any Litigation involving any Company, or any of their respective properties, which if adversely determined against any of them, reasonably could be expected to result in a Material Adverse Event, and

(b) No outstanding and unpaid judgments against any Company exist that reasonably could be expected to result in a Material Adverse Event.

6.9 Taxes.

(a) Except where the non-compliance of any of the following reasonably could not be expected to result in a Material Adverse Event, (i) all returns, reports and other information of each Company required to be filed in respect to a present or future liability for any Taxes have been prepared in compliance with all requisite Governmental Requirements, and as so prepared, have been properly filed (or extensions have been granted) and (ii) all Taxes imposed upon each Company that are due and payable have been timely and fully paid except as are being contested as permitted by Section 7.5.

(b) Borrower qualifies as a "real estate investment trust" for all purposes under the Code.

6.10 Environmental Matters.

(a) No Company has received notice from any Governmental Authority that it has any actual or potential Environmental Liability, and no Company has knowledge that it has any Environmental Liability, which actual or potential Environmental Liability in either case reasonably could be expected to constitute a Material Adverse Event.

(b) No Company has received notice from any Governmental Authority that any Real Property is affected by, and no Company has knowledge that any Real Property is affected by, any Release of any Hazardous Substance which reasonably could be expected to constitute a Material Adverse Event.

(c) No Company knows of any environmental conditions or circumstances adversely affecting any material portion of the collateral securing any of the Commercial Loans or Mortgage Loans. The Companies have taken all steps required under applicable Governmental Requirements to determine that all of the Projects securing the Mortgage Loans are in compliance with all applicable Governmental Requirements.

6.11 Employee Plans. Except where not a Material Adverse Event (a) no Employee Plan subject to ERISA has incurred an "accumulated funding deficiency" (as defined in Section 302 of ERISA or Section 512 of the Code), (b) neither any Company nor any ERISA Affiliate has incurred liability (except for liabilities for premiums that have been paid or that are not past due) under ERISA to the PBGC in connection with any Employee Plan, (c) neither any Company nor any ERISA Affiliate has withdrawn in whole or in part from participation in a Multiemployer Plan in a manner that has given rise to a withdrawal liability under Title IV of

ERISA, (d) neither any Company nor any ERISA Affiliate has engaged in any "prohibited transaction" (as defined in Section 406 of ERISA or Section 4975 of the Code), (e) no "reportable event" (as defined in Section 4043 of ERISA) has occurred excluding events for which the notice requirement is waived under applicable PBGC regulations, (f) neither any Company nor any ERISA Affiliate has any liability, or is subject to any Lien, under ERISA or the Code to or on account of any Employee Plan, (g) each Employee Plan subject to ERISA and the Code complies in all material respects, both in form and operation, with ERISA and the Code and (h) no Multiemployer Plan subject to the Code is in reorganization within the meaning of Section 418 of the Code.

6.12 Properties; Liens. Each Company has good and marketable title to all its property reflected on the Current Financials except for property that is obsolete or that has been disposed of in the ordinary course of business between the date of the Current Financials and the date of this agreement or, after the date of this agreement, as permitted by Section 8.10. No Lien exists on any property of any Company except Permitted Liens and Permitted Project Liens. Except for the Credit Documents, no Company is party or subject to any agreement, instrument or order which in any way restricts any Company's ability to allow Liens to exist upon any of its assets.

6.13 Government Regulations.

(a) No Company is subject to regulation under the Investment Company Act of 1940, as amended, or the Public Utility Holding Company Act of 1935, as amended.

(b) Each of the Companies has complied with all applicable Governmental Requirements of any Governmental Authority having jurisdiction over the conduct of their respective businesses or the ownership of their respective property.

6.14 Transactions with Affiliates. Except for transactions with other Companies as permitted by Section 8.5, no Company is a party to a transaction (other than of an inconsequential nature) with any of its Affiliates.

6.15 Debt. No Company has any Debt except Permitted Debt.

6.16 Leases. Except where it could not reasonably be expected to result in a Material Adverse Event, (a) each Company enjoys peaceful and undisturbed possession under all leases necessary or desirable for the operation of its properties and assets and (b) all material leases under which any Company is a lessee are in full force and effect.

6.17 Labor Matters. Except where it could not reasonably be expected to result in a Material Adverse Event (a) no actual or threatened strikes, labor disputes, slow downs, walkouts, work stoppages or other concerted interruptions of operations that involve any employees employed at any time in connection with the business activities or operations at any Real Property exist, (b) hours worked by and payment made to the employees of any Company have not been in violation of the Fair Labor Standards Act or any other applicable Governmental Requirements pertaining to labor matters, (c) all payments due from any Company for employee health and welfare insurance, including, without limitation, workers compensation insurance, have been paid or accrued as a liability on its books and (d) the business activities and operations

of each Company are in compliance with OSHA and other applicable health and safety Governmental Requirements.

6.18 Intellectual Property. Except where it could not reasonably be expected to result in a Material Adverse Event, (a) each Company owns or has the right to use all material licenses, patents, patent applications, copyrights, service marks, trademarks, trademark applications, trade names, trade secrets and other intellectual property rights necessary or desirable to continue to conduct its businesses as presently conducted by it and proposed to be conducted by it immediately after the date of this agreement, (b) each Company is conducting its business without infringement or claim of infringement of any license, patent, copyright, service mark, trademark, trade name, trade secret or other intellectual property right of others and (c) no infringement or claim of infringement by others of any material license, patent, copyright, service mark, trademark, trade name, trade secret or other intellectual property of any Company exists.

6.19 Insurance. Each Company maintains the insurance required by Section 7.9.

6.20 Full Disclosure. All information furnished to Administrative Agent or Lenders by or on behalf of any Company in connection with the Credit Documents was, and all information furnished to Administrative Agent or Lenders in the future by or on behalf of any Company will be, in each case, when so furnished, true, complete and accurate in all material respects or where estimates or projections were or will be therein made and so designated, based on good faith, reasonable estimates or projections on the date the information is stated or certified.

SECTION 7. AFFIRMATIVE COVENANTS.

7.1 Certain Items Furnished. Borrower shall furnish the following to Administrative Agent (with sufficient copies for each Lender):

(a) Annual Financials, Etc. Promptly after preparation but no later than 90 days after the last day of each fiscal year of Borrower, audited Financials showing the Companies' consolidated and consolidating financial condition and results of operations as of, and for the year ended on, that last day, accompanied by (i) the opinion, without qualification, of a nationally-recognized firm of independent certified public accountants acceptable to Required Lenders, based on an audit using generally accepted auditing standards, that the consolidated portion of those Financials were prepared in accordance with GAAP and present fairly, in all material respects, the Companies' consolidated financial condition and results of operations and (ii) with respect to the period covered by such Financials, a Compliance Certificate.

(b) Quarterly Financials, Etc. Promptly after preparation but no later than 60 days after the last day of each fiscal quarter of Borrower, Financials showing the Companies' consolidated financial condition and results of operations for that fiscal quarter and for the period from the beginning of the current fiscal year to the last day of that fiscal quarter, accompanied by a Compliance Certificate with respect to the period covered by such Financials.

(c) SEC Filings. Promptly after preparation, but in any event (i) within 60 days after the end of each of the first three fiscal quarters of Borrower, an accurate and complete copy of Borrower's Form 10-Q as filed with the Securities and Exchange Commission, (ii) within 90 days after the end of each fiscal year of Borrower, an accurate and complete copy of Borrower's Form 10-K as filed with the Securities and Exchange Commission, and (iii) promptly upon their becoming available, accurate and complete copies of all registration statements, other periodic reports and statements and schedules filed by Borrower with any securities exchange, the Securities and Exchange Commission or any other similar Governmental Authority.

(d) Quarterly Mortgage Loan Reports. Promptly after preparation, but no later than 30 days after the last day of each fiscal quarter, a schedule of all of Borrower's Mortgage Loans, each such report to be in form and scope acceptable to Administrative Agent, including, without limitation, setting forth information identifying (i) all Mortgage Loans with respect to which a default has occurred as to the payment of any installment of principal or interest or other monetary default has occurred under any Mortgage Loan Document related thereto and such default has not been cured for more than 60 days, or, in the case of Workout Loans, for more than 30 days, (ii) Mortgage Loans in Liquidation, (iii) Mortgage Loans in Litigation, (iv) any other Non-Performing Loans, (v) Renegotiated Loans, (vi) Construction Loans, and (vii) Segmented Loans.

(e) Annual Financial Projections. Promptly after preparation but no later than 45 days after the last day of each fiscal year of Borrower, annual financial projections for the Companies prepared by Borrower, in form and substance reasonably acceptable to Administrative Agent, setting forth management's projections for the next succeeding fiscal year.

(f) Other Reports. Promptly after preparation and distribution, accurate and complete copies of all reports and other communications about material financial matters or material corporate plans or projections by or for any Company for distribution to any Governmental Authority or any existing or potential creditor including, without limitation, each interim or special audit report and management letter issued by the Companies' accountants with respect to the Companies or their financial records, but excluding (x) credit, trade and other reports prepared and distributed in the ordinary course of business and (y) information otherwise furnished to Administrative Agent and Lenders under this agreement.

(g) Employee Plans. As soon as possible and within 20 days after Borrower knows that a Reportable Event has occurred, or that the PBGC has instituted or will institute proceedings under ERISA to terminate that Employee Plan, deliver a certificate of a Responsible Officer of Borrower setting forth details as to that Reportable Event and the action which Borrower or an ERISA Affiliate, as the case may be, proposes to take with respect to it, together with a copy of any notice of that Reportable Event which may be required to be filed with the PBGC, or any notice delivered by the PBGC evidencing its intent to institute those proceedings or any notice to the PBGC that the Employee Plan is to be terminated, as the case may be. For all purposes of this section, Borrower is

deemed to have all knowledge of all facts attributable to the plan administrator under ERISA.

(h) Project Lease Information. Promptly when requested by Administrative Agent or any Lender, correct and complete copies of all leases covering all or any portion of any Project, together with a rent roll covering such leases in form and substance reasonably required by Administrative Agent and certified to by the applicable Mortgage Loan Obligor as being true, correct and complete in all material respects.

(i) Other Notices. Promptly after Borrower knows or receives any notification thereof (whichever shall first occur), notice of (a) the existence and status of any Litigation or Environmental Liability that if determined adversely to any Company, could reasonably be expected to result in a Material Adverse Event, (b) any material Litigation that questions the validity of any Lien which secures or purports or is intended to secure any Mortgage Loan Document relating to any Mortgage Loan, any Lien which secures or purports or is intended to secure any Mortgage Loan or any Project Document relating to any Mortgage Loan, (c) any change in any fact or circumstance (other than of an inconsequential nature) represented or warranted by any Company in any Credit Document, (d) any challenge by the Internal Revenue Service with respect to Borrower's status as a REIT, (e) an Event of Default, Potential Default or Material Adverse Event, specifying the nature thereof and what action the Companies have taken, are taking and propose to take and (f) any notice of a "default," "event of default" or "potential default" from any other creditor of the Companies, with a copy thereof immediately delivered to Administrative Agent, together with an explanation from Borrower, in detail satisfactory to Administrative Agent, regarding the notice and effect of such notice.

(j) Other Information. Promptly when reasonably requested by Administrative Agent or any Lender, such additional information (not otherwise required to be furnished under this agreement) regarding (a) any Company's business affairs, assets, liabilities, results of operation and financial condition, (b) any Mortgage Loan, or (c) any Mortgage Loan Document, any Project Document or any Project which secures a Mortgage Loan as Administrative Agent or any Lender may request (all in form and substance satisfactory to Administrative Agent or that Lender).

7.2 Use of Credit. Borrower shall use the proceeds of Borrowings only for the purposes represented in this agreement.

7.3 Books and Records. Each Company shall maintain books, records and accounts necessary to prepare Financials in accordance with GAAP.

7.4 Inspections. Upon reasonable request and advance notice (but during the pendency of an Event of Default, no advance notice is required), each Company shall allow Administrative Agent or any Lender (or their respective Representatives) to inspect any of that Company's properties, to review reports, files and other records and to make and take away copies, to conduct tests or investigations and to discuss any of its affairs, conditions and finances with its other creditors, directors, officers, employees, outside accountants or representatives from time to time, during reasonable business hours (but during the pendency of an Event of

Default, at any time). Without limiting the foregoing, the Companies shall allow Administrative Agent to perform field examinations to test such systems and controls of the Companies as it deems appropriate. Borrower shall promptly reimburse Administrative Agent and Lenders for the reasonable expenses of such inspections and field examinations.

7.5 Taxes. Each Company shall promptly pay when due any and all Taxes, except Taxes that are being contested in good faith by lawful proceedings diligently conducted, against which reserve or other provision required by GAAP has been made and in respect of which levy and execution of any Lien sufficient to be enforced has been and continues to be stayed.

7.6 Payment of Obligation. Each Company shall promptly pay (or renew and extend) all of its obligations as they become due (unless the obligations, other than the Obligation or any part thereof, are being contested in good faith by appropriate proceedings).

7.7 Expenses. Within ten Business Days after demand accompanied by an invoice describing the costs, fees and expenses in reasonable detail, Borrower shall pay (a) all costs, fees and expenses paid or incurred by or on behalf of Administrative Agent incident to any Credit Document (including, without limitation, the reasonable fees and expenses of Administrative Agent's counsel in connection with the negotiation, preparation, delivery and execution of the Credit Documents and any related amendment, waiver or consent) and (b) all reasonable costs and expenses incurred by Administrative Agent in connection with the enforcement of the obligations of any Company under the Credit Documents or the exercise of any Rights under the Credit Documents (including, without limitation, reasonable allocated costs of in-house counsel, other reasonable attorneys' fees and court costs), all of which are part of the Obligation, bearing interest (if not paid within ten Business Days after demand accompanied by an invoice describing the costs, fees and expenses in reasonable detail) on the portion thereof from time to time unpaid at the Default Rate until paid.

7.8 Maintenance of Existence, Assets and Business. Each Company shall (a) maintain its trust, corporate or partnership (as applicable) existence and good standing in its state of incorporation or formation (as applicable) and (b) except where the failure to perform any of the following could not reasonably be expected to result in a Material Adverse Event (i) maintain its authority to transact business and good standing in all other states, (ii) maintain all licenses, permits and franchises necessary or desirable for its business and (iii) keep all of its assets that are useful in and necessary to its business in good working order and condition (ordinary wear and tear excepted) and make all necessary repairs and replacements.

7.9 Insurance. Each Company shall, at its cost and expense, maintain with financially sound, responsible and reputable insurance companies or associations, or as to workers' compensation or similar insurance, with an insurance fund or by self-insurance authorized by the jurisdictions in which it operates, insurance concerning its properties and businesses against casualties and contingencies and of types and in amounts (and with co-insurance and deductibles) as is customary in the case of similar businesses. In addition, Borrower shall and shall cause each other Company to, (a) name Administrative Agent as additional insured on all general and comprehensive liability insurance, (b) deliver copies of the policies and endorsements for the insurance required by this Section 7.9 to Administrative Agent promptly after issuance and renewal of each and (c) cause each policy of insurance to provide that it will

not be cancelled or modified (as to term, coverage, scope, property or risks covered, change or addition of loss payee or additional insured or otherwise) without 30 days prior written notice to Administrative Agent.

7.10 Compliance with Governmental Requirements. Each Company shall (a) operate and manage its businesses and otherwise conduct its affairs in compliance with all Governmental Requirements (including without limitation, all Environmental Laws and Environmental Permits) except to the extent noncompliance reasonably could be expected not to constitute a Material Adverse Event, (b) promptly deliver to Administrative Agent a copy of any notice received from any Governmental Authority alleging that any Company is not in compliance with any Governmental Requirements (including any Environmental Laws or Environmental Permits) if the allegation reasonably could constitute a Material Adverse Event and (c) promptly deliver to Administrative Agent a copy of any notice received from any Governmental Authority alleging that any Company has any potential Environmental Liability if the allegation reasonably could constitute a Material Adverse Event.

7.11 Indemnification.

(a) AS USED IN THIS SECTION: (I) "INDEMNITOR" MEANS BORROWER AND EACH OTHER COMPANY; (II) "INDEMNITEE" MEANS ADMINISTRATIVE AGENT, EACH LENDER, EACH PRESENT AND FUTURE AFFILIATE OF ADMINISTRATIVE AGENT AND EACH LENDER, EACH PRESENT AND FUTURE REPRESENTATIVE OF ADMINISTRATIVE AGENT AND EACH LENDER OR ANY OF THOSE AFFILIATES AND EACH PRESENT AND FUTURE SUCCESSOR AND ASSIGN OF ADMINISTRATIVE AGENT AND EACH LENDER OR ANY OF THOSE AFFILIATES OR REPRESENTATIVES; AND (III) "INDEMNIFIED LIABILITIES" MEANS ALL PRESENT AND FUTURE, KNOWN AND UNKNOWN, FIXED AND CONTINGENT, ADMINISTRATIVE, INVESTIGATIVE, JUDICIAL AND OTHER CLAIMS, DEMANDS, ACTIONS, CAUSES OF ACTION, INVESTIGATIONS, SUITS, PROCEEDINGS, AMOUNTS PAID IN SETTLEMENT, DAMAGES, JUDGMENTS, PENALTIES, COURT COSTS, LIABILITIES AND OBLIGATIONS, AND ALL PRESENT AND FUTURE COSTS, EXPENSES AND DISBURSEMENTS (INCLUDING ALL REASONABLE ATTORNEYS' FEES AND EXPENSES WHETHER OR NOT SUIT OR OTHER PROCEEDING EXISTS OR ANY INDEMNITEE IS PARTY TO ANY SUIT OR OTHER PROCEEDING) IN ANY WAY RELATED TO ANY OF THE FOREGOING, THAT MAY AT ANY TIME BE IMPOSED ON, INCURRED BY, OR ASSERTED AGAINST, ANY INDEMNITEE AND IN ANY WAY RELATING TO OR ARISING OUT OF ANY (1) CREDIT DOCUMENT OR TRANSACTION CONTEMPLATED BY ANY CREDIT DOCUMENT, (2) ENVIRONMENTAL LIABILITY IN ANY WAY RELATED TO ANY COMPANY, OR ACT, OMISSION, STATUS, OWNERSHIP, OR OTHER RELATIONSHIP, CONDITION, OR CIRCUMSTANCE CONTEMPLATED BY, CREATED UNDER, OR ARISING PURSUANT TO OR IN CONNECTION WITH ANY CREDIT DOCUMENT, OR (3) INDEMNITEE'S SOLE OR CONCURRENT ORDINARY NEGLIGENCE.

(b) EACH INDEMNITOR AGREES, JOINTLY AND SEVERALLY, TO INDEMNIFY PROTECT AND DEFEND EACH INDEMNITEE FROM AND AGAINST, HOLD EACH INDEMNITEE HARMLESS FROM AND AGAINST, AND ON DEMAND PAY OR REIMBURSE EACH INDEMNITEE FOR, ALL INDEMNIFIED LIABILITIES.

(c) THE FOREGOING PROVISIONS (I) ARE NOT LIMITED IN AMOUNT EVEN IF THAT AMOUNT EXCEEDS THE OBLIGATION, (II) INCLUDE, WITHOUT LIMITATION, REASONABLE FEES AND EXPENSES OF ATTORNEYS AND OTHER COSTS AND EXPENSES OF LITIGATION OR PREPARING FOR LITIGATION AND DAMAGES OR INJURY TO PERSONS, PROPERTY, OR NATURAL RESOURCES ARISING UNDER ANY STATUTORY OR COMMON LAW GOVERNMENTAL REQUIREMENT, PUNITIVE DAMAGES, FINES, AND OTHER PENALTIES, AND (III) ARE NOT AFFECTED BY THE SOURCE OR ORIGIN OF ANY HAZARDOUS SUBSTANCE, AND (IV) ARE NOT AFFECTED BY ANY INDEMNITEE'S INVESTIGATION, ACTUAL OR CONSTRUCTIVE KNOWLEDGE, COURSE OF DEALING, OR WAIVER.

