

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Financial Statements
September 30, 2009

November 9, 2009

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 Canadian generally accepted accounting principles. 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) "Glenn Squires"
Chief Executive Officer

(signed) "Tracy Sherren"
Chief Financial Officer

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Balance Sheets

As at September 30, 2009

	September 30, 2009 \$	December 31, 2008 \$
Assets		
Current assets		
Cash and cash equivalents (note 11)	151,068	4,991,951
Capital reserve	1,067,536	1,552,737
Restricted cash	570,044	653,504
Accounts receivable	3,624,956	3,376,048
Inventories	263,496	303,465
Prepaid expenses and deposits	2,333,375	2,238,765
Current portion of mezzanine loans receivable (note 4)	–	3,000,000
Assets of discontinued operations	14,779,318	–
	<hr/>	<hr/>
	22,789,793	16,116,470
Capital reserve – restricted	4,366,191	2,975,289
Loans receivable from related parties (note 3)	6,508,910	6,508,910
Mezzanine loans and advances receivable (note 4)	6,328,752	10,174,065
Investments in hotel properties	2,971,552	2,688,334
Property and equipment (note 5)	328,987,892	352,035,190
Other assets	922,370	1,123,944
Future income taxes	4,522,000	1,764,000
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	377,397,460	393,386,202
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	8,275,280	9,418,698
Distributions payable	–	684,866
Accrued interest on convertible debentures	1,112,305	674,600
Current portion of obligations under capital leases (note 6)	298,260	338,249
Current portion of mortgages and loans payable (note 7)	13,710,560	5,155,110
Liabilities of discontinued operations	7,875,874	–
	<hr/>	<hr/>
	31,272,279	16,271,523
Obligations under capital leases (note 6)	261,768	528,132
Mortgages and loans payable (note 7)	141,051,582	159,665,899
Promissory notes payable (note 8)	3,395,826	3,368,334
Convertible debentures (note 9)	65,287,107	63,457,890
	<hr/>	<hr/>
	241,268,562	243,291,778
Unitholders' Equity	136,128,898	150,094,424
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	377,397,460	393,386,202

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statements of Unitholders' Equity

For the nine-month periods ended September 30, 2009 and 2008

	Units \$	Class B LP units \$	Contributed surplus \$	Equity component of convertible debentures \$	Accumulated income (losses) \$	Accumulated distributions \$	Total \$
Balance, December 31, 2007	180,231,026	667,000	804,890	9,596,225	312,428	(17,806,019)	173,805,550
Unit-based compensation related to options	–	–	462,111	–	–	–	462,111
Exercise of options	84,268	–	(57,601)	–	–	–	26,667
Units repurchased and cancelled	(288,144)	–	72,633	–	–	–	(215,511)
Issuance costs	(2,500)	–	–	–	–	–	(2,500)
Units issued to trustees	67,828	–	–	–	–	–	67,828
Net loss	–	–	–	–	(177,247)	–	(177,247)
Distributions	–	–	–	–	–	(15,846,892)	(15,846,892)
Balance, September 30, 2008	180,092,478	667,000	1,282,033	9,596,225	135,181	(33,652,911)	158,120,006
Unit-based compensation related to options	–	–	9,362	–	–	–	9,362
Units repurchased and cancelled	(4,640)	–	3,799	–	–	–	(841)
Net loss	–	–	–	–	(4,903,223)	–	(4,903,223)
Distributions	–	–	–	–	–	(3,130,880)	(3,130,880)
Balance, December 31, 2008	180,087,838	667,000	1,295,194	9,596,225	(4,768,042)	(36,783,791)	150,094,424
Unit-based compensation related to options	–	–	48,750	–	–	–	48,750
Net loss	–	–	–	–	(9,905,079)	–	(9,905,079)
Distributions	–	–	–	–	–	(4,109,197)	(4,109,197)
Balance, September 30, 2009	180,087,838	667,000	1,343,944	9,596,225	(14,673,121)	(40,892,988)	136,128,898

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statements of Operations and Comprehensive Income (Loss)

