

Holloway Lodging Real Estate Investment Trust

Interim Consolidated Financial Statements

(Unaudited)

September 30, 2011

November 10, 2011

Management's Report

The accompanying unaudited interim consolidated financial statements of Holloway Lodging Real Estate Investment Trust are the responsibility of management. The unaudited interim consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The unaudited interim consolidated financial statements include some amounts and assumptions based on management's best estimates which have been derived with careful judgement.

In fulfilling its responsibilities, management has developed and maintains a system of internal accounting controls. These controls are designed to ensure that the financial records are reliable for preparation of the financial statements. The Board of Trustees have reviewed and approved these unaudited interim consolidated financial statements.

(signed) "W. Glenn Squires"
Chief Executive Officer

(signed) "Michael B. Rapps"
Interim Chief Financial Officer

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Financial Position

(Unaudited)

As at September 30, 2011

(in thousands of Canadian dollars)

	September 30, 2011 \$	December 31, 2010 \$
Assets		
Current assets		
Cash and cash equivalents (note 16)	1,959	830
Cash on deposit	299	–
Restricted cash	562	551
Capital reserve – internally restricted	221	921
Trade and other receivables	4,284	2,962
Loan receivable from related party (note 6)	159	–
Inventories	267	261
Prepaid expenses and deposits	2,010	2,617
	<u>9,761</u>	<u>8,142</u>
Non-current assets		
Property and equipment (note 5)	211,419	236,200
Minority interest investments in hotel properties	795	777
Loan receivable from related parties (note 6)	6,172	6,398
Capital reserve – restricted	4,215	5,440
Deferred income tax assets (note 20)	7,082	7,082
Other assets (note 7)	553	718
	<u>230,236</u>	<u>256,615</u>
Total assets	<u>239,997</u>	<u>264,757</u>
Liabilities		
Current liabilities		
Line of credit (note 8)	4,895	2,519
Trade payables and accrued liabilities	8,197	8,595
Accrued interest on convertible debentures	820	675
Current portion of mortgages and loans payable (note 9)	41,113	49,047
Current portion of convertible debentures (note 10)	48,716	19,138
Current portion of obligations under finance leases (note 11)	89	132
Derivative liability (note 12)	2	34
Class B LP units (note 13)	26	34
	<u>103,858</u>	<u>80,174</u>
Non-current liabilities		
Mortgages and loans payable (note 9)	99,055	103,546
Convertible debentures (note 10)	–	49,597
Other long-term debt (note 14)	12,873	–
Promissory notes payable (note 15)	3,231	3,203
Obligations under finance leases (note 11)	25	90
Derivative liability (note 12)	139	–
	<u>115,323</u>	<u>156,436</u>
Total liabilities	<u>219,181</u>	<u>236,610</u>
Equity	<u>20,816</u>	<u>28,147</u>
Total liabilities and equity	<u>239,997</u>	<u>264,757</u>

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

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Changes in Equity

(Unaudited)

For the nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars)

	Units (note 13) \$	Contributed surplus \$	Deficit \$	Accumulated other comprehensive income (loss) \$	Total equity \$
Balance, January 1, 2011	180,219	1,374	(152,740)	(706)	28,147
Net loss for the period	–	–	(7,551)	–	(7,551)
Other comprehensive income	–	–	–	158	158
Units issued to trustees for services	62	–	–	–	62
Balance, September 30, 2011	180,281	1,374	(160,291)	(548)	20,816
Balance, January 1, 2010	180,088	1,359	(142,201)	(1,049)	38,197
Net loss for the period	–	–	(7,113)	–	(7,113)
Other comprehensive income	–	–	–	615	615
Unit-based compensation related to options	–	15	–	–	15
Exchange of units	131	–	–	–	131
Balance, September 30, 2010	180,219	1,374	(149,314)	(434)	31,845

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

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Loss

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars)

	Three months ended		Nine months ended	
	September 30, 2011 \$	September 30, 2010 \$	September 30, 2011 \$	September 30, 2010 \$
Hotel revenues				
Rooms	18,843	18,812	52,064	47,658
Food and beverage	1,355	1,344	4,516	4,304
Parking	315	377	995	1,078
Other	649	640	2,064	2,005
	<u>21,162</u>	<u>21,173</u>	<u>59,639</u>	<u>55,045</u>
Hotel expenses				
Operating expenses	12,396	12,789	37,562	35,276
Property taxes and insurance	974	1,161	3,198	3,478
Management fees	517	536	1,452	1,369
Depreciation and amortization	2,354	2,551	7,484	7,612
	<u>16,241</u>	<u>17,037</u>	<u>49,696</u>	<u>47,735</u>
	<u>4,921</u>	<u>4,136</u>	<u>9,943</u>	<u>7,310</u>
Other (income) expenses				
Interest on mortgages and other debt	2,890	2,706	8,214	8,098
Interest on convertible debentures	971	1,247	3,465	3,742
Accretion on convertible debentures, other long-term debt, mortgages and deferred financing fees	799	820	2,603	2,293
Corporate and administrative	780	383	1,952	2,425
Investment income	(25)	(38)	(82)	(103)
Provision for impairment of minority interest investments in hotel properties	–	423	–	423
Loss (gain) on disposal of minority interest investments in hotel properties	–	(72)	–	62
Loss on acquisition of hotel property	–	–	–	47
Loss on disposal of hotel properties	1,452	–	1,950	–
Fair value adjustment on Class B LP units and derivative liabilities	(73)	(54)	(104)	(56)
Gain on repurchase of convertible debentures	(507)	–	(507)	–
Depreciation and amortization – trust assets	1	2	3	8
	<u>6,288</u>	<u>5,417</u>	<u>17,494</u>	<u>16,939</u>
Loss before income taxes	(1,367)	(1,281)	(7,551)	(9,629)
Recovery of deferred income taxes	–	–	–	(2,516)
Net loss for the periods	<u>(1,367)</u>	<u>(1,281)</u>	<u>(7,551)</u>	<u>(7,113)</u>
Net loss attributable to				
Unitholders and owners of Class B LP units	<u>(1,367)</u>	<u>(1,281)</u>	<u>(7,551)</u>	<u>(7,113)</u>

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

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Comprehensive Loss

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars)

	Three months ended		Nine months ended	
	September 30,	September 30,	September 30,	September 30,
	2011	2010	2011	2010
	\$	\$	\$	\$
Net loss for the periods	<u>(1,367)</u>	<u>(1,281)</u>	<u>(7,551)</u>	<u>(7,113)</u>
Other comprehensive income (loss)				
Foreign currency gain (loss) on translation of foreign operation	160	(58)	158	(103)
Adjustment for disposal or impairment of minority interest investments in hotel properties	<u>–</u>	<u>423</u>	<u>–</u>	<u>718</u>
Other comprehensive income for the periods	<u>160</u>	<u>365</u>	<u>158</u>	<u>615</u>
Comprehensive loss for the periods	<u>(1,207)</u>	<u>(916)</u>	<u>(7,393)</u>	<u>(6,498)</u>
Comprehensive loss attributable to Unitholders and owners of Class B LP units	<u>(1,207)</u>	<u>(916)</u>	<u>(7,393)</u>	<u>(6,498)</u>