(d) HOWEVER, NO INDEMNITEE IS ENTITLED TO BE INDEMNIFIED UNDER THE CREDIT DOCUMENTS FOR ITS OWN FRAUD, GROSS NEGLIGENCE, OR WILLFUL MISCONDUCT.

(e) ALTHOUGH FAILURE TO DO SO DOES NOT REDUCE OR IMPAIR ANY INDEMNITOR'S OBLIGATIONS UNDER THIS SECTION, EACH INDEMNITEE SHALL PROMPTLY NOTIFY BORROWER OF ANY EVENT ABOUT WHICH THE INDEMNITEE HAS RECEIVED WRITTEN NOTICE AND THAT IS REASONABLY LIKELY TO RESULT IN ANY INDEMNIFIED LIABILITY. EACH INDEMNITOR MAY, AT ITS OWN COST AND EXPENSE, PARTICIPATE IN THE DEFENSE IN ANY PROCEEDING INVOLVING ANY INDEMNIFIED LIABILITY. IF NO EVENT OF DEFAULT OR POTENTIAL DEFAULT EXISTS, INDEMNITORS MAY ASSUME THE DEFENSE IN THAT PROCEEDING ON BEHALF OF THE APPLICABLE INDEMNITEES, INCLUDING THE EMPLOYMENT OF COUNSEL IF FIRST APPROVED (WHICH APPROVAL MAY NOT BE UNREASONABLY WITHHELD) BY THE APPLICABLE INDEMNITEES. IF INDEMNITORS ASSUME ANY DEFENSE, THEY SHALL KEEP THE APPLICABLE INDEMNITEES FULLY ADVISED OF THE STATUS OF, AND SHALL CONSULT WITH, AND RECEIVE THE CONCURRENCE OF, THOSE INDEMNITEES BEFORE TAKING ANY MATERIAL POSITION IN RESPECT OF, THAT PROCEEDING. IF INDEMNITORS CONSENT, IF AN EVENT OF DEFAULT, POTENTIAL DEFAULT OR MATERIAL ADVERSE EVENT EXISTS OR IF ANY INDEMNITEE REASONABLY DETERMINES THAT AN ACTUAL CONFLICT OF INTERESTS EXISTS BETWEEN INDEMNITORS AND THAT INDEMNITEE WITH RESPECT TO THE SUBJECT MATTER OF THE PROCEEDING OR THAT INDEMNITORS ARE NOT DILIGENTLY PURSUING THE DEFENSE, THEN (I) THAT INDEMNITEE MAY, AT

INDEMNITORS' JOINT AND SEVERAL EXPENSE, EMPLOY COUNSEL TO REPRESENT THAT INDEMNITEE THAT IS SEPARATE FROM COUNSEL FOR INDEMNITORS OR ANY OTHER PERSON IN THAT PROCEEDING AND (II) INDEMNITORS ARE NO LONGER ENTITLED TO ASSUME THE DEFENSE ON BEHALF OF THAT INDEMNITEE. NO INDEMNITOR MAY AGREE TO THE SETTLEMENT OF ANY INDEMNIFIED LIABILITY, OR ANY MATTERS OR ISSUES MATERIAL TO OR NECESSARY FOR THE RESOLUTION OF ANY SUCH LIABILITY, WITHOUT THE PRIOR WRITTEN CONSENT OF THE APPLICABLE INDEMNITEES UNLESS, AS AGREED TO IN WRITING BY AN INDEMNITEE, THAT SETTLEMENT FULLY RELIEVES THOSE INDEMNITEES OF ANY LIABILITY WHATSOEVER FOR THAT INDEMNIFIED LIABILITY. IF AN INDEMNITEE AGREES TO THE SETTLEMENT OF ANY INDEMNIFIED LIABILITY WITHOUT THE PRIOR WRITTEN CONSENT OF INDEMNITORS (WHICH CONSENT MAY NOT BE UNREASONABLY WITHHELD), THEN INDEMNITORS ARE NO LONGER OBLIGATED FOR THAT INDEMNIFIED LIABILITY IN RESPECT OF THAT INDEMNITEE.

7.12 Mortgage Loan Approval, Collection and Servicing Standards.

Borrower shall follow the loan approval, collection and servicing policies and standards in effect as of the Closing Date, except for immaterial changes in such policies and standards or changes in such policies and standards disclosed to and approved in writing by Administrative Agent and Lenders.

7.13 Negative Pledge. Borrower hereby covenants and agrees (and agrees

to cause each other Company) not to directly or indirectly create, incur, grant, suffer, or permit to be created or incurred any Lien on any of the respective assets of such Companies, other than Permitted Liens and Permitted Project Liens. Furthermore, in the event that, notwithstanding the foregoing, any such Liens (other than Permitted Liens and Permitted Project Liens) are granted, incurred, or created, then, in addition to the other Rights granted to Administrative Agent and Lenders hereunder or under applicable Governmental Requirements, (a) the Companies hereby grant to Administrative Agent and Lenders an equal and ratable Lien in and to the property so encumbered, (b) any Person receiving the benefit of any such additional Liens shall be deemed to receive any such grant or conveyance of Liens for the ratable and pari passu benefit of Lenders and Administrative Agent and shall be deemed the bailee and agent for such Lenders for the sole purpose of holding any such collateral and Liens and perfecting Liens in favor of Administrative Agent and Lenders with respect thereto, and (c) upon the request of Administrative Agent, each Company shall execute, and shall request the other Person to execute, all such documents and take all actions requested by Required Lenders to more fully evidence and create such ratable, pari passu Liens in favor of Lenders and Administrative Agent.

SECTION 8. NEGATIVE COVENANTS.

For so long as any Lender is committed to lend under this agreement and until the Obligation has been fully paid and performed, Borrower covenants and agrees with Administrative Agent and Lenders as follows:

8.1 Payroll Taxes. No Company may directly or indirectly use any proceeds of any Borrowing (a) for any purpose other than as represented in this agreement, or (b) for the payment of wages of employees unless a timely payment to or deposit with the United States of America of all amounts of Tax required to be deducted and withheld with respect to such wages is also made.

8.2 Debt. No Company may:

(a) Create, incur or suffer to exist (directly or indirectly) any direct, indirect, fixed or contingent liability for any Debt except the following (the "Permitted Debt"):

(i) the Obligation;

(ii) Debt existing on the Closing Date, as more particularly described on Schedule 8.2 (the "Existing Debt");

(iii) Debt arising under or in connection with any Structured Financing that is entered into as a result of an Asset Securitization;

(iv) Debt of up to \$15,000,000 at any one time outstanding (including any such Debt existing on the Closing Date and described on Schedule 8.2), incurred by any Company, but in any case having recourse to Borrower, having the following general attributes: (A) such indebtedness is secured solely by liens on specified Amerihost Properties or parcels of Qualifying Real Estate; (B) the loan documents evidencing such indebtedness do not contain covenants or other agreements that are more restrictive than those found in the Credit Documents, do not cross-default to the Credit Documents, and are otherwise in form and substance acceptable to Administrative Agent and Required Lenders; and (C) no Event of Default or Potential Default has occurred and is continuing when any such Debt is to be incurred, and no Event of Default or Potential Default would be created by such incurrence. Prior to the incurrence of any Debt permitted by this clause (iv), Borrower shall deliver a written notice to Administrative Agent of its intent to incur such Debt, the proposed obligor, proposed obligee, amount, rate and scheduled amortization of such proposed Debt. Borrower shall also provide any other information requested by Administrative Agent and Lenders with respect to such proposed financing, including, without limitation, copies of the loan documents evidencing the proposed financing; and

(v) indebtedness and other obligations arising under Rate Management Transactions contemplated by this agreement.

(b) Prepay, purchase, repurchase, defease or redeem, or cause to be prepaid, purchased, repurchased, defeased or redeemed, any principal of, or any premium (if any) or interest on, any of its Debt, or fund or cause to be funded any sinking or similar fund for any such Debt, except for (i) the Obligation, (ii) any Debt permitted under Section 8.2(a)(iv) above in connection with the sale of the underlying real property to a third party in an arm's-length transaction, so long as all prepayments required by Section 3.2(c) are made simultaneously therewith, and (iii) any Debt owed by a Special Purpose

Entity incurred in connection with an Asset Securitization, so long as (A) such Debt has been reduced to 15% or less of its original principal amount, (B) such prepayment fully extinguishes such Debt, (C) no Default, Event of Default then exists or would be created by such prepayment, and (D) all remaining Mortgage Loans and related assets of such Special Purpose Entity are immediately transferred to Borrower.

8.3 Liens. No Company may (a) create, incur or suffer or permit to be created or incurred or to exist any Lien upon any of its properties except a Permitted Lien or (b) enter into or permit to exist any arrangement or agreement that directly or indirectly prohibits any Company from creating or incurring any Lien on any of its assets or properties except (i) the Credit Documents, (ii) any lease that places a Lien prohibition on only the property subject to that lease, and (iii) arrangements and agreements that apply only to property subject to Permitted Liens. The following are "Permitted Liens":

(a) Lender Liens;

(b) Liens existing on the Closing Date, as more particularly described on Schedule 8.3 (the "Existing Liens");

(c) Liens on the assets owned by any Special Purpose Entity, which Liens are created under or in connection with a Structured Financing permitted by this agreement;

(d) Liens on individual Amerihost Properties or parcels of Qualifying Real Estate securing Debt permitted by Section 8.2(a)(iv);

(e) Any interest or title of a lessor in property being leased under an operating lease that does not constitute Debt;

(f) Liens arising under Rate Management Transactions permitted by this agreement;

(g) Banker's Liens and Rights of setoff or recoupment;

(h) Pledges or deposits made to secure any Company's payment of workers' compensation, unemployment insurance or other forms of governmental insurance or benefits or to participate in any fund in connection with workers' compensation, unemployment insurance, pensions or other social security programs;

(i) Zoning and similar restrictions on the use of, and easements, restrictions, covenants, title defects and similar encumbrances on, Real Property that do not impair the use of such Real Property (other than of an inconsequential nature) and that are not violated by existing or proposed structures or land use; and

(j) If no Lien has been filed in any jurisdiction or agreed to (i) claims and Liens for Taxes not yet due and payable, (ii) statutory mechanic's Liens and materialman's Liens for services or materials and similar statutory Liens incident to construction and maintenance of Real Property, in each case for which payment is not yet due and payable, (iii) statutory landlord's Liens for rental not yet due and payable and

(iv) statutory Liens of warehousemen and carriers and similar statutory Liens securing obligations that are not yet due and payable.

8.4 Employee Plans. No Company may permit any of the events or circumstances described in Section 6.11 to exist or occur except where the failure to perform the foregoing could not reasonably be expected to result in a Material Adverse Event.

8.5 Transactions with Affiliates. No Company may enter into any transaction with any of its Affiliates except (a) Asset Securitizations, but only so long as (i) no Event of Default or Potential Default has occurred and is continuing at the time of such Asset Securitization, and (ii) all mandatory prepayments on the Obligation required by Section 3.2(c) are made in connection therewith and (b) transactions (other than Investments) in the ordinary course of business and upon fair and reasonable terms not materially less favorable than it could obtain or could become entitled to in an arm's-length transaction with a Person that was not its Affiliate.

8.6 Compliance with Governmental Requirements and Documents. No Company shall (a) violate the provisions of any Governmental Requirements (including, without limitation, OSHA and Environmental Laws) applicable to it or of any material agreement to which it is a party or by which any of its property is subject or bound if that violation alone, or when aggregated with all other violations, reasonably could be expected to result in a Material Adverse Event, (b) violate any provision of its Organizational Documents or (c) repeal, replace or amend any provision of its Organizational Documents if that action reasonably could be expected to result in a Material Adverse Event.

8.7 Investments. No Company may make any Investments except the following (the "Permitted Investments"):

(a) (i) Readily marketable, direct, full faith and credit obligations of the United States of America or obligations guaranteed by the full faith and credit of the United States of America and (ii) readily marketable obligations of an agency or instrumentality of, or corporation owned, controlled or sponsored by, the United States of America that are generally considered in the securities industry to be implicit obligations of the United States of America, in each case, due within one year after the acquisition of it (collectively, "Government Securities");

(b) Readily marketable direct obligations of any state of the United States of America given on the date of such investment a credit rating of at least Aa by Moody's Investors Service, Inc. or AA by Standard & Poor's Corporation, in each case due within one year from the making of the investment;

(c) Certificates of deposit issued by, bank deposits in, eurodollar deposits through, bankers' acceptances of, and repurchase agreements covering Government Securities executed by, (i) any Lender or (ii) any bank incorporated under the Governmental Requirements of the United States of America or any of its states and given on the date of the investment a short-term certificate of deposit credit rating of at least P-2 by Moody's Investors Service, Inc., or A-2 by Standard & Poor's Corporation, in each case due within one year after the date of the making of the investment;

(d) Certificates of deposit issued by, bank deposits in, eurodollar deposits through, bankers' acceptances of, and repurchase agreements covering Government Securities executed by, any branch or office located in the United States of America of a bank incorporated under the Governmental Requirements of any jurisdiction outside the United States of America having on the date of the investment a short-term certificate of deposit credit rating of a least P-2 by Moody's Investors Service, Inc., or A-2 by Standard & Poor's Corporation, in each case due within one year after the date of the making of the investment;

(e) Commercial paper maturing in 270 days or less from the date of issuance and rated P-1 or better by Moody's Investors Service, Inc., or A-1 or better by Standard & Poors Corporation;

(f) Money market instruments and mutual funds rated AAA by Standard & Poors Corporation or given one of the two highest credit rankings for such investments by any other nationally-recognized rating service;

(g) Investments by Borrower in any financial assets which are generated or outstanding as a result of an Asset Securitization involving a Special Purpose Entity; and

(h) Customary capital contributions or similar investments relating to the formation of any Subsidiary of that Company.

8.8 Qualifying Real Estate. Borrower may not purchase any real property or any hotel/motel project other than Qualifying Real Estate, provided that no Qualifying Real Estate shall be acquired in excess of any applicable Real Estate Purchase Limitation.

8.9 Distributions; Other Payments. No Company shall enter into or permit to exist any arrangement or agreement which directly or indirectly prohibits any such Company from declaring, making or paying, directly or indirectly, any Distribution to Borrower. No Company shall, directly or indirectly, declare, make or pay any Distributions except for:

(a) Distributions to Borrower from any other Company; and

(b) if no Event of Default or Potential Default exists or would exist after giving effect to the Distribution, and so long as any such Distributions are made in the ordinary course of business consistent with sound business practices, the following Distributions by Borrower: (i) Distributions declared or paid during any fiscal year which do not exceed the sum of (A) 100% of Funds from Operations for that fiscal year, plus (B) if paid by May 30 during that year, the portion of the then-preceding fiscal year's Distributions that would have been permitted under clause (A) above that did not represent any carryover from earlier years and was not declared and paid during that preceding fiscal year, and (ii) up to an aggregate of \$2,000,000 of other Distributions made or declared during the term of this agreement;

8.10 Disposition of Assets. No Company may sell, assign, lease, transfer or otherwise dispose of any of its assets (including, without limitation, equity interests in any other Company) other than pursuant to a Permitted Asset Sale.

8.11 Mergers, Consolidations and Dissolutions. No Company may merge or consolidate with any other Person, or acquire, in one or a series of related transactions, all or substantially all of the equity or assets of any Person; provided that, notwithstanding the foregoing, so long as no Event of Default then exists or would be created by such transaction, Borrower may from time to time acquire substantially all of the assets of any of the Special Purpose Entities that have repaid in full all of the indebtedness and other obligations incurred by them in connection with an Asset Securitization. In addition, no Company may dissolve or convert to any other form of entity.

8.12 Assignment. No Company may assign or transfer any of its Rights, duties or obligations under any of the Credit Documents.

8.13 Fiscal Year and Accounting Methods. No Company may change either its fiscal year for accounting purposes or any material aspect of its method of accounting.

8.14 New Businesses. No Company may engage in any business except the businesses in which it is presently engaged and any other reasonably related business.

8.15 Government Regulations. No Company may conduct its business in a way that it becomes regulated under the Investment Company Act of 1940, as amended, or the Public Utility Holding Company Act of 1935, as amended.

8.16 Financial Contracts. No Company will enter into or remain liable upon any Financial Contract, except the Rate Management Transactions contemplated by this agreement.

8.17 Strict Compliance. No Company may indirectly do anything that it may not directly do under any covenant in any Credit Document.

SECTION 9. FINANCIAL COVENANTS.

For so long as any Lender is committed to lend under this agreement, and until the Obligation has been fully paid and performed, Borrower covenants and agrees with Administrative Agent and Lenders as follows:

9.1 Minimum Net Worth. The Companies' consolidated Net Worth shall not at any time be less than the sum of (a) 90% of Net Worth as of the Closing Date, plus (b) 100% of the Net Proceeds from any Equity Issuances by Borrower after the Closing Date.

9.2 Maximum Leverage Ratio. The ratio of the Consolidated Companies' consolidated Total Liabilities to the Consolidated Companies' consolidated Net Worth shall not at any time exceed 1.5 to 1.00.

9.3 Maximum Non-Performing Loan Ratio. The ratio of the outstanding principal balance of the Companies' consolidated Non-Performing Loans to the Companies' consolidated Net Worth shall at all times be less than 0.10 to 1.00; provided that Borrower's compliance with this covenant will only be required on days on which there is outstanding Principal Debt.

9.4 Maximum Charge-Off Ratio. The Companies' consolidated Charge-Off Ratio shall at all times be less than 2.0%, to be determined for compliance reporting purposes as of the last day of each fiscal quarter of the Companies for the four quarters then ended.

9.5 Positive Cash Flow. The Companies, on a consolidated basis, shall maintain Cash Flow in an amount greater than \$0, to be determined for compliance reporting purposes as of the last day of each fiscal quarter of the Companies for the four fiscal quarters then ended.

9.6 Non-Hotel/Motel Loans. Borrower will not, at any time, permit the aggregate principal balance of its Mortgage Loans which are secured by Projects which are not hotels or motels to exceed an amount equal to (a) 25% of the aggregate principal balance of all of its Mortgage Loans less (b) the aggregate loan loss reserve established by Borrower with respect to its Mortgage Loans.

9.7 Minimum Asset Coverage Ratio. The Asset Coverage Ratio shall at all times (but calculated for compliance reporting purposes as of the last day of each fiscal quarter of the Borrower) be greater than or equal to 1.25 to 1.00 for the Borrower and First Western.

SECTION 10. EVENT OF DEFAULT.

The term "Event of Default" means the occurrence of any one or more of the following:

10.1 Payment of Obligation. Borrower's failure or refusal to pay (a) principal of any Note, or any part thereof, on or before the date when due (including any required mandatory prepayment when due), (b) any other part of the Obligation on or before 5 days after the date due, or (c) any final amounts due and payable under the Previous Agreement or the PMC Capital Agreement when due.

10.2 Covenants. Any Company's failure or refusal to punctually and properly perform, observe and comply with any of the covenants in Sections 8 and 9. It shall also constitute an Event of Default if any Company fails or refuses to punctually and properly perform, observe and comply with any covenant or agreement in any Credit Document (other than covenants to pay the Obligation and covenants set forth in Sections 8 and 9) applicable to it, and that failure or refusal continues for 15 days after that Company has, or with the exercise of reasonable diligence should have had, notice of that failure or refusal; provided, however, that with respect to the failure or refusal to perform any such covenant or agreement, Borrower shall not be entitled to an opportunity to cure any such failure or refusal if such failure or refusal is either not capable of being cured by Borrower or if the same covenant has already been breached more than two times during the twelve months preceding such breach.

