

Holloway Lodging Real Estate Investment Trust

Interim Consolidated Financial Statements

(Unaudited)

March 31, 2011

June 7, 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) "Tracy C. Sherren"
Chief Financial Officer

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Financial Position (Unaudited)

(in thousands of Canadian dollars)

| | March 31, 2011 \$ | December 31, 2010 \$ | January 1, 2010 \$ |
|---|-------------------------|----------------------------|--------------------------|
| Assets | | | |
| Current assets | | | |
| Cash and cash equivalents (note 17) | 307 | 830 | 3,786 |
| Restricted cash | 514 | 551 | 560 |
| Capital reserve – internally restricted | 897 | 921 | 912 |
| Trade and other receivables | 3,585 | 2,962 | 3,125 |
| Inventories | 268 | 261 | 279 |
| Prepaid expenses and deposits | 3,176 | 2,617 | 4,493 |
| | <u>8,747</u> | <u>8,142</u> | <u>13,155</u> |
| Non-current assets | | | |
| Property and equipment (note 6) | 234,256 | 236,200 | 240,238 |
| Investments in hotel properties | 777 | 777 | 912 |
| Loans receivable from related parties (note 7) | 6,398 | 6,398 | 6,509 |
| Capital reserve – restricted | 5,314 | 5,440 | 4,691 |
| Deferred income tax assets | 7,082 | 7,082 | 4,566 |
| Other assets (note 8) | 669 | 718 | 877 |
| | <u>254,496</u> | <u>256,615</u> | <u>257,793</u> |
| Total assets | <u>263,243</u> | <u>264,757</u> | <u>270,948</u> |
| Liabilities | | | |
| Current liabilities | | | |
| Line of credit (note 9) | 3,564 | 2,519 | – |
| Trade payables and accrued liabilities | 9,372 | 8,595 | 8,494 |
| Accrued interest on convertible debentures | 1,112 | 675 | 675 |
| Current portion of mortgages and loans payable (note 10) | 42,155 | 49,047 | 41,770 |
| Current portion of convertible debentures (note 11) | 19,535 | 19,138 | – |
| Current portion of obligations under finance leases (note 12) | 119 | 132 | 285 |
| Derivative liability (note 13) | 2 | 34 | 105 |
| Class B LP units (note 15) | 34 | 34 | 147 |
| | <u>75,893</u> | <u>80,174</u> | <u>51,476</u> |
| Non-current liabilities | | | |
| Mortgages and loans payable (note 10) | 109,214 | 103,546 | 111,713 |
| Convertible debentures (note 11) | 49,956 | 49,597 | 65,935 |
| Promissory notes payable (note 14) | 3,212 | 3,203 | 3,405 |
| Obligations under finance leases (note 12) | 66 | 90 | 222 |
| | <u>162,448</u> | <u>156,436</u> | <u>181,275</u> |
| Total liabilities | <u>238,341</u> | <u>236,610</u> | <u>232,751</u> |
| Equity | <u>24,902</u> | <u>28,147</u> | <u>38,197</u> |
| Total liabilities and equity | <u>263,243</u> | <u>264,757</u> | <u>270,948</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 three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars)

| | Units (note 15) \$ | Contributed surplus \$ | Retained earnings (deficit) \$ | Accumulated other comprehensive income \$ | Total equity \$ |
|---|--------------------------|------------------------------|---|---|-----------------------|
| Balance, January 1, 2011 | 180,219 | 1,374 | (152,740) | (706) | 28,147 |
| Net loss for the period | – | – | (3,240) | – | (3,240) |
| Other comprehensive income (loss) | – | – | – | (5) | (5) |
| Balance, March 31, 2011 | <u>180,219</u> | <u>1,374</u> | <u>(155,980)</u> | <u>(711)</u> | <u>24,902</u> |
| Balance, January 1, 2010 | 180,088 | 1,359 | (142,201) | (1,049) | 38,197 |
| Net loss for the period | – | – | (3,313) | – | (3,313) |
| Other comprehensive income (loss) | – | – | – | (187) | (187) |
| Unit-based compensation related to options | – | 15 | – | – | 15 |
| Exchange of units | 131 | – | – | – | 131 |
| Balance, March 31, 2010 | <u>180,219</u> | <u>1,374</u> | <u>(145,514)</u> | <u>(1,236)</u> | <u>34,843</u> |

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 months ended March 31, 2011 and 2010

(in thousands of Canadian dollars, except per unit amounts)

| | For the three months ended | |
|--|----------------------------|-------------------|
| | March 31, 2011 | March 31, 2010 |
| | \$ | \$ |
| Hotel revenues | | |
| Rooms | 16,224 | 14,130 |
| Food and beverage | 1,545 | 1,444 |
| Parking | 329 | 334 |
| Other | 687 | 673 |
| | <hr/> | <hr/> |
| | 18,785 | 16,581 |
| Hotel expenses excluding depreciation | | |
| Operating expenses | 12,457 | 10,993 |
| Property taxes and insurance | 1,202 | 1,191 |
| Management fees | 448 | 403 |
| | <hr/> | <hr/> |
| | 14,107 | 12,587 |
| | <hr/> | <hr/> |
| | 4,678 | 3,994 |
| Other (income) expenses | | |
| Interest on mortgages and other debt | 2,796 | 2,703 |
| Interest on convertible debentures | 1,247 | 1,247 |
| Accretion on convertible debentures, mortgages and deferred financing fees | 842 | 679 |
| Corporate and administrative | 519 | 1,345 |
| Investment income | (21) | (40) |
| Fair value adjustment on Class B LP units and derivative liability | (32) | 177 |
| Depreciation and amortization | 2,567 | 2,536 |
| | <hr/> | <hr/> |
| | 7,918 | 8,647 |
| Loss before income taxes | (3,240) | (4,653) |
| Provision for (recovery of) deferred income taxes | – | (1,340) |
| | <hr/> | <hr/> |
| Net loss for the periods | (3,240) | (3,313) |
| Net loss attributable to: | | |
| Unitholders and owners of Class B LP units | (3,240) | (3,313) |
| | <hr/> | <hr/> |
| Basic and diluted loss per unit | (0.08) | (0.08) |

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 months ended March 31, 2011 and 2010

