

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Financial Statements
September 30, 2010

November 9, 2010

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 judgment.

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) "Tracy C. Sherren"
Chief Financial Officer

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Balance Sheets

As at September 30, 2010

(In thousands of dollars)

	September 30, 2010 \$	December 31, 2009 \$
Assets		
Current assets		
Cash and cash equivalents (note 10)	347	3,756
Capital reserve	1,106	912
Restricted cash	569	560
Accounts receivable	3,727	2,438
Inventories	264	280
Prepaid expenses and deposits	2,493	4,479
Assets of discontinued operations	–	717
	8,506	13,142
Capital reserve – restricted	5,696	4,691
Loans receivable from related parties (note 3)	6,398	6,509
Investments in hotel properties	1,217	1,961
Property and equipment (note 5)	322,987	326,465
Other assets	764	877
Future income taxes	7,082	4,566
	352,650	358,211
Liabilities		
Current liabilities		
Line of credit	1,000	–
Accounts payable and accrued liabilities	8,419	7,856
Accrued interest on convertible debentures	1,112	675
Current portion of obligations under capital leases (note 6)	172	285
Current portion of mortgages and loans payable (note 7)	7,378	4,953
Current portion of convertible debentures (note 9)	18,756	–
Liabilities of discontinued operations	–	638
	36,837	14,407
Obligations under capital leases (note 6)	114	222
Mortgages and loans payable (note 7)	146,667	148,530
Promissory notes payable (note 8)	3,211	3,405
Convertible debentures (note 9)	49,246	65,935
	236,075	232,499
Unitholders' Equity	116,575	125,712
	352,650	358,211

Holloway Lodging Real Estate Investment Trust
 Unaudited Consolidated Statements of Unitholders' Equity
 For the nine-month periods ended September 30, 2010 and 2009

(In thousands of dollars)

	Units \$	Class B LP units \$	Contributed surplus \$	Equity component of convertible debentures \$	Accumulated income (losses) \$	Accumulated distributions \$	Total \$
Balance, December 31, 2008	180,088	667	1,295	9,596	(4,768)	(36,784)	150,094
Unit-based compensation related to options	–	–	49	–	–	–	49
Net loss	–	–	–	–	(9,905)	–	(9,905)
Distributions	–	–	–	–	–	(4,109)	(4,109)
Balance, September 30, 2009	180,088	667	1,344	9,596	(14,673)	(40,893)	136,129
Unit-based compensation related to options	–	–	15	–	–	–	15
Net loss	–	–	–	–	(10,432)	–	(10,432)
Balance, December 31, 2009	180,088	667	1,359	9,596	(25,105)	(40,893)	125,712
Unit-based compensation related to options	–	–	16	–	–	–	16
Exchange of units	460	(460)	–	–	–	–	–
Net loss	–	–	–	–	(9,153)	–	(9,153)
Balance, September 30, 2010	180,548	207	1,375	9,596	(34,258)	(40,893)	116,575

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statements of Operations and Comprehensive Loss

For the three and nine-month periods ended September 30, 2010 and 2009

(In thousands of dollars except per unit amounts)

	Three months ended		Nine months ended	
	September 30, 2010 \$	September 30, 2009 \$	September 30, 2010 \$	September 30, 2009 \$
Hotel revenues				
Rooms	18,812	17,436	47,658	48,590
Other	2,361	2,364	7,387	7,456
	21,173	19,800	55,045	56,046
Hotel expenses				
Operating expenses	12,789	11,896	35,276	35,160
Property taxes and insurance	1,161	1,188	3,478	3,523
Management fees	536	504	1,369	1,482
	14,486	13,588	40,123	40,165
Hotel operating income	6,687	6,212	14,922	15,881
Other (income) expenses				
Interest on mortgages and other debt	2,706	2,724	8,098	8,268
Interest on convertible debentures	1,247	1,247	3,742	3,742
Accretion on convertible debentures, mortgages and deferred financing fees	820	701	2,293	1,909
Corporate and administrative	382	517	2,425	1,628
Interest income	(38)	(176)	(103)	(660)
Unrealized foreign exchange gain	(161)	(408)	(103)	(651)
Depreciation and amortization	3,249	3,237	9,707	9,727
Loss (gain) on disposal	(72)	–	62	–
Loss on acquisition of hotel property	–	–	47	–
Provision for impairment on investments in hotel properties	423	–	423	–
Provision for impairment of mezzanine loans and advances	–	–	–	4,700
	8,556	7,842	26,591	28,663
Loss before income taxes from continuing operations	(1,869)	(1,630)	(11,669)	(12,782)
Recovery of future income taxes	–	412	2,516	2,643
Net loss from continuing operations	(1,869)	(1,218)	(9,153)	(10,139)
Income from discontinued operations (note 11)	–	79	–	234
Net loss and comprehensive loss for the periods	(1,869)	(1,139)	(9,153)	(9,905)
Basic and diluted earnings (loss) per unit				
-from continuing operations	(0.05)	(0.03)	(0.23)	(0.26)
-from discontinued operations	0.00	0.00	0.00	0.01