10.3 Debtor Relief. Any Company (a) is not Solvent, (b) fails to pay its debts generally as they become due, (c) voluntarily seeks, consents to or acquiesces in the benefit of any Debtor Relief Law, other than as a creditor or claimant, or (d) becomes a party to or is made the subject of any proceeding provided for by any Debtor Relief Law, other than as a creditor or claimant, that could suspend or otherwise adversely affect the Rights of Administrative Agent or any Lender under the Credit Documents (unless, in the event such proceeding is involuntary, the petition instituting same is dismissed within 60 days after its filing).

10.4 Judgments and Attachments. Any Company fails, within 10 days after entry, to pay, bond, or otherwise discharge any one or more judgments or orders for the payment of money (not paid or fully covered by insurance) in excess of \$1,000,000 (individually or collectively) or the equivalent thereof in another currency or currencies, or any warrant of attachment, sequestration, or similar proceeding against any Company's assets having a value (individually or collectively) of \$1,000,000 or the equivalent thereof in another currency or currencies, which is not either (a) stayed on appeals; (b) being diligently contested in good faith by appropriate proceedings with adequate reserves having been set aside on the books of such Company in accordance with GAAP, or (c) dismissed by a court of competent jurisdiction.

10.5 Government Action. Unless otherwise covered by any event described in Section 10.4, (a) the entry or issuance of an order by any Governmental Authority (including the United States Justice Department) seeking to cause any Company to divest a significant portion of its assets under any antitrust, restraint of trade, unfair competition, industry regulation or similar Governmental Requirements, or (b) the commencement of any action or proceeding by any Governmental Authority (i) for the purpose of condemning, seizing or otherwise appropriating, or taking custody or control of all or any substantial portion of, any Company's assets or (ii) which asserts any material violation by, or material liability against, any Company based on any Environmental Law.

10.6 Misrepresentation. Any representation or warranty made by any Company in any Credit Document, or any financial data or other information now or hereafter furnished to Administrative Agent or Lenders by or on behalf of Borrower, at any time proves to have been false, incorrect or misleading in any material respect when made.

10.7 Ownership of Other Companies. Except as a result of transactions permitted by this agreement, any Company (other than Borrower) fails to constitute the direct or indirect wholly owned Subsidiary of Borrower.

10.8 Change of Control of Borrower. Any Change of Control shall occur.

10.9 Change in Management. Any material change in the management of Borrower or the Companies as a whole, including, without limitation, any two or more of the following are no longer employed by Borrower in the same or similar capacities as they are on the Closing Date: Lance Rosemore, Andrew Rosemore, Jan Salit or Barry Berlin.

10.10 Other Funded Debt. In respect of any Funded Debt of any Company (other than the Obligation) (a) any Company fails to make any payment when due, (b) any default or other event or condition occurs or exists beyond the applicable grace or cure period, the effect of which is to permit any holder of that Funded Debt to cause (whether or not it elects to cause) any of such Funded Debt to become due before its stated maturity or regularly scheduled payment dates, or (c) any of that Funded Debt is declared to be due and payable or required to be prepaid by any Company before its stated maturity.

10.11 Rate Management Transactions. Nonpayment by Borrower of any Rate Management Obligation when due or the breach by Borrower of any term, provision or condition contained in any Rate Management Transaction.

10.12 Validity and Enforceability of Credit Documents. Any Credit Document ceases to be in full force and effect or is declared to be null and void, or the validity or enforceability of any Credit Document or any Lender Lien is contested by any Company or any other Person, or any Company or any other Person asserts the absence of, or denies that it has, any liability or obligations under any Credit Document to which it is a party except in accordance with that document's express provisions, or any Lender Lien shall fail to constitute a valid, perfected-first priority lien in favor of Administrative Agent for Lenders, except in accordance with the express provisions of any applicable Credit Document.

10.13 Material Agreement Default or Cancellation. The default under, or breach or cancellation of, any agreement or other contractual arrangement to which any Company is a party or beneficiary or by which any of its property is bound or subject, which reasonably could be expected to result in any (a) significant impairment of (i) the ability of Borrower or any other Company to perform any of its payment or other material obligations under any Credit Document or (ii) the ability of Administrative Agent or Lenders to enforce any of those obligations or any of their respective Rights under the Credit Documents, (b) significant and adverse effect on the business, management or financial condition of the Borrower or of the Companies as a whole, as represented to Lenders in the Financials then most recently received by them or (c) event or circumstance that could result in an Event of Default or Potential Default pursuant to Sections 10.1 through 10.15 (inclusive).

10.14 Environmental Matters. Any of the following shall occur and Required Lenders determine, in good faith, that (a) such occurrence could materially and adversely affect the business or operations of Borrower or its ability to pay its debts as they come due or to pay or perform any of the Obligation, and (b) the aggregate liability of Borrower resulting from such occurrences could exceed \$1,000,000: (i) the failure of any Loan Obligor or other owner of any Project which secures a Mortgage Loan or Commercial Loan to obtain and maintain any environmental permit, certificate, license approval, registration, or authorization required under any Environmental Law; (ii) any Loan Obligor or other owner of a Project which secures a Mortgage Loan or Commercial Loan is or may be potentially responsible or liable with respect to any investigation or clean up of any threatened or actual release of any Hazardous Substance with respect to such Project; (iii) a Release of any Hazardous Substance has occurred at, on or under any Project which secures any Mortgage Loan or Commercial Loan; (iv) any oral or written notification of a Release of Hazardous Substance has been filed by or on behalf of Borrower or any Loan Obligor or in relation to any Project which secures any Mortgage Loan or Commercial Loan; (v) any Project which secures any Mortgage Loan or Commercial Loan is or will be listed or is proposed for listing on the National Priority List promulgated pursuant to CERCLA, any related Governmental Requirement or on any federal or state list of sites requiring investigation or clean up; (vi) any Environmental Lien shall exist on any Project which secures any Mortgage Loan or Commercial Loan; or (vii) any governmental action shall have been taken or be in process or pending which could subject any Project which secures any Mortgage Loan or Commercial Loan to any Environmental Lien.

10.15 Employee Benefit Plans. (a) A Reportable Event or Reportable Events, or a failure to make a required installment or other payment (within the meaning of Section 412(n)(1) of the Code), shall have occurred with respect to any Employee Plan or Plans that is expected to result in liability of Borrower to the PBGC or to an Employee Plan in an aggregate amount

exceeding \$1,000,000 and, within 30 days after the reporting of any such Reportable Event to Administrative Agent or after the receipt by Administrative Agent of a statement required pursuant to Section 7.1(g), Administrative Agent shall have notified Borrower in writing that (i) Required Lenders have made a reasonable determination that, on the basis of such Reportable Event or Reportable Events or the failure to make a required payment, there are grounds under Title IV of ERISA for the termination of such Employee Plan or Plans by the PBGC, or the appointment by the appropriate United States district court of a trustee to administer such Employee Plan or Plans or the imposition of a Lien pursuant to section 412(n) of the Code in favor of an Employee Plan and (ii) as a result thereof, an Event of Default exists hereunder; or (b) Borrower or any ERISA Affiliate has provided to any affected party a 60-day notice of intent to terminate an Employee Plan pursuant to a distress termination in accordance with section 4041(c) of ERISA if the liability expected to be incurred as a result of such termination will exceed \$1,000,000; or (c) a trustee shall be appointed by a United States district court to administer any such Employee Plan; or (d) the PBGC shall institute proceedings (including giving notice of intent thereof) to terminate any such Employee Plan; or (e) (i) Borrower or any ERISA Affiliate shall have been notified by the sponsor of a Multiemployer Plan that is has incurred withdrawal liability (within the meaning of section 4201 of ERISA to such Multiemployer Plan), (ii) Borrower or such ERISA Affiliate does not have reasonable grounds for contesting such withdrawal liability or is not contesting such withdrawal liability in a timely and appropriate manner and (iii) the amount of such withdrawal liability specified in such notice, when aggregated with all other amounts required to be paid to Multiemployer Plans in connection with withdrawal liabilities (determined as of the date or dates of such notification), exceeds \$1,000,000; or (f) Borrower or any ERISA Affiliate shall have been notified by the sponsor of a Multiemployer Plan that such Multiemployer Plan is in reorganization or is being terminated, within the meaning of Title IV of ERISA, if solely as a result of such reorganization or termination the aggregate annual contributions of Borrower and its ERISA Affiliates to all Multiemployer Plans that are then in reorganization or have been or are being terminated have been or will be increased over the amounts required to be contributed to such Multiemployer Plans for their most recently completed plan years by an amount exceeding \$1,000,000.

SECTION 11. RIGHTS AND REMEDIES.

11.1 Remedies Upon Event of Default.

(a) Debtor Relief. If an Event of Default exists under Section 10.3, the commitment to extend credit under this agreement automatically terminates and the entire unpaid principal balance of the Obligation, together with all interest accrued thereon, and all other amounts then accrued and unpaid, automatically become and shall be due and payable without any action of any kind whatsoever.

(b) Other Events of Default. If any Event of Default exists, Administrative Agent may (with the consent of, and must, upon the request of Required Lenders), do any one or more of the following: (i) If the maturity of the Obligation has not already been accelerated under Section 11.1(a), declare the entire unpaid principal balance of all or any part of the Obligation, together with all interest accrued thereon, and all other amounts then accrued and unpaid, immediately due and payable, whereupon it is due and payable; (ii) terminate the commitments of Lenders to extend credit under this agreement; (iii)

reduce any claim to judgment; (iv) require the Companies to open and maintain a secured lockbox account for the receipt of the Companies' accounts receivables; notes receivable and other receivables; and (v) exercise any and all other legal or equitable Rights afforded by the Credit Documents, by applicable Governmental Requirements or otherwise at law or in equity.

(c) Offset. If an Event of Default exists, to the extent not prohibited by applicable Governmental Requirements, each Lender may exercise the Rights of offset and banker's lien against each and every account and other property, or any interest therein, which any Company may now or hereafter have with, or which is now or hereafter in the possession of, that Lender to the extent of the full amount of the Obligation owed to that Lender, provided, however, no such right of offset or banker's lien may be exercised against any account of a Special Purpose Entity.

11.2 Company Waivers. To the extent not prohibited by applicable Governmental Requirements, Borrower and each other Company waives, in respect to any action taken by Administrative Agent or Lenders at any time and from time to time pursuant to Section 11.1, presentment, demand for payment, protest, acceleration, notice of protest and nonpayment, NOTICE OF INTENTION TO ACCELERATE, NOTICE OF ACCELERATION, and all other notices and acts, and agrees that its liability with respect to all or any part of the Obligation is not affected by any renewal or extension in the time of payment of all or any part of the Obligation, by any indulgence, increase or other modification to, or by any release or change in any security for the payment of, all or any part of the Obligation.

11.3 Performance by Administrative Agent. If any Company's covenant, duty or agreement is not performed in accordance with the terms of the Credit Documents, Administrative Agent may at its option (but subject to the approval of Required Lenders), perform or attempt to perform that covenant, duty or agreement on behalf of that Company, and any amount expended by or on behalf of Administrative Agent in its performance or attempted performance is payable by the Companies, jointly and severally, to Administrative Agent on demand, becomes part of the Obligation, and bears interest on the portion thereof from time to time unpaid at the Default Rate from the date of Administrative Agent's expenditure until paid. However, Administrative Agent does not assume and shall never have, except by its express written consent, any liability or responsibility for the performance of any Company's covenants, duties or agreements. Notwithstanding the forgoing, unless an Event of Default then exists, Administrative Agent shall not take any such action without requesting that Borrower take such action on its own behalf.

11.4 Not in Control. Nothing in any Credit Document gives or may be deemed to give to Administrative Agent or any Lender the Right to exercise control over any Company's Real Property, other assets, affairs or management or to preclude or interfere with any Company's compliance with any Governmental Requirement or require any act or omission by any Company that may be harmful to Persons or property. Any "Material Adverse Event" or other materiality or substantiality qualifier of any representation, warranty, covenant, agreement or other provision of any Credit Document is included for credit documentation purposes only and does not imply and should not be deemed to mean that Administrative Agent or any Lender acquiesces in any non-compliance by any Company with any applicable Governmental

Requirement, document, or otherwise or does not expect the Companies to promptly, diligently and continuously carry out all appropriate removal, remediation, compliance, closure or other activities required or appropriate in accordance with all Environmental Laws. Administrative Agent's and Lenders' power is limited to the Rights provided in, or referred to by, the Credit Documents. All of those Rights exist solely to assure payment and performance of the Obligation in accordance with the terms of the Credit Documents, and may be exercised in a manner determined to be appropriate by Administrative Agent or Lenders in their sole business judgment.

11.5 Course of Dealing. The acceptance by Administrative Agent or Lenders of any partial payment on the Obligation is not a waiver of any Event of Default then existing. No waiver by Administrative Agent, Required Lenders or Lenders of any Event of Default is a waiver of any other then-existing or subsequent Event of Default. No delay or omission by Administrative Agent, Required Lenders or Lenders in exercising any Right under the Credit Documents impairs that Right or is a waiver thereof or any acquiescence therein, nor will any single or partial exercise of any Right preclude other or further exercise thereof or the exercise of any other Right under the Credit Documents or otherwise.

11.6 Cumulative Rights. All Rights available to Administrative Agent, Required Lenders and Lenders under the Credit Documents are cumulative of and in addition to all other Rights granted to Administrative Agent, Required Lenders and Lenders at law or in equity, whether or not the Obligation is due and payable and whether or not Administrative Agent, Required Lenders or Lenders have instituted any suit for collection, foreclosure, or other action in connection with the Credit Documents.

11.7 Application of Proceeds. Any and all proceeds ever received by Administrative Agent or Lenders from the exercise of any Rights pertaining to the Obligation shall be applied to the Obligation according to Section 3.

11.8 Certain Proceedings. Borrower shall promptly execute and deliver, or cause the execution and delivery of, all applications, certificates, instruments, registration statements, and all other documents and papers Administrative Agent or Required Lenders reasonably request in connection with the obtaining of any consent, approval, registration (other than securities law registrations), qualification, permit, license or authorization of any Governmental Authority or other Person necessary or appropriate for the effective exercise of any Rights under the Credit Documents. Because Borrower agrees that Administrative Agent's and Required Lenders' remedies under applicable Governmental Requirements for failure of Borrower to comply with the provisions of this section would be inadequate and that failure would not be adequately compensable in damages, Borrower agrees that the covenants of this section may be specifically enforced.

11.9 Expenditures by Administrative Agent or Lenders. Any sums spent by Administrative Agent or any Lender in the exercise of any Right under any Credit Document is payable by the Companies to Administrative Agent within 10 days of written demand, becomes part of the Obligation, and bears interest on the portion thereof from time to time unpaid at the Default Rate from the date spent until the date repaid.

SECTION 12. ADMINISTRATIVE AGENT AND LENDERS.

12.1 Administrative Agent.

(a) Appointment. Each Lender appoints Administrative Agent (including, without limitation, each successor Administrative Agent in accordance with this Section 12) as its nominee and agent to act in its name and on its behalf (and Administrative Agent and each such successor accepts that appointment): (i) To act as its nominee and on its behalf in and under all Credit Documents; (ii) to arrange the means whereby its funds are to be made available to Borrower under the Credit Documents; (iii) to take any action that it properly requests under the Credit Documents (subject to the concurrence of other Lenders as may be required under the Credit Documents); (iv) to receive all documents and items to be furnished to it under the Credit Documents; (v) to promptly distribute to it all material information, requests, documents, and items received from Borrower under the Credit Documents; (vi) to promptly distribute to it its ratable part of each payment or prepayment (whether voluntary, as proceeds of collateral upon or after foreclosure, as proceeds of insurance thereon, or otherwise) in accordance with the terms of the Credit Documents; and (vii) to deliver to the appropriate Persons requests, demands, approvals, and consents received from it. However, Administrative Agent may not be required to take any action that exposes it to personal liability or that is contrary to any Credit Document or applicable Governmental Requirements.

(b) Successor. Administrative Agent may assign all of its Rights and obligations as Administrative Agent under the Credit Documents to any of its Affiliates, which Affiliate shall then be the successor Administrative Agent under the Credit Documents. Administrative Agent may also voluntarily resign and shall resign upon the request of Required Lenders for cause (i.e., Administrative Agent is continuing to fail to perform its responsibilities as Administrative Agent under the Credit Documents). If the initial or any successor Administrative Agent ever ceases to be a party to this agreement or if the initial or any successor Administrative Agent ever resigns (whether voluntarily or at the request of Required Lenders), then Required Lenders shall (which, if no Event of Default or Potential Default exists, is subject to Borrower's approval that may not be unreasonably withheld) appoint the successor Administrative Agent from among Lenders (other than the resigning Administrative Agent). If Required Lenders fail to appoint a successor Administrative Agent within 30 days after the resigning Administrative Agent has given notice of resignation or Required Lenders have removed the resigning Administrative Agent, then the resigning Administrative Agent may, on behalf of Lenders, appoint a successor Administrative Agent, which must be a commercial bank having a combined capital and surplus of at least \$1,000,000,000 (as shown on its most recently published statement of condition). Upon its acceptance of appointment as successor Administrative Agent, the successor Administrative Agent succeeds to and becomes vested with all of the Rights of the prior Administrative Agent, and the prior Administrative Agent is discharged from its duties and obligations of Administrative Agent under the Credit Documents, and each Lender shall execute the documents that any Lender, the resigning or removed Administrative Agent, or the successor Administrative Agent reasonably request to reflect the change. After any Administrative Agent's resignation or removal as Administrative Agent under the Credit Documents, the

provisions of this section inure to its benefit as to any actions taken or not taken by it while it was Administrative Agent under the Credit Documents.

(c) Rights as Lender. Administrative Agent, in its capacity as a Lender, has the same Rights under the Credit Documents as any other Lender and may exercise those Rights as if it were not acting as Administrative Agent. The term "Lender", unless the context otherwise indicates, includes Administrative Agent. Administrative Agent's resignation or removal does not impair or otherwise affect any Rights that it has or may have in its capacity as an individual Lender. Each Lender and Borrower agree that Administrative Agent is not a fiduciary for Lenders or for Borrower but is simply acting in the capacity described in this agreement to alleviate administrative burdens for Borrower and Lenders, that Administrative Agent has no duties or responsibilities to Lenders or Borrower except those expressly set forth in the Credit Documents, and that Administrative Agent in its capacity as a Lender has the same Rights as any other Lender.

(d) Other Activities. Administrative Agent or any Lender may now or in the future be engaged in one or more loan, letter of credit, leasing, or other financing transactions with Borrower, act as trustee or depository for Borrower, or otherwise be engaged in other transactions with Borrower (collectively, the "other activities") not the subject of the Credit Documents. Without limiting the Rights of Lenders specifically set forth in the Credit Documents, neither Administrative Agent nor any Lender is responsible to account to the other Lenders for those other activities, and no Lender shall have any interest in any other Lender's activities, any present or future guaranties by or for the account of Borrower that are not contemplated by or included in the Credit Documents, any present or future offset exercised by Administrative Agent or any Lender in respect of those other activities, any present or future property taken as security for any of those other activities, or any property now or hereafter in Administrative Agent's or any other Lender's possession or control that may be or become security for the obligations of Borrower arising under the Credit Documents by reason of the general description of indebtedness secured or of property contained in any other agreements, documents, or instruments related to any of those other activities (but, if any payments in respect of those guaranties or that property or the proceeds thereof is applied by Administrative Agent or any Lender to reduce the Obligation, then each Lender is entitled to share ratably in the application as provided in the Credit Documents).

12.2 Expenses. Each Lender shall pay its Pro Rata Part of any reasonable expenses (including, without limitation, court costs, reasonable attorneys' fees and other costs of collection) incurred by Administrative Agent (while acting in such capacity) in connection with any of the Credit Documents if Administrative Agent is not reimbursed from other sources within 30 days after incurrence. Each Lender is entitled to receive its Pro Rata Part of any reimbursement that it makes to Administrative Agent if Administrative Agent is subsequently reimbursed from other sources.