(in thousands of Canadian dollars)

| | For the three months ended | |
|---|-----------------------------------|------------------|
| | March 31, | March 31, |
| | 2011 | 2010 |
| Net loss for the periods | <u>(3,240)</u> | <u>(3,313)</u> |
| Other comprehensive loss | | |
| Foreign currency loss on translation of foreign operation | <u>(5)</u> | <u>(187)</u> |
| Other comprehensive loss for the periods | <u>(5)</u> | <u>(187)</u> |
| Comprehensive loss for the periods | <u>(3,245)</u> | <u>(3,500)</u> |
| Comprehensive loss attributable to: | | |
| Unitholders and owners of Class B LP units | <u>(3,245)</u> | <u>(3,500)</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 three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars)

| | For the three months ended | |
|---|----------------------------|-------------------|
| | March 31, 2011 | March 31, 2010 |
| | \$ | \$ |
| Cash provided by (used in) | | |
| Operating activities | | |
| Net loss for the periods | (3,240) | (3,313) |
| Adjustments for non-cash items (note 17) | 3,477 | 2,067 |
| | 237 | (1,246) |
| Changes in items of working capital (note 17) | (58) | 1,943 |
| Net cash generated from operating activities | 179 | 697 |
| Investing activities | | |
| Decrease (increase) in restricted cash | 37 | (3) |
| Decrease (increase) in capital reserves | 149 | (1,400) |
| Additions to property and equipment | (595) | (1,314) |
| Net cash used in investing activities | (409) | (2,717) |
| Financing activities | | |
| Repayment of finance lease obligations | (37) | (76) |
| Increase in line of credit | 1,045 | – |
| Proceeds from mortgages and loans, net of deferred financing fees | – | 10,287 |
| Repayment of mortgages and loans | (1,301) | (10,145) |
| Net cash generated from (used in) financing activities | (293) | 66 |
| Decrease in cash and cash equivalents | (523) | (1,954) |
| Cash and cash equivalents – Beginning of period | 830 | 3,786 |
| Cash and cash equivalents – End of period | 307 | 1,832 |
| Supplemental cash flow information (note 17) | | |

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

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 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 March 31, 2011, 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. The address of its registered office is 30 Damascus Road, Suite 201, Bedford, Nova Scotia.

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.

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 require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the REIT has commenced reporting on this basis in these interim consolidated financial statements. In the 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*. Subject to certain transition elections disclosed in note 5, the REIT has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 5 discloses the impact of the transition to IFRS on the REIT’s reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the REIT’s consolidated financial statements for the year ended December 31, 2010.

The policies applied in these interim consolidated financial statements are based on IFRS issued and outstanding as of June 6, 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 the transitional 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. Note 5 discloses IFRS information for the year ended December 31, 2010 not provided in the 2010 annual financial statements.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies

The significant accounting policies used in the preparation of these consolidated interim financial statements are described below.

a) Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of certain property and equipment, financial assets and liabilities to fair value.

b) Consolidation

The financial statements of the REIT consolidate the accounts of the REIT and its subsidiaries. All intercompany transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

Subsidiaries are those entities which the REIT controls by having the power to govern the financial and operating policies. Subsidiaries are fully consolidated from the date on which control is obtained by the REIT and are de-consolidated from the date that control ceases.

c) Foreign currency translation

i) Functional and presentation currency

Items included in the financial statements of each consolidated entity in the REIT group are measured using the currency of the primary economic environment in which the entity operates (the “functional currency”). The consolidated financial statements are presented in Canadian dollars, which is the REIT’s functional currency.

The financial statements of entities that have a functional currency different from that of the REIT (“foreign operations”) are translated into Canadian dollars as follows: assets and liabilities - at the closing rate at the date of the statement of financial position and income and expenses - at the average rate of the period (as this is considered a reasonable approximation to actual rates). All resulting foreign currency gains or losses are recognized in other comprehensive income.

When an entity disposes of its entire interest in a foreign operation, or loses control, joint control, or significant influence over a foreign operation, the foreign currency gains or losses accumulated in other comprehensive income related to the foreign operation are recognized in profit or loss. If an entity disposes of part of an interest in a foreign operation which remains a subsidiary, a proportionate amount of foreign currency gains or losses accumulated in other comprehensive income related to the subsidiary is reallocated between controlling and non-controlling interests.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

c) Foreign currency translation (continued)

ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in currencies other than an operation's functional currency are recognized in the statement of income.

d) Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held with banks and other short-term highly liquid investments with original maturities of three months or less.

e) Financial instruments

i) Financial instruments – recognition and measurement

In accordance with IAS 39 – *Financial Instruments – Recognition and Measurement* (“IAS 39”), financial assets and financial liabilities are initially recognized at fair value and their subsequent measurement is dependent on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics and the REIT's designation of such instruments.

a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The REIT's loans and receivables comprise trade and other receivables, cash and cash equivalents, restricted cash and capital reserves that are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

e) Financial instruments (continued)

i) Financial instruments – recognition and measurement (continued)

b) Available-for-sale investments

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The REIT's available-for-sale assets are its investments in hotel properties.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income. Available-for-sale investments are classified as non-current unless management expects to dispose of them within twelve months.

Dividends or distributions on available-for-sale instruments are recognized in the statement of income in investment income. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of income.

c) Financial liabilities at amortized cost

Financial liabilities at amortized cost include trade payables and accrued liabilities, line of credit, accrued interest on convertible debentures, mortgages and loans payable, promissory notes payable, convertible debentures and obligations under finance leases. Trade payables and accrued liabilities are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method. All other financial liabilities are recognized initially at fair value, net of any transaction costs incurred and subsequently, at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

d) Financial assets and liabilities at fair value through profit or loss

A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. The only instruments held by the REIT classified in this category are the Class B LP units and derivative liability.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statement of income. Gains and losses arising from changes in fair value are presented in the statement of income in the period in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current assets or liabilities, respectively.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

e) Financial instruments (continued)

i) Financial instruments – recognition and measurement (continued)

The following is a summary of the accounting model the REIT elected to apply to each of its significant categories of financial instruments:

| | |
|--|---|
| Cash and cash equivalents | Loans and receivables |
| Restricted cash | Loans and receivables |
| Capital reserves | Loans and receivables |
| Trade and other receivables | Loans and receivables |
| Investments in hotel properties | Available-for-sale investments |
| Mortgages and loans payable | Financial liabilities at amortized cost |
| Convertible debentures | Financial liabilities at amortized cost |
| Line of credit | Financial liabilities at amortized cost |
| Promissory notes payable | Financial liabilities at amortized cost |
| Obligations under finance leases | Financial liabilities at amortized cost |
| Accrued interest on convertible debentures | Financial liabilities at amortized cost |
| Trade payables and accrued liabilities | Financial liabilities at amortized cost |
| Derivative liability | Financial liabilities through profit and loss |
| Class B LP units | Financial liabilities through profit and loss |

Impairment of financial assets

At each reporting date, the REIT assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the REIT recognizes an impairment loss, as follows:

Available-for-sale financial assets: The impairment loss is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of income. This amount represents the cumulative loss in accumulated other comprehensive income that is reclassified to net income. Impairment losses on available-for-sale investments are not reversed.

