

# **Holloway Lodging Real Estate Investment Trust**

Unaudited Consolidated Financial Statements  
**September 30, 2006**

# Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Balance Sheet

As at September 30, 2006

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	September 30, 2006 \$	December 31, 2005 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash	5,961,730	300,000
Accounts receivable	1,116,496	-
Inventories	386,612	-
Prepaid expenses and deposits	1,047,578	-
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	8,512,416	300,000
<b>Capital reserve</b>	1,685,262	
<b>Property and equipment</b> (note 4)	90,497,374	-
<b>Other assets</b> (note 5)	1,256,631	-
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	101,951,683	300,000
	<hr/>	
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	4,439,782	-
Distributions payable	530,802	-
Accrued interest on convertible debentures	269,840	-
Current portion of obligations under capital leases (note 6)	96,250	-
Current portion of mortgages payable (note 7)	1,040,520	-
	<hr/>	
	6,377,194	-
<b>Obligations under capital leases</b> (note 6)	125,251	-
<b>Mortgages payable</b> (note 7)	24,410,435	-
<b>Convertible debentures</b> (note 8)	15,114,667	-
	<hr/>	
	46,027,547	-
<b>Unitholders' equity</b> (note 9)	55,924,136	300,000
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	101,951,683	300,000
	<hr/>	
<b>Commitments</b> (note 12)		

# Holloway Lodging Real Estate Investment Trust

## Unaudited Consolidated Statement of Unitholders' Equity

For the period ended September 30, 2006

	Share capital \$	Units \$	Class B LP units \$	Contributed surplus \$	Equity component of convertible debentures \$	Net income \$	Distributions \$	Total \$
Balance, December 31, 2005	300,000	-	-	-	-	-	-	300,000
Initial public offering, net of issuance costs	852,209	-	-	-	-	-	-	852,209
Issuance of options	-	-	-	80,000	-	-	-	80,000
Units issued in exchange for shares	(1,152,209)	1,152,209	-	-	-	-	-	-
Creation of trust	-	10	-	-	-	-	-	10
Units issued by private placement, net of issuance costs	-	41,972,615	-	-	-	-	-	41,972,615
Units issued in property acquisitions	-	7,497,000	920,000	-	-	-	-	8,417,000
Equity component of convertible debentures	-	-	-	-	5,300,000	-	-	5,300,000
Net income	-	-	-	-	-	63,905	-	63,905
Distributions	-	-	-	-	-	-	(1,061,603)	(1,061,603)
Balance, September 30, 2006	-	50,621,834	920,000	80,000	5,300,000	63,905	(1,061,603)	55,924,136

# Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statement of Income

For the period ended September 30, 2006

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	For the three-month period ended September 30, 2006 \$	For the nine-month period ended September 30, 2006 \$
<b>Hotel revenues</b>		
Rooms	5,245,999	5,333,242
Other	1,446,946	1,448,622
	<hr/>	<hr/>
	6,692,945	6,781,864
<b>Hotel cost of sales</b>	2,225,943	2,242,149
	<hr/>	<hr/>
<b>Hotel gross profit</b>	4,467,002	4,539,715
<b>Hotel operating expenses</b>		
Sales and marketing	258,141	261,745
General and administrative	509,396	514,026
Maintenance, property taxes and insurance	737,415	747,381
Management and other fees	410,096	419,193
Depreciation and amortization	441,215	453,542
Land lease expense	324,150	324,930
Interest on mortgages and bank charges	284,040	296,075
	<hr/>	<hr/>
	2,964,453	3,016,892
<b>Income from hotel operations</b>	1,502,549	1,522,823
	<hr/>	<hr/>
<b>Trust expenses</b>		
General and administrative expenses	249,677	478,787
Depreciation	4,307	4,307
Debenture interest	269,840	269,840
Amortization of deferred financing fees	29,877	29,877
Accretion of discount on convertible debentures	176,667	176,667
Stock based compensation	-	80,000
Reorganization expenses	-	419,440
	<hr/>	<hr/>
	730,368	1,458,918
<b>Net income for the period</b>	772,181	63,905
	<hr/>	<hr/>
<b>Basic earnings per unit</b> (note 9)	0.08	0.02
<b>Fully diluted earnings per unit</b> (note 9)	0.06	0.01

# Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statement of Cash Flows

For the period ended September 30, 2006

	For the three-month period ended September 30, 2006 \$	For the nine-month period ended September 30, 2006 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net income for the period	772,181	63,905
Charges to income not involving cash		
Stock-based compensation	-	80,000
Depreciation and amortization	445,522	457,849
Non-cash land lease expense	2,660	3,440
Amortization of deferred financing fees	31,400	31,643
Non-cash reduction in interest expense	(20,425)	(20,425)
Accrued interest on convertible debentures	269,840	269,840
Accretion of discount on convertible debentures	176,667	176,667
	<u>1,677,845</u>	<u>1,062,919</u>
Net change in non-cash working capital balances related to operations (note 10)	<u>2,060,661</u>	<u>2,223,989</u>
<b>Cash flow from operating activities</b>	<u>3,738,506</u>	<u>3,286,908</u>
<b>Investing activities</b>		
Increase in capital reserve	(1,685,262)	(1,685,262)
Acquisition of hotel properties (note 3)	(62,836,115)	(66,516,115)
Increase in other assets	(28,790)	(47,011)
Acquisition of property and equipment	(1,185,636)	(1,234,190)
<b>Cash flow used in investing activities</b>	<u>(65,735,803)</u>	<u>(69,482,578)</u>
<b>Financing activities</b>		
Repayment of capital lease obligations	(13,418)	(13,418)
Proceeds from new mortgages	7,750,000	10,450,000
Repayment of mortgages payable	(110,586)	(110,586)
Issuance of common shares of HCC, net of issuance costs, subsequently converted to units	-	852,209
Creation of trust	-	10
Issuance of units through private placement, net of issuance costs	41,199,237	41,972,615
Issuance of convertible debentures	20,238,000	20,238,000
Deferred financing fees	(1,000,629)	(1,000,629)
Distributions paid to unitholders	(530,801)	(530,801)
<b>Cash flow from financing activities</b>	<u>67,531,803</u>	<u>71,857,400</u>
<b>Net change in cash during the period</b>	<u>5,534,506</u>	<u>5,661,730</u>
<b>Cash – Beginning of period</b>	<u>427,224</u>	<u>300,000</u>
<b>Cash – End of period</b>	<u>5,961,730</u>	<u>5,961,730</u>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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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. HCC had no operations during 2005.

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.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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## 2 Significant accounting policies

The interim 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., HL REIT (85 Treaty Trail) Inc., HL (133 Kearney Lake Road) Inc., HL (1649 Hollis Street) Inc., HL (2515 Mountain Road) Inc., HL (3727 50<sup>th</sup> Street) Inc., HL (308 Old Airport Road) Inc., HL (400 Midpark Way SE) Inc. and HL (618 5<sup>th</sup> Avenue SW) 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.

### 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:

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

### 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.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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## 2 Significant accounting policies (continued)

### e) Leases

Leases are classified as either capital or operating leases. Leases that transfer substantially all of the benefits and inherent risks of ownership of property to the REIT are accounted for as capital leases. At the time a capital lease is entered into or assumed, an asset is recorded together with its related long-term obligation to reflect the acquisition and financing. Equipment recorded under capital leases is amortized on the same basis as described in c). Payments under operating leases are expensed as incurred.

### f) Revenue recognition

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

### g) 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.

### h) Earnings per unit

Basic earnings per unit is computed by dividing net earnings by the weighted average number of units outstanding during the reporting period. Diluted earnings 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 convertible debentures, options and warrants. The diluted per unit amounts are calculated using the treasury stock method, as if all the unit equivalents where average market proceeds 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.