12.3 Proportionate Absorption of Losses. Except as otherwise provided in the Credit Documents, nothing in the Credit Documents gives any Lender any advantage over any other Lender insofar as the Obligation is concerned or relieves any Lender from ratably absorbing any losses sustained with respect to the Obligation (except to the extent unilateral actions or inactions

by any Lender result in Borrower or any other obligor on the Obligation having any credit, allowance, setoff, defense, or counterclaim solely with respect to all or any part of that Lender's Pro Rata Part of the Obligation).

12.4 Delegation of Duties; Reliance. Lenders may perform any of their duties or exercise any of their Rights under the Credit Documents by or through Administrative Agent, and Lenders and Administrative Agent may perform any of their duties or exercise any of their Rights under the Credit Documents by or through their respective Representatives. Administrative Agent, Lenders, and their respective Representatives (a) are entitled to rely upon (and shall be protected in relying upon) any written or oral statement believed by it or them to be genuine and correct and to have been signed or made by the proper Person and, with respect to legal matters, upon opinion of counsel selected by Administrative Agent or that Lender (but nothing in this clause (a) permits Administrative Agent to rely on (i) oral statements if a writing is required by this agreement or (ii) any other writing if a specific writing is required by this agreement), (b) are entitled to deem and treat each Lender as the owner and holder of its portion of the Obligation for all purposes until, written notice of the assignment or transfer is given to and received by Administrative Agent (and any request, authorization, consent, or approval of any Lender is conclusive and binding on each subsequent holder, assignee, or transferee of or Participant in that Lender's portion of the Obligation until that notice is given and received), (c) are not deemed to have notice of the occurrence of an Event of Default unless a responsible officer of Administrative Agent, who handles matters associated with the Credit Documents and transactions thereunder, has actual knowledge or Administrative Agent has been notified by a Lender or Borrower, and (d) are entitled to consult with legal counsel (including counsel for Borrower), independent accountants, and other experts selected by Administrative Agent and are not liable for any action taken or not taken in good faith by it in accordance with the advice of counsel, accountants, or experts.

12.5 Limitation of Administrative Agent's Liability.

(a) Exculpation. Neither Administrative Agent nor any of its Affiliates or Representatives will be liable for any action taken or omitted to be taken by it or them under the Credit Documents in good faith and believed by it or them to be within the discretion or power conferred upon it or them by the Credit Documents or be responsible for the consequences of any error of judgment (except for fraud, gross negligence, or willful misconduct), and neither Administrative Agent nor any of its Affiliates or Representatives has a fiduciary relationship with any Lender by virtue of the Credit Documents (but nothing in this agreement negates the obligation of Administrative Agent to account for funds received by it for the account of any Lender).

(b) Indemnity. Unless indemnified to its satisfaction against loss, cost, liability, and expense, Administrative Agent may not be compelled to do any act under the Credit Documents or to take any action toward the execution or enforcement of the powers thereby created or to prosecute or defend any suit in respect of the Credit Documents. If Administrative Agent requests instructions from Lenders, or Required Lenders, as the case may be, with respect to any act or action in connection with any Credit Document, Administrative Agent is entitled to refrain (without incurring any liability to any Person by so refraining) from that act or action unless and until it has

received instructions. In no event, however, may Administrative Agent or any of its Representatives be required to take any action that it or they determine could incur for it or them criminal or onerous civil liability. Without limiting the generality of the foregoing, no Lender has any right of action against Administrative Agent as a result of Administrative Agent's acting or refraining from acting under this agreement in accordance with instructions of Required Lenders.

(c) Reliance. Administrative Agent is not responsible to any Lender or any Participant for, and each Lender represents and warrants that it has not relied upon Administrative Agent in respect of, (i) the creditworthiness of any Company and the risks involved to that Lender, (ii) the effectiveness, enforceability, genuineness, validity, or the due execution of any Credit Document (except by Administrative Agent), (iii) any representation, warranty, document, certificate, report, or statement made therein (except by Administrative Agent) or furnished thereunder or in connection therewith, (iv) the adequacy of any collateral now or hereafter securing the Obligation or the existence, priority, or perfection of any Lien now or hereafter granted or purported to be granted on the collateral under any Credit Document, or (v) observation of or compliance with any of the terms, covenants, or conditions of any Credit Document on the part of any Company. EACH LENDER AGREES TO INDEMNIFY ADMINISTRATIVE AGENT AND ITS REPRESENTATIVES AND HOLD THEM HARMLESS FROM AND AGAINST (BUT LIMITED TO SUCH LENDER'S COMMITMENT PERCENTAGE OF) ANY AND ALL LIABILITIES, OBLIGATIONS, LOSSES, DAMAGES, PENALTIES, ACTIONS, JUDGMENTS, SUITS, COSTS, REASONABLE EXPENSES, AND REASONABLE DISBURSEMENTS OF ANY KIND OR NATURE WHATSOEVER THAT MAY BE IMPOSED ON, ASSERTED AGAINST, OR INCURRED BY THEM IN ANY WAY RELATING TO OR ARISING OUT OF THE CREDIT DOCUMENTS OR ANY ACTION TAKEN OR OMITTED BY THEM UNDER THE CREDIT DOCUMENTS IF ADMINISTRATIVE AGENT AND ITS REPRESENTATIVES ARE NOT REIMBURSED FOR SUCH AMOUNTS BY ANY COMPANY. ALTHOUGH ADMINISTRATIVE AGENT AND ITS REPRESENTATIVES HAVE THE RIGHT TO BE INDEMNIFIED UNDER THIS AGREEMENT FOR ITS OR THEIR OWN ORDINARY NEGLIGENCE, ADMINISTRATIVE AGENT AND ITS REPRESENTATIVES DO NOT HAVE THE RIGHT TO BE INDEMNIFIED UNDER THIS AGREEMENT FOR ITS OR THEIR OWN FRAUD, GROSS NEGLIGENCE, OR WILLFUL MISCONDUCT.

12.6 Event of Default. While an Event of Default exists, Lenders agree to promptly confer in order that Required Lenders or Lenders, as the case may be, may agree upon a course of action for the enforcement of the Rights of Lenders. Administrative Agent is entitled to act or refrain from taking any action (without incurring any liability to any Person for so acting or refraining) unless and until it has received instructions from Required Lenders. In actions with respect to any Company's property, Administrative Agent is acting for the ratable benefit of each Lender.

12.7 Limitation of Liability. No Lender or any Participant will incur any liability to any other Lender or Participant except for acts or omissions in bad faith, and neither Administrative Agent nor any Lender or Participant will incur any liability to any other Person for any act or omission of any other Lender or any Participant.

12.8 Relationship of Lenders. The Credit Documents do not create a partnership or joint venture among Administrative Agent and Lenders or among Lenders.

12.9 Benefits of Agreement. None of the provisions of this section inure to the benefit of any Company or any other Person except Administrative Agent and Lenders. Therefore, no Company or any other Person is entitled to rely upon, or entitled to raise as a defense, in any manner whatsoever, the failure of Administrative Agent or any Lender to comply with these provisions.

SECTION 13. BENEFIT OF AGREEMENT; ASSIGNMENTS; PARTICIPATIONS.

13.1 Successors and Assigns. The terms and provisions of the Credit Documents shall be binding upon and inure to the benefit of Borrower and the Lenders and their respective successors and assigns, except that (i) Borrower shall not have the right to assign its rights or obligations under the Credit Documents and (ii) any assignment by any Lender must be made in compliance with Section 13.3. The parties to this agreement acknowledge that clause (ii) of this Section 13.1 relates only to absolute assignments and does not prohibit assignments creating security interests, including, without limitation, any pledge or assignment by any Lender of all or any portion of its rights under this agreement and any Note to a Federal Reserve Bank; provided, however, that no such pledge or assignment creating a security interest shall release the transferor Lender from its obligations hereunder unless and until the parties thereto have complied with the provisions of Section 13.3. The Administrative Agent may treat the Person which made any loan or which holds any Note as the owner thereof for all purposes hereof unless and until such Person complies with Section 13.3; provided, however, that the Administrative Agent may in its discretion (but shall not be required to) follow instructions from the Person which made any loan or which holds any Note to direct payments relating to such loan or Note to another Person. Any assignee of the rights to any loan or any Note agrees by acceptance of such assignment to be bound by all the terms and provisions of the Credit Documents. Any request, authority or consent of any Person, who at the time of making such request or giving such authority or consent is the owner of the rights to any loan (whether or not a Note has been issued in evidence thereof), shall be conclusive and binding on any subsequent holder or assignee of the rights to such loan.

13.2 Participations.

(a) Permitted Participants; Effect. Any Lender may, in the ordinary course of its business and in accordance with applicable law, at any time sell to one or more banks or other entities ("Participants") participating interests in any loan owing to such Lender, any Note held by such Lender, any Commitment of such Lender or any other interest of such Lender under the Credit Documents. In the event of any such sale by a Lender of participating interests to a Participant, such Lender's obligations under the Credit Documents shall remain unchanged, such Lender shall remain solely responsible to the other parties hereto for the performance of such obligations, such Lender shall remain the owner of its loans and the holder of any Note issued to it in evidence thereof for all purposes under the Credit Documents, all amounts payable by Borrower under this agreement shall be determined as if such Lender had not sold such participating interests, and Borrower and Administrative Agent shall continue to deal solely and directly with

such Lender in connection with such Lender's rights and obligations under the Credit Documents.

(b) Voting Rights. Each Lender shall retain the sole right to approve, without the consent of any Participant, any amendment, modification or waiver of any provision of the Credit Documents other than any amendment, modification or waiver with respect to any loan or Commitment in which such Participant has an interest which forgives principal, interest or fees or reduces the interest rate or fees payable with respect to any such loan or Commitment, extends the Stated Termination Date, postpones any date fixed for any regularly-scheduled payment of principal of, or interest or fees on, any such loan or Commitment, releases any guarantor of any such loan or releases all or substantially all of the collateral, if any, securing any such loan.

(c) Benefit of Setoff. Borrower agrees that each Participant shall be deemed to have the right of setoff provided in Section 11.1 in respect of its participating interest in amounts owing under the Credit Documents to the same extent as if the amount of its participating interest were owing directly to it as a Lender under the Credit Documents, provided that each Lender shall retain the right of setoff provided in Section 11.1 with respect to the amount of participating interests sold to each Participant. The Lenders agree to share with each Participant, and each Participant, by exercising the right of setoff provided in Section 11.1, agrees to share with each Lender, any amount received pursuant to the exercise of its right of setoff, such amounts to be shared in accordance with Section 11.1 as if each Participant were a Lender.

13.3 Assignments.

(a) Permitted Assignments. Any Lender may, in the ordinary course of its business and in accordance with applicable law, at any time assign to one or more banks or other entities ("Purchasers") all or any part of its rights and obligations under the Credit Documents. Such assignment shall be substantially in the form of Exhibit E or in such other form as may be agreed to by the parties thereto. The consent of Borrower and Administrative Agent shall be required prior to an assignment becoming effective with respect to a Purchaser which is not a Lender or an Affiliate thereof; provided, however, that if an Event of Default has occurred and is continuing, the consent of Borrower shall not be required. Such consent shall not be unreasonably withheld or delayed. Each such assignment with respect to a Purchaser which is not a Lender or an Affiliate thereof shall (unless each of Borrower and Administrative Agent otherwise consents) be in an amount not less than the lesser of (i) \$5,000,000 or (ii) the remaining amount of the assigning Lender's Commitment (calculated as at the date of such assignment) or outstanding loans (if the applicable Commitment has been terminated).

(b) Effect; Effective Date. Upon (i) delivery to Administrative Agent of an assignment, together with any consents required by Section 13.3(a), and (ii) payment of a \$4,000 fee from the Purchaser or the assigning Lender to Administrative Agent for processing such assignment (unless such fee is waived by Administrative Agent), such assignment shall become effective on the effective date specified in such assignment. The assignment shall contain a representation by the Purchaser to the effect that none of

the consideration used to make the purchase of the Commitment and loans under the applicable assignment agreement constitutes "plan assets" as defined under ERISA and that the rights and interests of the Purchaser in and under the Credit Documents will not be "plan assets" under ERISA. On and after the effective date of such assignment, such Purchaser shall for all purposes be a Lender party to this agreement and any other Credit Document executed by or on behalf of the Lenders and shall have all the rights and obligations of a Lender under the Credit Documents, to the same extent as if it were an original party hereto, and no further consent or action by Borrower, the Lenders or Administrative Agent shall be required to release the transferor Lender with respect to the percentage of the Commitment and loans assigned to such Purchaser. Upon the consummation of any assignment to a Purchaser pursuant to this Section 13.3(b), the transferor Lender, Administrative Agent and Borrower shall, if the transferor Lender or the Purchaser desires that its loans be evidenced by Notes, make appropriate arrangements so that new Notes or, as appropriate, replacement Notes are issued to such transferor Lender and new Notes or, as appropriate, replacement Notes, are issued to such Purchaser, in each case in principal amounts reflecting their respective Commitments, as adjusted pursuant to such assignment.

13.4 Dissemination of Information. Borrower authorizes each Lender to disclose to any Participant or Purchaser or any other Person acquiring an interest in the Credit Documents by operation of law (each a "Transferee") and any prospective Transferee any and all information in such Lender's possession concerning the creditworthiness of Borrower and its Subsidiaries, so long as such Transferee or prospective Transferee agrees in writing to keep such information confidential.

13.5 Tax Treatment. If any interest in any Credit Document is transferred to any Transferee which is organized under the laws of any jurisdiction other than the United States or any State thereof, the transferor Lender shall cause such Transferee, concurrently with the effectiveness of such transfer, to comply with the provisions of Section 3.19.

SECTION 14. MISCELLANEOUS.

14.1 Nonbusiness Days. Any payment or action that is due under any Credit Document on a non-Business Day may be delayed until the next-succeeding Business Day (but interest shall continue to accrue on any applicable payment until payment is in fact made) unless the payment concerns a LIBOR Rate Borrowing, in which case if the next-succeeding Business Day is in the next calendar month, then such payment shall be made on the next-preceding Business Day.

14.2 Communications. Unless otherwise specifically provided, whenever any Credit Document requires or permits any consent, approval, notice, request or demand from one party to another, communication must be in writing (which may be by telex or fax) to be effective and shall be deemed to have been given (i) if by telex, when transmitted to the appropriate telex number and the appropriate answer back is received, (ii) if by fax, when transmitted to the appropriate fax number and machine confirmation of receipt is received (and all communications sent by fax must be confirmed promptly thereafter by telephone; but any requirement in this parenthetical shall not affect the date when the fax shall be deemed to have been delivered),

(iii) if by mail, on the third Business Day after it is enclosed in an envelope and properly addressed, stamped, sealed and deposited in the appropriate official postal service, (iv) if by e-mail, when transmitted to the appropriate e-mail address of the receiving party (and all communications sent by e-mail must be followed by a facsimile of that e-mail sent to the receiving party), or (v) if by any other means, when actually delivered. Until changed by notice pursuant to this agreement, the addresses (and fax numbers) for Borrower and Administrative Agent are stated beside their respective signatures to this agreement. The address (and fax number) for each Lender who becomes party to this agreement shall be stated beside its name on the then most recently amended Schedule 2.

14.3 Form and Number of Documents. The form, substance and number of counterparts of each writing to be furnished under this agreement must be satisfactory to Administrative Agent and its counsel.

14.4 Exceptions to Covenants. No Company may take or fail to take any action that is permitted as an exception to any of the covenants contained in any Credit Document if that action or omission would result in the breach of any other covenant contained in any Credit Document.

14.5 Survival. All covenants, agreements, undertakings, representations, and warranties made in any of the Credit Documents survive all closings under the Credit Documents and, except as otherwise indicated, are not affected by any investigation made by any party.

14.6 Governing Governmental Requirements. Unless otherwise stated in any Credit Document, the Governmental Requirements of the State of Texas and of the United States of America govern the Rights and duties of the parties to the Credit Documents and the validity, construction, enforcement, and interpretation of the Credit Documents.

14.7 Invalid Provisions. Any provision in any Credit Document held to be illegal, invalid or unenforceable is fully severable; the appropriate Credit Document shall be construed and enforced as if that provision had never been included; and the remaining provisions shall remain in full force and effect and shall not be affected by the severed provision. Administrative Agent, Lenders and each Company party to the affected Credit Document agree to negotiate, in good faith, the terms of a replacement provision as similar to the severed provision as may be possible and be legal, valid and enforceable.

14.8 Conflicts Between Credit Documents. The provisions of this agreement control if in conflict (i.e., the provisions contradict each other as opposed to a Credit Document containing additional provisions not in conflict) with the provisions of any other Credit Document.

14.9 Discharge Only Upon Payment in Full; Reinstatement in Certain Circumstances. Each Company's obligations under the Credit Documents shall remain in full force and effect until termination of the Commitment and payment in full of the Principal Debt and of all interest, fees, and other amounts of the Obligation then due and owing, except that Sections 3.16, 3.18, Section 11, and Section 13, and any other provisions under the Credit Documents expressly intended to survive by the terms hereof or by the terms of the applicable Credit Documents, shall survive such termination. If at any time any payment of the principal of or interest on any Note

or any other amount payable by Borrower under any Credit Document is rescinded or must be otherwise restored or returned upon the insolvency, bankruptcy, or reorganization of Borrower or otherwise, the obligations of each Company under the Credit Documents with respect to such payment shall be reinstated as though such payment had been due but not made at such time.

14.10 Amendments, Consents, Conflicts, and Waivers.

(a) Required Lenders. Unless otherwise specifically provided (i) the provisions of this agreement may be amended, modified, or waived, only by an instrument in writing executed by Borrower, Administrative Agent, and Required Lenders and supplemented only by documents delivered or to be delivered in accordance with the express terms of this agreement, and (ii) the other Credit Documents may only be the subject of an amendment, modification, or waiver that has been approved by Required Lenders and Borrower.

(b) All Lenders. Any amendment to or consent or waiver under this agreement or any Credit Document that purports to accomplish any of the following must be by an instrument in writing executed by Borrower and Administrative Agent and executed (or approved, as the case may be) by each Lender: (i) Extends the due date or decreases the amount of any scheduled payment or amortization of the Obligation beyond the date specified in the Credit Documents; (ii) decreases any rate or amount of interest, fees, or other sums payable to Administrative Agent or Lenders under this agreement (except such reductions as are contemplated by this agreement); (iii) changes the definition of "Commitment," "Commitment Percentage," "Required Lenders," or "Pro Rata Part;" (iv) increases any one or more Lenders' Commitment; or (v) changes this clause (b) or any other matter specifically requiring the consent of all Lenders under this agreement.

(c) Conflicts. Any conflict or ambiguity between the terms and provisions of this agreement and terms and provisions in any other Credit Document is controlled by the terms and provisions of this agreement.

(d) Waivers. No course of dealing or any failure or delay by Administrative Agent, any Lender, or any of their respective Representatives with respect to exercising any Right of Administrative Agent or any Lender under this agreement operates as a waiver thereof. A waiver must be in writing and signed by Administrative Agent and Lenders (or Required Lenders, if permitted under this agreement) to be effective, and a waiver will be effective only in the specific instance and for the specific purpose for which it is given.

14.11 Multiple Counterparts. Any Credit Document may be executed in a number of identical counterparts, and by each party thereto on separate counterparts (including, at Administrative Agent's discretion, counterparts or signature pages executed and transmitted by fax) with the same effect as if all signatories had signed the same document. All counterparts must be construed together to constitute one and the same instrument.