Fair value

The fair value of a financial instrument is the amount of consideration that could be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. In certain circumstances, however, the initial fair value may be based on other observable current market transactions of the same instrument, without modification or on a valuation technique using market-based inputs. The REIT's financial assets include cash and cash equivalents, restricted cash, capital reserves and trade and other receivables. The REIT's financial liabilities include trade payables and accrued liabilities, line of credit, accrued interest on convertible debentures, obligations under finance leases, mortgages and loans payable, convertible debentures and promissory notes payable.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

e) Financial instruments (continued)

Fair value (continued)

Fair value measurements recognized in the balance sheet accounts are categorized using a fair value hierarchy that reflects the significance of inputs used in determining the fair values:

Level 1 - Quoted prices in active markets for identical assets or liabilities;

Level 2 - Quoted prices in active markets for similar assets or liabilities or valuation techniques where significant inputs are based on observable market data;

Level 3 - Valuation techniques for which any significant input is not based on observable market data.

Each type of fair value is categorized based on the lowest level input that is significant to the fair value measurement in its entirety.

ii) Comprehensive income

Comprehensive income is comprised of both net earnings and other comprehensive income ("OCI") which generally includes unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign currency translation adjustments, net of hedging and foreign exchange gains or losses arising from translating foreign operations. The REIT currently recognizes the foreign exchange on the translation of the Myrtle Beach subsidiary in OCI as well as the adjustments on the investments in hotel properties. These are presented as a separate component of equity.

f) Inventories

Inventories consist of linen, food, beverages and other supplies. Inventories are stated at the lower of cost and net realizable value. Cost is determined using the first in, first out ("FIFO") method. Net realizable value is the estimated selling price.

g) Capital reserve

The capital reserve account represents funds held by mortgagors ("Capital reserve – restricted") or funds internally restricted for capital improvements to the properties.

h) Investments in hotel properties

The investments in hotel properties represent equity ownership interests in six hotel partnerships or co-tenancies ranging from 2.52% to 19.06%. These investments are accounted for as available-for-sale investments reflected at fair value at each reporting period with changes in value recognized in other comprehensive income. Significant or prolonged declines in fair value are removed from other comprehensive income and recognized in profit or loss for the period.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

i) Property and equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probably that future economic benefits associated with the item will flow to the REIT and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the statement of income during the period in which they are incurred.

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

| | |
|-----------------------------------|-------------------|
| Land lease | Term of the lease |
| Buildings | 15 to 60 years |
| Furniture, fixtures and equipment | 7 years |
| Paving | 10 years |
| Signage | 10 years |
| Landscaping | 5 years |
| Computer equipment | 3 years |
| Vehicles | 3 years |

The REIT allocates the amount initially recognized in respect of an item of property and equipment to its significant parts and depreciates each part separately. Residual values, method of amortization and useful lives of the assets are reviewed annually and adjusted if appropriate.

Gains and losses on disposals of property and equipment are determined by comparing the proceeds to the net book value of the asset and are presented as gain or loss on disposal in the statement of income.

j) Impairment of non-financial assets

Property and equipment are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units or "CGU"s). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Value in use is defined as the present value of the expected future cash flows of the relevant asset or CGU. An impairment loss is the amount by which the asset's carrying amount exceeds its recoverable amount.

The REIT evaluates impairment losses for potential reversals annually or when events or circumstances warrant such consideration.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

k) Impairment of loans receivable

Loans receivable are classified as impaired when, in the opinion of management, there is a reasonable doubt as to the timely collection of principal, interest and the underlying security of the loan. The carrying amount of a loan receivable classified as impaired is reduced to its estimated fair value.

l) Other assets

Other assets consist of franchise fees and agreements. Application and initial franchise fees are amortized on a straight-line basis over the term of the franchise agreement and the amortization is included in depreciation and amortization in these consolidated financial statements. The Non-competition, Right of First Opportunity and Participation Agreements are amortized on a straight-line basis over the five-year terms of the agreements.

m) Leases

Leases entered into by the REIT in which substantially all of the benefits and risks of ownership are transferred to the REIT are recorded as finance leases and classified as property and equipment and obligations under finance leases. At the inception of the lease, the asset and the obligation under finance lease are recorded at the lesser of the fair value of the leased asset or the net present value of the minimum lease payments. Assets under finance leases are amortized based on the estimated useful life of the asset. All other leases are classified as operating leases and lease payments are expensed in the period in which they are incurred.

n) Provisions

Provisions are recognized in the financial statements when all of the following three criteria are met: (i) there is a present obligation as a result of a past event; (ii) it is more likely than not that an outflow of resources will be required to settle the obligation; and (iii) the amount of the obligation can be reliably estimated. Provisions are measured at management's best estimate of the expenditures required to settle the obligation at the end of the reporting period.

o) Income taxes

Under the provisions of Bill C-52, Budget Implementation Act, 2007, which was substantively enacted on June 12, 2007, the REIT, as a publicly-traded income trust, is considered a specified investment flow-through ("SIFT"). As the REIT has exceeded the "normal growth" rates as defined in the guidelines issued by the Department of Finance, the REIT became subject to tax in 2007.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

o) Income taxes (continued)

Income tax expense includes both current and deferred taxes. Current tax is based on the results of the REIT and is calculated according to local rules including any adjustments to taxes payable in respect of previous years. Deferred tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements, using enacted or substantially enacted tax rates that are expected to prevail when the temporary differences reverse. No deferred tax asset or liability is recognized on initial recognition of transactions that are not business combinations and that do not affect taxable profit. Deferred tax assets are recognized to the extent that it is probable that future taxable profits will be available against which the tax losses carried forward and the temporary differences can be utilized.

Under both IFRS and Canadian GAAP, deferred income taxes are recorded for the temporary differences arising in respect of assets and liabilities for the periods when the REIT is subject to tax as a specified investment flow-through ("SIFT"). This is determined at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled based on the SIFT tax rates in effect at that time. Under Canadian GAAP, future distributions are factored into the tax rate applied and the rate used ranged from 31% to 34%. Under IFRS, the tax rate applied is the rate excluding future distributions, which ranges from 48.25% to 50%.