For the three and nine-month periods ended September 30, 2009 and 2008

	Three months ended		Nine months ended	
	September 30, 2009 \$	September 30, 2008 \$	September 30, 2009 \$	September 30, 2008 \$
Hotel revenues				
Rooms	17,435,806	21,626,806	48,590,320	59,840,850
Other	2,364,566	2,882,793	7,455,670	9,001,424
	19,800,372	24,509,599	56,045,990	68,842,274
Hotel expenses				
Operating expenses	11,896,445	13,545,340	35,159,613	39,649,790
Property taxes and insurance	1,188,403	1,215,366	3,523,470	3,600,942
Management fees	503,634	621,636	1,481,823	1,743,210
	13,588,482	15,382,342	40,164,906	44,993,942
Hotel operating income	6,211,890	9,127,257	15,881,084	23,848,332
Other (income) expenses				
Interest on mortgages and other debt and accretion of deferred financing fees	2,775,030	2,720,664	8,314,248	8,233,072
Convertible debentures interest and accretion	1,896,725	1,810,162	5,604,992	5,411,398
Corporate and administrative	516,923	654,869	1,628,369	2,284,422
Interest income	(176,267)	(692,140)	(659,776)	(2,095,478)
Unrealized foreign exchange loss (gain)	(407,540)	200,428	(651,230)	329,162
Depreciation and amortization	3,237,109	3,224,308	9,726,791	9,538,199
Provision for impairment of mezzanine loans and advances	–	–	4,700,000	–
	7,841,980	7,918,291	28,663,394	23,700,775
Income (loss) before income taxes from continuing operations	(1,630,090)	1,208,966	(12,782,310)	147,557
Provision for (recovery of) future income taxes	(412,000)	641,000	(2,643,000)	773,000
Income (loss) from continuing operations	(1,218,090)	567,966	(10,139,310)	(625,443)
Income from discontinued operations (note 10)	78,746	213,132	234,231	448,196
Net income (loss) and comprehensive income (loss) for the periods	(1,139,344)	781,098	(9,905,079)	(177,247)
Basic and diluted earnings (loss) per unit				
-from continuing operations	(0.03)	0.01	(0.26)	(0.01)
-from discontinued operations	0.00	0.01	0.01	0.01

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statements of Cash Flows

For the three and nine-month periods ended September 30, 2009 and 2008

	Three months ended		Nine months ended	
	September 30, 2009 \$	September 30, 2008 \$	September 30, 2009 \$	September 30, 2008 \$
Cash provided by (used in)				
Operating activities				
Net income (loss) and comprehensive income (loss) for the periods from continuing operations	(1,218,090)	567,966	(10,139,310)	(625,443)
Charges (credits) to income not involving cash				
Unit-based compensation	15,417	119,916	48,750	462,111
Depreciation and amortization	3,237,109	3,224,308	9,726,793	9,538,967
Accretion of mortgages and convertible debentures	700,832	541,290	1,908,991	1,595,212
Unrealized foreign exchange (gain) loss	(407,540)	200,428	(651,230)	329,162
Provision for impairment of mezzanine loans and advances	–	–	4,700,000	–
Provision for (recovery of) future income taxes	(412,000)	641,000	(2,643,000)	773,000
Net change in non-cash working capital balances related to operations (note 11)	(236,881)	1,979,092	(742,126)	378,360
Cash flow from discontinued operations	423,909	569,499	1,005,835	1,172,514
Cash flow from operating activities	2,102,756	7,843,499	3,214,703	13,623,883
Investing activities				
Decrease (increase) in restricted cash	46,031	(22,192)	83,460	1,746,131
Increase in capital reserves, continuing operations	(448,804)	(492,224)	(1,091,220)	(1,552,031)
Issuance of mezzanine loans and advances	(24,333)	(1,250,000)	(854,686)	(1,250,000)
Proceeds from repayment of mezzanine loans	–	–	3,000,000	–
Issuance of loan to a related party	–	–	–	(6,350,000)
Investment in hotel properties	(4,822)	–	(283,218)	–
Additions to property and equipment	(388,647)	(230,354)	(936,304)	(1,513,963)
Increase in other assets	–	(31,500)	–	(39,015)
Additions to property and equipment, discontinued operations	(13,891)	(46,971)	(121,226)	(102,105)
Decrease (increase) in capital reserve, discontinued operations	–	(25,010)	99,346	(69,250)
Cash flow used in investing activities	(834,466)	(2,098,251)	(103,848)	(9,130,233)
Financing activities				
Repayment of capital lease obligations	(83,793)	(80,261)	(254,349)	(310,493)
Proceeds from mortgages and loans, net of financing fees, continuing operations	(40,602)	–	1,069,086	–
Repayment of mortgages and loans payable	(1,155,308)	(964,380)	(3,412,714)	(2,931,291)
Units repurchased and cancelled	–	(28,280)	–	(215,511)
Issuance costs	–	–	–	(2,500)
Exercise of options	–	26,667	–	26,667
Distributions paid to unitholders	(684,866)	(5,282,406)	(4,794,063)	(15,847,661)
Repayment of mortgages and capital leases, discontinued operations	(76,509)	(68,838)	(228,773)	(166,153)
Cash flow used in financing activities	(2,041,078)	(6,397,498)	(7,620,813)	(19,446,942)
Net change in cash and cash equivalents during the periods	(772,788)	(652,250)	(4,509,958)	(14,953,292)
Cash and cash equivalents, continuing operations – Beginning of periods	1,003,805	8,447,776	4,859,780	22,757,609
Cash and cash equivalents, discontinued operations – Beginning of periods	248,376	145,621	129,571	136,830
Cash and cash equivalents, discontinued operations – End of periods	(328,325)	(192,920)	(328,325)	(192,920)
Cash and cash equivalents, continuing operations – End of periods	151,068	7,748,227	151,068	7,748,227