14.12 VENUE, SERVICE OF PROCESS, AND JURY TRIAL.

(a) VENUE AND SERVICE OF PROCESS. BORROWER, FOR ITSELF AND ITS SUCCESSORS AND ASSIGNS, IRREVOCABLY (I) SUBMITS TO THE NONEXCLUSIVE JURISDICTION OF THE STATE AND FEDERAL COURTS IN TEXAS, (II) WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE GOVERNMENTAL REQUIREMENTS, ANY OBJECTION THAT IT MAY NOW OR IN THE FUTURE HAVE TO THE LAYING OF VENUE OF ANY LITIGATION ARISING OUT OF OR IN CONNECTION WITH ANY CREDIT DOCUMENT AND THE OBLIGATION BROUGHT IN THE DISTRICT COURTS OF DALLAS COUNTY, TEXAS, OR IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION, (III) WAIVES ANY CLAIMS THAT ANY LITIGATION BROUGHT IN ANY OF THE FOREGOING COURTS HAS BEEN BROUGHT IN AN INCONVENIENT FORUM, (IV) CONSENTS TO THE SERVICE OF PROCESS OF ANY OF THOSE COURTS IN ANY LITIGATION BY THE MAILING OF COPIES OF THAT PROCESS BY CERTIFIED MAIL, RETURN RECEIPT REQUESTED, POSTAGE PREPAID, BY HAND DELIVERY, OR BY DELIVERY BY A NATIONALLY RECOGNIZED COURIER SERVICE, AND SERVICE SHALL BE DEEMED COMPLETE UPON DELIVERY OF THE LEGAL PROCESS AT ITS ADDRESS FOR PURPOSES OF THIS AGREEMENT, AND (V) AGREES THAT ANY LEGAL PROCEEDING AGAINST ANY PARTY TO ANY CREDIT DOCUMENT ARISING OUT OF OR IN CONNECTION WITH THE CREDIT DOCUMENTS OR THE OBLIGATION MAY BE BROUGHT IN ONE OF THE FOREGOING COURTS.

(b) JURY WAIVER. EACH OF BORROWER, ADMINISTRATIVE AGENT AND EACH LENDER HEREBY VOLUNTARILY, KNOWINGLY, IRREVOCABLY AND UNCONDITIONALLY WAIVES ANY RIGHT TO HAVE A JURY PARTICIPATE IN RESOLVING ANY DISPUTE (WHETHER BASED UPON CONTRACT, TORT OR OTHERWISE) BETWEEN OR AMONG SUCH PARTIES ARISING OUT OF OR IN ANY WAY RELATED TO THIS AGREEMENT OR ANY OTHER CREDIT DOCUMENT. THIS PROVISION IS A MATERIAL INDUCEMENT TO LENDERS TO PROVIDE THE FINANCING DESCRIBED HEREIN OR IN THE OTHER CREDIT DOCUMENTS.

(c) General. The scope of each of the foregoing waivers is intended to be all encompassing of any and all disputes that may be filed in any court and that relate to the subject matter of this transaction, including, without limitation, contract claims, tort claims, breach of duty claims, and all other common law and statutory claims. BORROWER ACKNOWLEDGES THAT THESE WAIVERS ARE A MATERIAL INDUCEMENT TO ADMINISTRATIVE AGENT'S AND EACH LENDER'S AGREEMENT TO ENTER INTO A BUSINESS RELATIONSHIP, THAT EACH OF ADMINISTRATIVE AGENT AND EACH LENDER HAVE ALREADY RELIED ON THESE WAIVERS IN ENTERING INTO THIS AGREEMENT, AND THAT ADMINISTRATIVE AGENT AND EACH LENDER WILL CONTINUE TO RELY ON EACH OF THESE WAIVERS IN RELATED FUTURE DEALINGS. BORROWER FURTHER WARRANTS AND REPRESENTS THAT IT HAS REVIEWED THESE WAIVERS WITH ITS LEGAL COUNSEL,

AND THAT IT KNOWINGLY AND VOLUNTARILY AGREES TO EACH WAIVER FOLLOWING CONSULTATION WITH LEGAL COUNSEL. The waivers in this section are irrevocable, meaning that they may not be modified either orally or in writing, and these waivers apply to any future renewals, extensions, amendments, modifications, or replacements in respect of the applicable Credit Document. In connection with any Litigation, this agreement may be filed as a written consent to a trial by the court.

14.13 Entirety. the credit documents represent the final agreement between borrower, the other companies, lenders, and administrative agent and may not be contradicted by evidence of prior, contemporaneous, or subsequent oral agreements of the parties. There are no unwritten oral agreements between the parties.

[REMAINDER OF PAGE INTENTIONALLY BLANK.
SIGNATURE PAGE FOLLOWS]

DULY EXECUTED AND DELIVERED by each of the signatories hereto as of the date first stated in this agreement.

Address for Notice

PMC COMMERCIAL TRUST, as Borrower

PMC Commercial Trust
18111 Preston Road, Suite 600
Dallas, Texas 75252
Attn: Chief Financial Officer
Fax No.: 972/349-3265

By: /s/ Barry N. Berlin

Name: Barry N. Berlin
Title: Chief Financial Officer

Address for Notice

BANK ONE, NA, as Administrative Agent,
Bank One, and a Lender

Bank One, NA
1717 Main Street, 3rd Floor
Dallas, Texas 75201
Attn: Alan L. Miller
Fax No.: 214/290-2305

By: /s/ Alan L. Miller

Alan L. Miller, First Vice President

EXECUTIVE EMPLOYMENT CONTRACT

THIS AGREEMENT made as of September 17, 2003 by and between PMC Capital, Inc., a Florida Corporation with its principal places of business in Dallas, Collin County, Texas, hereinafter referred to as the "CORPORATION", and Lance B. Rosemore, hereinafter referred to as "EXECUTIVE".

WITNESSETH THAT:

In consideration of the promises herein contained, the parties hereto mutually agree as follows:

1. Employment: The Corporation hereby employs the Executive as its President and Chief Executive Officer with such powers and duties as may be specified by the Board of Directors. The Executive hereby accepts employment upon the terms and conditions as hereinafter set forth.
2. Term: Subject to the provisions for termination as hereinafter provided, the term of this Agreement shall begin immediately and shall terminate on October 1, 2006 or such later date as determined by the Board of Directors (the "Term"). The Term of this Executive Employment Contract may be extended annually by the Board of Directors.
3. Compensation: For all services rendered by the Executive under this contract, the Executive shall be paid an annual salary at a minimum at the annual rate for the Executive effective as of July 1, 1998 (the "Minimum Rate"). The Minimum Rate may be increased by the Board at its discretion. The annual salary is payable pursuant to the normal payroll practices of the Corporation.

The Board of Directors may consider bonus compensation for the Executive if the performance of the Corporation and the Executive justifies such bonus compensation.

4. Authorized Expenses: The Executive is authorized to incur reasonable expenses for the promotion of the business of the Corporation. The Corporation will reimburse the Executive for all such reasonable expenses upon the presentation by the Executive, from time to time, of an itemized account of such expenditures.

The Executive shall be entitled to such additional and other fringe benefits as the Board of Directors shall from time to time authorize, including but not limited to: A) health insurance coverage for the Executive, his wife and minor children; B) a monthly automotive allowance of \$550, which the Executive is to use to obtain an automobile to be utilized for his own company needs. All maintenance, insurance etc. (excluding fuel) will be the responsibility and expense of the Executive.

5. Extent of Services: The Executive shall devote a substantial portion of business time, attention and energies to the business of the Corporation, and shall not, during the term of this Agreement, engage in any other business activities, whether or not such activities are pursued for gain, profit or other pecuniary advantage. This provision is not meant to prevent him from A) devoting reasonable time to civic or philanthropic activities or B) investing his assets in such form or manner providing that it does not require any substantial services on the part of the Executive that will interfere with the Executive's employment pursuant to this Agreement. Executive's employment is considered as full-time.

6. Working Facilities: The Executive shall be furnished with such facilities and services suitable to his position and adequate for the performance of his duties.

7. Duties: The Executive is employed in an executive and supervisory capacity and shall perform such duties consistent herewith as the Board of Directors of the Corporation shall from time to time specify. Subject to the provisions of Section 14 hereof, the precise services of the Executive may be extended or curtailed, from time to time, at the discretion of the Board of Directors of the Corporation.

8. Disclosure of Information: The Executive recognizes and acknowledges that the Corporation's operating procedures or service techniques are valuable, special and unique assets of the Corporation's business. The Executive will not, during or after the term of his employment, disclose the list of the Corporation's operating procedures or service techniques to any person, firm, corporation, association or other entity for any reason or purpose whatsoever. In the event of breach or threatened breach by the Executive of the provisions of this paragraph, the Corporation shall be entitled to an injunction restraining any such breach. Nothing herein shall be construed as prohibiting the Corporation from pursuing any other remedies available to the Corporation for such breach or threatened breach, including the recovery of damages from the Executive.

9. Vacations: The Executive shall be entitled each year to a vacation in accordance with the vacation contract addendum dated effective July 1, 1999.

10. Disability: If the Executive is unable to perform his services by reason of illness or total incapacity, based on standards similar to those utilized by the U.S. Social Security Administration, he shall receive his full salary for one (1) year of said total incapacity through coordination of benefits with any existing disability insurance program provided by the Corporation (a reduction in salary by that amount paid by any Corporation provided insurance). Should said Executive be totally incapacitated beyond a one-year period, so that he is not able to devote full time to his employment with said Corporation, then this Agreement shall terminate.

11. Death During Employment: If the Executive dies during the term of employment and has not attained the age of seventy years, the Corporation and/or any third party insurance provided by the Corporation, through a coordination of benefits, shall pay the estate of the Executive a death benefit equal to two times the Executive's annual salary. In the event the Executive receives death benefits payable under any group life insurance policy issued to the Corporation, the Corporation's liability under this clause will be reduced by the amount of the death benefit paid under such policy. The Corporation shall pay any remaining death benefits to the estate of the Executive over the course of twelve (12) months in the same manner and under the same terms as the Executive would have been paid if he had still been working for the Corporation. No later than one (1) month from the date of death, the estate of the Executive will also be paid any accumulated vacation pay. Such payments pursuant to this paragraph shall constitute the full compensation of said Executive and he and his estate shall have no further claim for compensation by reason of his employment by the Corporation.

12. Assignment: The acts and obligations of the Corporation under this Agreement shall inure to the benefit of and be binding upon the successors and assigns of the Corporation.

13. Invalidity: If any paragraph or part of this Agreement is invalid, it shall not affect the remainder of this Agreement but the remainder shall be binding and effective against all parties.

14. Additional Compensation: If during the Term, this Agreement is terminated by the Corporation (other than pursuant to the provisions of Section 15 hereof) or by the Executive due to "Constructive Discharge" then the Executive shall receive termination pay in an amount equal to 2.99 times the average of the last three years compensation. For purposes of this Agreement, "Constructive Discharge" shall mean:

- Any reduction in salary below the Minimum Rate;
- A material change without the consent of the Executive which is within the discretion of the Employer diminishing the Executive's job function, authority, duties or responsibilities, or any change materially deteriorating Executive's working conditions that would not be in accordance with the spirit of this Agreement;
- A required relocation of Executive of more than 35 miles from Executive's current job location; or requires Executive to travel away from Executive's office in the course of discharging Executive's responsibilities in excess of that typically required of executives in similar positions.
- Any breach of any of the terms of this Agreement by the Corporation which is not cured within

14 days following written notice thereof by Executive to the Corporation, which notice must be given within 14 days of the date on which the Executive receives actual knowledge of such breach shall be deemed waived by the Executive.

The amount payable by the Corporation pursuant to this Section 14 shall be made in one lump sum cash payment payable to the Executive no later than 30 days following termination of this Agreement.

15. Termination: The Corporation cannot terminate this agreement except for: 1) the intentional, unapproved misuse of corporate funds, 2a) professional incompetence (i.e. the intentional refusal to perform or the inability to perform the duties associated with Executive's position with the Corporation in a competent manner, which is not cured within 15 days following written notice to Executive) or 2b) willful neglect of duties or responsibilities in either case not otherwise related to or triggered by the occurrence of any event or events described in or prescribed by Section 14 hereof.

16. Indemnification: The Corporation hereby agrees to indemnify and hold the Executive harmless from any loss for any corporate undertaking, as contemplated in Section 7 hereof, whereby a claim, allegation or cause of action shall be made against the Executive in the performance of his contractual duties except for willful illegal misconduct. Said indemnification shall include but not be limited to reasonable cost incurred in defending the Executive in his faithful performance of contractual duties. 17. Dispute Resolution/ARBITRATION: Any dispute, controversy or claim between the parties arising out of, or related in any manner to the employment of Executive, this Agreement, or the breach thereof, shall be exclusively and finally settled by arbitration pursuant to this Section. The arbitration proceedings shall be conducted pursuant to the Federal Arbitration Act and in accordance with the rules established for the arbitration of employment (or alternatively, commercial) disputes by the Center for Public Resources, or alternatively, the American Arbitration Association. The parties will select a neutral arbitrator based upon the procedures set forth by the arbitration service selected. The Arbitrator selected shall have no prior or existing relationship with the Company or the Executive. The decision of the Arbitrator shall be in writing, and shall be final and binding upon both parties, except that errors of law shall be subject to appeal. Any arbitration shall be held in Dallas, Texas.

18. Entire Agreement: This contract may not be changed except in writing and embodies the whole Agreement between the parties hereto and there are no inducements, promises, terms, conditions or obligations made or entered into by the Corporation or the Executive other than contained herein. This Executive Employment

Contract supercedes and replaces that certain Executive Employment Contract dated June 14, 2002 between the Corporation and the Executive.

IN WITNESS WHEREOF, the parties here hereunto signed and sealed this Agreement the date first above written.

Signed, Sealed and Delivered
In the presence of:

"Corporation"
PMC Capital, Inc.

/s/ Barry N. Berlin

Barry N. Berlin

/s/ Andrew S. Rosemore

By: Andrew S. Rosemore,
Executive Vice President

/s/ Jan F. Salit

Jan F. Salit

"EXECUTIVE"

/s/ Barry N. Berlin

Barry N. Berlin

/s/ Lance B. Rosemore

By: Lance B. Rosemore,
President and
Chief Executive Officer

/s/ Jan F. Salit

Jan F. Salit

(CORPORATE SEAL)

EXECUTIVE EMPLOYMENT CONTRACT

THIS AGREEMENT made as of September 17, 2003 by and between PMC Capital, Inc., a Florida Corporation with its principal places of business in Dallas, Collin County, Texas, hereinafter referred to as the "CORPORATION", and Andrew S. Rosemore, hereinafter referred to as "EXECUTIVE".

WITNESSETH THAT:

In consideration of the promises herein contained, the parties hereto mutually agree as follows:

1. Employment: The Corporation hereby employs the Executive as its Executive Vice President and Chief Operating Officer with such powers and duties as may be specified by the Board of Directors. The Executive hereby accepts employment upon the terms and conditions as hereinafter set forth.
2. Term: Subject to the provisions for termination as hereinafter provided, the term of this Agreement shall begin immediately and shall terminate on October 1, 2006 or such later date as determined by the Board of Directors (the "Term"). The Term of this Executive Employment Contract may be extended annually by the Board of Directors.
3. Compensation: For all services rendered by the Executive under this contract, the Executive shall be paid an annual salary at a minimum at the annual rate for the Executive effective as of July 1, 1998 (the "Minimum Rate"). The Minimum Rate may be increased by the Board at its discretion. The annual salary is payable pursuant to the normal payroll practices of the Corporation.

The Board of Directors may consider bonus compensation for the Executive if the performance of the Corporation and the Executive justifies such bonus compensation.

4. Authorized Expenses: The Executive is authorized to incur reasonable expenses for the promotion of the business of the Corporation. The Corporation will reimburse the Executive for all such reasonable expenses upon the presentation by the Executive, from time to time, of an itemized account of such expenditures.

The Executive shall be entitled to such additional and other fringe benefits as the Board of Directors shall from time to time authorize, including but not limited to: A) health insurance coverage for the Executive, his wife and minor children; B) a monthly automotive allowance of \$550, which the Executive is to use to obtain an automobile to be utilized for his own company needs. All maintenance, insurance etc. (excluding fuel) will be the responsibility and expense of the Executive.

5. Extent of Services: The Executive shall devote a substantial portion of business time, attention and energies to the business of the Corporation, and shall not, during the term of this Agreement, engage in any other business activities, whether or not such activities are pursued for gain, profit or other pecuniary advantage. This provision is not meant to prevent him from A) devoting reasonable time to civic or philanthropic activities or B) investing his assets in such form or manner providing that it does not require any substantial services on the part of the Executive that will interfere with the Executive's employment pursuant to this Agreement. Executive's employment is considered as full-time.

6. Working Facilities: The Executive shall be furnished with such facilities and services suitable to his position and adequate for the performance of his duties.

7. Duties: The Executive is employed in an executive and supervisory capacity and shall perform such duties consistent herewith as the Board of Directors of the Corporation shall from time to time specify. Subject to the provisions of Section 14 hereof, the precise services of the Executive may be extended or curtailed, from time to time, at the discretion of the Board of Directors of the Corporation.

8. Disclosure of Information: The Executive recognizes and acknowledges that the Corporation's operating procedures or service techniques are valuable, special and unique assets of the Corporation's business. The Executive will not, during or after the term of his employment, disclose the list of the Corporation's operating procedures or service techniques to any person, firm, corporation, association or other entity for any reason or purpose whatsoever. In the event of breach or threatened breach by the Executive of the provisions of this paragraph, the Corporation shall be entitled to an injunction restraining any such breach. Nothing herein shall be construed as prohibiting the Corporation from pursuing any other remedies available to the Corporation for such breach or threatened breach, including the recovery of damages from the Executive.

9. Vacations: The Executive shall be entitled each year to a vacation in accordance with the vacation contract addendum dated effective July 1, 1999.

10. Disability: If the Executive is unable to perform his services by reason of illness or total incapacity, based on standards similar to those utilized by the U.S. Social Security Administration, he shall receive his full salary for one (1) year of said total incapacity through coordination of benefits with any existing disability insurance program provided by the Corporation (a reduction in salary by that amount paid by any Corporation provided insurance). Should said Executive be totally incapacitated beyond a one-year period, so that he is not able to devote full time to his employment with said Corporation, then this Agreement shall terminate.

11. Death During Employment: If the Executive dies during the term of employment and has not attained the age of seventy years, the Corporation and/or any third party insurance provided by the Corporation, through a coordination of benefits, shall pay the estate of the Executive a death benefit equal to two times the Executive's annual salary. In the event the Executive receives death benefits payable under any group life insurance policy issued to the Corporation, the Corporation's liability under this clause will be reduced by the amount of the death benefit paid under such policy. The Corporation shall pay any remaining death benefits to the estate of the Executive over the course of twelve (12) months in the same manner and under the same terms as the Executive would have been paid if he had still been working for the Corporation. No later than one (1) month from the date of death, the estate of the Executive will also be paid any accumulated vacation pay. Such payments pursuant to this paragraph shall constitute the full compensation of said Executive and he and his estate shall have no further claim for compensation by reason of his employment by the Corporation.

12. Assignment: The acts and obligations of the Corporation under this Agreement shall inure to the benefit of and be binding upon the successors and assigns of the Corporation.

13. Invalidity: If any paragraph or part of this Agreement is invalid, it shall not affect the remainder of this Agreement but the remainder shall be binding and effective against all parties.

14. Additional Compensation: If during the Term, this Agreement is terminated by the Corporation (other than pursuant to the provisions of Section 15 hereof) or by the Executive due to "Constructive Discharge" then the Executive shall receive termination pay in an amount equal to 2.99 times the average of the last three years compensation. For purposes of this Agreement, "Constructive Discharge" shall mean:

- Any reduction in salary below the Minimum Rate;
- A material change without consent of the Executive which is within the discretion of the Employer diminishing the Executive's job function, authority, duties or responsibilities, or any change materially deteriorating Executive's working conditions that would not be in accordance with the spirit of this Agreement;
- A required relocation of Executive of more than 35 miles from Executive's current job location; or requires Executive to travel away from Executive's office in the course of discharging Executive's responsibilities in excess of that typically required of executives in similar positions.
- Any breach of any of the terms of this Agreement by the Corporation which is not cured within

14 days following written notice thereof by Executive to the Corporation, which notice must be given within 14 days of the date on which the Executive receives actual knowledge of such breach and if not such breach shall be deemed waived by the Executive.