Deferred income taxes relating to temporary differences of the REIT's US subsidiary use the US tax rate of 37.96%.

p) Revenue

Revenues are generated primarily from room occupancy, food and beverage services and parking. Revenue is recognized when it is probable that the economic benefits will flow to the REIT, the service has been provided, the price for the services is fixed or determinable and collectability is reasonably assured.

q) REIT units

The REIT units meet the definition of a financial liability under IFRS as the redemption feature of the REIT units creates an unavoidable contractual obligation to pay cash (or another financial instrument such as notes payable if redemptions exceed \$50 in a given month).

The REIT units are considered to be "puttable instruments" because of the redemption feature. IFRS provides a very limited exemption to allow puttable instruments to be presented as equity provided certain criteria are met.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

q) REIT units (continued)

To be presented as equity, a puttable instrument must meet all of the following conditions: (i) it must entitle the holder to a pro-rata share of the entity's net assets in the event of the entity's dissolution; (ii) it must be in the class of instruments that is subordinate to all other instruments; (iii) all instruments in the class in (ii) must have identical features; (iv) other than the redemption feature, there can be no other contractual obligations that meet the definition of a liability; and (v) the expected cash flows for the instrument must be based substantially on the profit or loss of the entity or change in fair value of the instrument. This is called the "Puttable Instrument Exemption".

The REIT units meet the Puttable Instrument Exemption criteria and accordingly are presented as equity in the consolidated financial statements. Distributions on REIT units are deducted from retained earnings.

r) Unit repurchases

If the REIT repurchases its own units as the result of a unit buy-back, those units are deducted from equity and the associated units are cancelled. No gain or loss is recognized and the consideration paid including any directly attributable incremental costs is recognized directly in equity.

s) Earnings per unit

Basic earnings per unit is calculated by dividing the net income (loss) for the period attributable to owners of REIT units by the weighted average number of units outstanding during the period.

Diluted earnings per unit is calculated by adjusting the weighted average number of units outstanding for dilutive instruments. The number of units included with respect to options and convertible debentures is computed using the treasury stock method. The REIT's potentially dilutive instruments are made up of the Class B LP units, the convertible debentures and unit options outstanding.

t) Employee benefits

i) Unit-based compensation

The REIT grants unit options to certain employees, trustees, consultants and employees of Pacrim Hospitality Services Inc. Unit options vest over three years (33.33% per year) and expire after five years. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. Fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the tranche's vesting period by increasing contributed surplus based on the number of awards expected to vest. The number of awards expected to vest is reviewed at least annually, with any impact being recognized immediately.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

t) Employee benefits (continued)

ii) Termination benefits

The REIT recognizes termination benefits when it is demonstrably committed to terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal.

u) Accounting standards issued but not yet applied

i) International Financial Reporting Standard 9, *Financial Instruments* (“IFRS 9”)

IFRS 9 was issued in November 2009 and contains standards for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends recognized in profit or loss to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated other comprehensive income indefinitely.

Requirements for financial liabilities were added in October 2010 and largely carried forward the existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

This standard is required to be applied for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted. The REIT has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

ii) IFRS 10, *Consolidated Financial Statements* (“IFRS 10”), IFRS 11, *Joint Arrangements* (“IFRS 11”), IFRS 12, *Disclosure of Interests in Other Entities* (“IFRS 12”), IAS 27, *Separate Financial Statements* (“IAS 27”), IFRS 13, *Fair Value Measurement* (“IFRS 13”) and IAS 28, *Investments in Associates and Joint Ventures* (“IAS 28”)

In May 2011, the IASB issued the following standards which have not yet been adopted by the REIT: IFRS 10, IFRS 11, IFRS 12, IAS 27, IFRS 13 and amended IAS 28. Each of the new standards is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The REIT has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

u) Accounting standards issued but not yet applied

The following is a brief summary of the new standards:

IFRS 10 – Consolidated Financial Statements

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation - Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*.

IFRS 11 - Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities - Non-monetary Contributions by Venturers*.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

IFRS 13 - Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

3 Significant accounting policies (continued)

u) Accounting standards issued but not yet applied

Amendments to other standards

In addition, there have been amendments to existing standards, including IAS 27, *Separate Financial Statements* ("IAS 27"), and IAS 28, *Investments in Associates and Joint Ventures* ("IAS 28"). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

iii) International Accounting Standard 12, *Income Taxes* ("IAS 12")

In December 2010, the IASB made amendments to IAS 12 that are applicable to the measurement of deferred tax liabilities and deferred tax assets where investment property is measured using the fair value model in IAS 40, *Investment Property*. The REIT has no investment properties and therefore expects these amendments will have no impact on the financial statements.

4 Critical accounting estimates and judgments

The REIT makes estimates and assumptions concerning the future that will, by definition, seldom equal actual results. The following are the estimates and judgments applied by management that most significantly affect the REIT's financial statements. These estimates and judgments have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The REIT has no critical accounting judgments.

Critical accounting estimates

a) Property and equipment

i) Fair value

On January 1, 2010, the REIT increased the carrying value of seven CGUs to their fair value by \$16,644 (note 5). The fair value of the property and equipment was determined by recent independent third party appraisals and internal models. Based on this information, management estimated that the range of reasonably possible values for the assets would be between \$12,852 and \$20,685 for the four CGUs that were valued using the internal models.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

4 Critical accounting estimates and judgments (continued)

Critical accounting estimates (continued)

a) Property and equipment (continued)

ii) Impairment

An impairment charge of \$103,560 was recorded on the REIT's property and equipment on 14 CGUs based on estimates of value in use. These calculations use cash flow projections based on financial projections approved by management covering a ten-year period as well as independent third party valuations for a sample of various hotel properties. Cash flows beyond the ten-year period are capitalized to a terminal value using capitalization rates specific to the market in which the CGU operates. Various growth rates for each CGU and the discount and capitalization rates applied to the cash flows were derived based on independent third party market and opinion surveys. The growth rates do not exceed the long term average growth rates expected in the hospitality industry or the various markets in which the CGUs operate.

Management determined the net operating income based on past performance and its expectations for market growth. The weighted average growth rates used are consistent with forecasts included in industry reports. The discount rates used are pre-tax and reflect specific risks in relation to the relevant CGU.