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

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Cash Flows

(Unaudited)

For the nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars)

	Nine months ended	
	September 30, 2011	September 30, 2010
	\$	\$
Cash provided by (used in)		
Operating activities		
Net loss for the periods	(7,551)	(7,113)
Adjustments for non-cash items (note 16)	11,491	7,888
	3,940	775
Changes in items of working capital (note 16)	(1,173)	1,565
Net cash generated from operating activities	<u>2,767</u>	<u>2,340</u>
Investing activities		
Increase in restricted cash	(11)	(9)
Decrease (increase) in capital reserves	1,925	(1,199)
Proceeds from sale of minority interest investments in hotel properties	–	271
Proceeds from sale of property and equipment	17,679	–
Increase in minority interest investments in hotel properties	(18)	–
Additions to property and equipment	(1,641)	(3,042)
Net cash generated from (used in) investing activities	<u>17,934</u>	<u>(3,979)</u>
Financing activities		
Repayment of finance lease obligations	(108)	(222)
Repayment of promissory notes	–	(221)
Increase in line of credit	2,376	1,000
Proceeds from mortgages and loans, net of deferred financing fees	724	10,221
Repayment of mortgages and loans	(13,868)	(12,578)
Proceeds from other long-term debt	14,000	–
Repayment of other long-term debt	(1,000)	–
Repayment of convertible debentures	(20,238)	–
Repurchase of convertible debentures	(1,458)	–
Net cash used in financing activities	<u>(19,572)</u>	<u>(1,800)</u>
Increase (decrease) in cash and cash equivalents	1,129	(3,439)
Cash and cash equivalents – Beginning of period	<u>830</u>	<u>3,786</u>
Cash and cash equivalents – End of period	<u>1,959</u>	<u>347</u>
Supplemental cash flow information (note 16)		

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

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

1 General information

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 its Declaration of Trust on March 28, 2006. The REIT and its subsidiaries own and operate hotels. As at September 30, 2011, the REIT owned 19 hotels in Canada and 1 hotel in the United States with 2,183 guest rooms and suites and held minority ownership interests in six other hotels. The address of its registered office is 30 Damascus Road, Suite 201, Bedford, Nova Scotia.

The results of operations for the three months ended September 30, 2011 represent the operations of twenty hotels for the full quarter and one hotel for part of the quarter. For the third quarter of the prior year, the REIT owned twenty-two hotels. The Radisson Suite hotel in Halifax, NS was sold on June 30, 2011 and the Holiday Inn Express in Halifax, NS was sold on August 15, 2011.

2 Basis of preparation and adoption of International Financial Reporting Standards

The REIT prepares its financial statements in accordance with Canadian generally accepted accounting principles (“GAAP”) as set out in the Handbook of the Canadian Institute of Chartered Accountants (“CICA Handbook”). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards (“IFRS”), and requires publicly accountable enterprises to apply such standards for years beginning on or after January 1, 2011, including comparative periods. Accordingly, the REIT commenced reporting on this basis in its 2011 interim consolidated financial statements. In these interim consolidated financial statements, the term “Canadian GAAP” refers to Canadian GAAP before the adoption of IFRS.

These interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34, *Interim Financial Reporting*, and IFRS 1, *First-time Adoption of International Financial Reporting Standards*. The accounting policies followed in these interim financial statements are the same as those applied in the REIT's interim financial statements for the period ended June 30, 2011. Subject to certain transition elections, the REIT has consistently applied the same accounting policies throughout all periods presented, as if these policies had always been in effect. Note 3 discloses the impact of the transition to IFRS on the REIT's reported equity as at September 30, 2010, comprehensive income for the three and nine months ended September 30, 2010 and other account balances as at September 30, 2010.

The accounting policies applied in these interim consolidated financial statements are based on IFRS effective for the year ended December 31, 2011, as issued and outstanding as of November 10, 2011, the date the Board of Trustees approved the statements. Any subsequent changes to IFRS that are given effect in the REIT's annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of these interim consolidated financial statements, including transition adjustments recognized on change-over to IFRS.

The interim consolidated financial statements should be read in conjunction with the REIT's Canadian GAAP annual financial statements for the year ended December 31, 2010 and the REIT's interim financial statements for the three and six months ended June 30, 2011, prepared in accordance with IFRS applicable to interim financial statements.

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Transition to IFRS

The effect of the REIT's transition to IFRS is summarized in this note as follows:

- i) Reconciliation of equity, net loss and comprehensive loss and other account balances as previously reported under Canadian GAAP to IFRS:

Equity

	Note 3 (ii)	September 30, 2010 \$
Unitholder's equity as reported under Canadian GAAP		116,575
IFRS adjustments increase (decrease):		
Exchange of Class B LP units		131
Impact of earnings adjustments		2,041
Property and equipment:		
Revaluation		16,644
Impairment		(103,560)
Adjustment to fair value of investments in hotel properties	a	(331)
Fair value adjustment of conversion option on convertible debentures	b	(105)
Fair value adjustment of Class B LP units	c	(147)
Impact of foreign exchange	d	597
Equity as reported under IFRS		<u>31,845</u>

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Transition to IFRS (continued)

- i) Reconciliation of equity, net loss and comprehensive loss and other account balances as previously reported under Canadian GAAP to IFRS (continued):

Net loss and comprehensive loss

	Notes 3 (ii)	Three months ended September 30, 2010 \$	Nine months ended September 30, 2010 \$
Net loss and comprehensive loss as reported under Canadian GAAP		(1,869)	(9,153)
Decrease (increase) in net loss for:			
Depreciation on revaluation and impairment of property and equipment		696	2,087
Fair value adjustment of conversion option on convertible debentures	b	47	74
Fair value adjustment of Class B LP units	c	6	(18)
Reversal of unrealized foreign exchange gains under Canadian GAAP		(161)	(103)
Net loss under IFRS		(1,281)	(7,113)
Increase (decrease) in other comprehensive loss for:			
Changes in investments in hotel properties	a	423	718
Foreign currency loss on translation of foreign operation		(58)	(103)
Comprehensive loss under IFRS		(916)	(6,498)

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Transition to IFRS (continued)

- i) Reconciliation of equity, net loss and comprehensive loss and other account balances as previously reported under Canadian GAAP to IFRS (continued):