The amount payable by the Corporation pursuant to this Section 14 shall be made in one lump sum cash payment payable to the Executive no later than 30 days following termination of this Agreement.

15. Termination: The Corporation cannot terminate this agreement except for: 1) the intentional, unapproved misuse of corporate funds, 2a) professional incompetence (i.e. the intentional refusal to perform or the inability to perform the duties associated with Executive's position with the Corporation in a competent manner, which is not cured within 15 days following written notice to Executive) or 2b) willful neglect of duties or responsibilities in either case not otherwise related to or triggered by the occurrence of any event or events described in or prescribed by Section 14 hereof.

16. Indemnification: The Corporation hereby agrees to indemnify and hold the Executive harmless from any loss for any corporate undertaking, as contemplated in Section 7 hereof, whereby a claim, allegation or cause of action shall be made against the Executive in the performance of his contractual duties except for willful illegal misconduct. Said indemnification shall include but not be limited to reasonable cost incurred in defending the Executive in his faithful performance of contractual duties.

17. Dispute Resolution/ARBITRATION: Any dispute, controversy or claim between the parties arising out of, or related in any manner to the employment of Executive, this Agreement, or the breach thereof, shall be exclusively and finally settled by arbitration pursuant to this Section. The arbitration proceedings shall be conducted pursuant to the Federal Arbitration Act and in accordance with the rules established for the arbitration of employment (or alternatively, commercial) disputes by the Center for Public Resources, or alternatively, the American Arbitration Association. The parties will select a neutral arbitrator based upon the procedures set forth by the arbitration service selected. The Arbitrator selected shall have no prior or existing relationship with the Company or the Executive. The decision of the Arbitrator shall be in writing, and shall be final and binding upon both parties, except that errors of law shall be subject to appeal. Any arbitration shall be held in Dallas, Texas.

18. Entire Agreement: This contract may not be changed except in writing and embodies the whole Agreement between the parties hereto and there are no inducements, promises, terms, conditions or obligations

made or entered into by the Corporation or the Executive other than contained herein. This Executive Employment Contract supercedes and replaces that certain Executive Employment Contract dated June 14, 2002 between the Corporation and the Executive.

IN WITNESS WHEREOF, the parties here hereunto signed and sealed this Agreement the date first above written.

Signed, Sealed and Delivered
In the presence of:

"Corporation"
PMC Capital, Inc.

/s/ Jan F. Salit

Jan F. Salit

/s/ Lance B. Rosemore

By: Lance B. Rosemore
President

/s/ Barry N. Berlin

Barry N. Berlin

"EXECUTIVE"

/s/ Jan F. Salit

Jan F. Salit

/s/ Andrew S. Rosemore

By: Andrew S. Rosemore,
Executive Vice President
and Chief Operating Officer

/s/ Barry N. Berlin

Barry N. Berlin

(CORPORATE SEAL)

EXECUTIVE EMPLOYMENT CONTRACT

THIS AGREEMENT made as of September 17, 2003 by and between PMC Capital, Inc., a Florida Corporation with its principal places of business in Dallas, Collin County, Texas, hereinafter referred to as the "CORPORATION", and Barry N. Berlin, hereinafter referred to as "EXECUTIVE".

WITNESSETH THAT:

In consideration of the promises herein contained, the parties hereto mutually agree as follows:

1. Employment: The Corporation hereby employs the Executive as its Chief Financial Officer with such powers and duties as may be specified by the Board of Directors. The Executive hereby accepts employment upon the terms and conditions as hereinafter set forth.

2. Term: Subject to the provisions for termination as hereinafter provided, the term of this Agreement shall begin immediately and shall terminate on October 1, 2006 or such later date as determined by the Board of Directors (the "Term"). The Term of this Executive Employment Contract may be extended annually by the Board of Directors.

3. Compensation: For all services rendered by the Executive under this contract, the Executive shall be paid an annual salary at a minimum at the annual rate for the Executive effective as of July 1, 1998 (the "Minimum Rate"). The Minimum Rate may be increased by the Board at its discretion. The annual salary is payable pursuant to the normal payroll practices of the Corporation.

The Board of Directors may consider bonus compensation for the Executive if the performance of the Corporation and the Executive justifies such bonus compensation.

4. Authorized Expenses: The Executive is authorized to incur reasonable expenses for the promotion of the business of the Corporation. The Corporation will reimburse the Executive for all such reasonable expenses upon the presentation by the Executive, from time to time, of an itemized account of such expenditures.

The Executive shall be entitled to such additional and other fringe benefits as the Board of Directors shall from time to time authorize, including but not limited to: A) health insurance coverage for the Executive, his wife and minor children; B) a monthly automotive allowance of \$450, which the Executive is to use to obtain an automobile to be utilized for his own company needs. All maintenance, insurance etc. (excluding fuel) will be the responsibility and expense of the Executive; C) the cost of all continuing professional education related courses required to maintain CPA certification.

5. Extent of Services: The Executive shall devote a substantial portion of business time, attention and energies to the business of the Corporation, and shall not, during the term of this Agreement, engage in any other business activities, whether or not such activities are pursued for gain, profit or other pecuniary advantage. This provision is not meant to prevent him from A) devoting reasonable time to civic or philanthropic activities or B) investing his assets in such form or manner providing that it does not require any substantial services on the part of the Executive that will interfere with the Executive's employment pursuant to this Agreement. Executive's employment is considered as full-time.

6. Working Facilities: The Executive shall be furnished with such facilities and services suitable to his position and adequate for the performance of his duties.

7. Duties: The Executive is employed in an executive and supervisory capacity and shall perform such duties consistent herewith as the Board of Directors of the Corporation shall from time to time specify. Subject to the provisions of Section 14 hereof, the precise services of the Executive may be extended or curtailed, from time to time, at the discretion of the Board of Directors of the Corporation.

8. Disclosure of Information: The Executive recognizes and acknowledges that the Corporation's operating procedures or service techniques are valuable, special and unique assets of the Corporation's business. The Executive will not, during or after the term of his employment, disclose the list of the Corporation's operating procedures or service techniques to any person, firm, corporation, association or other entity for any reason or purpose whatsoever. In the event of breach or threatened breach by the Executive of the provisions of this paragraph, the Corporation shall be entitled to an injunction restraining any such breach. Nothing herein shall be construed as prohibiting the Corporation from pursuing any other remedies available to the Corporation for such breach or threatened breach, including the recovery of damages from the Executive.

9. Vacations: The Executive shall be entitled each year to a vacation in accordance with the vacation contract addendum dated effective July 1, 1999.

10. Disability: If the Executive is unable to perform his services by reason of illness or total incapacity, based on standards similar to those utilized by the U.S. Social Security Administration, he shall receive his full salary for one (1) year of said total incapacity through coordination of benefits with any existing disability insurance program provided by the Corporation (a reduction in salary by that amount paid by any Corporation provided insurance). Should said Executive be totally incapacitated beyond a one-year period, so that he is not able to devote full time to his employment with said Corporation, then this Agreement shall terminate.

11. Death During Employment: If the Executive dies during the term of employment and has not attained the age of seventy years, the Corporation and/or any third party insurance provided by the Corporation, through a coordination of benefits, shall pay the estate of the Executive a death benefit equal to two times the Executive's annual salary. In the event the Executive receives death benefits payable under any group life insurance policy issued to the Corporation, the Corporation's liability under this clause will be reduced by the amount of the death benefit paid under such policy. The Corporation shall pay any remaining death benefits to the estate of the Executive over the course of twelve (12) months in the same manner and under the same terms as the Executive would have been paid if he had still been working for the Corporation. No later than one (1) month from the date of death, the estate of the Executive will also be paid any accumulated vacation pay. Such payments pursuant to this paragraph shall constitute the full compensation of said Executive and he and his estate shall have no further claim for compensation by reason of his employment by the Corporation.

12. Assignment: The acts and obligations of the Corporation under this Agreement shall inure to the benefit of and be binding upon the successors and assigns of the Corporation.

13. Invalidity: If any paragraph or part of this Agreement is invalid, it shall not affect the remainder of this Agreement but the remainder shall be binding and effective against all parties.

14. Additional Compensation: If during the Term, this Agreement is terminated by the Corporation (other than pursuant to the provisions of Section 15 hereof) or by the Executive due to "Constructive Discharge" then the Executive shall receive termination pay in an amount equal to 2.99 times the average of the last three years compensation. For purposes of this Agreement, "Constructive Discharge" shall mean:

- Any reduction in salary below the Minimum Rate;
- A material change without consent of the Executive which is within the discretion of the Employer diminishing the Executive's job function, authority, duties or responsibilities, or any change materially deteriorating Executive's working conditions that would not be in accordance with the spirit of this Agreement;
- A required relocation of Executive of more than 35 miles from Executive's current job location; or requires Executive to travel away from Executive's office in the course of discharging Executive's responsibilities in excess of that typically required of executives in similar positions.
- Any breach of any of the terms of this Agreement by the Corporation which is not cured within 14 days following written notice thereof by Executive to the Corporation, which notice must be

given within 14 days of the date on which the Executive receives actual knowledge of such breach and if not such breach shall be deemed waived by the Executive.

The amount payable by the Corporation pursuant to this Section 14 shall be made in one lump sum cash payment payable to the Executive no later than 30 days following termination of this Agreement.

15. Termination: The Corporation cannot terminate this agreement except for: 1) the intentional, unapproved misuse of corporate funds, 2a) professional incompetence (i.e. the intentional refusal to perform or the inability to perform the duties associated with Executive's position with the Corporation in a competent manner, which is not cured within 15 days following written notice to Executive) or 2b) willful neglect of duties or responsibilities in either case not otherwise related to or triggered by the occurrence of any event or events described in or prescribed by Section 14 hereof.

16. Indemnification: The Corporation hereby agrees to indemnify and hold the Executive harmless from any loss for any corporate undertaking, as contemplated in Section 7 hereof, whereby a claim, allegation or cause of action shall be made against the Executive in the performance of his contractual duties except for willful illegal misconduct. Said indemnification shall include but not be limited to reasonable cost incurred in defending the Executive in his faithful performance of contractual duties.

17. Dispute Resolution/ARBITRATION: Any dispute, controversy or claim between the parties arising out of, or related in any manner to the employment of Executive, this Agreement, or the breach thereof, shall be exclusively and finally settled by arbitration pursuant to this Section. The arbitration proceedings shall be conducted pursuant to the Federal Arbitration Act and in accordance with the rules established for the arbitration of employment (or alternatively, commercial) disputes by the Center for Public Resources, or alternatively, the American Arbitration Association. The parties will select a neutral arbitrator based upon the procedures set forth by the arbitration service selected. The Arbitrator selected shall have no prior or existing relationship with the Company or the Executive. The decision of the Arbitrator shall be in writing, and shall be final and binding upon both parties, except that errors of law shall be subject to appeal. Any arbitration shall be held in Dallas, Texas.

18. Entire Agreement: This contract may not be changed except in writing and embodies the whole Agreement between the parties hereto and there are no inducements, promises, terms, conditions or obligations made or entered into by the Corporation or the Executive other than contained herein. This Executive Employment Contract supercedes and replaces that certain Executive Employment Contract dated June 14, 2002 between the Corporation and the Executive.

IN WITNESS WHEREOF, the parties here hereunto signed and sealed this Agreement the date first above written.

Signed, Sealed and Delivered
In the presence of:

"Corporation"
PMC Capital, Inc.

/s/ Jan F. Salit

Jan F. Salit

/s/ Lance B. Rosemore

By: Lance B. Rosemore
President

/s/ Angela Sparks

Angela Sparks

"EXECUTIVE"

/s/ Jan F. Salit

Jan F. Salit

/s/ Barry N. Berlin

By: Barry N. Berlin,
Chief Financial Officer

/s/ Angela Sparks

Angela Sparks

(CORPORATE SEAL)

EXECUTIVE EMPLOYMENT CONTRACT

THIS AGREEMENT made as of September 17, 2003 by and between PMC Capital, Inc., a Florida Corporation with its principal places of business in Dallas, Collin County, Texas, hereinafter referred to as the "CORPORATION", and Jan F. Salit, hereinafter referred to as "EXECUTIVE".

WITNESSETH THAT:

In consideration of the promises herein contained, the parties hereto mutually agree as follows:

1. Employment: The Corporation hereby employs the Executive as its Executive Vice President and Chief Investment Officer with such powers and duties as may be specified by the Board of Directors. The Executive hereby accepts employment upon the terms and conditions as hereinafter set forth.

2. Term: Subject to the provisions for termination as hereinafter provided, the term of this Agreement shall begin immediately and shall terminate on October 1, 2006 or such later date as determined by the Board of Directors (the "Term"). The Term of this Executive Employment Contract may be extended annually by the Board of Directors.

3. Compensation: For all services rendered by the Executive under this contract, the Executive shall be paid an annual salary at a minimum at the annual rate for the Executive effective as of July 1, 1998 (the "Minimum Rate"). The Minimum Rate may be increased by the Board at its discretion. The annual salary is payable pursuant to the normal payroll practices of the Corporation.

The Board of Directors may consider bonus compensation for the Executive if the performance of the Corporation and the Executive justifies such bonus compensation.

4. Authorized Expenses: The Executive is authorized to incur reasonable expenses for the promotion of the business of the Corporation. The Corporation will reimburse the Executive for

all such reasonable expenses upon the presentation by the Executive, from time to time, of an itemized account of such expenditures.

The Executive shall be entitled to such additional and other fringe benefits as the Board of Directors shall from time to time authorize, including but not limited to: A) health insurance coverage for the Executive, his wife and minor children; B) a monthly automotive allowance of \$450, which the Executive is to use to obtain an automobile to be utilized for his own company needs. All maintenance, insurance etc. (excluding fuel) will be the responsibility and expense of the Executive.

5. Extent of Services: The Executive shall devote a substantial portion of business time, attention and energies to the business of the Corporation, and shall not, during the term of this Agreement, engage in any other business activities, whether or not such activities are pursued for gain, profit or other pecuniary advantage. This provision is not meant to prevent him from A) devoting reasonable time to civic or philanthropic activities or B) investing his assets in such form or manner providing that it does not require any substantial services on the part of the Executive that will interfere with the Executive's employment pursuant to this Agreement. Executive's employment is considered as full-time.

6. Working Facilities: The Executive shall be furnished with such facilities and services suitable to his position and adequate for the performance of his duties.

7. Duties: The Executive is employed in an executive and supervisory capacity and shall perform such duties consistent herewith as the Board of Directors of the Corporation shall from time to time specify. Subject to the provisions of Section 14 hereof, the precise services of the Executive may be extended or curtailed, from time to time, at the discretion of the Board of Directors of the Corporation.

8. Disclosure of Information: The Executive recognizes and acknowledges that the Corporation's operating procedures or service techniques are valuable, special and unique assets of the Corporation's business. The Executive will not, during or after the term of his employment, disclose the list of the Corporation's operating procedures or service techniques to any person, firm, corporation, association or other entity for any reason or purpose whatsoever. In the event of breach or threatened breach by the Executive of the provisions of this paragraph, the Corporation shall be entitled to an injunction restraining any such breach. Nothing herein shall be construed as prohibiting the Corporation from pursuing any other remedies available to the Corporation for such breach or threatened breach, including the recovery of damages from the Executive.

9. Vacations: The Executive shall be entitled each year to a vacation in accordance with the vacation contract addendum dated effective July 1, 1999.

10. Disability: If the Executive is unable to perform his services by reason of illness or total incapacity, based on standards similar to those utilized by the U.S. Social Security Administration, he shall receive his full salary for one (1) year of said total incapacity through coordination of benefits with any existing disability insurance program provided by the Corporation (a reduction in salary by that amount paid by any Corporation provided insurance). Should said Executive be totally incapacitated beyond a one-year period, so that he is not able to devote full time to his employment with said Corporation, then this Agreement shall terminate.

11. Death During Employment: If the Executive dies during the term of employment and has not attained the age of seventy years, the Corporation and/or any third party insurance provided by the Corporation, through a coordination of benefits, shall pay the estate of the Executive a death benefit equal to two times the Executive's annual salary. In the event the Executive receives death benefits payable under any group life insurance policy issued to the Corporation, the Corporation's liability under this clause will be reduced by the amount of the death benefit paid under such policy. The Corporation shall pay any remaining death benefits to the estate of the Executive over the course

of twelve (12) months in the same manner and under the same terms as the Executive would have been paid if he had still been working for the Corporation. No later than one (1) month from the date of death, the estate of the Executive will also be paid any accumulated vacation pay. Such payments pursuant to this paragraph shall constitute the full compensation of said Executive and he and his estate shall have no further claim for compensation by reason of his employment by the Corporation.

12. Assignment: The acts and obligations of the Corporation under this Agreement shall inure to the benefit of and be binding upon the successors and assigns of the Corporation.

13. Invalidity: If any paragraph or part of this Agreement is invalid, it shall not affect the remainder of this Agreement but the remainder shall be binding and effective against all parties.

14. Additional Compensation: If during the Term, this Agreement is terminated by the Corporation (other than pursuant to the provisions of Section 15 hereof) or by the Executive due to "Constructive Discharge" then the Executive shall receive termination pay in an amount equal to 2.99 times the average of the last three years compensation. For purposes of this Agreement, "Constructive Discharge" shall mean:

- Any reduction in salary below the Minimum Rate;
- A material change without consent of the Executive which is within the discretion of the Employer diminishing the Executive's job function, authority, duties or responsibilities, or a any change materially deteriorating Executive's working conditions that would not be in accordance with the spirit of this Agreement;
- A required relocation of Executive of more than 35 miles from Executive's current job location; or requires Executive to travel away from Executive's office in the course of discharging Executive's responsibilities in excess of that typically required of executives in similar positions.
- Any breach of any of the terms of this Agreement by the Corporation which is not

cured within 14 days following written notice thereof by Executive to the Corporation, which notice must be given within 14 days of the date on which the Executive receives actual knowledge of such breach and if not such breach shall be deemed waived by the Executive.

The amount payable by the Corporation pursuant to this Section 14 shall be made in one lump sum cash payment payable to the Executive no later than 30 days following termination of this Agreement.

15. Termination: The Corporation cannot terminate this agreement except for: 1) the intentional, unapproved misuse of corporate funds, 2a) professional incompetence (i.e. the intentional refusal to perform or the inability to perform the duties associated with Executive's position with the Corporation in a competent manner, which is not cured within 15 days following written notice to Executive) or 2b) willful neglect of duties or responsibilities in either case not otherwise related to or triggered by the occurrence of any event or events described in or prescribed by Section 14 hereof.

16. Indemnification: The Corporation hereby agrees to indemnify and hold the Executive harmless from any loss for any corporate undertaking, as contemplated in Section 7 hereof, whereby a claim, allegation or cause of action shall be made against the Executive in the performance of his contractual duties except for willful illegal misconduct. Said indemnification shall include but not be limited to reasonable cost incurred in defending the Executive in his faithful performance of contractual duties.

17. Dispute Resolution/ARBITRATION: Any dispute, controversy, or claim between the parties arising out of, or related in any manner to the employment of Executive, this Agreement, or the breach thereof, shall be exclusively and finally settled by arbitration pursuant to this Section. The arbitration proceedings shall be conducted pursuant to the Federal Arbitration Act and in accordance

with the rules established for the arbitration of employment (or alternatively, commercial) disputes by the Center for Public Resources, or alternatively, the American Arbitration Association. The parties will select a neutral arbitrator based upon the procedures set forth by the arbitration service selected. The Arbitrator selected shall have no prior or existing relationship with the Company or the Executive. The decision of the Arbitrator shall be in writing, and shall be final and binding upon both parties, except that errors of law shall be subject to appeal. Any arbitration shall be held in Dallas, Texas.