If management reduces the growth rate by 1%, the impairment would increase by \$4,957 for the nine CGUs valued using the internal models. An increase in both the discount and capitalization rates by 0.5% would increase impairment by \$3,957.

iii) Estimated useful lives

Management estimates the useful lives of property and equipment based on the period during which the assets are expected to be available for use. The amounts and timing of recorded depreciation expense of property and equipment for any period are affected by these estimated useful lives. The estimates are reviewed at least annually and are updated if expectations change as a result of physical wear and tear and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the REIT's property and equipment in the future.

b) Financial instruments

i) Fair value of investments in hotel properties

The fair value of the REIT's investments in hotel properties not traded in an active market are determined using valuation techniques. The REIT uses an earnings approach to value these investments based on earnings multiples. If the applicable capitalization rates were to increase or decrease by 1%, the value of the investments would change by \$261.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

5 Transition to IFRS

The effect of the REIT's transition to IFRS, described in note 2, is summarized in this note as follows:

- i) Transition elections
- ii) Reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS
- iii) Adjustments to the statement of cash flows
- iv) Additional IFRS information for the year ended December 31, 2010

i) Transition elections

IFRS 1 – First time adoption of IFRS (“IFRS 1”)

Generally, the conversion to IFRS requires an entity to present its financial statements as if it had always reported under IFRS. IFRS 1 provides guidance on the initial adoption of IFRS and provides certain exceptions and exemptions to full retrospective application of IFRS which an entity may elect. The key exceptions and exemptions elected by the REIT are as follows:

Business combinations - IFRS 1 provides the option to apply IFRS 3, *Business Combinations*, retrospectively or prospectively from the transition date. Applying the standard retrospectively would require restatement of all business combinations that occurred prior to the transition date. The REIT elected not to retrospectively apply IFRS 3 to business combinations that occurred prior to its transition date and such business combinations have not been restated.

Cumulative translation adjustments - Retrospective application of IFRS would require the REIT to determine cumulative currency translation differences in accordance with IAS 21, *The Effects of Changes in Foreign Exchange Rates*, from the date a subsidiary or equity method investee was formed or acquired. IFRS 1 permits cumulative translation gains and losses to be reset to zero at transition date. The REIT elected to reset all cumulative translation gains and losses to zero in opening retained earnings at its transition date.

Borrowing costs - IAS 23, *Borrowing Costs*, requires an entity to capitalize the borrowing costs related to all qualifying assets for which the commencement date for capitalization is on or after January 1, 2009. At transition to IFRS, the REIT elected not to retroactively apply this standard. Therefore, borrowing costs prior to the transition date were expensed.

Deemed cost of property and equipment – IFRS 1 allows an entity to measure an item of property and equipment at its fair value at transition date and use that fair value as its deemed cost at the transition date. The REIT elected to revalue certain items of property and equipment to fair value at the transition date and as such, recognized \$16,644 in retained earnings (deficit).

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

5 Transition to IFRS (continued)

ii) Reconciliation of equity, net loss and comprehensive loss as previously reported under Canadian GAAP to IFRS

Equity

| | Note 5 (ii) | December 31, 2010 \$ | March 31, 2010 \$ | January 1, 2010 \$ |
|--|-------------|----------------------------|-------------------------|--------------------------|
| Unitholder's equity as reported under Canadian GAAP | | 105,820 | 122,048 | 125,712 |
| IFRS adjustments increase (decrease): | | | | |
| Exchange of Class B LP units | | 131 | 131 | – |
| Impact of earnings adjustments | | 9,368 | 366 | – |
| Property and equipment: | | | | |
| Revaluation | a | 16,644 | 16,644 | 16,644 |
| Impairment | b | (103,560) | (103,560) | (103,560) |
| Adjustment to fair value of investments in hotel properties | c | (440) | (1,049) | (1,049) |
| Fair value adjustment of conversion option on convertible debentures | d | (105) | (105) | (105) |
| Fair value adjustment of Class B LP units | e | (147) | (147) | (147) |
| Impact of foreign exchange | f | 436 | 515 | 702 |
| Equity as reported under IFRS | | 28,147 | 34,843 | 38,197 |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

5 Transition to IFRS (continued)

ii) Reconciliation of equity, net loss and comprehensive loss as previously reported under Canadian GAAP to IFRS (continued)

Net loss and comprehensive loss

| | Note 5 (ii) | Year ended December 31, 2010 \$ | Three months ended March 31, 2010 \$ |
|--|----------------|--|---|
| Net loss and comprehensive loss as reported under Canadian GAAP | | (19,907) | (3,679) |
| Decrease (increase) in net loss for: | | | |
| Depreciation on revaluation and impairment of property and equipment | a/b | 2,789 | 696 |
| Reversal of hotel impairment loss under Canadian GAAP | b | 6,768 | – |
| Fair value adjustment of conversion option on convertible debentures | d | 72 | (13) |
| Fair value adjustment of Class B LP units | e | (19) | (164) |
| Reversal of unrealized foreign exchange gains under Canadian GAAP | | (242) | (153) |
| Net loss under IFRS | | (10,539) | (3,313) |
| Increase (decrease) in other comprehensive loss for: | | | |
| Changes in investments in hotel properties | c | 609 | – |
| Cumulative foreign exchange adjustment | | (266) | (187) |
| Comprehensive loss under IFRS | | (10,196) | (3,500) |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

5 Transition to IFRS (continued)

Explanatory notes

- a) In accordance with IFRS transitional provisions, the REIT elected to use fair value as deemed cost for certain of its property and equipment resulting in an increase of \$16,644 to its fair value of \$105,769 at January 1, 2010. The fair value of the property and equipment was determined by third party independent appraisals using market based discount and capitalization rates as well as the REIT's internal valuation models which incorporated estimates of discounted future cash flows.
- b) An impairment loss of \$103,560 relating to property and equipment was recognized in retained earnings (deficit) at January 1, 2010. This adjustment arose because under IFRS the recoverable amount used in recognizing and measuring an impairment is the higher of the asset's fair value less costs to sell and its value in use. The resulting decrease in depreciation expense is recognized over the useful life of the applicable assets and is reflected in earnings for the year ended December 31, 2010 and three months ended March 31, 2010 and 2011. Under Canadian GAAP, the recoverable amount used to determine whether recognition of an impairment loss is required is the undiscounted future cash flows expected from its use and eventual disposition. At December 31, 2010, an impairment loss of \$6,768 was recognized under Canadian GAAP. This loss was reversed under IFRS as the impairment amounts associated with the property were recognized directly in equity on transition at January 1, 2010.

As a result of the transition to IFRS, the REIT recognized an impairment adjustment in (retained earnings) in the amount of \$103,560 related to various CGUs in the portfolio. For the purposes of determining the specific impairment adjustments, each hotel property and the associated assets were considered a separate CGU for the purposes of impairment testing.

The recoverable amount of each CGU is based on its value in use and was derived using a combination of independent third party appraisals or the REIT's internal valuation models which incorporated estimates of discounted future cash flows for a ten year period.

The use of CGU specific discount rates was derived based on independent third party market and opinion surveys specific to the geographic location of the CGU, the economic environment in which it operates and the specific brand of the hotel property.