### i) 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.

# Holloway Lodging Real Estate Investment Trust

## Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

### 2 Significant accounting policies (continued)

#### j) 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 Hotel acquisitions

During the nine months ended September 30, 2006, Holloway Lodging REIT acquired eight hotel properties. The acquisitions have been accounted for under the purchase method and accordingly, the results of operations of each of the hotels since the dates of acquisition have been included in the consolidated statement of income. The following table details the acquisitions and how they were financed.

Hotel	Super 8	Holiday Inn Express	Holiday Inn Express	Radisson	Super 8	5 Calgary Downtown	Wingate Inn	Super 8
Location	Truro, NS	Halifax, NS	Moncton, NB	Halifax, NS	Drayton Valley, AB	Calgary, AB	Calgary, AB	Yellowknife, NWT
Date of acquisition	June 7	August 2	August 2	August 2	August 2	August 23	September 1	September 29
		\$	\$	\$	\$	\$	\$	\$
<b>Assets acquired</b>								
Land	500,000	1,000,000	1,300,000	1,500,000	400,000	-	3,000,000	800,000
Building	3,435,421	4,189,065	4,480,949	8,889,596	5,773,584	27,208,500	10,610,935	6,230,612
Furniture, fixtures and equipment	450,000	990,000	1,520,000	1,040,000	382,812	2,200,000	1,030,000	924,000
Paving	135,000	75,000	150,000	20,000	75,000	67,000	400,000	175,000
Signage	30,000	45,000	45,000	45,000	-	-	75,000	70,000
Computer equipment	2,586	8,974	25,104	7,756	23,030	24,000	34,358	2,421
Assets under capital lease	-	51,609	57,104	221,455	-	-	-	-
Franchise fee	25,058	-	117,462	19,877	17,159	-	41,253	23,427
Working capital	21,935	40,352	104,381	56,316	28,415	500	58,454	24,540
	<b>4,600,000</b>	<b>6,400,000</b>	<b>7,800,000</b>	<b>11,800,000</b>	<b>6,700,000</b>	<b>29,500,000</b>	<b>15,250,000</b>	<b>8,250,000</b>
<b>Financed by</b>								
Cash	3,680,000	2,202,910	3,778,039	4,652,166	6,700,000	24,001,000	13,252,000	8,250,000
Mortgages assumed	-	3,775,202	3,947,700	6,409,064	-	-	-	-
Obligations under capital leases assumed	-	51,888	74,261	108,770	-	-	-	-
Difference in fair value and carrying value of mortgage payable	-	370,000	-	630,000	-	-	-	-
Issuance of REIT units	920,000	-	-	-	-	5,499,000	1,998,000	-
	<b>4,600,000</b>	<b>6,400,000</b>	<b>7,800,000</b>	<b>11,800,000</b>	<b>6,700,000</b>	<b>29,500,000</b>	<b>15,250,000</b>	<b>8,250,000</b>

The REIT is continuing to evaluate the fair value of the assets acquired and as a result, the purchase price allocation may be adjusted.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

## 4 Property and equipment

			September 30, 2006	December 31, 2005
	Cost \$	Accumulated amortization \$	Net \$	Net \$
Land	8,246,390	-	8,246,390	-
Land lease	500,000	3,440	496,560	-
Buildings	71,722,709	242,742	71,479,967	-
Furniture, fixtures and equipment	8,746,228	175,268	8,570,960	-
Paving	1,097,500	13,921	1,083,579	-
Signage	324,153	4,061	320,092	-
Computer equipment	318,081	18,255	299,826	-
	90,955,061	457,687	90,497,374	-

## 5 Other assets

			September 30, 2006	December 31, 2005
	Cost \$	Accumulated amortization \$	Net \$	Net \$
Deferred financing fees	1,000,629	31,643	968,986	-
Franchise fees	291,247	3,602	287,645	-
	1,291,876	35,245	1,256,631	-

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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## 6 Obligations under capital leases

The REIT assumed various capital lease obligations to acquire computer equipment, signs and hotel equipment.