18. Entire Agreement: This contract may not be changed except in writing and embodies the whole Agreement between the parties hereto and there are no inducements, promises, terms, conditions or obligations made or entered into by the Corporation or the Executive other than contained herein. This Executive Employment Contract supercedes and replaces that certain Executive Employment Contract dated June 14, 2002 between the Corporation and the Executive.

IN WITNESS WHEREOF, the parties here hereunto signed and sealed this Agreement the date first above written.

Signed, Sealed and Delivered
In the presence of:

"Corporation"
PMC Capital, Inc.

/s/ Barry N. Berlin

Barry N. Berlin

/s/ Lance B. Rosemore

By: Lance B. Rosemore
President

/s/ Angela Sparks

Angela Sparks

"EXECUTIVE"

/s/ Barry N. Berlin

Barry N. Berlin

/s/ Jan F. Salit

By: Jan F. Salit,
Executive Vice President
and Chief Investment Officer

/s/ Angela Sparks

Angela Sparks

(CORPORATE SEAL)

EXECUTIVE EMPLOYMENT CONTRACT

THIS AGREEMENT made as of July 1, 2001 by and between PMC Capital, Inc., a Florida Corporation with its principal places of business in Dallas, Collin County, Texas, hereinafter referred to as the "CORPORATION", and Cheryl T. Murray, hereinafter referred to as "EXECUTIVE".

WITNESSETH THAT:

In consideration of the promises herein contained, the parties hereto mutually agree as follows:

1. Employment: The Corporation hereby employs the Executive as its General Counsel with such powers and duties as may be specified by the Board of Directors. The Executive hereby accepts employment upon the terms and conditions as hereinafter set forth.

2. Term: Subject to the provisions for termination as hereinafter provided, the term of this Agreement shall begin immediately and shall terminate on the earlier of (i) the Executive's seventieth (70th) birthday or (ii) July 31, 2004 or such later date as determined by the Board of Directors (the "Term"). The Term of this Executive Employment Contract may be extended annually by the Board of Directors.

3. Compensation: For all services rendered by the Executive under this contract, the Executive shall be paid an annual salary at a minimum at the annual rate for the Executive effective as of July 1, 1998 (the "Minimum Rate"). The Minimum Rate may be increased by the Board at its discretion. The annual salary is payable pursuant to the normal payroll practices of the Corporation.

The Board of Directors may consider bonus compensation for the Executive if the performance of the Corporation and the Executive justifies such bonus compensation.

4. Authorized Expenses: The Executive is authorized to incur reasonable expenses for the promotion of the business of the Corporation. The Corporation will reimburse the Executive for all such reasonable expenses upon the presentation by the Executive, from time to time, of an itemized account of such expenditures.

5. Extent of Services: The Executive shall devote a substantial portion of business time, attention and energies to the business of the Corporation, and shall not, during the term of this Agreement, engage in any other business activities, whether or not such activities are pursued for gain, profit or other pecuniary advantage. This provision is not meant to prevent him from A) devoting reasonable time to civic or philanthropic activities or B) investing his assets in such form or manner providing that it does not require any substantial services on the part of the Executive that will interfere with the Executive's employment pursuant to this Agreement. Executive's employment is considered as full-time.

6. Working Facilities: The Executive shall be furnished with such facilities and services suitable to his position and adequate for the performance of his duties.

7. Duties: The Executive is employed in an executive and supervisory capacity and shall perform such duties consistent herewith as the Board of Directors of the Corporation shall from time to time specify. Subject to the provisions of Section 14 hereof, the precise services of the Executive may be extended or curtailed, from time to time, at the discretion of the Board of Directors of the Corporation.

8. Disclosure of Information: The Executive recognizes and acknowledges that the Corporation's operating procedures or service techniques are valuable, special and unique assets of the Corporation's business. The Executive will not, during or after the term of his employment, disclose the list of the Corporation's operating procedures or service techniques to any person, firm, corporation, association or other entity for any reason or purpose whatsoever. In the event of breach or threatened breach by the Executive of the provisions of this paragraph, the Corporation shall be entitled to an injunction restraining any such breach. Nothing herein shall be construed as prohibiting the Corporation from pursuing any other remedies available to the Corporation for such breach or threatened breach, including the recovery of damages from the Executive.

9. Vacations: The Executive shall be entitled each year to a vacation in accordance with the vacation policy of the Corporation.

10. Disability: If the Executive is unable to perform his services by reason of illness or total incapacity, based on standards similar to those utilized by the U.S. Social Security Administration, he shall receive his full salary for one (1) year of said total incapacity through coordination of benefits with any existing disability insurance program provided by the Corporation (a reduction in salary by that amount paid by any Corporation provided insurance). Should said Executive be totally incapacitated beyond a one-year period, so that he is not able to devote full time to his employment with said Corporation, then this Agreement shall terminate.

11. Death During Employment: If the Executive dies during the term of employment and has not attained the age of seventy years, the Corporation and/or any third party insurance provided by the Corporation, through a coordination of benefits, shall pay the estate of the Executive a death benefit equal to two times the Executive's annual salary. In the event the Executive receives death benefits payable under any group life insurance policy issued to the Corporation, the Corporation's liability under this clause will be reduced by the amount of the

death benefit paid under such policy. The Corporation shall pay any remaining death benefits to the estate of the Executive over the course of twelve (12) months in the same manner and under the same terms as the Executive would have been paid if he had still been working for the Corporation. No later than one (1) month from the date of death, the estate of the Executive will also be paid any accumulated vacation pay. Such payments pursuant to this paragraph shall constitute the full compensation of said Executive and he and his estate shall have no further claim for compensation by reason of his employment by the Corporation.

12. Assignment: The acts and obligations of the Corporation under this Agreement shall inure to the benefit of and be binding upon the successors and assigns of the Corporation.

13. Invalidity: If any paragraph or part of this Agreement is invalid, it shall not affect the remainder of this Agreement but the remainder shall be binding and effective against all parties.

14. Additional Compensation: If during the Term, this Agreement is terminated by the Corporation (other than pursuant to the provisions of Section 15 hereof) or by the Executive due to "Constructive Discharge" then the Executive shall receive termination pay in an amount equal to 2.99 times the average of the last three years compensation. For purposes of this Agreement, "Constructive Discharge" shall mean:

- Any reduction in salary below the Minimum Rate;
- A material change diminishing the Executive's job function, authority, duties or responsibilities, or a similar change deteriorating Executive's working conditions that would not be in accordance with the spirit of this Agreement;
- A required relocation of Executive of more than 35 miles from Executive's current job location; or requires Executive to travel away from Executive's office in the course of discharging Executive's responsibilities in excess of that typically required of executives in similar positions.
- Any breach of any of the terms of this Agreement by the Corporation which is not cured within 14 days following written notice thereof by Executive to the Corporation.

The amount payable by the Corporation pursuant to this Section 14 shall be made in one lump sum cash payment payable to the Executive no later than 30 days following termination of this Agreement.

15. Termination: The Corporation cannot terminate this agreement except for: 1) the intentional, unapproved misuse of corporate funds, 2a) professional incompetence (i.e. the intentional refusal to perform or the inability to perform the duties associated with Executive's position with the Corporation in a competent manner,

which is not cured within 15 days following written notice to Executive) or 2b) willful neglect of duties or responsibilities in either case not otherwise related to or triggered by the occurrence of any event or events described in or prescribed by Section 14 hereof.

16. Indemnification: The Corporation hereby agrees to indemnify and hold the Executive harmless from any loss for any corporate undertaking, as contemplated in Section 7 hereof, whereby a claim, allegation or cause of action shall be made against the Executive in the performance of his contractual duties except for willful illegal misconduct. Said indemnification shall include but not be limited to reasonable cost incurred in defending the Executive in his faithful performance of contractual duties.

17. Entire Agreement: This contract may not be changed except in writing and embodies the whole Agreement between the parties hereto and there are no inducements, promises, terms, conditions or obligations made or entered into by the Corporation or the Executive other than contained herein. This Executive Employment Contract supercedes and replaces that certain Executive Employment Contract dated July 1, 2000 between the Corporation and the Executive.

IN WITNESS WHEREOF, the parties here hereunto signed and sealed this Agreement the date first above written.

Signed, Sealed and Delivered
In the presence of:

"Corporation"
PMC Capital, Inc.

/s/ Lance B. Rosemore

By: Lance B. Rosemore
President

"EXECUTIVE"

/s/ Cheryl T. Murray

By: Cheryl T. Murray,
General Counsel

(CORPORATE SEAL)

ASSUMPTION, WAIVER AND AMENDMENT AGREEMENT

THIS ASSUMPTION, WAIVER AND AMENDMENT AGREEMENT (this "AGREEMENT") is entered into as of February 27, 2004, by and among PMC CAPITAL, INC., a Florida corporation ("PMC"), PMC COMMERCIAL TRUST, a Texas real estate investment trust (the "COMPANY"), SECURITY LIFE OF DENVER INSURANCE COMPANY ("SLD") and ING USA ANNUITY AND LIFE INSURANCE COMPANY ("ING USA") (collectively, the "NOTEHOLDERS").

RECITALS:

A. PMC and SLD (in such capacity, the "1995 FLOATING RATE PURCHASER") entered into that certain Note Agreement dated as of April 19, 1995, as amended prior to the date hereof (as so amended, the "1995 FLOATING RATE NOTE AGREEMENT"), pursuant to which PMC issued and sold to the 1995 Floating Rate Purchaser \$5,000,000 in aggregate principal amount of its Floating Rate Senior Promissory Notes due April 19, 2004 (the "1995 FLOATING RATE NOTES"). The 1995 Floating Rate Purchaser is the holder, directly or through its nominees, of 100% of the outstanding principal amount of the 1995 Floating Rate Notes.

B. PMC and ING USA (or its predecessor) (in such capacity, the "7.44% PURCHASER") entered into those certain Note Agreements each dated as of July 19, 1999, as amended prior to the date hereof (as so amended, the "7.44% NOTE AGREEMENTS"), pursuant to which PMC issued and sold to the 7.44% Purchaser \$10,000,000 in aggregate principal amount of its 7.44% Senior Promissory Notes due July 19, 2005 (the "7.44% NOTES"). The 7.44% Purchaser is the holder, directly or through their respective nominees, of 100% of the outstanding principal amount of the 7.44% Notes.

C. PMC and SLD (in such capacity, the "2000 FLOATING RATE PURCHASER") entered into that certain Note Agreement dated as of July 19, 2000, as amended prior to the date hereof (as so amended, the "2000 FLOATING RATE NOTE AGREEMENT"), pursuant to which the PMC issued and sold to the 2000 Floating Rate Purchaser \$10,000,000 in aggregate principal amount of its Floating Rate Senior Promissory Notes due July 19, 2004 (the "2000 FLOATING RATE NOTES"). The 2000 Floating Rate Purchaser is the holder, directly or through its nominees, of 100% of the outstanding principal amount of the 2000 Floating Rate Notes.

D. PMC and SLD (in such capacity, the "2001 FLOATING RATE PURCHASER") entered into that certain Note Agreement dated as of July 19, 2001, as amended prior to the date hereof (as so amended, the "2001 FLOATING RATE NOTE AGREEMENT"; together with the 1995 Floating Rate Note Agreement, the 7.44% Note Agreements and the 2000 Floating Rate Note Agreement, collectively, the "NOTE AGREEMENTS" and, each, a "NOTE AGREEMENT"), pursuant to which the PMC issued and sold to the 2001 Floating Rate Purchaser \$10,000,000 in aggregate principal amount of its Floating Rate Senior Promissory Notes due July 19, 2006 (the "2001 FLOATING RATE NOTES"; together with the 1995 Floating Rate Notes, the 7.44% Notes and the 2000 Floating Rate Notes, together with any promissory notes now or hereafter issued in replacement or substitution thereof in accordance with the Note Agreements, collectively, the "NOTES" and, each, a "NOTE"). The 2001 Floating Rate Purchaser is the holder, directly or through its nominees, of 100% of the outstanding principal amount of the 2001 Floating Rate Notes.

E. PMC and the Company have authorized the merger of PMC with and into the Company, with the Company being the surviving entity after giving effect to such merger (the "MERGER"). Pursuant to the plan of merger adopted by both PMC and the Company, and in accordance with applicable law, upon the effective date of the Merger (i) PMC will cease to exist as a separate legal entity, (ii) all of the rights, titles and interests of PMC in and to its licenses, assets, properties and franchises will be deemed transferred and assigned to the Company and the Company will be deemed to have acquired all such rights, titles and interests in and to such licenses, assets, properties and franchises automatically without any further action, and (iii) PMC will be deemed to have assigned and delegated to the Company, and the Company will be deemed to have assumed, all of the outstanding obligations of PMC, whether arising under contract or under law.

F. The parties hereto desire to enter into this agreement to, among other things (i) provide for the express assumption by the Company of all of PMC's obligations under each of the Note Agreements and the related Notes and (ii) amend and/or waive certain provisions of the Note Agreements and the Notes, only as expressly set forth herein.

G. Capitalized terms used herein shall have the respective meanings ascribed thereto in the Note Agreements unless herein defined or the context shall otherwise require.

NOW, THEREFORE, in order to induce the Purchasers to grant their consent to the Merger, in consideration of the mutual premises herein contained, and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto hereby agree as follows:

SECTION 1. ASSUMPTION AGREEMENT. The Company has authorized its assumption of, and (subject to the satisfaction in full of the conditions precedent set forth in Section 5.1 hereof) hereby irrevocably assumes and agrees to be fully liable for, all of the obligations and undertakings of PMC, whether now existing or hereafter arising, provided for in the Note Agreements and the Notes, including, without limitation, all the covenants in the Note Agreements and the Notes and the obligation to duly and punctually pay the principal and interest, Yield-Maintenance Premium, if any, on the Notes in accordance with the terms of the Note Agreements and the Notes.

SECTION 2. CONSENT AND WAIVERS. Subject to the satisfaction in full of the conditions precedent set forth in Section 5.1 hereof, the Noteholders hereby grant the following consent and waivers:

2.1. The Noteholders hereby (a) consent to the Merger and (b) waive the provisions of paragraph 5E that would otherwise require PMC to maintain its corporate existence and waive the provisions of paragraph 6C(4) that would otherwise prohibit the Merger, in each case to the extent and only to the extent to permit the Merger to be consummated, provided that (in the case of clause (a) and (b) above of this Section 2.1) each of the following conditions are met: (i) after giving effect to the Merger, the Company is the surviving entity, and the Company has expressly assumed all of the obligations of PMC and agreed to be bound by all of the covenants applicable to PMC under the Note Agreements and the Notes; (ii) the merger is consummated no later than March 31, 2004; and (iii) the Merger is consummated in accordance with the terms of the plan of

merger that has been furnished by PMC to the Noteholders, a copy of which is attached hereto as Exhibit A.

2.2. The Noteholders hereby waive any violation of the financial covenant in paragraph 6A(i) of the Note Agreements providing that the Company will not permit Net Loans Receivable at any time to be less than 150% of Senior Funded Debt of the Company and its Subsidiaries provided that (i) such waiver relates solely to the fiscal month ended December 31, 2003, and (ii) on the date that each of the conditions precedent in Section 5 have been satisfied (the "EFFECTIVE DATE") and after giving effect to the Merger, the Company will be in pro forma compliance with the financial covenant in paragraph 6A(i) of the Note Agreements.

SECTION 3. AMENDMENTS. Subject to the satisfaction in full of the conditions precedent set forth in Section 5.1 hereof, the parties hereto hereby agree that the Note Agreements, the Schedules to the Note Agreements and the Notes are hereby amended as follows:

3.1. Each reference to the "Company" or to "PMC Capital, Inc." appearing in the Note Agreements and the Notes shall be deemed to refer to "PMC Commercial Trust, a Texas real estate investment trust".

3.2. Schedule I (Outstanding Debt and Liens) to each of the Note Agreements is hereby deleted in its entirety and a new Schedule I is substituted in lieu thereof as set forth on Schedule I attached to this Agreement.

3.3. Schedule II (Subsidiaries) to each of the Note Agreements is hereby deleted in its entirety and a new Schedule II is substituted in lieu thereof as set forth on Schedule II attached to this Agreement.

3.4. Schedule III (Agreements Restricting Debt) to each of the Note Agreements is hereby deleted in its entirety and a new Schedule III is substituted in lieu thereof as set forth on Schedule III attached to this Agreement.

3.5. Schedule IV (Agreements with Shareholders) to each of the Note Agreements is hereby deleted in its entirety and a new Schedule IV is substituted in lieu thereof as set forth on Schedule IV attached to this Agreement.

3.6. Paragraph 5H of each of the Note Agreements is hereby deleted and a new paragraph 5H is substituted in lieu thereof to read in its entirety as follows:

"5H. BUSINESS OF THE COMPANY. The Company covenants that neither it nor any Subsidiary will engage in any business if, as a result, the general nature of the business which would then be engaged in by the Company and its Subsidiaries taken as a whole would be materially changed from the general nature of the business engaged in by the Company and its Subsidiaries on the date of this Agreement; provided, however that the Company may engage in the business of a real estate investment trust as conducted by the Company on the Amendment Effective Date, including the origination of loans to small businesses collateralized by first liens on the real estate of the related business, the origination of loans for commercial real estate collateralized by first liens on real

estate and the ownership of commercial properties predominantly in the hospitality industry."

3.7. Paragraph 6A of each of the Note Agreements is hereby amended by adding the following sentence immediately after the end of the first paragraph thereof to read in its entirety as follows:

"In addition to the foregoing covenants, the Company hereby covenants and agrees that it will not permit (a) the Company's consolidated Net Worth at any time to be less than the sum of (i) \$145,000,000, plus (ii) 100% of the net proceeds from any Equity Issuances (defined below) by the Company after the Amendment Effective Date; (b) the Maximum Non-performing Loan Ratio (defined below) at any time to exceed 10%; and (c) the Maximum Charge-off Ratio (defined below) at any time to exceed 2%, to be determined for compliance reporting purposes as of the last day of each fiscal quarter.

As used herein, "EQUITY ISSUANCES" shall mean the issuance by the Company of any shares of any class of beneficial interests, stock, warrants, options or other equity interests, whether pursuant to a public offering or otherwise, but does not include (a) any present and future shares of beneficial interests, stock, options or warrants issued to employees or trust managers of the Company or (b) any present and future shares of beneficial interests, stock, options or warrants issued in respect of any dividend reinvestment plan established and maintained by the Company. As used herein, "MAXIMUM NON-PERFORMING LOAN RATIO" shall mean, as of any date of determination, the ratio expressed as a percentage equal to (a) the aggregate amount of all non-performing commercial mortgage loans (including delinquent loans) of the Company and its consolidated Subsidiaries as of such date, divided by (b) the Company's consolidated Net Worth as of such date. As used herein, the term "MAXIMUM CHARGE-OFF RATIO" shall mean, as of any date of determination, a fraction expressed as a percentage, the numerator of which is the sum of the total amounts charged off by the Company and its consolidated Subsidiaries (less any such amounts subsequently recovered) for the four fiscal quarters then ended, and the denominator of which is the aggregate average principal balance of commercial mortgage loans of the Company and its consolidated Subsidiaries for the four fiscal quarters of the Company then ended.

3.8. Paragraph 6B(b) of each of the Note Agreements is hereby deleted and a new paragraph 6B(b) is substituted in lieu thereof to read in its entirety as follows:

"(b) the aggregate amount of all Restricted Payments declared, paid or made on or after the Amendment Effective Date shall not exceed the sum of (A) \$3,000,000 plus (B) 100% (or minus 100% in the case of any deficit or loss) of Net Taxable Income for the period (taken as one accounting period) commencing on April 1, 2004 and terminating at the end of the last fiscal quarter preceding the date of the Restricted Payment in question."