The following are key assumptions used in the value in use calculations:

Discount rates: 9% to 13%

Capitalization rates: 10% to 12%

Growth rates: Consistent with management forecasts and industry reports.

All discount rates and cash flows are pre tax and reflect the risks and growth possibilities in relation to the relevant CGU.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

5 Transition to IFRS (continued)

Explanatory notes (continued)

- c) Under IFRS, 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. 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 comprehensive income and to the carrying value of the investments to recognize this difference were (\$1,049) at January 1, 2010, (\$440) at December 31, 2010 and \$nil at March 31, 2010.
- d) 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 the statement of income. 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 at January 1, 2010 by \$105 (\$239 at March 31, 2010 and \$34 at December 31, 2010).
- e) 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 the statement of income. 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 at January 1, 2010 by \$147 (\$59 at March 31, 2010 and \$34 at December 31, 2010).
- f) As a result of the transition to IFRS, the REIT now 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 other comprehensive income. Under previous Canadian GAAP, the adjustments related to translation of this foreign subsidiary was recognized through profit or loss using historic or current rates depending on whether the asset 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.

iii) Adjustments to the statement of cash flows

The transition from Canadian GAAP to IFRS had no significant impact on cash flows generated by the REIT except that previously unrecognized fair value adjustment on Class B LP units and derivative liability included in the determination of net income are now included as an adjustment for non-cash items on the statement of cash flows.

In addition, under IFRS changes in the translation of the REIT's foreign operation are recognized in other comprehensive income and not on the statement of income. Under Canadian GAAP, unrealized foreign exchange gains or losses were included on the statement of income and were included as an adjustment for non-cash items on the statement of cash flows.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

5 Transition to IFRS (continued)

Explanatory notes (continued)

iv) Additional IFRS information for the year ended December 31, 2010

The following items are financial statement items which the REIT did not previously disclose under Canadian GAAP or where amounts have been significantly affected as a result of the transition to IFRS and not previously discussed.

a) Reconciliation of the REIT's retained earnings as previously reported under Canadian GAAP to IFRS:

| | Note 5 (ii) | December 31, 2010 \$ | March 31, 2010 \$ | January 1, 2010 \$ |
|---|----------------|----------------------------|-------------------------|--------------------------|
| Accumulated losses as reported under Canadian GAAP | | (45,012) | (28,784) | (25,105) |
| IFRS adjustments increase (decrease): | | | | |
| Accumulated distributions reclassified to retained earnings (deficit) | | (40,893) | (40,893) | (40,893) |
| Impairment of property and equipment | | (103,560) | (103,560) | (103,560) |
| Revaluation of property and equipment | | 16,644 | 16,644 | 16,644 |
| Depreciation expense on revaluation and impairment of property and equipment | a | 2,789 | 696 | – |
| Reversal of hotel impairment loss recognized under Canadian GAAP | b | 6,768 | – | – |
| Portion of the equity component of convertible debentures reclassified to retained earnings (deficit) | d | 9,490 | 9,490 | 9,490 |
| Portion of the Class B LP units reclassified to retained earnings (deficit) | | 520 | 520 | 520 |
| Fair value adjustment of conversion option on convertible debentures | d | 72 | (13) | – |
| Conversion and fair value adjustment of Class B LP units | | (19) | (164) | – |
| Reversal of foreign exchange gain | | (242) | (153) | – |
| Adjustments for impact of foreign exchange | e | 703 | 703 | 703 |
| Total retained earnings (deficit) as reported under IFRS | | (152,740) | (145,514) | (142,201) |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

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5 Transition to IFRS (continued)

iv) Additional IFRS information for the year ended December 31, 2010 (continued)

b) Reconciliation of the REIT's property and equipment as previously reported under Canadian GAAP to IFRS:

| | Note 5 (ii) | December 31, 2010 \$ | March 31, 2010 \$ | January 1, 2010 \$ |
|--|----------------|----------------------------|-------------------------|--------------------------|
| Property and equipment as reported under Canadian GAAP | | 313,374 | 324,752 | 326,465 |
| IFRS adjustments increase (decrease): | | | | |
| Revaluation | a | 16,644 | 16,644 | 16,644 |
| Impairment | b | (103,560) | (103,560) | (103,560) |
| Reversal of hotel impairment loss recognized under Canadian GAAP | b | 6,768 | – | – |
| Change in accumulated depreciation | | 2,789 | 696 | – |
| Foreign exchange | | 185 | 272 | 689 |
| Property and equipment as reported under IFRS | | 236,200 | 238,804 | 240,238 |

c) Reconciliation of the REIT's investments in hotel properties previously reported under Canadian GAAP to IFRS:

| | Note 5 (ii) | December 31, 2010 \$ | March 31, 2010 \$ | January 1, 2010 \$ |
|--|----------------|----------------------------|-------------------------|--------------------------|
| Investments in hotel properties as reported under Canadian GAAP | | 1,217 | 1,961 | 1,961 |
| IFRS adjustments increase (decrease): | | | | |
| Fair value adjustment recognized on transition in other comprehensive income | c | (1,049) | (1,049) | (1,049) |
| Fair value adjustment recognized in other comprehensive income during the period | | (145) | – | – |
| Sale of investments in hotel properties | | 295 | – | – |
| Recovery in value | | 36 | – | – |
| Recognition of impairment in profit or loss | | 423 | – | – |
| Investments in hotel properties as reported under IFRS | | 777 | 912 | 912 |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

5 Transition to IFRS (continued)

iv) Additional IFRS information for the year ended December 31, 2010 (continued)

d) Fair value of financial instruments

The following gains and losses, included in net income for the year ended December 31, 2010, were not previously included in net income under Canadian GAAP:

| | Year ended December 31, 2010 |
|--|---|
| | \$ |
| Financial instruments at fair value through profit or loss | |
| Fair value adjustment on Class B LP units and derivative liability | 54 |

e) Earnings per unit

Basic and diluted

Basic and diluted earnings per share are calculated by dividing the net loss attributable to unitholders and owners of Class B LP units by the weighted average number of units outstanding during the year. The impact of Class B LP units, convertible debentures and unit options is antidilutive.

| | Year ended December 31, 2010 |
|--|---|
| | (\$) |
| Net loss attributable to owners of the REIT | (\$10,539) |
| Weighted average number of units outstanding | 39,031,716 |
| Basic and diluted loss per unit | (\$0.27) |

f) Compensation of key management

| | Year ended December 31, 2010 |
|---|---|
| | \$ |
| Salaries and short-term employee benefits | 552 |
| Unit-based compensation | 15 |
| Termination benefits | 658 |
| Trustee fees | 147 |
| | <u>1,372</u> |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

