

# **Holloway Lodging Real Estate Investment Trust**

Consolidated Financial Statements

**June 30, 2006**

(Unaudited – Prepared by Management)

In accordance with National Instrument 51-102, released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited financial statements for the period ended June 30, 2006.

# Holloway Lodging Real Estate Investment Trust

Consolidated Balance Sheet

As at June 30, 2006

(Unaudited – Prepared by Management)

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	June 30, 2006 \$	December 31, 2005 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash	427,224	300,000
Accounts receivable	86,768	-
Inventories	23,610	-
Prepaid expenses and deposits	212,247	-
	<hr/> 749,849	<hr/> 300,000
<b>Property and equipment</b> (note 4)	4,589,332	-
<b>Other assets</b> (note 5)	42,938	-
	<hr/> 5,382,119	<hr/> 300,000
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	464,798	-
Current portion of mortgage payable (note 6)	94,640	-
	<hr/> 559,438	<hr/> -
<b>Mortgage payable</b> (note 6)	2,605,360	-
	<hr/> 3,164,798	<hr/> -
<b>Unitholders' equity</b> (note 7)	2,217,321	300,000
	<hr/> 5,382,119	<hr/> 300,000

# Holloway Lodging Real Estate Investment Trust

Consolidated Statement of Unitholders' Equity

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

	For the three-month period ended June 30, 2006 \$	For the six-month period ended June 30, 2006 \$
<b>Share capital</b> (note 7)	1,152,209	1,152,209
<b>Elimination on reorganization</b> (note 7)	(1,152,209)	(1,152,209)
	-	-
<b>Trust units</b>		
Creation of trust	10	10
Units issued in exchange for shares (note 7)	1,152,209	1,152,209
Units issued by private placement (note 7)	860,000	860,000
Cost of raising capital	(86,622)	(86,622)
	1,925,597	1,925,597
<b>Class B Limited Partnership units</b>		
Units issued in property acquisition (note 3 and note 7)	920,000	920,000
<b>Contributed surplus</b> (note 7 )	80,000	80,000
<b>Deficit – Beginning period</b>	(90,221)	-
Net loss	(618,055)	(708,276)
<b>Deficit – End of period</b>	(708,276)	(708,276)
<b>Unitholders' equity – End of period</b>	2,217,321	2,217,321

# Holloway Lodging Real Estate Investment Trust

Consolidated Statement of Loss

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

	For the three-month period ended June 30, 2006 \$	For the six-month period ended June 30, 2006 \$
<b>Hotel revenues</b>		
Rooms	87,243	87,243
Other	1,676	1,676
	<u>88,919</u>	<u>88,919</u>
<b>Hotel cost of sales</b>	16,206	16,206
<b>Hotel gross profit</b>	<u>72,713</u>	<u>72,713</u>
<b>Hotel operating expenses</b>		
Sales and marketing	3,604	3,604
General and administrative	5,167	5,167
Maintenance, property taxes and insurance	9,966	9,966
Management and other fees	9,097	9,097
Depreciation and amortization	12,570	12,570
Interest on mortgages and bank charges	12,035	12,035
	<u>52,439</u>	<u>52,439</u>
<b>Income from hotel operations</b>	<u>20,274</u>	<u>20,274</u>
<b>Other expenses</b>		
Trust general and administrative expenses	83,647	92,793
Trust professional fees	135,242	136,317
Stock based compensation	-	80,000
Reorganization expenses	419,440	419,440
	<u>638,329</u>	<u>728,550</u>
<b>Net loss for the period</b>	<u>(618,055)</u>	<u>(708,276)</u>
<b>Basic and fully diluted loss per unit</b> (note 7)	(0.34)	(0.49)