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statements of Cash Flows

For the three and nine-month periods ended September 30, 2010 and 2009

(In thousands of dollars)

	Three months ended		Nine months ended	
	September 30, 2010 \$	September 30, 2009 \$	September 30, 2010 \$	September 30, 2009 \$
Cash provided by (used in)				
Operating activities				
Net loss from continuing operations for the periods	(1,869)	(1,218)	(9,153)	(10,139)
Charges (credits) to income not involving cash (note 10)	4,259	3,134	9,928	13,090
	2,390	1,916	775	2,951
Net change in non-cash working capital balances related to operations (note 10)	(1,600)	(237)	1,516	(742)
Cash flow from discontinued operations	–	424	49	1,006
Cash flow from operating activities	790	2,103	2,340	3,215
Investing activities				
Decrease (increase) in restricted cash	19	46	(9)	83
Decrease (increase) in capital reserve	(38)	(449)	(1,199)	(992)
Issuance of mezzanine loans and advances	–	(24)	–	(855)
Proceeds from sale of (increase in) investments in hotel properties	72	(5)	271	(283)
Proceeds from repayment of mezzanine loan	–	–	–	3,000
Additions to property and equipment and other assets	(731)	(403)	(3,042)	(1,057)
Cash flow used in investing activities	(678)	(835)	(3,979)	(104)
Financing activities				
Repayment of capital lease obligations	(69)	(84)	(222)	(254)
Proceeds from mortgages and loans, net of deferred financing fees	(40)	(41)	10,221	1,069
Repayment of mortgages and loans payable	(1,232)	(1,155)	(12,578)	(3,413)
Repayment of promissory notes	(221)	–	(221)	–
Increase in line of credit	1,000	–	1,000	–
Distributions paid to unitholders	–	(685)	–	(4,794)
Repayment of mortgages and capital leases, discontinued operations	–	(76)	–	(229)
Cash flow used in financing activities	(562)	(2,041)	(1,800)	(7,621)
Net change in cash and cash equivalents during the periods	(450)	(773)	(3,439)	(4,510)
Cash and cash equivalents, continuing operations – Beginning of periods	797	1,004	3,756	4,860
Cash and cash equivalents, discontinued operations – Beginning of periods	–	248	30	129
	797	1,252	3,786	4,989
Cash and cash equivalents, continuing operations – End of periods	347	151	347	151
Cash and cash equivalents, discontinued operations – End of periods	–	328	–	328
	347	479	347	479

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

1 Basis of presentation and nature of operations

Holloway Lodging Real Estate Investment Trust (“Holloway” 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 cash flows from operations in order to resume distributions to unitholders at the appropriate time.

As at September 30, 2010, the REIT owned 21 hotels in Canada and 1 hotel in the United States with 2,386 guest rooms and suites and held minority ownership interests in six other hotels.

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, 2009.

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, 2009.

3 Loans receivable from related parties

The REIT has a \$6,239 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 declined to 0% with the suspension of distributions, the interest rate is currently 1%.

During the second quarter of 2010, the loan was reduced by \$111 representing the unpaid remuneration for services rendered between Pacrim Hospitality Services Inc. and the Windsor Super 8 hotel and was applied against the principal balance of the loan when the Windsor Super 8 hotel was acquired.