Deficit

	Note 3 (ii)	September 30, 2010 \$
Accumulated losses as reported under Canadian GAAP		(34,258)
IFRS adjustments increase (decrease):		
Accumulated distributions reclassified to deficit		(40,893)
Impairment of property and equipment		(103,560)
Revaluation of property and equipment		16,644
Depreciation expense on revaluation and impairment of property and equipment		2,087
Portion of the equity component of convertible debentures reclassified to deficit	b	9,490
Portion of the Class B LP units reclassified to deficit		520
Fair value adjustment of conversion option on convertible debentures	b	74
Conversion and fair value adjustment of Class B LP units		(18)
Reversal of foreign exchange loss (gain)		(103)
Adjustments for impact of foreign exchange	d	703
Total deficit as reported under IFRS		<u>(149,314)</u>

Property and equipment

	September 30, 2010 \$
Property and equipment as reported under Canadian GAAP	322,987
IFRS adjustments increase (decrease):	
Revaluation	16,644
Impairment	(103,560)
Change in accumulated depreciation	2,087
Foreign exchange	480
Property and equipment as reported under IFRS	<u>238,638</u>

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Transition to IFRS (continued)

- i) Reconciliation of equity, net loss and comprehensive loss and other account balances as previously reported under Canadian GAAP to IFRS (continued):

Minority interest investments in hotel properties

	Note 3 (ii)	September 30, 2010 \$
Minority interest investments in hotel properties as reported under Canadian GAAP		1,217
IFRS adjustments increase (decrease):		
Fair value adjustment recognized on transition in other comprehensive income	a	(1,049)
Disposal of minority interest investments in hotel properties		295
Recognition of impairment in profit or loss		423
		<hr/>
		(331)
		<hr/>
Investments in hotel properties as reported under IFRS		886

ii) Explanatory notes

- a) In accordance with IFRS, minority interest investments in hotel properties are considered available-for-sale financial instruments and are measured at fair value with changes in fair value recognized in other comprehensive income ("OCI"). Significant or prolonged declines in fair value are removed from OCI and recognized in profit and loss. Under Canadian GAAP, these investments were recognized at cost with a provision for other than temporary impairment recognized in profit or loss. The adjustments to accumulated other comprehensive income (loss) and to the carrying value of the investments to recognize this difference was (\$331) at September 30, 2010.
- b) In accordance with IFRS, an obligation to issue units associated with the REIT's convertible debentures must be classified as a derivative liability and measured at fair value with any subsequent changes in value recognized in profit or loss. The REIT has recorded these changes as a "fair value adjustment on derivative liability". Under Canadian GAAP, this conversion option was classified as a separate component of equity at the issuance date and changes in fair value were not recognized. This change increased liabilities by \$32 at September 30, 2010.
- c) In accordance with IFRS, the REIT was required to reclassify the outstanding Class B LP units as a liability measured at fair value with changes recognized in profit or loss. The REIT has recorded these changes as a "fair value adjustment on Class B LP units". Under Canadian GAAP, these Class B LP units were classified as a separate component of equity and changes in fair value were not recognized. This change increased liabilities by \$33 at September 30, 2010.

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Transition to IFRS (continued)

- d) In accordance with IFRS, the REIT translates assets and liabilities of its foreign subsidiary using the exchange rate effective at the balance sheet date with gains or losses recorded as a “foreign currency gain (loss) on translation of foreign operation” in OCI. Under Canadian GAAP, the adjustments related to translation of this foreign subsidiary were recognized in the statement of income using historic or current rates depending on whether the balance sheet item was monetary or non-monetary. As a result of this change, an adjustment of \$703 was recognized in retained earnings (deficit) at January 1, 2010.

4 Sale of hotel properties

On June 30, 2011, the REIT sold the Radisson Suite hotel in Halifax, Nova Scotia for gross proceeds of \$12,324. The net proceeds from the sale were received by Holloway and the mortgage on the property was paid out on July 4, 2011. The REIT recognized a loss on sale of property and equipment of \$502. After repayment of the mortgage and closing costs, the net cash proceeds, including \$963 released from restricted capital reserves, were \$6,126.

On August 15, 2011, the REIT sold the Holiday Inn Express hotel in Halifax, Nova Scotia for gross proceeds of \$6,500. The REIT recognized a loss on sale of property and equipment of \$1,448. After repayment of the mortgage and closing costs, the net cash proceeds were \$2,602.

5 Property and equipment

	For the nine months ended September 30, 2011					
	Opening net book value \$	Additions \$	Disposals \$	Depreciation for the period \$	Foreign exchange \$	Closing net book value \$
Land	22,243	–	(2,933)	–	58	19,368
Land lease	418	–	–	(9)	–	409
Building	197,044	558	(14,726)	(4,227)	307	178,956
Renovations in progress	169	243	–	–	–	412
Furniture, fixtures and equipment and other	13,428	617	(1,490)	(2,700)	56	9,911
Paving	1,623	–	(66)	(194)	10	1,373
Landscaping	26	–	–	(4)	–	22
Signage	848	57	(96)	(61)	1	749
Computer equipment and websites	277	70	(7)	(141)	4	203
Vehicles	22	–	–	(6)	–	16
Tenant inducements	102	–	(102)	–	–	–
	236,200	1,545	(19,420)	(7,342)	436	211,419

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

5 Property and equipment (continued)

	As at September 30, 2011			
	Cost	Accumulated impairment losses	Accumulated depreciation	Net book value
	\$	\$	\$	\$
Land	28,078	(8,710)	–	19,368
Land lease	500	(28)	(63)	409
Building	291,208	(88,425)	(23,827)	178,956
Renovations in progress	412	–	–	412
Furniture, fixtures and equipment and other	28,900	(5,906)	(13,083)	9,911
Paving	3,134	(749)	(1,012)	1,373
Landscaping	32	–	(10)	22
Signage	1,018	–	(269)	749
Computer equipment and websites	1,584	–	(1,381)	203
Vehicles	180	–	(164)	16
	355,046	(103,818)	(39,809)	211,419

	For the year ended December 31, 2010					
	Opening net book value	Additions	Disposals	Depreciation for the period	Foreign exchange	Closing net book value
	\$	\$	\$	\$	\$	\$
Land	22,031	318	–	–	(106)	22,243
Land lease	430	–	–	(12)	–	418
Building	200,256	2,808	–	(5,658)	(362)	197,044
Renovations in progress	706	(515)	–	–	(22)	169
Furniture, fixtures and equipment and other	13,419	3,334	(2)	(3,321)	(2)	13,428
Paving	1,856	26	–	(252)	(7)	1,623
Landscaping	16	14	–	(4)	–	26
Signage	872	98	(95)	(25)	(2)	848
Computer equipment and websites	413	205	–	(339)	(2)	277
Vehicles	94	–	–	(72)	–	22
Tenant inducements	145	–	–	(42)	(1)	102
	240,238	6,288	(97)	(9,725)	(504)	236,200