# Holloway Lodging Real Estate Investment Trust

Consolidated Statement of Cash Flows

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

	For the three-month period ended June 30, 2006 \$	For the six-month period ended June 30, 2006 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net loss for the period	(618,055)	(708,276)
Charges to income not involving cash		
Stock-based compensation	-	80,000
Depreciation and amortization	12,229	12,229
Amortization of other assets	341	341
	<u>(605,485)</u>	<u>(615,706)</u>
Net change in non-cash working capital balances related to operations	<u>204,365</u>	<u>142,173</u>
<b>Cash flow used in operating activities</b>	<u>(401,120)</u>	<u>(473,533)</u>
<b>Investing activities</b>		
Acquisition of property and equipment	(4,601,561)	(4,601,561)
Increase in other assets	(43,279)	(43,279)
<b>Cash flow used in investing activities</b>	<u>(4,644,840)</u>	<u>(4,644,840)</u>
<b>Financing activities</b>		
Receipt of mortgage payable	2,700,000	2,700,000
Issuance of common shares of HCC, net of share issue costs, subsequently converted to units	(2,942)	852,209
Issuance of units through private placement	860,000	860,000
Issuance of Class B Limited Partnership units	920,000	920,000
Creation of trust	10	10
Cost of raising capital	(86,622)	(86,622)
<b>Cash flow from financing activities</b>	<u>4,390,446</u>	<u>5,245,597</u>
<b>Net change in cash and cash equivalents during the period</b>	(655,514)	127,224
<b>Cash – Beginning of period</b>	<u>1,082,738</u>	<u>300,000</u>
<b>Cash – End of period</b>	<u>427,224</u>	<u>427,224</u>

# Holloway Lodging Real Estate Investment Trust

Notes to the Consolidated Financial Statements

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

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## 1 Basis of presentation and corporate reorganization

Holloway Lodging Real Estate Investment Trust (“Holloway Lodging REIT” or the “REIT”) is an open-ended real estate investment trust that was formed under the laws of the Province of Ontario pursuant to the Declaration of Trust on March 28, 2006. On April 3, 2006, Holloway Lodging REIT entered into an Arrangement Agreement with Holloway Capital Corporation (“HCC”), a capital pool company listed on the TSX Venture Exchange, in connection with its proposed qualifying transaction. The plan of arrangement and qualifying transaction involved three primary components:

- i) the reorganization of HCC into Holloway Lodging REIT by way of a plan of arrangement;
- ii) a private placement of trust units of Holloway Lodging REIT for gross proceeds to the REIT of \$860,000 at a price of \$2.00 per unit, after giving effect to the exchange of shares of HCC for units pursuant to the plan of arrangement on a one unit for five shares basis; and
- iii) the acquisition by Holloway Lodging REIT, through an indirectly wholly-owned limited partnership named Holloway Lodging Limited Partnership (“Holloway Lodging LP”), of a 50 room, three storey “Super 8” branded hotel in Truro, Nova Scotia from Truro Motel 8 Partnership, the vendor for a purchase price of \$4.6 million.

On June 7, 2006, the plan of arrangement and qualifying transaction were completed. All of the issued and outstanding shares of HCC were transferred to the REIT in exchange for units based on the exchange ratio of one unit for five shares. All of the outstanding options to purchase shares of HCC were exchanged for unit options having identical terms, subject to adjustment of the number of units underlying the unit options and the exercise price of the unit options based on the exchange ratio of one unit for five shares.

The arrangement involving conversion to the REIT has been accounted for as a continuity of interests. Accordingly, these consolidated financial statements reflect the financial position, results of operations and cash flows as if the REIT had always carried on the business formerly carried on by HCC. All assets and liabilities are recorded at historical cost.

The objectives of the REIT are: (a) to generate stable cash distributions on a tax efficient basis; (b) to expand its asset base and increase its funds from operations through accretive acquisitions and internal growth initiatives; and (c) to enhance the value of its assets to maximize long-term unit value through active management of its assets.

## 2 Significant accounting policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following policies:

### a) Consolidation

The consolidated financial statements include the accounts of the REIT and its wholly-owned subsidiaries, Holloway Lodging Limited Partnership, HL Trust, HL General Partner Inc. and HL REIT (85 Treaty Trail) Inc. Any reference to the “REIT” throughout these consolidated financial statements refers to the REIT and its subsidiaries. All transactions between the REIT and its subsidiaries have been eliminated.

# Holloway Lodging Real Estate Investment Trust

Notes to the Consolidated Financial Statements

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

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## 2 Significant accounting policies (con't)

### b) Inventories

Inventories consist of linen, food, beverages and other supplies. Inventories are valued at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis.