The REIT has a \$159 loan receivable due December 31, 2011 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 the REIT and a guarantee by 3475425 Canada Inc., a company in which a member of management and trustee has a significant ownership interest, is repayable at any time without penalty and bears interest at 12% per annum.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

4 Acquisition of hotel property

During the second quarter of 2010, the REIT acquired the Super 8 hotel in Windsor, Nova Scotia. As Holloway had provided a \$1.9 million mezzanine loan to the hotel which was in default, the owners relinquished ownership to Holloway pursuant to a quit claim. Holloway assumed all the assets and liabilities of the hotel effective June 1, 2010. The excess of liabilities assumed over assets acquired of \$47 was recorded as a loss on acquisition of hotel property. The acquisition has been accounted for under the purchase method and accordingly, the results of the operations of the hotel since the date of acquisition have been included in the consolidated statement of income. The following table details the acquisition and how it was financed:

Location: Windsor, Nova Scotia

Date of Acquisition: June 1, 2010

	\$
Assets acquired	
Land	300
Building	2,400
Furniture, fixtures, equipment and other	340
Signage	10
Franchise fees	14
Other working capital and short-term liabilities assumed	(277)
	<u>2,787</u>
Financed by	
Assumed mortgage	2,834
Excess of liabilities over assets acquired	(47)
	<u>2,787</u>

5 Property and equipment

	<u>September 30, 2010</u>		
	Cost \$	Accumulated amortization \$	Net \$
Land	29,534	—	29,534
Land lease	500	50	450
Buildings	296,743	25,532	271,211
Renovations in progress	326	—	326
Furniture, fixtures, equipment and other	32,581	14,732	17,849
Paving	3,315	1,122	2,193
Landscaping	24	5	19
Signage	1,312	336	976
Computer equipment and websites	1,976	1,688	288
Vehicles	353	325	28
Tenant inducements	212	99	113
	<u>366,876</u>	<u>43,889</u>	<u>322,987</u>

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

5 Property and equipment (continued)

	December 31, 2009		
	Cost	Accumulated	Net
	\$	amortization	\$
	\$	\$	\$
Land	29,217	–	29,217
Land lease	500	42	458
Buildings	294,179	20,002	274,177
Renovations in progress	684	–	684
Furniture, fixtures and equipment and other	29,403	11,450	17,953
Paving	3,315	875	2,440
Landscaping	18	2	16
Signage	1,122	252	870
Computer equipment and websites	1,799	1,388	411
Vehicles	353	259	94
Tenant inducements	212	67	145
	<u>360,802</u>	<u>34,337</u>	<u>326,465</u>

6 Obligations under capital leases

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

	September 30, 2010	December 31, 2009
	\$	\$
Present value of future minimum lease payments	286	507
Less: Current portion	172	285
	<u>114</u>	<u>222</u>

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

	\$
Remainder of 2010	70
Year ending December 31, 2011	147
Year ending December 31, 2012	85
Year ending December 31, 2013	11
	<u>313</u>
Future minimum lease payments	313
Less: Amounts representing interest at a weighted average rate of 10.60%	27
Present value of future minimum lease payments	<u>286</u>

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

7 Mortgages and loans payable

	September 30, 2010 \$	December 31, 2009 \$
Mortgages payable, bearing interest at a weighted average rate of 6.81% (December 31, 2009 - 6.82%) and maturing on various dates from June 2011 to July 2017. Individual first charges on most of the hotel properties have been pledged as security for individual mortgages	155,035	154,446
Other	7	39
	<hr/> 155,042	<hr/> 154,485
Less: Deferred financing fees	997	1,002
Less: Current portion	7,378	4,953
	<hr/> 146,667	<hr/> 148,530

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

	\$
Remainder of 2010	1,260
Year ending December 31, 2011	30,509
Year ending December 31, 2012	21,777
Year ending December 31, 2013	3,309
Year ending December 31, 2014	3,537
Thereafter	94,650

8 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 investments in hotel properties. 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 has been discounted by \$183, 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. During the third quarter of 2010, Holloway repaid \$221 on the \$3,000 promissory note as a result of the sale of its interests in two hotels. 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.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

9 Convertible debentures

On August 1, 2006, the REIT issued \$20,238 in convertible, redeemable debentures. The debentures bear interest at 8%, payable semi-annually on February 1st and August 1st and mature on August 1, 2011. 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 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.

Subject to various conditions and time frames, the REIT can redeem the debentures. In the event the REIT gives notice of redemption, the debenture holders have 30 days to elect to convert their debentures into units.

The REIT has the option to repay the principal amount of the 6.5% debentures, in whole or in part, at 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. This alternative does not exist with the 8% debentures.

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 on the August 1, 2006 8% debentures, \$4,150 on the June 21, 2007 6.5% debentures and \$644 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. This 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 components to their face value over the term of the debentures.