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2009 and 2008

1 Basis of presentation and nature of operations

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 objectives of the REIT are: (a) to expand its asset base and increase its funds from operations through accretive acquisitions and internal growth initiatives; (b) to enhance the value of its assets to maximize long-term unit value through active management of its assets; and (c) to increase cashflow from operations in order to resume distributions to unitholders at the appropriate time.

As at September 30, 2009, the REIT owned 21 hotels in Canada and 1 hotel in the United States with 2,423 guest rooms and suites and held minority ownership interests in nine other hotels. With the sale of the Wingate by Wyndham in Calgary, AB, (note 10), the REIT now owns 20 hotels in Canada and 1 hotel in the United States with 2,320 guest rooms and suites.

2 Significant accounting policies

The accompanying unaudited consolidated financial statements have been prepared in accordance with the requirements of the Canadian Institute of Chartered Accountants (CICA) Handbook Section 1751, “Interim Financial Statements”. Accordingly, certain information and note disclosure normally included in annual financial statements prepared in accordance with Canadian generally accepted accounting principles have been omitted or condensed. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the REIT for the year ended December 31, 2008.

In the opinion of management, the unaudited interim consolidated financial statements include all adjustments considered necessary by management to present a fair statement of the results of operations, financial position and cash flows. Except as otherwise noted hereunder, these unaudited interim consolidated financial statements were prepared using the same policies and methods of computation as the audited consolidated financial statements of the REIT for the year ended December 31, 2008.

Changes in accounting standards

In the first quarter of 2009, the REIT adopted the following new Handbook Sections issued by CICA.

Goodwill and Intangible Assets

Section 3064 Goodwill and Intangible Assets establishes new standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Section 1000 Financial Statement Concepts was also amended to provide consistency with Section 3064. These new standards have no impact on the REIT’s 2009 financial statements.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2009 and 2008

3 Loans receivable from related parties

The REIT has a \$6.35 million loan receivable from Pacrim Hospitality Services Inc., a company in which a member of management and trustee 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 plus 1% on Holloway's units. As the yield on Holloway's units has declined to 0% with the suspension of distributions, the interest rate became 1% on October 1, 2009.

The REIT has a \$158,910 loan receivable from Winport Developments Inc., a company in which a member of management and trustee has a significant ownership interest. The loan is secured by 55,555 units of Holloway and a guarantee by 3475425 Canada Inc., is repayable at any time without penalty and bears interest at 12% per annum.

4 Mezzanine loans and advances receivable

The REIT provides mezzanine loans on hotel projects being developed by Winport Developments Inc., Winport Developments Limited Partnership and its partners.

