# HOLLY MORTGAGE TRUST

2008 ANNUAL REPORT

**TO OUR SHAREHOLDERS:**

The financial statements of Holly Mortgage Trust (“Holly”) audited by Melton & Melton, L.L.P. for the year ended December 31, 2008 appear at the end of this report. Gross revenues were $325,896 and net income was $121,632. Net income in 2008 of $0.09 per share is similar to earnings in 2006 but is less than that earned in 2007. In 2007, Holly sold its interest in a land development project in Tennessee resulting in a significant profit and a net income per share that was much higher than in 2008. Holly’s common stock was initially issued using a valuation of $1.00 per share and net income per share in 2008 represents a 9% return on that investment.

An important part of revenues for both 2008 and 2007 is the recovery of amounts previously written off related to Holly’s investments in the Wilco Building, a twenty-two story office building in Midland, Texas. In 1999, Holly purchased all of the stock of A.R. Goldrick Company, Inc. (Goldrick), the general partner of Wilco Building Partners, Ltd. (Wilco), the owner of the Wilco Building. During the years 2003 through 2005, all amounts invested in Goldrick were deemed to be impaired for accounting purposes and were written off Holly’s books. During 2004, Goldrick sold a major portion of its partnership interest in Wilco for $100,000 plus a $500,000 installment note maturing over the next five years. Collections on this installment note have resulted in income from a recovery of the earlier impairment losses.

In 2008, Holly began a preferential stock offering of 990,000 shares at $1.00 per share. The shares of the 2008 stock are entitled to receive cumulative preferential dividends at the annual rate of eight cents ($0.08) per share with a right to convert the shares at anytime into eight tenths of a share of common stock of Holly. At the end of 2008, subscriptions had been received for 460,000 preferential shares, and as of the offering expiration date, subscriptions had been received for 920,000 preferential shares.

## LOANS

The following tabulation summarizes all of the mortgage loans outstanding at December 31, 2008 funded by Holly.

| Principal Amount Outstanding | Maturity | Interest Provision | Property Securing Loan |
|---|---|---|---|
| $197,403 | 2010 | 11% | Apartment Complexes in Pasadena, CA |
| $337,993 | 2009 | 12% | Real Estate in El Paso, TX |
| $920,000 | Demand | 18% | Real Estate in Tampa, FL |
| $105,980 | Demand | 0.7824 of Prime | Office Building in Midland, TX |
| $64,701 | 2009 | 12% | Office Building in Midland, TX |
| $185,000 | 2009 | 12% | Office Building in Midland, TX |

The $920,000 loan in the proceeding chart represents Holly's participation in a $4 million note secured by part of a redevelopment project in Tampa, Florida. The project called the Heights of Tampa ("HOT") is an assemblage of approximately 50 acres on the Hillsborough River north of downtown Tampa. The property is near the new office building of a major law firm and the new Stetson Law School building which also houses a state appellate court. The first vertical development in HOT is a 30,000 square foot office building, construction of which began in March 2009. The building is master leased to the construction company, which will be the new office of its Florida divisional headquarters. Financing of the new building was arranged despite the current economic downturn. The development of HOT will probably be slower than originally contemplated until the national economy improves.

At the 2008 meeting of shareholders, a proposal was approved to change Holly from a Massachusetts business trust to a Texas real estate investment trust. The change became effective on July 1, 2008. There was no change in the capitalization of Holly resulting from the change in domicile and each share of Holly, both common and preferential, continues as a share of the new Texas entity.

Holly maintains a website www.hollymortgage.com that contains additional information about the trust. Copies of earlier annual reports are posted on the website

Robert W. Scharar
President

Robert A. Burns
Vice President & Treasurer

April 9, 2009

# HOLLY MORTGAGE TRUST

## FINANCIAL STATEMENTS

**December 31, 2008 and 2007**

# HOLLY MORTGAGE TRUST

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M&M MELTON & MELTON, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS

## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

March 17, 2009

To the Board of Trust Managers of
**Holly Mortgage Trust**

We have audited the accompanying balance sheet of Holly Mortgage Trust (the "Trust") as of December 31, 2008 and 2007, and the related statements of operations, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As more fully discussed in Note 8 to the financial statements, the Trust reports its investment in A. R. Goldrick Company, Inc. ("A. R. Goldrick"), its wholly owned subsidiary, under the cost method of accounting. In our opinion, accounting principles generally accepted in the United States of America require that this investment be accounted for as a consolidated subsidiary. The effects of this departure from accounting principles generally accepted in the United States of America cannot be reasonably estimated.