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

5 Property and equipment (continued)

	As at December 31, 2010			
	Cost	Accumulated impairment losses	Accumulated depreciation	Net book value
	\$	\$	\$	\$
Land	30,936	(8,693)	—	22,243
Land lease	500	(28)	(54)	418
Building	305,456	(88,269)	(20,143)	197,044
Renovations in progress	169	—	—	169
Furniture, fixtures and equipment and other	30,417	(5,896)	(11,093)	13,428
Paving	3,214	(748)	(843)	1,623
Landscaping	32	—	(6)	26
Signage	1,025	—	(177)	848
Computer equipment and websites	1,513	—	(1,236)	277
Vehicles	179	—	(157)	22
Tenant inducements	146	—	(44)	102
	<u>373,587</u>	<u>(103,634)</u>	<u>(33,753)</u>	<u>236,200</u>

The net book value of assets under finance leases as at September 30, 2011 was \$457 (December 31, 2010 - \$675).

6 Loans receivable from related parties

The REIT has a \$6,172 (December 31, 2010 - \$6,239) loan receivable from Pacrim Hospitality Services Inc. (“PHSI”), a company in which a member of management has a significant ownership interest. The loan is unsecured, is due on February 1, 2018, is repayable at any time without penalty and bears interest at the lesser of 13% and the trailing three-month yield on the units of the REIT (calculated in accordance with the loan agreement) plus 1%. The interest rate is currently 1%.

The REIT has a \$159 (December 31, 2010 - \$159) loan receivable due December 31, 2011 from Winport Developments Inc., a company in which a member of management has a significant ownership interest. The loan is secured by 55,555 units of the REIT and a guarantee by 3475425 Canada Inc., a company in which a member of management has a significant ownership interest, is repayable at any time without penalty and bears interest at 11% per annum.

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

7 Other assets

For the nine months ended September 30, 2011

	Opening net book value \$	Amortization for the period \$	Disposals \$	Closing net book value \$
Agreements	151	(75)	–	76
Franchise fees	567	(61)	(29)	477
	718	(136)	(29)	553

As at September 30, 2011

	Cost \$	Accumulated amortization \$	Net book value \$
Agreements	500	(424)	76
Franchise fees	814	(337)	477
	1,314	(761)	553

For the year ended December 31, 2010

	Opening net book value \$	Additions \$	Amortization for the year \$	Closing net book value \$
Agreements	250	–	(99)	151
Franchise fees	627	22	(82)	567
	877	22	(181)	718

As at December 31, 2010

	Cost \$	Accumulated amortization \$	Net book value \$
Agreements	500	(349)	151
Franchise fees	876	(309)	567
	1,376	(658)	718

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

8 Line of credit

The REIT has two available lines of credit for \$5,000 and \$500. As at September 30, 2011, the REIT had drawn \$4,895 (December 31, 2010 - \$2,519) of the \$5,000 line of credit. This line of credit bears interest at prime plus 2.5%, is payable on demand and is secured by a demand collateral mortgage and charge on the Holiday Inn Express in Kamloops, BC. The amount available to be drawn on the \$500 line of credit is \$465 which is net of outstanding letters of credit.

9 Mortgages and loans payable

	September 30, 2011	December 31, 2010
	\$	\$
Mortgages payable, bearing interest at a weighted average rate of 6.72% (December 31, 2010 - 6.75%) and maturing on various dates from October, 2011 to July, 2017. Individual first charges on most of the hotel properties have been pledged as security for individual mortgages	140,752	153,630
Other	—	4
	<u>140,752</u>	<u>153,634</u>
Less: Deferred financing fees	584	1,041
Less: Current portion	<u>41,113</u>	<u>49,047</u>
	<u>99,055</u>	<u>103,546</u>

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

	\$
Remainder of 2011	20,257
Year ending December 31, 2012	21,671
2013	3,194
2014	3,411
2015	5,450
Thereafter	86,769

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

9 Mortgages and loans payable (continued)

The following table summarizes significant changes in mortgages and loans payable for the year ended December 31, 2010 and the nine months ended September 30, 2011:

	September 30, 2011	December 31, 2010
Opening balance at January 1	152,593	153,483
New debt	755	10,500
Assumption of mortgage	–	2,834
Deferred financing fees	456	(341)
Repayment of debt	(13,868)	(13,844)
Impact of foreign exchange	232	(39)
Closing balance	<u>140,168</u>	<u>152,593</u>

In July 2011, the REIT refinanced a mortgage secured by the Super 8 hotel in Yellowknife, NWT. The REIT increased the outstanding mortgage balance by \$765 and reduced the annual interest rate by 0.75%. This mortgage will mature in July 2016. In August 2011, the REIT refinanced a mortgage secured by the Super 8 hotel in Truro, NS. The outstanding mortgage balance remained the same while the interest rate decreased by 0.75%. This mortgage will mature in September 2016.

10 Convertible debentures

On August 1, 2006, the REIT issued \$20,238 in convertible, redeemable debentures with an interest rate of 8%. The debentures were repaid in full on July 29, 2011.

On June 21, 2007, the REIT issued \$45,000 in convertible, redeemable debentures. The debentures bear interest at 6.5%, payable semi-annually on June 30th and December 31st and mature on June 30, 2012. The convertible debentures can be converted into units of the REIT at \$6.15 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. On July 18, 2007, the REIT issued an additional \$6,844 in convertible, redeemable debentures with the same terms as the June 21, 2007 debentures, pursuant to the underwriters exercising their over-allotment option.

The REIT has the option to repay the principal amount of the debentures, in whole or in part, at maturity or redeem the debentures, in whole or in part, at or prior to maturity, by issuing the number of units calculated by dividing the aggregate principal amount by 95% of the “current market price” of the units on the maturity date (calculated in accordance with the trust indenture).

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

10 Convertible debentures (continued)

Under IFRS, the convertible debentures are valued at their estimated fair value according to the terms and conditions in place at the time of their issuance. The difference between the gross proceeds and the estimated fair value of the debt of \$4,150 on the June 21, 2007 issuance and \$644 on the July 18, 2007 issuance represents the value of the conversion feature of the debentures and accordingly, has been recorded as a derivative liability. As a result of the transitional revaluation of this liability to fair value, \$9,490 has been reallocated from liabilities to retained earnings as a transitional adjustment. 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, using the effective interest rate method, over the term of the debentures.

On April 27, 2011, the REIT initiated a Normal Course Issuer Bid (“NCIB”) to repurchase, over the 12 months commencing on April 29, 2011 and ending on April 28, 2012, up to \$5,184 of its issued and outstanding 6.5% convertible debentures due June 30, 2012, such amount representing 10% of the REIT’s public float as of April 26, 2011. During the three months ended September 30, 2011, the REIT purchased \$2,017 face value of the convertible debentures at a cost of \$1,458 (average cost of \$72.31 per \$100 face value – price not in thousands).