	September 30, 2010	December 31, 2009
	\$	\$
Debt component	61,988	61,988
Accretion of convertible debentures	6,933	5,295
Deferred financing fees	(919)	(1,348)
Current portion	(18,756)	—
	<u>49,246</u>	<u>65,935</u>

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

10 Supplemental cash flow information

Charges (credits) to income not involving cash:

	Three months ended		Nine months ended	
	September 30, 2010 \$	September 30, 2009 \$	September 30, 2010 \$	September 30, 2009 \$
Unit-based compensation	–	16	15	48
Depreciation and amortization	3,249	3,237	9,707	9,727
Accretion on mortgages and convertible debentures	820	701	2,293	1,909
(Gain) loss on disposal of investments in properties	(83)	–	49	–
Loss on acquisition of hotel property	–	–	47	–
Loss on disposal of property and equipment	11	–	13	–
Provision for impairment on investments in hotel properties	423	–	423	–
Provision for impairment of mezzanine loans and advances	–	–	–	4,700
Unrealized foreign exchange gain	(161)	(408)	(103)	(651)
Recovery of future income taxes	–	(412)	(2,516)	(2,643)
	<u>4,259</u>	<u>3,134</u>	<u>9,928</u>	<u>13,090</u>

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

	Three months ended		Nine months ended	
	September 30, 2010 \$	September 30, 2009 \$	September 30, 2010 \$	September 30, 2009 \$
Accounts receivable	(840)	(255)	(1,289)	(305)
Inventories	(2)	5	16	38
Prepaid expenses and deposits	273	(7)	1,986	(125)
Accounts payable and accrued liabilities	(1,469)	(418)	365	(788)
Accrued interest on convertible debentures	438	438	438	438
	<u>(1,600)</u>	<u>(237)</u>	<u>1,516</u>	<u>(742)</u>

Cash and cash equivalents are comprised of the following:

	September 30, 2010 \$	December 31, 2009 \$
Cash on hand and balances with banks	<u>347</u>	<u>3,756</u>

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

11 Discontinued operations

On October 5, 2009, the REIT sold the Wingate by Wyndham hotel in Calgary, AB (the “Wingate”). Accordingly, operations of the Wingate have been included in discontinued operations on the consolidated statements of operations and comprehensive loss and are reflected as assets and liabilities of discontinued operations on the consolidated balance sheets.

Discontinued operations for the three and nine months ended September 30, 2010 and 2009 are as follows:

	Three months ended		Nine months ended	
	September 30, 2010 \$	September 30, 2009 \$	September 30, 2010 \$	September 30, 2009 \$
Hotel revenues	–	443	–	2,442
Hotel expenses	–	236	–	1,450
Hotel operating income	–	207	–	992
Interest on mortgages and other debt and accretion of deferred financing fees	–	39	–	273
Depreciation and amortization	–	46	–	320
	–	85	–	593
Income before income taxes	–	122	–	399
Provision for future income taxes	–	43	–	165
Income from discontinued operations	–	79	–	234

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, 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. Certain of the REIT’s hotels in Alberta and British Columbia generate higher revenues in the first quarter from oil and gas drilling activities.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

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.

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 mortgages, 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, the face value of promissory notes and the face value of convertible debentures ("Debt") divided by total assets plus accumulated depreciation and amortization ("GBV"). The REIT's Declaration of Trust states that the REIT's Debt to GBV should not exceed 60%.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

13 Capital management (continued)

	September 30, 2010 \$	December 31, 2009 \$
Capital structure		
Line of credit	1,000	–
Obligations under capital leases	286	507
Mortgages and loans payable	154,045	153,483
Convertible debentures	68,002	65,935
Promissory notes	3,211	3,405
Total debt	226,544	223,330
Unitholders' equity	116,575	125,712
Total capital	343,119	349,042
Ratios		
Total debt	226,544	223,330
Adjustment of convertible debentures to face value	4,080	6,147
Adjustment of promissory notes to face value	119	146
Debt	230,743	229,623
Gross book value	397,152	393,025
Debt to GBV	58.1%	58.4%
Trailing 12 months ended		
	September 30, 2010 \$	December 31, 2009 \$
Earnings base	15,563	18,909
Debt service	20,946	21,520
Debt service ratio	0.74	0.88

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 ratio presented above. The REIT is in compliance with, or has obtained waivers for, all financial covenants that are measured on a quarterly basis.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

14 Financial instruments

i) Fair value of financial instruments

The REIT's financial instruments consist of cash and cash equivalents, restricted cash, accounts receivable, capital reserves, loans receivable from related parties, line of credit, accounts payable and accrued liabilities, 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, line of credit, accounts receivable, capital reserves, accounts payable 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.