### c) Property and equipment

Property and equipment, including land, building, furniture, fixtures and equipment, are stated at cost less accumulated depreciation or estimated net recoverable amount, adjusted for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

Depreciation is provided on a straight-line basis at rates designed to write-off the assets over their estimated economic lives as follows:

Buildings	40 years
Furniture, fixtures and equipment	7 years
Paving	10 years
Signage	10 years
Landscaping	5 years
Computer equipment	3 years
Land lease	Term of the lease

### d) Other assets

Other assets include deferred financing fees and franchise fees. Deferred financing fees are amortized on a straight-line basis over the term of the related debt and the amortization is included in depreciation and amortization in these consolidated financial statements. Franchise fees are amortized on a straight-line basis over the term of the franchise agreement and the amortization is included in depreciation and amortization in these consolidated financial statements.

### e) Revenue recognition

Revenues are generated primarily from room occupancy and food and beverage services. Revenues are recognized when the services are provided and collection is reasonably assured.

### f) Income taxes

Holloway Lodging REIT is taxed as a mutual fund trust for income tax purposes. Pursuant to the Declaration of Trust, the trustees of Holloway Lodging REIT will make distributions or designate all taxable income earned by Holloway Lodging REIT to unitholders. The unitholders will include or deduct, as appropriate, such distributions and designations for income tax purposes. Accordingly, it is expected that Holloway Lodging REIT will not be subject to income taxes and no provision for income taxes under the liability method of accounting for income taxes is required.

# Holloway Lodging Real Estate Investment Trust

Notes to the Consolidated Financial Statements

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

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## 2 Significant accounting policies (con't)

### g) Earnings (loss) per unit

Basic earnings (loss) per unit is computed by dividing net earnings (loss) by the weighted average number of units outstanding during the reporting period. Diluted earnings (loss) per unit is calculated based on the weighted average number of units outstanding during the period, plus the effect of dilutive unit equivalents such as options and warrants. The diluted per unit amounts are calculated using the treasury stock method, as if all the unit equivalents where average market process exceeds issue price and had been exercised at the beginning of the reporting period, or the period of issue, as the case may be, and that the funds obtained thereby were used to purchase units of the REIT at the average trading price of the units during the period.

### h) Unit-based compensation

The REIT accounts for unit options issued under its unit option plan using the fair value method. Under this method, compensation expense is measured at fair value at the grant date using the Black-Scholes option pricing model and is recognized over the vesting period. Option pricing models require the input of highly subjective assumptions including the expected volatility. Changes in the assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the REIT's unit options.

### i) Management estimates

The presentation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

## 3 Acquisition of initial property

Effective June 7, 2006, upon completion of the Qualifying Transaction, Holloway Lodging REIT purchased the Super 8 Motel in Truro, Nova Scotia. The acquisition has been recorded at the exchange amount, which is the amount of consideration negotiated between the parties. The assets acquired were as follows:

	\$
Land lease	500,000
Building	3,435,421
Furniture, fixtures and equipment	450,000
Paving	135,000
Signage	30,000
Computer equipment	2,586
Franchise fee	25,058
Working capital	21,935
	<hr/>
	4,600,000
	<hr/>

# Holloway Lodging Real Estate Investment Trust

Notes to the Consolidated Financial Statements

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

## 3 Acquisition of initial property (con't)

The purchase was financed as follows:

	\$
Cash	980,000
Mortgage payable (note 6)	2,700,000
Class B units of Holloway Lodging Limited Partnership	920,000
	<u>4,600,000</u>

## 4 Property and equipment

	June 30, 2006 \$	December 31, 2005 \$		
	Cost \$	Accumulated amortization \$	Net \$	Net \$
Land lease	500,000	780	499,220	-
Building	3,439,540	6,006	3,433,534	-
Furniture, fixtures and equipment	450,000	4,286	445,714	-
Paving	135,000	900	134,100	-
Signage	30,000	200	29,800	-
Computer equipment	47,021	57	46,964	-
	<u>4,601,561</u>	<u>12,229</u>	<u>4,589,332</u>	<u>-</u>

\$12,000 has been credited to building for a building condition allowance on closing and \$16,118 has been capitalized to building for appraisal and other professional fees related to the acquisition of the hotel.