See note 23 – Subsequent events.

	September 30, 2011	December 31, 2010
	\$	\$
Debt component	45,220	61,988
Accretion of convertible debentures	3,798	7,515
Deferred financing fees	(302)	(768)
	<hr/>	<hr/>
	48,716	68,735
Less: Current portion	<hr/>	<hr/>
	48,716	19,138
	<hr/>	<hr/>
	–	49,597

The following table summarizes significant changes in convertible debentures for the year ended December 31, 2010 and the nine months ended September 30, 2011:

	September 30, 2011	December 31, 2010
	\$	\$
Opening balance at January 1	68,735	65,935
Accretion of discount and deferred financing fees	2,182	2,800
Repayment of debentures at maturity	(20,238)	–
Purchase of debentures under NCIB	(1,963)	–
	<hr/>	<hr/>
Closing balance	48,716	68,735

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars except unit and warrant amounts)

11 Obligations under finance leases

The REIT has various finance lease obligations for computer equipment, signage, furniture and hotel equipment.

	September 30, 2011	December 31, 2010
	\$	\$
Present value of future minimum lease payments	114	222
Less: Current portion of principal payments	89	132
	<u>25</u>	<u>90</u>

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

	\$
Remainder of 2011	26
Year ending December 31, 2012	84
Year ending December 31, 2013	11
	<u>121</u>
Future minimum lease payments	121
Less: Amounts representing interest at a weighted average rate of 10.0%	<u>7</u>
Present value of future minimum lease payments	<u>114</u>

The leases outstanding at September 30, 2011 bear interest at a weighted average annual rate of 10.01% (December 31, 2010 – 10.52%). During the nine months ended September 30, 2011, the REIT did not enter into any new finance leases.

12 Derivative liabilities

Conversion option on convertible debentures

The amount recognized as a current derivative liability of \$2 (December 31, 2010 – \$34) results from the periodic revaluation of the conversion option related to the REIT's convertible debentures. The conversion option is subject to periodic revaluation with the subsequent adjustment reflected in the statement of income. The Black Scholes option pricing model was used for the purposes of the valuation with the following assumptions:

As at September 30, 2011	June 2007 Issuance	July 2007 Overallotment
End of period unit price	\$0.25	\$0.25
Exercise price of option	\$6.15	\$6.15
Term remaining on option (years)	0.75	0.75
Volatility	117%	117%
Annual distribution	—	—
Discount rate	1.15%	1.15%

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars except unit and warrant amounts)

12 Derivative liabilities (continued)

Warrants

The amount recognized as a long-term derivative liability of \$139 (December 31, 2010 - \$nil) represents the value of the outstanding warrants issued with respect to the other long-term debt (note 14). In accordance with IFRS, the warrants associated with the REIT's other long-term debt must be classified as a derivative liability and measured at fair value with any subsequent changes in value recognized in the statement of income. The Black Scholes option pricing model was used for the purposes of valuation of the 2,100,000 warrants with the following assumptions:

As at September 30, 2011

End of period unit price	\$0.25
Exercise price of warrants	\$0.40
Term remaining on warrants (years)	2.83
Volatility	60%
Annual distribution	—
Discount rate	1.84%

13 Units

The REIT is authorized to issue an unlimited number of units ("units" or "REIT units") for the consideration of and on the terms and conditions according to its 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.

Issued and outstanding units

The following presents the number of units issued and outstanding, and the related ascribed values as at September 30, 2011 and December 31, 2010:

	<u>Number of units issued and outstanding</u>	<u>Ascribed value \$</u>
	<u>REIT Units</u>	<u>REIT Units</u>
Balance, January 1, 2010	38,801,716	180,088
Exchange of Class B LP units for REIT units	230,000	131
Balance, September 30, 2010 and December 31, 2010	39,031,716	180,219
Issuance of units to trustees for services	198,774	62
Balance, September 30, 2011	39,230,490	180,281

REIT units can be redeemed by unitholders at the lesser of: i) 90% of the weighted average market price of the units during the 10 day trading period ending immediately prior to the day on which the units were surrendered for redemption; and ii) 100% of the closing price on the redemption date. The monthly limit for cash redemptions is \$50. The REIT does not expect any significant redemptions.

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars except unit and warrant amounts)

13 Units (continued)

Issued and outstanding units (continued)

On April 27, 2011, the REIT initiated a NCIB to repurchase over the 12 month period commencing on April 29, 2011 and ending on April 28, 2012, up to 2,508,122 of its issued and outstanding REIT units, such amount representing 10% of the REIT's public float as of April 26, 2011. As of September 30, 2011, no units have been purchased under the NCIB.

See note 23 – Subsequent events.

Class B LP units

At transition to IFRS, the REIT was required to present its Class B LP units as a liability at fair value. As the Class B LP units are convertible on a one-for-one basis for REIT units, the fair value at transition to IFRS reflects the market value of the outstanding Class B LP units based on the applicable closing price of REIT units.

The liability will continue to be presented at market value at each reporting period with adjustments being reflected as a fair value adjustment on Class B LP units on the statement of income. The number of Class B LP units outstanding at September 30, 2011 was 103,500 (December 31, 2010 - 103,500).

The following table provides the total units outstanding including the Class B LP units as well as the impact of outstanding options, if exercised, and the conversion of convertible debentures into REIT units.

	September 30, 2011	December 31, 2010
REIT units outstanding	39,230,490	39,031,716
Class B LP units outstanding	103,500	103,500
Options outstanding (exercisable)	763,856	973,841
Conversion of convertible debentures (conversion price \$5.40)	–	3,747,778
Conversion of convertible debentures (conversion price \$6.15)	8,101,951	8,429,919
Total units reflecting exercise and conversion	<u>48,199,797</u>	<u>52,286,754</u>

14 Other long-term debt

On June 15, 2011 the REIT entered into an agreement with a related party, Geosam Capital Inc. (“Geosam”) as administrative agent for itself and a third party, to collectively provide a non-revolving bridge loan in an amount up to \$20,000. On July 29, 2011 the REIT drew \$14,000 of the loan to repay the August 1, 2006 convertible debentures.

The loan matures on March 31, 2013 and bears interest at an annual rate of 12.5% payable monthly. The REIT may repay the loan in whole, or in part, without premium or penalty at any time prior to the maturity date.

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars except unit and warrant amounts)

14 Other long-term debt (continued)

The loan is secured by a general security agreement over the assets of the REIT and fixed charge second or third mortgages on the Holiday Inn Express Kamloops, BC, Holiday Inn Express Moncton, NB, 5 Calgary Downtown Suites Hotel Calgary, AB, Super 8 Yellowknife, NWT, Super 8 Windsor, NS, Super 8 Three Hills, AB and Super 8 Truro, NS.