In our opinion, except for the effects on the financial statements of the matter discussed in the preceding paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Holly Mortgage Trust as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Melton & Melton, L.L.P.

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# HOLLY MORTGAGE TRUST
## BALANCE SHEET
## December 31, 2008 and 2007

| | 2008 | 2007 |
|---|---|---|
| **ASSETS** | | |
| **Mortgage Notes Receivable:** | | |
| Mortgage notes receivable | $ 4,748,810 | $ 5,507,459 |
| Mortgage participations | (3,187,435) | (4,086,060) |
| | 1,561,375 | 1,421,399 |
| Cash and cash equivalents | 139,368 | 18,032 |
| Accrued interest receivable, net of participated interest payable of $591,585 and allowance of $729,570 at December 31, 2008 | 212,518 | - |
| Advances to affiliate | 249,701 | 113,640 |
| Investment in affiliates | 112,977 | 192,677 |
| | **$ 2,275,939** | **$ 1,745,748** |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **Liabilities:** | | |
| Accounts payable and accrued expenses | $ 25,708 | $ 23,409 |
| Participated interest payable, net of accrued interest receivable of $893,332 and allowance of $676,604 at December 31, 2007 | - | 17,480 |
| Notes payable | 62,209 | 98,469 |
| Preferential cumulative mandatorily redeemable shares of beneficial interest | 1,410,000 | 950,000 |
| | 1,497,917 | 1,089,358 |
| **Shareholders' Equity:** | | |
| Shares of beneficial interest, no par value, 20,000,000 shares authorized, 1,404,232 shares issued and outstanding at December 31, 2008 and 2007 | 1,336,119 | 1,336,119 |
| Accumulated deficit | (558,097) | (679,729) |
| | 778,022 | 656,390 |
| | **$ 2,275,939** | **$ 1,745,748** |

(See Notes to Financial Statements)

## HOLLY MORTGAGE TRUST
## STATEMENT OF OPERATIONS
## For the Years Ended December 31, 2008 and 2007

| | 2008 | 2007 |
|---|---|---|
| **Revenue:** | | |
| Interest income | $ 263,173 | $ 411,775 |
| Other income | 62,723 | 198,184 |
| | 325,896 | 609,959 |
| **Costs and Expenses:** | | |
| General and administrative | 104,116 | 120,718 |
| Interest expense | 100,148 | 105,087 |
| | 204,264 | 225,805 |
| Net income | **$ 121,632** | **$ 384,154** |
| Weighted average shares outstanding | **1,404,232** | **1,404,232** |
| Net income per share, basic and diluted | **$ 0.09** | **$ 0.27** |

(See Notes to Financial Statements)

# HOLLY MORTGAGE TRUST
## STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
### For the Years Ended December 31, 2008 and 2007

| | Shares of Beneficial Interest | | Accumulated | Shareholders' |
|---|---|---|---|---|
| | Number | Amount | Deficit | Equity |
| **Balance,** December 31, 2006 | 1,404,232 | $ 1,336,119 | $ (1,063,883) | $ 272,236 |
| Net income | - | - | 384,154 | 384,154 |
| **Balance,** December 31, 2007 | 1,404,232 | 1,336,119 | (679,729) | 656,390 |
| Net income | - | - | 121,632 | 121,632 |
| **Balance,** December 31, 2008 | **1,404,232** | **$ 1,336,119** | **$ (558,097)** | **$ 778,022** |

(See Notes to Financial Statements)