	September 30, 2009 \$	December 31, 2008 \$
Winport Developments Limited Partnership, a related party, and Pacrim North York Limited Partnership, principal balance due November 3, 2011, with \$8.0 million bearing interest at 12% and \$1.5 million bearing interest at 11%	9,500,000	9,500,000
Winport Development Limited Partnership, a related party, and Pacrim North York Limited Partnership, principal balance due January 13, 2009, bearing interest at 12%	1,250,000	1,250,000
RegWin Hotel Ltd., principal balance due January 19, 2012, bearing interest at 12%, repaid on February 5, 2009	–	3,000,000
Windsor 8 Motel Limited, principal balance due January 19, 2012, bearing interest at 12%	1,913,000	1,913,000
Accrued interest on loans to Winport Developments Limited Partnership and Pacrim North York Limited Partnership to December 31, 2008	511,065	511,065
Additional advances to Winport Developments Limited Partnership and Pacrim North York Limited Partnership, non-interest bearing with no set terms of repayment and other expenses	814,677	–
Additional advances to Windsor 8 Motel Limited, non-interest bearing with no set terms of repayment	40,010	–
	<u>14,028,752</u>	<u>16,174,065</u>
Less: Current portion	–	3,000,000
Less: Provision for impairment	<u>7,700,000</u>	<u>3,000,000</u>
	<u>6,328,752</u>	<u>10,174,065</u>

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2009 and 2008

4 Mezzanine loans and advances receivable (continued)

The REIT believes that the loans to Winport Development Limited Partnership and Pacrim North York Limited Partnership are impaired. The loans are in default and the REIT has issued a demand notice for payment. On August 6, 2009, a court-appointed receiver on behalf of the first mortgagee for the property was named, with a mandate to sell the property and maximize the return to the debt-holders. The REIT's loans have been written down to the estimated fair value of the REIT's underlying security. During the nine months ended September 30, 2009, the REIT recorded an additional provision for impairment of \$4.7 million. Significant judgment was exercised by management in making this estimate. As such, actual losses will differ from the estimate and the differences could be material.

5 Property and equipment

	September 30, 2009		
	Cost \$	Accumulated amortization \$	Net \$
Land	29,216,832	-	29,216,832
Land lease	500,000	38,817	461,183
Buildings	294,168,414	18,165,633	276,002,781
Renovations in progress	326,162	-	326,162
Furniture, fixtures, equipment and other	29,307,559	10,376,017	18,931,542
Paving	3,252,178	792,178	2,460,000
Landscaping	18,047	1,428	16,619
Signage	1,025,378	225,503	799,875
Computer equipment and website	1,757,296	1,262,371	494,925
Vehicles	353,467	230,902	122,565
Tenant inducements	211,920	56,512	155,408
	360,137,253	31,149,361	328,987,892
	December 31, 2008		
	Cost \$	Accumulated amortization \$	Net \$
Land	32,216,832	-	32,216,832
Land lease	500,000	30,037	469,963
Buildings	304,904,833	13,282,864	291,621,969
Renovations in progress	220,541	-	220,541
Furniture, fixtures and equipment	29,940,422	7,549,543	22,390,879
Paving	3,619,378	644,063	2,975,315
Landscaping	22,984	1,656	21,328
Signage	1,008,114	173,139	834,975
Computer equipment and websites	1,759,212	870,297	888,915
Vehicles	353,467	146,190	207,277
Tenant inducements	211,920	24,724	187,196
	374,757,703	22,722,513	352,035,190

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2009 and 2008

6 Obligations under capital leases

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

	September 30, 2009 \$	December 31, 2008 \$
Present value of future minimum lease payments	560,028	866,381
Less: Current portion	298,260	338,249
	<u>261,768</u>	<u>528,132</u>

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

	\$
Reminder of 2009	94,175
Year ending December 31, 2010	314,951
Year ending December 31, 2011	133,694
Year ending December 31, 2012	75,174
Year ending December 31, 2013	10,311
Thereafter	<u>—</u>
Future minimum lease payments	628,305
Less: Amounts representing interest at a weighted average rate of 10.45%	<u>68,277</u>
Present value of future minimum lease payments	<u>560,028</u>