The mandatory repayment provisions of the loan stipulate that the REIT must apply 75% of the net sale proceeds of any asset and 100% of all offering proceeds from the issuance of debt or equity securities to the loan amount outstanding.

As required by the loan agreement, the REIT issued warrants to the lender to purchase 150,000 units for every \$1,000 drawn on the loan. At the time of drawing 2,100,000 warrants were issued. The warrants are exercisable for three years from the date of issuance and have an exercise price of \$0.40, subject to reduction under certain anti-dilution rights to a minimum price of \$0.135.

On August 30, 2011, the REIT repaid \$1,000 of the loan amount outstanding following the sale of the Holiday Inn Express in Halifax, Nova Scotia. One of the lenders agreed to waive an additional \$1,000 repayment it was entitled to for a fee of \$100.

The other long-term debt is valued at its estimated fair value according to the terms and conditions in place at the time of issuance. The difference between the gross proceeds and the estimated fair value of the debt of \$202 represents the value of the warrants and accordingly, has been recorded as a derivative liability. The difference between the recorded value of the other-long term debt and its face value is being accreted to interest expense, using the effective interest rate method, over the term of the other long-term debt.

The following table summarizes significant changes in other-long term debt for the year ended December 31, 2010 and the nine months ended September 30, 2011:

	September 30, 2011	December 31, 2010
	\$	\$
Opening balance at January 1	—	—
Fair value of new debt	13,798	—
Accretion	75	—
Repayment of debt	(1,000)	—
Closing balance	<u>12,873</u>	<u>—</u>

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

15 Promissory notes payable

On December 22, 2008, the REIT issued two promissory notes for \$3,000 and \$552, respectively, payable to Winport Developments Limited Partnership to finance the acquisition of the minority interest investments in hotel properties. The notes were assigned by Winport Developments Limited Partnership to its partners/owners. The partners include various Dynamic mutual funds, a Gluskin Sheff mutual fund, Canadian Mortgage Capital Corporation, Holloway Investments Inc., a related party, and SLC Development Corporation, a related party. The \$3,000 promissory note bears interest at 6% per year until December 22, 2011 and 12% per year, thereafter. The \$552 note does not bear interest and therefore was discounted by \$183 at December 22, 2008, representing the net present value of the implicit interest. The discount is being accreted to interest expense over five years, the expected term of the promissory notes. The principal of the notes is repayable on the sale of Holloway's ownership interests or the sale of the underlying properties. The notes mature on December 22, 2011, at which time the REIT can pay all or a portion of the notes in cash, or by the issuance of units, or extend the term of either or both of the notes at its sole discretion. As the REIT can extend the terms of the notes, they are presented as a long-term liability.

The following table summarizes significant changes in promissory notes payable for the year ended December 31, 2010 and the nine months ended September 30, 2011:

	September 30, 2011 \$	December 31, 2010 \$
Opening balance at January 1	3,203	3,405
Accretion of discount	28	37
Repayment of debt	—	(239)
Closing balance	<u>3,231</u>	<u>3,203</u>

16 Supplemental cash flow information

Adjustments for non-cash items:

	For the nine months ended September 30, 2011 \$	September 30, 2010 \$
Unit-based compensation	62	15
Depreciation and amortization	7,487	7,620
Accretion on mortgages, convertible debentures and deferred financing fees	2,603	2,293
Loss on disposal of minority interest investments in hotel properties	—	62
Loss on acquisition of hotel property	—	47
Loss on disposal of hotel properties	1,950	—
Gain on repurchase of convertible debentures	(507)	—
Fair value adjustment on Class B LP units and derivative liabilities	(104)	(56)
Recovery of deferred income taxes	—	(2,516)
Provision for impairment on minority interest investments in hotel properties	—	423
	<u>11,491</u>	<u>7,888</u>

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

16 Supplemental cash flow information (continued)

Changes in items of working capital:

	For the nine months ended	
	September 30,	September 30,
	2011	2010
	\$	\$
Cash on deposit	(299)	–
Trade and other receivables	(1,199)	(1,240)
Inventories	(6)	16
Prepaid expenses and deposits	607	1,986
Trade payable and accrued liabilities	(421)	365
Accrued interest on convertible debentures	145	438
	<hr/>	<hr/>
	(1,173)	1,565

Cash and cash equivalents are comprised of the following:

	September 30,	December 31,
	2011	2010
	\$	\$
Cash on hand and balances with banks	1,959	830

Supplemental cash flow information:

	For the nine months ended	
	September 30,	September 30,
	2011	2010
	\$	\$
Interest paid	11,619	11,393

17 Commitments and contingencies

Refer to the REIT's consolidated financial statements for the year ended December 31, 2010 for a description of the REIT's commitments and contingencies.

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

18 Capital management

The REIT defines capital as the aggregate of equity and interest-bearing debt. The objectives of the REIT's capital management program are to maintain a level of capital that complies with the investment and debt restrictions according to the REIT's Declaration of Trust, complies with existing debt covenants, optimizes the cost of capital, funds its business strategies and builds long-term unitholder value.

In managing its capital structure, the REIT monitors performance throughout the year to ensure anticipated working capital requirements and capital expenditures are funded from operations, available cash on deposit and, where applicable, borrowings. The REIT will make adjustments to its capital structure to meet the objectives of the broader corporate strategy or in response to changes in economic conditions and risk. In order to maintain or adjust the capital structure, the REIT may issue and/or redeem or repay debt and/or issue or redeem units.

The REIT monitors capital using the following financial metrics, including (but not limited to):

- a Debt to Gross Book Value ("Debt to GBV") ratio defined as line of credit, mortgages and loans payable, other long-term debt, obligations under finance leases, the face value of promissory notes, the face value of convertible debentures, derivative liability and Class B LP units ("Debt") divided by total assets plus accumulated impairment losses, depreciation and amortization ("GBV"). The REIT's Declaration of Trust states that the REIT's Debt to GBV should not exceed 60%; and
- a Debt service coverage ratio defined as earnings before interest, income taxes, depreciation, amortization, non-cash accretion, fair value adjustments for Class B LP units and derivative liabilities, gains or losses on the repurchase of convertible debentures and unit-based compensation ("earnings base") to the sum of the annual principal and interest payments on mortgages, loans, promissory notes and finance leases ("debt service").