5 Transition to IFRS (continued)

iv) Additional IFRS information for the year ended December 31, 2010 (continued)

g) Expenses by nature

| | Year ended December 31, 2010 \$ |
|--|--|
| Food, beverage and service costs | 4,524 |
| Materials, supplies, repairs and utilities | 10,989 |
| Salaries, wages and employee benefits | 23,519 |
| Insurance, property taxes, licensing, land leasing and permits | 6,545 |
| Management, royalty, franchise and other fees | 6,758 |
| Depreciation and amortization | 10,197 |
| Interest and financing costs | 18,908 |
| Other | 5,066 |
| | <hr/> |
| | 86,506 |
| | <hr/> |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

6 Property and equipment

As at January 1, 2010

| | Cost \$ | Accumulated impairment losses \$ | Accumulated depreciation \$ | Net book value \$ |
|---|------------|---|-----------------------------------|-------------------------|
| Land | 30,689 | 8,658 | – | 22,031 |
| Land lease | 500 | 28 | 42 | 430 |
| Building | 303,107 | 88,207 | 14,644 | 200,256 |
| Renovations in progress | 706 | – | – | 706 |
| Furniture, fixtures and equipment and other | 27,088 | 5,912 | 7,757 | 13,419 |
| Paving | 3,194 | 755 | 583 | 1,856 |
| Landscaping | 18 | – | 2 | 16 |
| Signage | 1,025 | – | 153 | 872 |
| Computer equipment and websites | 1,311 | – | 898 | 413 |
| Vehicles | 179 | – | 85 | 94 |
| Tenant inducements | 145 | – | – | 145 |
| | 367,962 | 103,560 | 24,164 | 240,238 |

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 | – | – | (66) | 22,243 |
| Land lease | 430 | – | – | 12 | – | 418 |
| Building | 200,256 | 2,808 | – | 5,658 | (404) | 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 | – | 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

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

6 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> |

| | For the three month period ended March 31, 2011 | | | | |
|--|--|-----------------|--------------------------------------|-------------------------------|---------------------------------|
| | Opening net book value \$ | Additions \$ | Depreciation for the period \$ | Exchange Differences \$ | Closing net book value \$ |
| Land | 22,243 | – | – | (8) | 22,235 |
| Land lease | 418 | – | 3 | – | 415 |
| Building | 197,044 | 287 | 1,409 | (11) | 195,911 |
| Renovations in progress | 169 | 51 | – | – | 220 |
| Furniture, fixtures, equipment and other | 13,428 | 194 | 914 | (32) | 12,676 |
| Paving | 1,623 | – | 64 | – | 1,559 |
| Landscaping | 26 | – | 1 | – | 25 |
| Signage | 848 | 9 | 29 | – | 828 |
| Computer equipment and websites | 277 | 54 | 56 | – | 275 |
| Vehicles | 22 | – | 2 | – | 20 |
| Tenant inducements | 102 | – | 10 | – | 92 |
| | <u>236,200</u> | <u>595</u> | <u>2,488</u> | <u>(51)</u> | <u>234,256</u> |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

6 Property and equipment (continued)

| | As at March 31, 2011 | | | |
|---|----------------------|-------------------|---------------|----------------|
| | Cost | Accumulated | Accumulated | Net book |
| | \$ | impairment losses | depreciation | value |
| | \$ | \$ | \$ | \$ |
| Land | 30,925 | 8,690 | – | 22,235 |
| Land lease | 500 | 28 | 57 | 415 |
| Building | 305,691 | 88,239 | 21,541 | 195,911 |
| Renovations in progress | 220 | – | – | 220 |
| Furniture, fixtures and equipment and other | 30,567 | 5,895 | 11,996 | 12,676 |
| Paving | 3,213 | 748 | 906 | 1,559 |
| Landscaping | 32 | – | 7 | 25 |
| Signage | 1,034 | – | 206 | 828 |
| Computer equipment and websites | 1,566 | – | 1,291 | 275 |
| Vehicles | 179 | – | 159 | 20 |
| Tenant inducements | 145 | – | 53 | 92 |
| | <u>374,072</u> | <u>103,600</u> | <u>36,216</u> | <u>234,256</u> |

The net book value of assets under finance leases as at March 31, 2011 was \$617 (December 31, 2010 - \$675; January 1, 2010 - \$945).

7 Loans receivable from related parties

The REIT has a \$6,239 (December 31, 2010 - \$6,239 and January 1, 2010 - \$6,350) loan receivable from Pacrim Hospitality Services Inc. (“PHSI”), 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%.

The REIT has a \$159 (December 31, 2010 and January 1, 2010 - \$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 11% per annum.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

8 Other assets

| | | As at January 1, 2010 | | | | | |
|--|--|------------------------------|-----------------------|---------------------|-----------------|--|--|
| | | Cost | Accumulated | Net book | | | |
| | | \$ | \$ | value | | | |
| | | \$ | \$ | \$ | | | |
| Agreements | | 500 | 250 | 250 | | | |
| Franchise fees | | 854 | 227 | 627 | | | |
| | | <u>1,354</u> | <u>477</u> | <u>877</u> | | | |
| For the year ended December 31, 2010 | | | | | | | |
| | | Opening net | Additions | Amortization | Closing | | |
| | | book value | \$ | for the year | net book | | |
| | | \$ | \$ | \$ | value | | |
| | | \$ | \$ | \$ | \$ | | |
| Agreements | | 250 | – | 99 | 151 | | |
| Franchise fees | | 627 | 22 | 82 | 567 | | |
| | | <u>877</u> | <u>22</u> | <u>181</u> | <u>718</u> | | |
| As at December 31, 2010 | | | | | | | |
| | | Cost | Accumulated | Net book | | | |
| | | \$ | \$ | value | | | |
| | | \$ | \$ | \$ | | | |
| Agreements | | 500 | 349 | 151 | | | |
| Franchise fees | | 876 | 309 | 567 | | | |
| | | <u>1,376</u> | <u>658</u> | <u>718</u> | | | |
| For the three months ended March 31, 2011 | | | | | | | |
| | | Opening net | Amortization | Exchange | Closing | | |
| | | book value | for the period | differences | net book | | |
| | | \$ | \$ | \$ | value | | |
| | | \$ | \$ | \$ | \$ | | |
| Agreements | | 151 | 25 | – | 126 | | |
| Franchise fees | | 567 | 20 | (4) | 543 | | |
| | | <u>718</u> | <u>45</u> | <u>(4)</u> | <u>669</u> | | |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

8 Other assets (continued)

| | As at March 31, 2011 | | |
|----------------|-----------------------------|---------------------|-----------------|
| | Cost | Accumulated | Net book |
| | \$ | amortization | value |
| | | \$ | \$ |
| Agreements | 500 | 374 | 126 |
| Franchise fees | 872 | 329 | 543 |
| | <u>1,372</u> | <u>703</u> | <u>669</u> |

9 Line of credit

The REIT has two available lines of credit for \$5,000 and \$500. As at March 31, 2011, the REIT had drawn \$3,564 (December 31, 2010 - \$2,519; January 1, 2010 - \$nil) 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.