	September 30, 2006 \$	December 31, 2005 \$
Present value of future minimum lease payments	221,501	-
Less: Current portion	96,250	-
	<u>125,251</u>	<u>-</u>

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

	\$
Remainder of 2006	37,250
2007	111,854
2008	54,033
2009	49,508
2010	6,836
	<u>259,481</u>
Future minimum lease payments	259,481
Less: Amounts representing interest	37,980
	<u>221,501</u>

## 7 Mortgages payable

	September 30, 2006 \$	December 31, 2005 \$
Mortgages payable, bearing interest at a weighted average rate of 6.8% and maturing on various dates from April, 2010 to September, 2011. First mortgages on certain hotel properties have been pledged as security for these mortgages	25,450,955	-
Less: Current portion	1,040,520	-
	<u>24,410,435</u>	<u>-</u>

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

	\$
Remainder of 2006	202,000
2007	838,000
2008	905,000
2009	977,000
2010	8,971,000

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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## 8 Convertible debentures

On August 1, 2006, the REIT issued \$20,238,000 in convertible, redeemable debentures. The debentures bear interest at 8% and mature in five years. The convertible debentures can be converted into units of the REIT at \$5.40 per unit at any time commencing two years and one day from the issuance date and ending on the date that is 15 days prior to the maturity date.

The convertible debentures have been valued at their estimated fair value at the time of issuance, according to the terms and conditions in place at the time. The difference between the gross proceeds and the estimated fair value of the debt represents the value of the conversion feature of the debentures and accordingly has been recorded as a component of equity. The difference between the recorded value of the debt component of the debentures and their face value has been accounted for as a discount on the issuance of the debt and is being accreted to interest expense over the term of the debentures.

	<b>September 30, 2006</b>	<b>December 31, 2005</b>		
	<b>Debt \$</b>	<b>Equity \$</b>	<b>Total Proceeds \$</b>	<b>Total \$</b>
Issue date – August 1, 2006	14,938,000	5,300,000	20,238,000	-

The debt component of the convertible debentures is recorded as a liability. The accretion of the discount on the issuance of the debentures increases the debt component to their face value over the term of the debentures.

	<b>September 30, 2006 \$</b>	<b>December 31, 2005 \$</b>
Debt component at issue date	14,938,000	-
Accretion of discount on convertible debentures	176,667	-
	<u>15,114,667</u>	<u>-</u>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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## 9 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 placements

On June 7, 2006, under a private placement, 430,000 units were issued for net cash consideration of \$773,378.

On August 1, 2006, under a private placement, 9,965,377 units were issued for net cash consideration of \$41,199,237.

As part of the consideration of the acquisition of the 5 Calgary Downtown Suites and Spa Hotel, the REIT issued 1,222,000 units at \$4.50 per unit.

As part of the consideration of the acquisition of the Wingate Inn, the REIT issued 444,000 units at \$4.50 per unit.

### Class B limited partnership units

On June 7, 2006, in connection with 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 to the vendor, Truro Motel 8 Partnership. 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 REIT also issued special voting units to the vendor such that the vendor, as holder of the exchangeable LP units, would hold the economic and voting equivalent of the REIT units.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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## 9 Unitholders' equity (continued)

### Unit options

HCC had a share option plan under which officers and directors are eligible to receive share 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	-
Expected volatility	90%

### Number of units outstanding

The basic and fully diluted number of units outstanding as at September 30, 2006 was 14,121,377 and 18,029,155 respectively (June 30, 2006 – basic 2,490,000; fully diluted 2,650,000).

### Weighted average number of units

	<b>For the three-month period ended September 30, 2006 \$</b>	<b>For the nine-month period ended September 30, 2006 \$</b>
Basic weighted average number of units outstanding	9,638,681	4,215,087
Dilutive effect of convertible debentures	2,444,203	823,687
Dilutive effect of unit options	160,000	132,454
Fully diluted weighted average number of units	<u>12,242,884</u>	<u>5,171,228</u>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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## 10 Change in non-cash working capital