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

18 Capital management (continued)

	September 30, 2011 \$	December 31, 2010 \$
Capital structure		
Line of credit	4,895	2,519
Derivative liabilities	141	34
Class B LP units	26	34
Obligations under finance leases	114	222
Mortgages and loans payable	140,168	152,593
Other long-term debt	12,873	—
Convertible debentures	48,716	68,735
Promissory notes payable	3,231	3,203
	<hr/>	<hr/>
Total debt	210,164	227,340
Equity	20,816	28,147
	<hr/>	<hr/>
Total capital	230,980	255,487
	<hr/>	<hr/>
Ratios		
Total debt	210,164	227,340
Adjustment of convertible debentures to face value	1,109	3,313
Adjustment of promissory notes to face value	82	110
	<hr/>	<hr/>
Debt	211,355	230,763
	<hr/>	<hr/>
Gross book value	384,385	402,802
Debt to GBV	55.0%	57.3%
	<hr/>	<hr/>
	Trailing 12 months ended	Trailing 12 months ended
	September 30,	December 31,
	2011	2010
	\$	\$
Earnings base	19,570	16,612
Debt service	21,023	20,994
Debt service coverage ratio	0.93	0.79

The REIT is also subject to financial covenants on its mortgages and loans payable, the majority of which are measured on an annual basis and include customary terms and conditions for borrowings of this nature. These include the debt service coverage ratio presented above. Some of these covenants were in violation at the period-end dates. As waivers were not in place by the period-end dates, the mortgages have been classified as current liabilities. The REIT has one lender that measures its covenants on a quarterly basis. The covenants were not satisfied at September 30, 2011. As the mortgages with this lender mature in the next twelve months, they are included in current liabilities. As a result of discussions with this lender, management believes the loans will not be called prior to maturity. At December 31, 2010, one lender had not provided a waiver. However, as a result of discussions with this lender, management believes the loans, which mature in October 2011 and January 2012, will not be called prior to maturity.

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

19 Financial instruments

i) Fair value of financial instruments

The REIT's financial instruments consist of cash and cash equivalents, cash on deposit, restricted cash, trade and other receivables, capital reserves, minority interest investments in hotel properties, line of credit, trade payables and accrued liabilities, derivative liabilities, Class B LP units, accrued interest on convertible debentures, obligations under finance leases, mortgages and loans payable, other long-term debt, promissory notes payable and convertible debentures. The REIT's cash and cash equivalents, restricted cash, trade and other receivables, capital reserves, line of credit, trade payables and accrued liabilities and accrued interest on convertible debentures are carried at amortized cost, which approximates fair value due to the immediate or short-term maturities of these financial instruments.

Minority interest investments in hotel properties, Class B LP units and derivative liabilities are carried at fair value with changes in fair value recognized in other comprehensive income or profit and loss respectively.

The fair value of the REIT's obligations under finance leases, mortgages and loans payable and other long-term debt is based on discounted future cash flows using discount rates that reflect current market conditions for instruments with similar terms and risks. The fair values do not necessarily represent the amounts the REIT might pay in actual market transactions. The fair value of the convertible debentures is the trading value at September 30, 2011 and December 31, 2010, respectively.

	<u>September 30, 2011</u>		<u>December 31, 2010</u>	
	<u>Carrying value \$</u>	<u>Fair value \$</u>	<u>Carrying value \$</u>	<u>Fair value \$</u>
Loans and receivables (cash and cash equivalents, cash on deposit, restricted cash, capital reserves and trade and other receivables)	11,540	11,540	10,704	10,704
Available-for-sale investments (minority interest investments in hotel properties)	795	795	777	777
Financial liabilities (trade payables and accrued liabilities, line of credit, accrued interest on convertible debentures)	13,912	13,912	11,789	11,789
Obligations under finance leases	114	114	222	222
Mortgages and loans payable	140,168	131,689	152,593	150,318
Other long-term debt	12,873	12,873	—	—
Convertible debentures	48,718	33,840	68,769	50,775
Class B LP units	26	26	34	34
Derivative liabilities	141	141	34	34

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

19 Financial instruments (continued)

i) Fair value of financial instruments (continued)

Fair value hierarchy

The following table presents the financial instruments recorded at the fair value in the interim consolidated balance sheets, classified using the fair value hierarchy described above:

	September 30, 2011			December 31, 2010		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	\$	\$	\$	\$	\$	\$
Minority interest investments in hotel properties	–	–	795	–	–	777
Derivative liabilities	–	141	–	–	34	–
Class B LP units	–	26	–	–	34	–

ii) Risk management

The REIT, through its financial assets and liabilities, has exposure to the following risks from its use of financial instruments: interest rate risk, credit risk, currency risk and liquidity risk. Senior management is responsible for setting acceptable levels of risk and reviewing risk management activities as necessary.

a) Interest rate risk

The REIT is exposed to interest rate risk on its lending and borrowing activities. It manages its exposure to interest rate risk by using fixed rate debt so cash flow is not impacted significantly by a change in interest rates. The REIT has \$38,200 in mortgages maturing in the next 12 months. The weighted average interest rate on its mortgages payable is 6.72% (December 31, 2010 - 6.75%) with a weighted average maturity of 4.3 years (December 31, 2010 - 4.7 years).

The convertible debentures have a weighted average interest rate of 6.5% (December 31, 2010 - 6.9%) and a weighted average maturity of 0.8 years (December 31, 2010 - 1.2 years).

The REIT has no long-term debt at floating rates. The REIT's lines of credit are at floating rates. For the nine months ended September 30, 2011, a 1% change in interest rates would change the net loss by \$5 (year ended December 31, 2010 - \$3).

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

19 Financial instruments (continued)

ii) Risk management (continued)

b) Credit risk

In accordance with its investment policy, the REIT invests excess cash in Government of Canada treasury bills, short-term Canadian and provincial government debt, bankers' acceptance notes and term deposits of Schedule 1 Banks. The credit risk on cash and cash equivalents is limited because the counter-parties are governments and banks with high credit-ratings assigned by international credit-rating agencies.

The amount of trade and other receivables disclosed on the balance sheet of \$4,228 is net of allowance for doubtful accounts, estimated by management based on prior experience and their assessment of the current economic environment.

Historically, there have been no significant collection issues and the REIT does not believe it is subject to any significant concentration of credit risk. The REIT assesses the credit worthiness of customers requesting credit and listings of trade receivables are reviewed by management and discussed with operations personnel on a monthly basis.

The following table sets forth details of trade and other receivables and the related allowance for doubtful accounts:

	September 30, 2011	December 31, 2010
	\$	\$
Trade and other receivables under 30 days aged	1,287	1,867
Trade and other receivables over 30 days aged	3,109	1,178
Less: Allowance for doubtful accounts	(112)	(83)
	<hr/> 4,284	<hr/> 2,962

The REIT is exposed to credit risk on its loans receivable from related parties (note 6). Management reviews the results and cash flows of these entities on a monthly basis.

c) Currency risk

The REIT earns revenue and incurs expenses in US and Canadian currency, and as such, is subject to fluctuations as a result of foreign exchange rate variations. The REIT manages its exposure to currency risk by billing for its services in the US in the underlying currency related to the expenditure. As this natural hedging effectively matches the revenue and expenses, the REIT's management considers there to be little currency risk. However, a \$0.01 change in the US dollar exchange rate will change the foreign currency gain or loss on translation of foreign operation recognized in other comprehensive income by \$42 (year ended December 31, 2010 - \$43).