**HOLLY MORTGAGE TRUST**
**STATEMENT OF CASH FLOWS**
**For the Years Ended December 31, 2008 and 2007**

| | 2008 | 2007 |
|---|---|---|
| **Cash Flows from Operating Activities:** | | |
| Net income | $ 121,632 | $ 384,154 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Amortization of loan discounts | - | (11,816) |
| Bad debt recovery | (60,000) | (189,675) |
| Changes in operating assets and liabilities: | | |
| Accrued interest receivable, net | (169,998) | (356,057) |
| Prepaid expenses | - | 7,922 |
| Accounts payable and accrued expenses | 2,299 | (39,745) |
| Total adjustments | (227,699) | (589,371) |
| Net cash used in operating activities | (106,067) | (205,217) |
| **Cash Flows from Investing Activities:** | | |
| Mortgage notes originated | - | (4,400,000) |
| Mortgage note participations sold | - | 3,465,500 |
| Principal collected (disbursed) on mortgage notes receivable, net of participation | (139,976) | 391,384 |
| Collection on (advance to) affiliate, net | (136,061) | 23,360 |
| Return of investment in affiliate | 79,700 | 210,000 |
| Redemption of certificate of deposit | - | 403,264 |
| Net cash provided by (used in) investing activities | (196,337) | 93,508 |
| **Cash Flows from Financing Activities:** | | |
| Issuance of preferential shares | 460,000 | - |
| Proceeds from note payable | - | 530,000 |
| Payments on notes payable | (36,260) | (458,798) |
| Net cash provided by financing activities | 423,740 | 71,202 |
| Net increase (decrease) in cash and and cash equivalents | 121,336 | (40,507) |
| **Cash and Cash Equivalents**, beginning of year | 18,032 | 58,539 |
| **Cash and Cash Equivalents**, end of year | **$ 139,368** | **$ 18,032** |

(See Notes to Financial Statements)

# HOLLY MORTGAGE TRUST
## STATEMENT OF CASH FLOWS (CONTINUED)
## For the Years Ended December 31, 2008 and 2007

| | 2008 | 2007 |
|---|---|---|
| **Supplemental Information:** | | |
| Cash paid for interest | $ 100,148 | $ 105,087 |
| **Non-Cash Investing and Financing Activities:** | | |
| Mortgage note received as payment for accrued interest | | $ 385,500 |

(See Notes to Financial Statements)

**HOLLY MORTGAGE TRUST**
**NOTES TO FINANCIAL STATEMENTS**
**December 31, 2008**

## NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

### Nature of Organization

Holly Mortgage Trust (the "Trust") was organized as a Massachusetts business trust on January 2, 1998. The Trust reorganized as a Texas real estate investment trust in 2008. The Trust has a termination date of December 31, 2030. The Trust is engaged primarily in the business of investing in second mortgages and equity participation mortgages. First Commonwealth Holdings Corporation ("FCHC"), whose principal shareholder is a trust manager and shareholder of the Trust, is the Trust's compensated manager.

### Cash and Cash Equivalents

The Trust considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

The Trust maintains cash balances in a bank that at times, exceeds federal insured limits. The Trust monitors the financial condition of the bank and has experienced no losses associated with this account.

### Mortgage Notes Receivable

Mortgage notes receivable are carried at unpaid principal balances since generally it is management's intention to hold mortgage notes to maturity. Commitment and origination fees collected from prospective borrowers are deferred and recognized as income using a method approximating the interest method over the life of those loans.

A loan is considered impaired when it is probable that the scheduled principal or interest will not be collected when due. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or collateral fair value, if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, an impairment loss is recognized through a valuation allowance and a corresponding charge to income.

### Allowance for Losses

The allowance for losses is based on management's estimate of the amount required to maintain an allowance adequate to reflect the risks inherent in the loan portfolio after giving consideration to existing economic conditions, loss experience in relation to outstanding loans, changes in the loan portfolio, borrowers' performance in reducing loan principal, adequacy of loan collateral, and other relevant factors.

# HOLLY MORTGAGE TRUST
# NOTES TO FINANCIAL STATEMENTS (CONTINUED)
# December 31, 2008

## NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Interest Income

Interest income on loans is accrued based upon the principal amount outstanding.

If a loan is placed on nonaccrual status, interest previously recognized but uncollected is reversed and charged against current income. Subsequent interest collected on such a loan is credited to principal if, in the opinion of management, collectibility of principal is doubtful; otherwise, the interest collected is recognized as revenue.

### Net Income per Share

Net income per share is calculated by dividing net income by the weighted average number of shares of beneficial interest outstanding during the year. Earnings per share, both basic and diluted, are the same.

### Concentrations of Credit Risk

The Trust's primary business activity is investing in loans collateralized by mortgages on real estate. These loans are principally collateralized by real estate in Texas, Florida, and California.

### Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and 1iabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include the value of collateral and, therefore, the resulting allowance for losses. Actual results could differ from those estimates. Management believes that these estimates and assumptions provide a reasonable basis for the fair presentation of the financial statements.

## NOTE 2 - MORTGAGE NOTES RECEIVABLE AND COMMITMENTS

Notes receivable from funding mortgage loans are principally collateralized by second mortgage loans on commercial or residential property and are due at various dates, with the latest maturity due in October 2009. Notes receivable bear interest at rates generally ranging from prime (3.25% at December 31, 2008) to 18%.

There were no commitments to lend additional funds at December 31, 2008.

## NOTE 3 - NOTES PAYABLE

Notes payable at December 31, 2008 and 2007 consist of the following:

| | 2008 | 2007 |
|---|---|---|
| Unsecured note payable to an individual, bearing interest at 8%, principal and interest due monthly; due on demand | $12,209 | $48,469 |
| Unsecured note payable to an individual, bearing interest at 8%, interest due monthly; due on demand or at maturity in January 2010 | 50,000 | 50,000 |
| | $62,209 | $98,469 |

## NOTE 4 - FEDERAL INCOME TAXES

The Trust operates in such a manner to qualify as a "real estate investment trust" under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder. Under those sections, the Trust will not be taxed on that portion of its qualifying income distributed to shareholders so long as at least 90% of the Trust's otherwise taxable income is distributed to shareholders each year and other requirements of a qualified real estate investment trust are met. The Trust satisfied the income distribution requirements for the years ending December 31, 2008 and 2007. Management believes that all other requirements of a qualified real estate investment trust have been met. For tax purposes, interest on the mandatorily redeemable shares of beneficial interest is treated as dividends.

The tax status of per-share dividend distributions declared attributable to the years presented is as follows:

| | 2008 | 2007 |
|---|---|---|
| Return of capital | 100% | 100% |

The Trust has elected to defer FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48") to annual financial statements for fiscal years beginning after December 15, 2008 in accordance with FASB Staff Position FIN 48-3, *Effective Date of Interpretation No. 48 for Certain Nonpublic Enterprises* ("FSP FIN 48-3").

Uncertain tax positions are evaluated in accordance with FASB Statement No. 5, *Accounting for Contingencies* ("FAS 5"). FAS 5 requires the Trust to record a liability for an estimated contingent loss if the information available indicates that it is probable that there is a tax liability incurred at the date of the financial statements, and the amount of the tax liability can be reasonably estimated.

The Trust is evaluating the impact of FIN 48 on its financial statements.

## NOTE 5 - PREFERENTIAL SHARES OF BENEFICIAL INTEREST

Except for the rights and preferences in payment of dividends and in liquidations, the Preferential Shares of Beneficial Interest ("Preferential Shares") have the same voting and other rights as the Shares of Beneficial Interest ("Common Shares"). The Preferential Shares issued in 2004 are entitled to receive cumulative preferential dividends at the annual rate of nine cents ($0.09) per share before any dividends are paid on the Common Shares. The Preferential Shares issued in 2008 are entitled to receive cumulative preferential dividends at the annual rate of eight cents ($0.08) per share before any dividends are paid on the Common Shares.

In the event of liquidation of the Trust, the assets available for distribution will be distributed first to the holders of the Preferential Shares up to one dollar ($1) per share plus any deferred dividends, then second to the holders of Common Shares up to one dollar ($1) per share and then equally on all of the shares of Preferential and Common Shares.

The Preferential Shares issued in 2004 are subject to redemption at any time after January 1, 2009 upon not less than thirty days' prior written notice, in whole or in part, at the election of the Trust at the redemption price of one dollar ($1) per share plus all unpaid dividends accrued to the redemption date. Any Preferential Shares issued in 2004 that are outstanding on September 30, 2014 will be redeemed on that date.

The Preferential Shares issued in 2008 are subject to redemption at any time after January 1, 2012 upon not less than thirty days' prior written notice, in whole or in part, at the election of the Trust at the redemption price of one dollar ($1) per share plus all unpaid dividends accrued to the redemption date. Any Preferential Shares issued in 2008 that are outstanding on September 30, 2019 will be redeemed on that date.