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2009 and 2008

7 Mortgages and loans payable

	September 30, 2009 \$	December 31, 2008 \$
Mortgages payable, bearing interest at a weighted average rate of 6.79% (December 31, 2008 – 6.77%) and maturing on various dates from April, 2010 to July, 2017. Individual first charges on most of the hotel properties have been pledged as security for individual mortgages	155,761,703	165,919,967
Vehicle loans payable, bearing interest at a weighted average rate of 7.64% (December 31, 2008 - 7.62%) and maturing on various dates from April, 2010 to April, 2011	54,003	98,834
	<u>155,815,706</u>	<u>166,018,801</u>
Less: Deferred financing fees	1,053,564	1,197,792
Less: Current portion	<u>13,710,560</u>	<u>5,155,110</u>
	<u>141,051,582</u>	<u>159,665,899</u>

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

	\$
Reminder of 2009	1,244,900
Year ending December 31, 2010	13,603,024
Year ending December 31, 2011	29,998,129
Year ending December 31, 2012	18,800,669
Year ending December 31, 2013	2,901,629
Thereafter	89,267,355

The current portion of long-term debt on the balance sheet is based on the twelve months ending September 30, 2010, whereas the repayment schedule above reflects the fiscal year. The current portion of long-term debt on the balance sheet includes \$8.9 million of the principal for two mortgages that mature on April 1, 2010. The REIT is in the process of refinancing these mortgages.

8 Promissory notes payable

On December 22, 2008, the REIT issued two promissory notes for \$3.0 million and \$551,613, respectively, payable to Winport Developments Limited Partnership to finance the acquisition of the investments in hotel properties. The \$3.0 million promissory note bears interest at 6% per year until December 22, 2011 and 12% per year, thereafter. The \$551,613 note does not bear interest and therefore has been discounted by \$183,279, 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.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2009 and 2008

9 Convertible debentures

On August 1, 2006, the REIT issued \$20,238,000 in convertible, redeemable debentures. The debentures bear interest at 8%, payable semi-annually on February 1st and August 1st, 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.

On June 21, 2007, the REIT issued \$45,000,000 in convertible, redeemable debentures. The debentures bear interest at 6.5%, payable semi-annually on June 30th and December 31st, and mature in five years. 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 \$6,844,000 in convertible, redeemable debentures with the same terms as the June 21, 2007 debentures, pursuant to the underwriters exercising their over-allotment option.

In the event, the REIT gives notice of redemption, the debenture holders have 30 days to elect to convert their debentures into units.

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 of \$5,300,000 on the August 1, 2006 8% debentures, \$4,150,000 on the June 21, 2007 6.5% debentures and \$644,000 on the July 18, 2007 6.5% debentures 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, using the effective interest rate method, over the terms of the debentures.

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.

	September 30, 2009	December 31, 2008
	\$	\$
Debt component	61,988,000	61,988,000
Accretion of convertible debentures	4,782,600	3,336,996
Deferred financing fees	(1,483,493)	(1,867,106)
	<u>65,287,107</u>	<u>63,457,890</u>

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2009 and 2008

10 Discontinued operations

The operations of the Wingate by Wyndham hotel in Calgary, Alberta have been included in discontinued operations on the consolidated statement of operations and comprehensive income (loss) and are reflected as assets and liabilities of discontinued operations on the consolidated balance sheet.

On August 5, 2009, the REIT entered into a binding agreement for the sale of this hotel to an arm's length purchaser for \$16.5 million, representing a gain of approximately \$1.4 million. After repayment of the mortgage on the property, net cash proceeds were approximately \$8.7 million. The income from the property after July 31, 2009 accrued to the purchaser. The sale transaction closed on October 5, 2009.