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

19 Financial instruments (continued)

ii) Risk management (continued)

d) Liquidity risk

The REIT's objective is to have sufficient liquidity to meet liabilities when due, as well as to maintain compliance with liquidity covenants on financing agreements and its capital management requirements and objectives.

The REIT has \$38,200 in mortgages that mature in the next 12 months. The REIT expects to refinance its maturing mortgages at similar or better terms with existing or other lenders.

The REIT has \$49,827 face value in convertible debentures that mature on June 30, 2012. At the present time, the REIT does not have sufficient cash resources available to repay all of the outstanding convertible debentures when they mature. As well, the REIT does not expect to be in a position to repay or refinance all of the outstanding principal amount of convertible debentures when they mature.

The Board of Trustees and management of the REIT are reviewing various options to address the maturity of the convertible debentures. These options include:

- repaying a portion of the principal amount of convertible debentures, including by disposing of one or more hotel properties. At the present time, 11 of the REIT's 20 hotels are financed by mortgages that are part of commercial mortgage backed securities pools; the REIT does not intend to dispose of any of these hotels at the present time due to the terms and conditions of such mortgages. To the extent the REIT disposes of any of its hotels or other assets, it is required, pursuant to the terms of its non-revolving bridge loan, to apply at least 75% of the net proceeds resulting from such dispositions to the repayment of amounts outstanding under such bridge loan;
- refinancing all or a portion of the principal amount of convertible debentures;
- pursuing an extension of the maturity date of the convertible debentures;
- reducing the principal amount of convertible debentures outstanding prior to maturity through normal course issuer bids and/or other permitted purchases;
- satisfying all or a portion of the principal amount of the convertible debentures at maturity, or redeeming all or a portion of the principal amount of the convertible debentures prior to maturity, by issuing trust units to holders of convertible debentures rather than paying cash;
- combinations of the above options.

The REIT monitors and forecasts its cash balances and cash flows generated from operations to meet its required obligations. At September 30, 2011, the REIT had drawn \$4,895 (December 31, 2010 - \$2,519) from its available lines of credit of \$5,500.

Based on overall cash generation capability and overall financial position, while there can be no assurance, management believes the REIT will be able to meet all financial obligations as they become due, which, in the case of the convertible debentures that mature on June 30, 2012, may include the issuance of units in lieu of repayment in cash.

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

20 Income taxes

The following table is a reconciliation of expected income taxes recoverable at the statutory tax rate to the amounts recognized in the interim consolidated statements of income for the three and nine month periods ended September 30, 2011 and 2010:

	Three months ended		Nine months ended	
	September 30,	September 30,	September 30,	September 30,
	2011	2010	2011	2010
	\$	\$	\$	\$
Loss before income taxes	(1,367)	(1,281)	(7,551)	(9,629)
Income tax rate	50%	50%	50%	50%
	(684)	(641)	(3,776)	(4,815)
Non-taxable portion of capital gain	(108)	21	(580)	(3)
Non-deductible stock option expense	–	–	–	7
Unused tax losses and deductible temporary differences not recognized as tax assets	128	620	3,242	2,274
Impact on deferred tax asset of change in future tax rate due to the plan to convert to a corporation	655	–	1,271	–
Other	9	–	(157)	21
Income tax recovery	–	–	–	(2,516)

The following table is the analysis of deferred tax assets (liabilities) presented in the consolidated statements of financial position:

	September 30,	December 31,
	2011	2010
	\$	\$
Deferred tax assets		
Deferred financing fees	192	456
Non-capital losses	7,007	7,899
Property and equipment	222	–
	7,421	8,355
Deferred tax liabilities		
Convertible debentures	(339)	(1,273)
	7,082	7,082

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

20 Income taxes (continued)

Deductible temporary differences and unused tax losses for which no deferred tax assets have been recognized are attributable to the following:

	September 30, 2011	December 31, 2010
	\$	\$
Non-capital losses	2,202	7,748
Realized capital losses	5,851	7,057
Impaired loans receivable	80	80
Minority interest investments in hotel properties	539	547
Property and equipment	85,874	82,990
Other assets	472	317
Other	100	72
	<hr/>	<hr/>
	95,118	98,811

The REIT has incurred Canadian non-capital loss carryforwards which expire in the following years:

Year of expiration	Loss \$
2026	1,043
2027	2,837
2028	4,519
2029	6,402
2030	6,699
	<hr/>
	21,500

The REIT's US subsidiary has incurred US non-capital loss carryforwards which expire in the following years. All numbers in thousands of USD:

Year of expiration	USD Loss \$
2027	243
2028	341
2029	549
2030	637
	<hr/>
	1,770

21 Seasonality

The REIT's financial results for any individual quarter are not necessarily indicative of results to be expected for the full year. Revenues from hotel operations tend to fluctuate throughout the year, with greater demand in the second and third quarters of the calendar year, due to higher leisure travel in the summer months. The first quarter revenues are usually the lowest as leisure travel is lower during the winter, although certain of the REIT's hotels in Alberta and British Columbia generate higher revenue in the first quarter from oil and gas drilling activities.

Holloway Lodging Real Estate Investment Trust

Condensed Notes to Interim Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

22 Segmented information

In measuring performance, the REIT does not distinguish or group its operations on a geographic or any other basis and accordingly, results have been aggregated into a single reportable segment.

Geographical information

	Nine months ended	
	September 30, 2011 \$	September 30, 2010 \$
Revenues		
Canada	57,959	53,402
United States	1,680	1,643
	<hr/>	<hr/>
	59,639	55,045
	<hr/>	<hr/>
	September 30, 2011 \$	December 31, 2010 \$
Property and equipment		
Canada	204,835	229,990
United States	6,584	6,210
	<hr/>	<hr/>
	211,419	236,200
	<hr/>	<hr/>

23 Subsequent events

On October 6, 2011, the Super 8 in Barrie, ON, in which the REIT had a minority interest was sold. The REIT received proceeds of \$60 from the sale.

On October 7, 2011, the REIT issued 160,392 units to its trustees as compensation in lieu of cash for the third quarter of 2011.

On October 7, 2011, the REIT issued 548,000 options to purchase REIT units to trustees and certain employees with an option price of \$0.23 per unit.

Subsequent to September 30, 2011, the REIT purchased \$1,597 face value of the convertible debentures at a weighted average price of \$67.63 per \$100.00 face value (price not in thousands).