## 5 Other assets

	June 30, 2006 \$	December 31, 2005 \$		
	Cost \$	Accumulated amortization \$	Net \$	Net \$
Deferred financing costs	18,221	243	17,978	-
Franchise fees	25,058	98	24,960	-
	<u>43,279</u>	<u>341</u>	<u>42,938</u>	<u>-</u>

# Holloway Lodging Real Estate Investment Trust

Notes to the Consolidated Financial Statements

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

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## 6 Mortgage payable

	June 30, 2006 \$	December 31, 2005 \$
Mortgage payable to Peace Hills Trust Company, bearing interest at 6.75% per annum, repayable in monthly payment of \$22,141 due June 7, 2011, secured by:	2,700,000	-
<ul style="list-style-type: none"><li>• First ranking mortgage of leasehold interest over the property;</li><li>• Consent to a mortgage of lease by Indian and Northern Affairs Canada supported by Band Council Resolution of the Millbrook First Nation;</li><li>• First ranking general security agreement over all fixed and floating assets;</li><li>• Assignment of leases and rentals;</li><li>• Demand promissory note in the amount of \$2.7 million; and</li><li>• Assignment of insurance with Peace Hills Trust Company recorded as first loss payee.</li></ul>		
Less current portion	94,640	-
	<u>2,605,360</u>	<u>-</u>

Estimated future principal repayments over the next five years are as follows:

	\$
Remainder of 2006	31,124
2007	91,837
2008	97,659
2009	104,844
2010	112,039
Thereafter	2,262,497
	<u>2,700,000</u>

# Holloway Lodging Real Estate Investment Trust

Notes to the Consolidated Financial Statements

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

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## 7 Unitholders' equity

The REIT is authorized to issue an unlimited number of units ("REIT units") for the consideration of, and on the terms and conditions determined by, the Declaration of Trust. Each REIT unit is transferable and represents an equal undivided beneficial interest in any distribution from the REIT. All REIT units are of the same class and have equal rights and privileges.

### Reorganization of Holloway Capital Corporation

Pursuant to the qualifying transaction and plan of arrangement completed on June 7, 2006, the common shares of Holloway Capital Corporation with a carrying value of \$1,152,209 were exchanged for units of Holloway Lodging REIT on the basis of one unit in Holloway Lodging REIT for every five common shares of Holloway Capital Corporation resulting in issuance of 1,600,000 units to current shareholders of Holloway Capital Corporation. The arrangement involving conversion to the REIT has been accounted for as a continuity of interests.

### Private placement

On June 7, 2006, under a private placement, 430,000 units were issued for cash consideration of \$860,000.

### Class B limited partnership units

On June 7, 2006, as a result of the acquisition of the Truro Super 8 motel, Holloway Lodging Limited Partnership issued 460,000 Class B Limited Partnership units (exchangeable LP units) with a value of \$920,000. The exchangeable LP units are exchangeable for units of the REIT on a one-for-one basis pursuant to an exchange agreement entered into between the REIT, Holloway Lodging LP and Truro Motel 8 Partnership, the vendor. The REIT also issued special voting units to the holders of the exchangeable LP units such that the holders of the exchangeable LP units hold the economic and voting equivalent of the REIT units.

### Unit options

Holloway Lodging REIT has a unit option plan under which officers and directors are eligible to receive unit options. During the period ended March 31, 2006, HCC granted 800,000 options at an exercise price of \$0.20 per share expiring on February 17, 2011. These options are exercisable upon granting. As a result of the plan of arrangement, these units to purchase shares of HCC were exchanged for unit options of the REIT having identical terms, subject to adjustment of the number of units underlying the unit options and the exercise price of the unit options based on the exchange ratio of one unit for five shares. After reflecting the exchange, there are 160,000 options outstanding with an exercise price of \$1.00. The total number of units reserved under option for issuance may not exceed 10% of the units outstanding.

The compensation expense for the options issued was determined based on the fair value of the options at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

Expected option life	2 years
Risk-free interest rate	3.5%
Dividend yield	—

# Holloway Lodging Real Estate Investment Trust

Notes to the Consolidated Financial Statements

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

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Expected volatility 90%

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## 7 Unitholders' equity (con't)

### Number of units outstanding

The basic and fully diluted number of units outstanding as at June 30, 2006 was 2,490,000 and 2,650,000, respectively (March 31, 2006 – basic 1,600,000; fully diluted 1,760,000).

### Weighted average number of units

The weighted average number of units outstanding for the three months ended June 30, 2006 was 1,834,725; fully diluted 1,994,725 (six months ended June 30, 2006 – 1,458,343; fully diluted 1,576,796).