Discontinued operations for the three and nine month periods are as follows:

	<u>Three months ended</u>		<u>Nine months ended</u>	
	<u>September 30, 2009</u>	<u>September 30, 2008</u>	<u>September 30, 2009</u>	<u>September 30, 2008</u>
	\$	\$	\$	\$
Hotel revenues	442,739	1,238,429	2,441,989	3,282,716
Hotel expenses	235,405	678,305	1,450,233	1,888,756
Hotel operating income	207,334	560,124	991,756	1,393,960
Interest on mortgages and other debt and accretion of deferred financing fees	39,437	120,083	272,863	361,106
Depreciation and amortization	46,151	125,909	319,662	373,658
	85,588	245,992	592,525	734,764
Income before income taxes	121,746	314,132	399,231	659,196
Provision for future income taxes	43,000	101,000	165,000	211,000
Income from discontinued operations	78,746	213,132	234,231	448,196

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2009 and 2008

11 Supplemental cash flow information

Net change in non-cash working capital balances related to operations:

	Three months ended		Nine months ended	
	September 30, 2009 \$	September 30, 2008 \$	September 30, 2009 \$	September 30, 2008 \$
Accounts receivable	(255,186)	367,804	(305,303)	(1,212,200)
Inventories	5,237	(49,770)	38,287	61,073
Prepaid expenses and deposits	(6,855)	327,006	(125,253)	565,389
Accounts payable and accrued liabilities	(417,782)	896,347	(787,562)	526,393
Accrued interest on convertible debentures	437,705	437,705	437,705	437,705
	<u>(236,881)</u>	<u>1,979,092</u>	<u>(742,126)</u>	<u>378,360</u>

Cash and cash equivalents are comprised of the following:

	September 30, 2009 \$	December 31, 2008 \$
Cash on hand and balances with banks, continuing operations	151,068	4,991,951
Cash on hand and balances with banks, discontinued operations	328,325	—
	<u>479,393</u>	<u>4,991,951</u>

12 Seasonality

Revenues from hotel operations tend to fluctuate throughout the year, with greater demand in the second and third quarters of the calendar year.

13 Capital management

The REIT defines capital as the aggregate of unitholders' 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, bank 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 debt and/or issue or redeem units.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2009 and 2008

13 Capital management (continued)

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

- a Debt Service coverage ratio defined as earnings before interest, income taxes, depreciation, amortization, non-cash accretion of deferred financing fees and unit-based compensation (Earnings base) to mortgage, loans, promissory notes and capital lease interest and principal payments (Debt Service); and
- a Debt to Gross Book Value (Debt to GBV) ratio defined as mortgages and loans payable, obligations under capital leases, promissory notes and the face value of the convertible debentures (Debt) divided by total assets plus accumulated depreciation and amortization (GBV). This ratio cannot exceed 60% based on the REIT's Declaration of Trust.

	September 30, 2009 \$	December 31, 2008 \$
Capital structure		
Obligations under capital leases	560,028	866,381
Mortgages and loans payable	154,762,142	164,821,009
Mortgage and capital leases of discontinued operations	6,943,727	—
Convertible debentures	65,287,107	63,457,890
Promissory notes	3,395,826	3,368,334
Total debt	230,948,830	232,513,614
Unitholders' equity	136,128,898	150,094,424
Total capital	367,077,728	382,608,038
Ratios		
Total debt	230,948,830	232,513,614
Adjustment of convertible debentures to face value	6,794,893	8,624,110
Adjustment of promissory notes to face value	155,787	183,279
Debt	237,899,510	241,321,003
Gross book value of continuing operations	394,199,439	416,447,047
Gross book value of discontinued operations	16,205,747	—
	410,405,186	416,447,047
Debt to GBV	58.0%	57.9%
Trailing 12 months ended		
	September 30, 2009 \$	December 31, 2008 \$
Earnings base	22,182,970	30,019,577
Debt service	21,565,124	21,093,105
Debt service ratio	1.03	1.52

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13 Capital management (continued)

The REIT is also subject to financial covenants on its mortgages payable, which are measured on an annual basis and include customary terms and conditions for borrowings of this nature. These include the Debt Service ratio presented above. The REIT is in compliance with, or has obtained waivers for, all its financial covenants.

For 2008 and 2009, cash distributions to unitholders exceeded the REIT's distributable income, as defined in the REIT's Declaration of Trust. On November 13, 2008, the REIT reduced its distributions to \$0.21 per unit on an annual basis. On July 21, 2009, the REIT suspended distributions.