	For the three-month period ended September 30, 2006 \$	For the nine-month period ended September 30, 2006 \$
Accounts receivable	(1,029,728)	(1,116,496)
Inventories	(49,264)	(51,719)
Prepaid expenses and deposits	(835,331)	(1,047,578)
Accounts payable and accrued liabilities	3,974,984	4,439,782
	<hr/> 2,060,661	<hr/> 2,223,989

## 11 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.

### 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. On October 6, 2006, the development agreement was assigned to Winport Developments Limited Partnership.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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## 12 Commitments

The REIT is committed to lease areas of certain hotel facilities to outside parties. The minimum revenue from future rentals is expected to be as follows:

	\$
Remainder of 2006	56,829
2007	227,315
2008	227,315
2009	212,915
2010	212,915

The following fees are payable under the terms of the various franchise agreements covering certain of the hotel properties.

	<b>As a % of gross room revenue</b>
<b>To Super 8 Motels Inc.</b>	
Royalty fee	5%
Marketing assessment	3%
<b>To Intercontinental Hotels Group (for Holiday Inns)</b>	
Royalty fee	5%
Marketing assessment	2%
Reservation assessment	1%
<b>To Radisson Hotels Worldwide</b>	
Royalty fee	4%
Marketing assessment	2%
Reservation assessment	2%
<b>To Wingate Inns L.P. Inc.</b>	
Royalty fee	4.5%
Marketing assessment	4.0%
<b>To Prime Restaurants (East Side Mario's restaurant in Radisson Suite Hotel)</b>	
Royalty fee	5%
Marketing assessment	3%

The Holiday Inn hotels are charged approximately \$2,000US per month for property management systems. The Priority Club loyalty program is charged at a rate of 5% of the total dollars spent by a Priority Club member during each stay.

The Radisson Suite hotel is charged approximately \$13,000US per year, some of which is paid monthly for software and website maintenance. The Gold Points loyalty program is charged at a rate of 3.5% of the total dollars spent by a Gold Points member during each stay.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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## 12 Commitments (continued)

The REIT has entered into a ground lease agreement on the 5 Calgary Downtown Suites and Spa Hotel for an annual lease payment calculated in compliance with the terms of the agreement. The amount of the annual lease payment varies with gross revenues, with \$10,255 being paid monthly and deducted from the total lease liability calculated at the end of the fiscal year. The lease expires June 24, 2064. The minimum annual lease payments are as follows:

	\$
Remainder of 2006	30,765
2007	123,060
2008	123,060
2009	123,060
2010	123,060

## 13 Related party transactions

During the period, the REIT incurred management fees of \$182,166 and accounting fees of \$11,850 due to Pacrim Hospitality Services Inc. Included in accounts payable and accrued liabilities is \$98,312 related to these fees.

## 14 Financial instruments

### Fair value

Financial instruments consist of recorded amounts receivable which will result in future cash receipts, accounts payable and accrued liabilities, distributions payable, accrued interest, obligation under capital leases and long-term debt which will result in future cash outlays.

The REIT's carrying value of accounts receivable, accounts payable and accrued liabilities, distributions payable and accrued interest approximate their fair value due to the immediate or short-term nature of these instruments.

The carrying value of the mortgages payable approximates the fair value as interest rates are consistent with current rates. The interest rates on two of the mortgages assumed exceeded current rates and a fair value adjustment has been reflected in these financial statements. The fair value of the convertible debentures approximates book value as they were issued recently.

### 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 Unaudited Consolidated Financial Statements

For the period ended September 30, 2006

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## 14 Financial instruments (continued)

### Interest rate risk

The REIT manages its exposure to interest rate risk through fixed rate borrowings. The fixed rate debt is subject to interest rate pricing risk, as the value will fluctuate as a result of changes in market rates.

## 15 Subsequent events

On October 5, 2006, the REIT obtained mortgage financing of \$3,840,000 on the Super 8 motel in Drayton Valley, Alberta.

On October 24, 2006, the REIT obtained mortgage financing of \$4,800,000 on the Super 8 motel in Yellowknife, Northwest Territories.

On November 2, 2006, the REIT provided mezzanine financing of \$8,000,000 to Winport. The loan bears interest at 12% and matures in five years.