## 8 Agreements

### Hotel Management Agreement

On June 7, 2006, Holloway Lodging REIT entered into a long-term management agreement with Pacrim Hospitality Services Inc. ("PHSI") to manage the hotels purchased by the REIT, with an initial term of ten years and an automatic renewal for successive five year terms commencing on the last day of the initial term. PHSI is entitled to a base management fee of 3% of gross hotel revenues, an incentive fee commencing January 1, 2007, a purchasing fee of 4% of the cost of exceptional operating supplies and furniture, fixtures and equipment, a construction fee of 3% of the cost of construction materials, labour and equipment in connection with any construction or capital expenditures and an accounting fee ranging from \$15,000 to \$24,000 per year depending on the size of the hotel when accounting services are provided by PHSI. In addition, Intergy, a division of PHSI provides central reservation services for the hotels purchased by the REIT. A commission of 10% is paid on reservations made through Intergy.

### Franchise Agreement

On purchasing the Super 8 motel in Truro, Nova Scotia the franchise agreement with Super 8 Motels Inc., the franchisor, was transferred to the REIT. Under the terms of this agreement, a royalty fee of 5% and a marketing assessment fee of 3% of gross room revenue is payable to the franchisor.

### Development Agreement

On June 7, 2006, Holloway Lodging REIT entered into a long-term development agreement with Winport Developments Inc. ("Winport") to provide mezzanine financing to Winport and to have the option to purchase properties developed by Winport. The agreement has an initial term of ten years with an automatic renewal for five year terms thereafter.

# **Holloway Lodging Real Estate Investment Trust**

Notes to the Consolidated Financial Statements

**For the period ended June 30, 2006**

(Unaudited – Prepared by Management)

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# Holloway Lodging Real Estate Investment Trust

Notes to the Consolidated Financial Statements

For the period ended June 30, 2006

(Unaudited – Prepared by Management)

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## 9 Related party transactions

During the normal course of business, Holloway Lodging REIT had the following related party transactions and balances recorded at their exchange value:

	<b>June 30, 2006</b>
	<b>\$</b>
Accounts payable and accrued liabilities to Pacrim Hospitality Services Inc.	4,223
Management and accounting fees expense from Pacrim Hospitality Services Inc. included in management and other fees	3,268
Reservation fees expense to Intergy included in sales and marketing expense	555

## 10 Contingent liabilities

The Declaration of Trust provides that the Trustees will act honestly and in good faith with a view to the best interests of the REIT and in connection with that duty will exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The Declaration of Trust provides that each Trustee will be entitled to indemnification from the REIT in respect of the exercise of the Trustee's power and the discharge of the Trustee's duties, provided that the Trustee acted honestly and in good faith with a view to the best interests of all unitholders, or in the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, where the Trustee had reasonable grounds for believing that his/her conduct was lawful. The REIT has entered into indemnification agreements with its trustees and officers. The REIT has purchased trustees' and officers' liability insurance. No claims with respect to such occurrences have been made and, as such, no amount has been recorded in this balance sheet with respect to these indemnifications.

## 11 Financial instruments

### Fair values

The fair values of accounts receivable, accounts payable and accrued liabilities approximate their carrying values due to the relatively short periods to maturity of these instruments.

The fair value of the mortgage payable approximates its carrying value due to the recent date of obtaining this financing.

### Credit risk

The REIT is exposed to credit risk through accounts receivable. The REIT assesses its credit risk on a regular basis and does not anticipate significant credit losses.

# Holloway Lodging Real Estate Investment Trust

Notes to the Consolidated Financial Statements

**For the period ended June 30, 2006**

(Unaudited – Prepared by Management)

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## 12 Subsequent events

On August 1, 2006, the REIT completed a private placement of 9,965,377 REIT Units at \$4.50 per unit and \$20,238,000 in subordinated convertible debentures. In connection with property acquisitions to be closed in late August and early September, the REIT also issued 1,666,000 REIT Units at \$4.50 per unit. Total securities issued from these transactions were approximately \$72.5 million.

On August 2, 2006, the REIT purchased four hotel properties for \$31,700,000. The REIT acquired two Holiday Inn Express hotels located in Halifax, Nova Scotia and Moncton, New Brunswick, the Radisson Suite Hotel in Halifax and the Super 8 Motel in Drayton Valley, Alberta.

On August 21, 2006, the REIT declared a distribution of \$0.0375 per unit will be paid on September 15, 2006 to unitholders of record on August 31, 2006.

On August 23, 2006, the REIT purchased the 5 Calgary Downtown Suites and Spa Hotel in Calgary, Alberta for \$29.5 million.