14 Financial instruments

i) Fair value of financial instruments

The REIT's financial instruments consist of cash and cash equivalents, restricted cash, accounts receivable, mezzanine loans and advances receivable, capital reserves, loans receivable from related parties, accounts payable and accrued liabilities, distributions payable, accrued interest on convertible debentures, obligations under capital leases, mortgages and loans payable, promissory notes payable and convertible debentures. The REIT's cash and cash equivalents, restricted cash, accounts receivable, capital reserves, accounts payable and accrued liabilities, distributions payable 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.

The fair value of the REIT's obligations under capital leases and mortgages and loans payable is based on discounted future cashflows using discount rates that reflect current market conditions for instruments with similar terms and risks. The fair values do not necessarily represent amounts the REIT might pay in actual market transactions. The fair value of the convertible debentures is the trading value at September 30, 2009 and December 31, 2008, respectively.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2009 and 2008

14 Financial instruments (continued)

	September 30, 2009		December 31, 2008	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
Held for trading (cash, restricted cash and capital reserve)	6,154,839	6,154,839	10,173,481	10,173,481
Loans and receivables (accounts receivable)	3,624,956	3,624,956	3,376,048	3,376,048
Other financial liabilities (accounts payable and accrued liabilities, distributions payable and accrued interest on convertible debentures)	9,387,585	9,387,585	10,778,164	10,778,164
Obligations under capital leases	560,028	560,028	866,381	866,381
Mortgages and loans payable	154,762,142	162,680,738	164,821,009	179,289,428
Convertible debentures	74,883,332	43,834,019	73,054,115	43,832,469

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, liquidity risk and currency risk. Senior management is responsible for setting acceptable levels of risk and reviewing risk management activities as necessary.

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 that cashflow is not impacted significantly by a change in interest rates. The REIT does not have any mortgages to be re-financed in 2009 and \$8.9 million to be re-financed in 2010. The weighted average interest rate on its mortgages payable is 6.79% (December 31, 2008 - 6.77%) with a weighted average maturity of 5.6 years (December 31, 2008 - 6.4 years). The convertible debentures have a weighted average interest rate of 6.9% (December 31, 2008 - 6.9%) and a weighted average maturity of 2.5 years (December 31, 2008 - 3.2 years).

At September 30, 2009, the REIT had no long-term debt at floating rates and thus, for the three and nine months ended September 30, 2009, a 1% change in interest rates would not change the net loss.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

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14 Financial instruments (continued)

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 accounts receivable disclosed in the balance sheet of \$3,624,956 is net of allowances for bad debts, estimated by management based on prior experience and their assessment of the current economic environment.

Historically, there have been no 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 accounts receivable are reviewed by management on a monthly basis.

The following table sets forth details of accounts receivable and the related allowance for doubtful accounts:

	September 30, 2009 \$	December 31, 2008 \$
Accounts receivable under 30 days aged	2,350,321	2,111,945
Accounts receivable over 30 days aged	1,457,760	1,349,345
Less: Allowance for doubtful accounts	(183,125)	(85,242)
	<u>3,624,956</u>	<u>3,376,048</u>

The REIT is exposed to credit risk on its loans receivable from related parties and mezzanine loans receivable. The mezzanine loans are secured by a second or third charge on the property. Management reviews the results and cashflows of these entities on a monthly basis and will take steps to enforce its security when this is deemed appropriate.

Currency risk

The REIT incurs revenue and expenses in U.S. and Canadian currency, and as such, is subject to fluctuations as a result of foreign exchange rate variation. The REIT manages its exposure to currency risk by billing for its services in the U.S. 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 unrealized foreign exchange gain or loss by \$44,028 (December 31, 2008 - \$44,735).

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Notes to Unaudited Consolidated Financial Statements

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14 Financial instruments (continued)

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 contracts and its capital management requirements and objectives. In November 2008, distributions were reduced to \$0.0175 per unit per month (\$0.21 per unit annually) and on July 21, 2009, the REIT suspended distributions in order to conserve cash and satisfy its operating obligations, including principal repayments. The REIT monitors and forecasts its cash balances and cash flows generated from operations to meet its requirements. Based on overall cash generation capacity and overall financial position, while there can be no assurance, management believes the REIT will be able to meet financial obligations as they come due while maintaining compliance with all financial covenants.