3.9. Paragraph 6C(2) of each of the Note Agreements is hereby amended by deleting the proviso appearing immediately after clause (vi) in said paragraph and substituting in lieu thereof the following proviso to read in its entirety as follows:

provided always, however, that the Company shall not permit (A) the aggregate amount of Secured Funded Debt of the Company and its Subsidiaries at any time outstanding, determined on a consolidated basis (except as otherwise provided in the proviso to clause (iii) of paragraph 6C(1)), to exceed an amount equal to (x) 25% of Consolidated Shareholders' Equity at such time, or (y) if at any time the Minimum Asset Coverage Ratio (defined below) equals or exceeds 1.50 to 1.00, 35% of Consolidated Shareholders' Equity at such time; (B) the aggregate amount of Senior Funded Debt of the Company and its Subsidiaries at any time outstanding, determined on a consolidated basis, to exceed 200% of Consolidated Shareholders' Equity at such time; or (C) the aggregate amount of Funded Debt of the Company and its Subsidiaries at any time outstanding, determined on a consolidated basis, to exceed 300% of Consolidated Shareholders' Equity at such time; and provided further, that, for purposes of clause (A) of this proviso, Funded Debt (other than SBA Debentures) of a Subsidiary that is not a Wholly-Owned Subsidiary shall, to the extent such Funded Debt is attributable to minority interests, be deemed to be Secured Funded Debt; and provided further that, for purposes of clauses (B) and (C) of this proviso, Funded Debt shall be deemed to include Base Current Debt for the period of 365 consecutive days ending on the date of determination of Funded Debt. As used herein, the term "MINIMUM ASSET COVERAGE RATIO" means, as of any date of determination, the ratio of unencumbered assets of the Company and its consolidated subsidiaries to unsecured Senior Funded Debt.

3.10. Paragraph 6C(5) of each of the Note Agreements is hereby amended by deleting clause (iv) thereof in its entirety and substituting in lieu thereof the following new clause (iv) to read in its entirety as follows:

(iv) the aggregate book value (as valued on the books of the Company or its Subsidiary, as applicable, immediately prior to sale) of all such loans and accounts receivable sold by the Company and its Subsidiaries shall not at any time exceed (x) \$370,000,000 prior to the repayment in full, satisfaction and discharge by the Company of all of its obligations under the 2001 Floating Rate Note Agreement and the 2001 Floating Rate Notes (as such terms are defined in the Assumption, Waiver and Amendment Agreement), and (y) \$500,000,000 after the repayment in full, satisfaction and discharge by the Company of all of its obligations under the 2001 Floating Rate Note Agreement and the 2001 Floating Rate Notes (as such terms are defined in the Assumption, Waiver and Amendment Agreement).

3.11. Paragraph 8A of each of the Note Agreements is hereby deleted and a new paragraph 8A is substituted in lieu thereof to read in its entirety as follows:

"8A. ORGANIZATION; AUTHORIZATION. The Company is a real estate investment trust duly organized and validly existing under the laws of the State of Texas; each Subsidiary is duly organized, validly existing and in good standing under the laws of the jurisdiction in which it is organized and is identified on Schedule II attached hereto; the Company is and each Subsidiary is duly qualified as a foreign

corporation or organization and in good standing in each jurisdiction where the ownership of property or the nature of the business transacted by it makes such qualification necessary; and the Company has and each Subsidiary has the corporate, partnership, trust or limited liability company power to own its respective property and to carry on its respective business as now being conducted. The Company has all requisite trust power and authority to execute and deliver this Agreement and the Notes and to perform its obligations hereunder and thereunder. This Agreement and the Notes will be duly authorized by all requisite trust action and duly executed and delivered by authorized officers of the Company, and this Agreement constitutes and the Notes will each constitute, a valid obligation of the Company, legally binding upon and enforceable against the Company in accordance with their respective terms. The Company has no Majority Subsidiaries except its Subsidiaries.

3.12 (a) Paragraph 8G of each of the Note Agreements is hereby amended by deleting the first sentence thereof in its entirety and substituting in lieu thereof the following to read in its entirety as follows:

"Neither the Company nor any of its Subsidiaries is a party to any contract or agreement or subject to any organizational document, charter or other corporate restriction which materially and adversely affects its business, property or assets, or financial condition."

(b) Paragraph 8G of each of the Note Agreements is hereby further amended by deleting the reference to "charter or by-laws" appearing in the second sentence of Paragraph 8G and substituting in lieu thereof "organizational documents".

3.13. Paragraph 8M of each of the Note Agreements is hereby amended by deleting the last sentence thereof in its entirety and substituting in lieu thereof the following to read in its entirety as follows:

"The Company is not an "investment company" or an "affiliated person" of, or "promoter" or "principal underwriter" for, a company required to be registered as an "investment company", as such terms are defined in the Investment Company Act of 1940, as amended."

3.14 Paragraph 10 of each of the Note Agreements is hereby amended by deleting the definition of "Net Investment Company Taxable Income." In addition, the reference to "Net Investment Company Taxable Income" in paragraph 5A(v) of the Agreement shall be deemed to refer to "Net Taxable Income."

3.15 Paragraph 10 of each of the Note Agreements is hereby further amended by adding the following new definitions in alphabetical order to read in their entirety as follows:

"Amendment Effective Date" shall mean the Effective Date as defined in the Assumption, Waiver and Amendment Agreement.

"Assumption, Waiver and Amendment Agreement" shall mean that certain Assumption, Waiver and Amendment Agreement dated as of February 27, 2004 by and among PMC Capital, Inc., a Florida corporation, PMC Commercial Trust, a Texas real estate investment trust, Security Life of Denver Insurance Company and ING USA Annuity and Life Insurance Company.

"Net Taxable Income" for any period shall mean Consolidated Net Earnings for such period, adjusted for differences in timing of recognition of items of income or expense between generally accepted accounting principles and tax accounting principles, plus, to the extent deducted in computing the foregoing, current and deferred taxes on income.

"Net Worth" means, for any Person, total beneficiaries' or stockholders' equity, as applicable, as determined in accordance with generally accepted accounting principles consistently applied."

SECTION 4. REPRESENTATIONS AND WARRANTIES OF THE COMPANY.

4.1. To induce the Noteholders to execute and deliver this Agreement (which representations shall survive the execution and delivery of this Agreement), the Company represents and warrants to the Noteholders that (and agrees that any material breach of any such representation or warranty shall be deemed an Event of Default under the Note Agreements):

(a) this Agreement has been duly authorized, executed, and delivered by it and this Agreement constitutes the legal, valid, and binding obligation, contract, and agreement of the Company enforceable against it in accordance with its terms, except as enforcement may be limited by bankruptcy, insolvency, reorganization, moratorium, or similar laws or equitable principles relating to or limiting creditors' rights generally;

(b) the Note Agreements and the Notes, as heretofore amended and as amended by this Agreement, constitute the legal, valid, and binding obligations, contracts, and agreements of the Company enforceable against it in accordance with their respective terms, except as enforcement may be limited by bankruptcy, insolvency, reorganization, moratorium, or similar laws or equitable principles relating to or limiting creditors' rights generally;

(c) the execution, delivery, and performance by the Company of this Agreement (i) has been duly authorized by all requisite corporate action and, if required, shareholder action, (ii) does not require the consent or approval of any governmental or regulatory body or agency, and (iii) will not (A) violate (1) any provision of law, statute, rule, or regulation or its certificate of incorporation or bylaws, (2) any order of any court or any rule, regulation, or order of any other agency or government binding upon it, or (3) any provision of any material indenture, agreement, or other instrument to which it is a party or by which its properties or assets are or may be bound, or (B) result in a breach or constitute (alone or with due notice or lapse of time or both) a default under any indenture, agreement, or other instrument referred to in clause (iii)(A)(3) of this Section 4.1(c);

(d) as of the date hereof and after giving effect to this Agreement and the consummation of the Merger, no Default or Event of Default has occurred that is continuing;

(e) each of the representations and warranties made by the Company in the Note Agreements is true and correct as of the date of this Agreement and after giving effect to the Merger, except as such representations and warranties may expressly refer to a prior date (and in such case, such representations and warranties are true and correct as of such prior date). After giving effect to the Merger, all of the Subsidiaries of PMC existing immediately prior to the date of the Merger will become Subsidiaries of the Company pursuant to the terms of the applicable merger documents and applicable law;

(f) this Agreement and the documents, certificates, and other writings delivered to the Noteholders by or on behalf of the Company in connection with this Agreement and the transactions contemplated hereby, taken as a whole, do not contain any untrue statement of a material fact or omit to state any material fact necessary to make the statements herein and therein not misleading in light of the circumstances under which they were made; and

(g) on the Effective Date and after giving effect to the Merger and the transactions contemplated by this Agreement including, without limitation, the assumption of the Company's obligations as provided for in Section 1 hereof, the Company will be solvent.

SECTION 5. CONDITIONS TO EFFECTIVENESS OF THIS AGREEMENT.

5.1. Upon satisfaction in full of each of the following conditions, this Agreement (including, the consents, waivers and amendments contained herein) shall become effective on and as of the Effective Date:

(a) executed counterparts of this Agreement, duly executed and delivered by PMC, the Company and the Noteholders, and the Noteholders shall have received original manually signed counterparts of this Agreement from all parties hereto;

(b) the Merger shall have been consummated in accordance with the terms of the articles of merger in the form attached as Exhibit A to this Agreement, and the Noteholders shall have received certified copies of the articles of merger relating to the Merger as filed with the Secretary of State of Florida and the county clerk of Dallas County, Dallas, Texas;

(c) PMC and the Company shall have obtained all governmental and third party consents and/or approvals to the Merger as required under applicable law and under any existing contractual arrangements of PMC and the Company, and the Merger shall have been approved by the requisite number of shareholders of PMC and the Company;

(d) all corporate and other proceedings taken or to be taken in connection with the transactions contemplated hereby and all documents incident thereto shall be satisfactory to the Noteholders and their counsel, and the Noteholders and their counsel shall have received all such counterpart originals or certified or other copies of such documents, certificates or instruments relating to the Merger or the transactions contemplated by this Agreement as the Noteholders or their counsel may request;

(e) the Noteholders shall have received a certificate from the Secretary of the Company, in form and substance satisfactory to the Noteholders and their counsel, certifying as to matters relating to incumbency, due authorization by the Board of Trust Managers and valid existence, and certifying as to and attaching true, correct and complete copies of, the Company's organizational documents, merger documents and Board of Trust Managers resolutions approving the entering into of this Agreement and the transactions contemplated hereby and by the Merger;

(f) the Noteholders shall have received a signed opinion from counsel to the Company dated the Effective Date and addressed to the Noteholders in the form attached hereto as Exhibit B; and

(g) the representations and warranties of the Company set forth in Section 4 hereof shall be true and correct on and as of the date hereof.

SECTION 6. ADDITIONAL COVENANTS.

6.1. The Company hereby covenants and agrees that it will not enter into any amendment or modification to its existing Credit Agreement with Bank One, N.A. and one or more other lenders (or any replacement credit agreement) and any loan documents relating thereto, if the effect of such amendment or modification would render any of the covenants (financial or otherwise) or events of default more restrictive on the Company or any of its Subsidiaries than the covenants and events of default in the Note Agreements (as amended hereby and further amended from time to time), unless either (a) the Noteholders consent to such amendment or modification or (b) the Company enters into an amendment or modification, in form and substance satisfactory to the Noteholders, which amends or modifies the applicable provisions of the Note Agreements to render such covenants or events of default, as the case may be, in the Note Agreements as restrictive on the Company and/or its Subsidiaries as the applicable covenants or events of defaults under such Credit Agreement (or any replacement credit agreement) and any loan documents relating thereto, as the case may be.

6.2. Promptly upon (and in any event within 5 Business Days' after) request of any Noteholder, the Company will duly execute and deliver to such Noteholder a new promissory note in replacement of the existing Notes held by such Noteholder, which note shall be executed and delivered by the Company as maker and otherwise be in the same form as the Note being replaced.

SECTION 7. PAYMENT OF COUNSEL FEES AND EXPENSES.

7.1. The Company agrees to pay, upon demand, the reasonable fees and expenses of Kilpatrick Stockton LLP in connection with the negotiation, preparation, approval, execution, and delivery of this Agreement.

SECTION 8. MISCELLANEOUS.

8.1. This Agreement shall be construed in connection with and as part of each of the Note Agreements and the Notes, and except as modified and expressly amended or expressly waived by this Agreement, all terms, conditions, and covenants contained in the Note

Agreements and the Notes, and all rights, powers, privileges, and remedies of the Noteholders with respect thereto, are hereby ratified and shall be and remain in full force and effect.

8.2. Any and all notices, requests, certificates, and other instruments executed and delivered after the execution and delivery of this Agreement may refer to the Note Agreements and the Notes without making specific reference to this Agreement, but nevertheless all such references shall include this Agreement unless the context otherwise requires.

8.3. The descriptive headings of the various Sections or parts of this Agreement are for convenience only and shall not affect the meaning or construction of any of the provisions hereof.

8.4. All representations and warranties contained in this Agreement shall survive the execution and delivery of this Agreement.

8.5. This Agreement shall be construed and enforced in accordance with, and the rights of the parties shall be governed by, the law of the State of Georgia excluding choice-of-law principles of the law of such State that would require the application of the laws of a jurisdiction other than such State.

8.6. The execution hereof by you shall constitute a contract between us for the uses and purposes hereinabove set forth, and this Agreement may be executed in any number of counterparts, each executed counterpart constituting an original, but all together only one agreement.

[Remainder of Page Intentionally Left Blank]

IN WITNESS WHEREOF, the parties have caused this Assumption, Waiver and Amendment Agreement to be duly executed by their respective officers or representatives thereunto duly authorized, as of the date first above written.

PMC CAPITAL, INC.

By: /s/ Barry N. Berlin

Name: Barry N. Berlin
Title: Chief Financial Officer

PMC COMMERCIAL TRUST

By: /s/ Lance B. Rosemore

Name: Lance B. Rosemore
Title: President

SECURITY LIFE OF DENVER INSURANCE COMPANY
AND ING USA ANNUITY AND LIFE INSURANCE
COMPANY

By: ING INVESTMENT MANAGEMENT LLC, ITS AGENT

By: /s/ Christopher P. Lyons

Name: Christopher P. Lyons
Title: Senior Vice President

Code of Ethical Conduct for Senior Financial Officers

In my role as the principal executive officer, principal financial officer, or principal accounting officer or controller, or a person performing similar functions (collectively, "Senior Financial Officers") of PMC Commercial Trust (the "Company"),

I recognize that I hold an important and elevated role in corporate governance. I am uniquely capable and empowered to ensure that shareholders' interests are appropriately balanced, protected and preserved. Accordingly, this Code provides principles to which Senior Financial Officers are expected to adhere and advocate. This Code embodies rules regarding individual and peer responsibilities, as well as responsibilities to the Company, the public and shareholders.

I certify that I adhere to and advocate the following principles and responsibilities governing my professional and ethical conduct:

1. I act honestly and ethically, including ethically handling actual or apparent conflicts of interest between personal and professional relationships.
2. I act to ensure full, fair, accurate, timely and understandable disclosure in reports and documents that the Company files with, or submits to, the Securities and Exchange Commission and in other public communications made by the Company.
3. I comply with applicable governmental laws, rules and regulations.
4. I act in good faith, responsibly and with due care and diligence, without misrepresenting material facts or allowing my independent judgment to be impaired.
5. I do not disclose any confidential information acquired in the course of my work, except when authorized or when I am legally obligated to disclose such information. I do not use such confidential information for personal advantage.
6. I comply with the Company's Code of Business Conduct and Ethics for all employees.
7. I promptly report to the Chairman of the Nominating and Corporate Governance Committee any conduct that I believe to be a violation of law or business ethics or of any provision of this Code or the Company's Code of Conduct and Ethics, including any transaction or relationship that reasonably could be expected to give rise to such a violation.

I understand that violations of this Code of Ethical Conduct for Senior Financial Officers, including failures to report actual or potential violations by others, will be viewed as a severe disciplinary matter that may result in disciplinary action, up to and including termination of employment.

/s/ Lance B. Rosemore

Print Name:

Date: March 15, 2004

Code of Ethical Conduct for Senior Financial Officers

In my role as the principal executive officer, principal financial officer, or principal accounting officer or controller, or a person performing similar functions (collectively, "Senior Financial Officers") of PMC Commercial Trust (the "Company"),

I recognize that I hold an important and elevated role in corporate governance. I am uniquely capable and empowered to ensure that shareholders' interests are appropriately balanced, protected and preserved. Accordingly, this Code provides principles to which Senior Financial Officers are expected to adhere and advocate. This Code embodies rules regarding individual and peer responsibilities, as well as responsibilities to the Company, the public and shareholders.

I certify that I adhere to and advocate the following principles and responsibilities governing my professional and ethical conduct:

1. I act honestly and ethically, including ethically handling actual or apparent conflicts of interest between personal and professional relationships.
2. I act to ensure full, fair, accurate, timely and understandable disclosure in reports and documents that the Company files with, or submits to, the Securities and Exchange Commission and in other public communications made by the Company.
3. I comply with applicable governmental laws, rules and regulations.
4. I act in good faith, responsibly and with due care and diligence, without misrepresenting material facts or allowing my independent judgment to be impaired.
5. I do not disclose any confidential information acquired in the course of my work, except when authorized or when I am legally obligated to disclose such information. I do not use such confidential information for personal advantage.
6. I comply with the Company's Code of Business Conduct and Ethics for all employees.
7. I promptly report to the Chairman of the Nominating and Corporate Governance Committee any conduct that I believe to be a violation of law or business ethics or of any provision of this Code or the Company's Code of Conduct and Ethics, including any transaction or relationship that reasonably could be expected to give rise to such a violation.

I understand that violations of this Code of Ethical Conduct for Senior Financial Officers, including failures to report actual or potential violations by others, will be viewed as a severe disciplinary matter that may result in disciplinary action, up to and including termination of employment.

/s/ Barry N. Berlin

Print Name:

Date: March 15, 2004

Exhibit 21.1
Subsidiaries of Registrant

<u>Company</u>	<u>State of Incorporation</u>
PMC Commercial Trust, Ltd. 1998-1	Delaware
PMCT Corp. 1998-1	Delaware
PMCT Sycamore, L.P.	Delaware
PMCT AH Sycamore, Inc.	Delaware
PMCT Macomb, L.P.	Delaware
PMCT AH Macomb, Inc.	Delaware
PMCT Marysville, L.P.	Delaware
PMCT AH, Inc.	Delaware
PMCT Plainfield, L.P.	Delaware
PMC Joint Venture, L.P. 2000	Delaware
PMC Joint Venture LLC 2000	Delaware
PMC Joint Venture, L.P. 2001	Delaware
PMC Joint Venture LLC 2001	Delaware
PMC Joint Venture, L.P. 2002-1	Delaware
PMC Joint Venture LLC 2002-1	Delaware
PMC Joint Venture, L.P. 2003-1	Delaware
PMC Joint Venture LLC 2003-1	Delaware

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-3 (No. 333-24767) of PMC Commercial Trust of our reports dated March 15, 2004 relating to the financial statements and financial statement schedules, which appear in this Form 10-K.

Dallas, Texas
March 15, 2004

CERTIFICATION

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

1. I have reviewed this annual report on Form 10-K 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 annual 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;
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: March 15, 2004

/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 report on Form 10-K 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 annual 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 annual 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;
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): 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: March 15, 2004

/s/ Barry N. Berlin

Barry N. Berlin
Chief Financial Officer

EXHIBIT 32.1

**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 Annual Report of PMC Commercial Trust (the "Company") on Form 10-K for the year ended December 31, 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
March 15, 2004

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.

EXHIBIT 32.2

**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 Annual Report of PMC Commercial Trust (the "Company") on Form 10-K for the year ended December 31, 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
March 15, 2004

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.