During 2003, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 150 ("FAS 150"), *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. This statement requires an issuer to classify a financial instrument issued in the form of shares that is mandatorily redeemable and embodies an unconditional obligation to redeem it by transferring its assets at a specified or determinable date or upon an event that is certain to occur as liabilities. The Trust has adopted these provisions in its financial statements and has included mandatorily redeemable preferred shares in liabilities on the accompanying balance sheet and dividends on the mandatorily redeemable preferred shares as interest expense in the accompanying statement of operations.

## NOTE 6 - MANAGEMENT AGREEMENT AND RELATED PARTY TRANSACTIONS

Management fees paid to FCHC were approximately $31,000 and $41,000 for the years ended December 31, 2008 and 2007, respectively. The management fee is based on the greater of $50,000 or 1.4% of the book value of the assets of the Trust at the end of each fiscal year less accounting and certain board member fees. In 2008, FCHC received fees for management services to Heights of Tampa, LLC, which was a borrower from the Trust. Some of those fees were voluntarily credited by FCHC against the management fee otherwise payable by the Trust to avoid FCHC being compensated twice. The voluntary credit to the Trust in 2008 totaled $9,660.

## NOTE 6 - MANAGEMENT AGREEMENT AND RELATED PARTY TRANSACTIONS (CONTINUED)

At December 31, 2008 and 2007, the Trust had advanced $249,701 and $113,640, respectively, to Wilco Building Partners, Ltd. (See Note 8.)

At December 31, 2008 and 2007, the Trust also had a mortgage note receivable due from Wilco Building Partners, Ltd. of $105,980, which is included in mortgage notes receivable on the balance sheet.

At December 31, 2008, the Trust had one outstanding mortgage note receivable with an affiliated business trust for $920,000, net of $3,080,000 participation payables, and is included in mortgage notes receivable, net on the balance sheet. The note receivable incurs interest at 18% and is due on demand. Interest income on the mortgage note receivable amounted to approximately $196,400, net of $523,600 interest expense for the year ended December 31, 2008.

During the year 2007, the Trust engaged in three mortgage participation payables with an affiliated business trust. At December 31, 2007, the Trust had two outstanding mortgage participation payables that totaled $735,500 and is included in mortgage notes receivable, net on the balance sheet. The participations incur interest at rates ranging from 8% to 11% and maturity dates ranging from January 30, 2008 to July 31, 2010. Interest expense on such participations amounted to approximately $28,000 for the year ended December 31, 2007.

## NOTE 7 - SIGNIFICANT MORTGAGE NOTES RECEIVABLE

At December 31, 2008, one mortgage note receivable represented approximately 80% of total mortgage notes receivable and related participations payable represented approximately 97% of total participations payable. Interest related to this note and one other note was approximately 75% of total interest income for the year ended December 31, 2008.

At December 31, 2007, one mortgage note receivable represented approximately 71% of total mortgage notes receivable and related participations payable represented approximately 75% of total participations payable. Interest related to this note and one other note was approximately 74% of total interest income for the year ended December 31, 2007.

## NOTE 8 - INVESTMENT IN AFFILIATES

The Trust owns 100% of the common stock of A. R. Goldrick Company, Inc. (a C corporation) (A. R. Goldrick). A. R. Goldrick is the general partner of Wilco Building Partners, Ltd., a limited partnership which owns and operates an office building in Midland, Texas. The financial statements of A. R. Goldrick have not been consolidated with those of the Trust. The investment in A. R. Goldrick is accounted for using the cost method of accounting. In 2008 and 2007, the Trust received a return of capital of $79,700 and $210,000, respectively, from A. R. Goldrick. The investment at December 31, 2008 is secured by notes receivable totaling $210,000. At December 31, 2008 and 2007, the cost of the investment was $59,499 and $139,199, respectively.

**NOTE 8 - INVESTMENT IN AFFILIATES (CONTINUED)**

The Trust owns 50 partnership units of Global REIT, L.P. The Trust accounts for this investment using the cost method of accounting. The cost of this investment was $53,478 at December 31, 2008 and 2007.

Investments with an aggregate cost of $112,977 and $192,677 at December 31, 2008 and 2007, respectively, were not evaluated for impairment because (a) the Trust did not estimate the fair value of those investments in accordance with Financial Accounting Standards Board Standard No. 107, *Disclosure about Fair Value of Financial Instruments*, and (b) the Trust did not identify any events or changes in circumstances that may have had a significant adverse effect on the fair value of those investments.

## TRANSFER AGENT

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