The fair value of the REIT's obligations under capital leases and mortgages and loans payable 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 amounts the REIT might pay in actual market transactions. The fair value of the convertible debentures is the trading value at September 30, 2010 and December 31, 2009, respectively.

	September 30, 2010		December 31, 2009	
	Carrying value \$	Fair value \$	Carrying value \$	Fair value \$
Held for trading (cash, restricted cash and capital reserves)	7,718	7,718	9,919	9,919
Loans and receivables (accounts receivable)	3,727	3,727	2,438	2,438
Other financial liabilities (accounts payable and accrued liabilities, and accrued interest on convertible debentures)	9,531	9,531	8,531	8,531
Line of credit	1,000	1,000	—	—
Obligations under capital leases	286	286	507	507
Mortgages and loans payable	154,045	153,632	153,483	152,929
Convertible debentures	77,598	48,118	75,531	44,254

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

14 Financial instruments (continued)

ii) Fair value hierarchy

Financial instruments recorded at fair value on the balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1: valuation based on quoted prices observed in active markets for identical assets or liabilities.

Level 2: valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: valuation techniques with significant unobservable market inputs.

A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

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

	September 30, 2010			December 31, 2009		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	\$	\$	\$	\$	\$	\$
Financial assets						
Cash and cash equivalents	347	—	—	3,756	—	—
Capital reserves	6,802	—	—	5,603	—	—
Restricted cash	569	—	—	560	—	—

iii) 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.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

14 Financial instruments (continued)

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 cash flow is not impacted significantly by a change in interest rates. The REIT had \$8,905 in mortgages maturing on April 1, 2010, which it refinanced on March 1, 2010 at a 6.6% interest rate (the interest rate on the maturing mortgages was 9.285%). The REIT does not have any additional mortgages to be re-financed in 2010. The weighted average interest rate on its mortgages payable is 6.81% (December 31, 2009 - 6.82%) with a weighted average maturity of 4.9 years (December 31, 2009 - 5.4 years). The convertible debentures have a weighted average interest rate of 6.9% (December 31, 2009 - 6.9%) and a weighted average maturity of 1.5 years (December 31, 2009 - 2.2 years).

At September 30, 2010, the REIT had no long-term debt at floating rates and thus, for the three and nine months ended September 30, 2010, a 1% change in interest rates would not change the net loss. The REIT's lines of credit are at floating rates.

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 \$3,727 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 significant or material 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 and discussed with operations personnel on a monthly basis.

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

	September 30, 2010	December 31, 2009
	\$	\$
Accounts receivable under 30 days aged	2,127	1,503
Accounts receivable over 30 days aged	1,690	1,065
Less: Allowance for doubtful accounts	(90)	(130)
	<hr/>	<hr/>
	3,727	2,438
	<hr/>	<hr/>

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

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2010 and 2009

(All dollar amounts are in thousands, except per unit amounts)

14 Financial instruments (continued)

Currency risk

The REIT earns revenue and incurs expenses in U.S. 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 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 U.S. dollar exchange rate will change the unrealized foreign exchange gain or loss by \$43 (December 31, 2009 - \$44).

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.

On July 21, 2009, the REIT suspended distributions in order to conserve cash and satisfy its operating obligations, including principal repayments on its mortgages and loans payable and obligations under capital leases. On March 1, 2010, the REIT re-financed two mortgages, totalling \$8,905, that were scheduled to mature on April 1, 2010. The REIT does not have any additional mortgages that mature in 2010 but has mortgages maturing in the first nine months of 2011 of \$2,200. The REIT has approached the existing mortgagor on this maturing mortgage to a positive initial response.

The REIT also has \$20,238 in convertible debentures that are due in August 2011. The Board and management established an action plan to raise funds to repay the debenture holders either by new debt financing, by the sale of certain properties, or by some combination thereof.

The REIT monitors and forecasts its cash balances and cash flows generated from operations to meet its requirements. At September 30, 2010, the REIT had drawn \$1,000 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 financial obligations as they come due.