10 Mortgages and loans payable

| | March 31, | December 31, | January 1, |
|---|------------------|---------------------|-------------------|
| | 2011 | 2010 | 2010 |
| | \$ | \$ | \$ |
| Mortgages payable, bearing interest at a weighted average rate of 6.75% (December 31, 2010 - 6.75%; January 1, 2010 - 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 | 152,232 | 153,630 | 154,446 |
| Other | — | 4 | 39 |
| | <u>152,232</u> | <u>153,634</u> | <u>154,485</u> |
| Less: Deferred financing fees | 863 | 1,041 | 1,002 |
| Less: Current portion | <u>42,155</u> | <u>49,047</u> | <u>41,770</u> |
| | <u>109,214</u> | <u>103,546</u> | <u>111,713</u> |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

10 Mortgages and loans payable (continued)

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

| | \$ |
|-------------------------------|--------|
| Remainder of 2011 | 42,155 |
| Year ending December 31, 2012 | 8,828 |
| 2013 | 3,302 |
| 2014 | 3,530 |
| 2015 | 11,939 |
| Thereafter | 82,478 |

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

| | March 31, 2011 | December 31, 2010 |
|-------------------------------------|-------------------|----------------------|
| Opening balance at January 1 | 152,593 | 153,483 |
| New debt | – | 10,500 |
| Assumption of mortgage | – | 2,834 |
| Deferred financing fees | 178 | (341) |
| Repayment of debt | (1,301) | (13,844) |
| Impact of foreign exchange | (101) | (39) |
| Closing balance | <u>151,369</u> | <u>152,593</u> |

11 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.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

11 Convertible debentures (continued)

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.

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 \$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 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 terms of the debentures.

| | March 31, 2011 \$ | December 31, 2010 \$ | January 1, 2010 \$ |
|-------------------------------------|-------------------------|----------------------------|--------------------------|
| Debt component | 61,988 | 61,988 | 61,988 |
| Accretion of convertible debentures | 8,116 | 7,515 | 5,295 |
| Deferred financing fees | (613) | (768) | (1,348) |
| | <u>69,491</u> | <u>68,735</u> | <u>65,935</u> |
| Less: Current portion | <u>19,535</u> | <u>19,138</u> | <u>—</u> |
| | <u>49,956</u> | <u>49,597</u> | <u>65,935</u> |

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

| | March 31, 2011 | December 31, 2010 |
|---|-------------------|----------------------|
| Opening balance at January 1 | 68,735 | 65,935 |
| Accretion of discount and deferred financing fees | <u>756</u> | <u>2,800</u> |
| Closing balance | <u>69,491</u> | <u>68,735</u> |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

12 Obligations under finance leases

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

| | March 31, 2011 \$ | December 31, 2010 \$ | January 1, 2010 \$ |
|--|-------------------------|----------------------------|--------------------------|
| Present value of future minimum lease payments | 185 | 222 | 507 |
| Less: Current portion of principal payments | 119 | 132 | 285 |
| | <u>66</u> | <u>90</u> | <u>222</u> |

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

| | \$ |
|--|------------|
| Remainder of 2011 | 105 |
| Year ending December 31, 2012 | 84 |
| Year ending December 31, 2013 | 11 |
| Future minimum lease payments | <u>200</u> |
| Less: Amounts representing interest at a weighted average rate of 10.40% | <u>15</u> |
| Present value of future minimum lease payments | <u>185</u> |

The leases outstanding at March 31, 2011 bear interest at a weighted average annual rate of 10.40% per annum (December 31, 2010 – 10.52%; January 1, 2010 – 10.33%). During the year ended December 31, 2010, the REIT did not enter into any new finance leases.

13 Derivative liability

Convertible debentures

Amounts recognized as a derivative liability result from the periodic revaluation of the conversion option related to Holloway's convertible debentures. At transition to IFRS \$105 was recognized as a liability related to the conversion option on the convertible debentures. These options are 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:

| For the three months ended March 31, 2011 | August 2006 Issuance | June 2007 Issuance | July 2007 Overallotment |
|---|-------------------------|-----------------------|----------------------------|
| End of period unit price | \$0.33 | \$0.33 | \$0.33 |
| Exercise price of option | \$5.40 | \$6.15 | \$6.15 |
| Term remaining on option (years) | 0.42 | 1.25 | 1.25 |
| Volatility | 83.8% | 81.2% | 81.2% |
| Annual distribution | — | — | — |
| Discount rate | 1.18% | 1.33% | 1.33% |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

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14 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 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 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. 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 three months ended March 31, 2011:

| | March 31, 2011 | December 31, 2010 |
|-------------------------------------|---------------------------|------------------------------|
| Opening balance at January 1 | 3,203 | 3,405 |
| Accretion of discount | 9 | 37 |
| Repayment of debt | - | (239) |
| Closing balance | <u>3,212</u> | <u>3,203</u> |

15 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 determined by 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.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

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15 Units (continued)

Issued and outstanding units

The following presents the number of units issued and outstanding, and the related ascribed values for the three months ended March 31, 2011 and the year ended 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, March 31, 2010, December 31, 2010 and March 31, 2011 | <u>39,031,716</u> | <u>180,219</u> |

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 \$50,000. The REIT does not expect any significant redemptions.

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. As a result, a liability for the fair value of the Class B LP units in the amount of \$147 was recognized and the difference between the liability and the amounts previously recognized under Canadian GAAP was transferred to retained earnings.

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 March 31, 2011 was 103,500 (December 31, 2010 – 103,500; January 1, 2010 – 333,500).

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.

| | March 31, 2011 | December 31, 2010 | January 1, 2010 |
|---|---------------------------|------------------------------|----------------------------|
| REIT units outstanding | 39,031,716 | 39,031,716 | 38,801,716 |
| Class B LP units outstanding | 103,500 | 103,500 | 333,500 |
| Options outstanding (exercisable) | 828,849 | 973,841 | 1,139,837 |
| Conversion of convertible debentures (conversion price \$5.40) | 3,747,778 | 3,747,778 | 3,747,778 |
| Conversion of convertible debentures (conversion price \$6.15) | 8,429,919 | 8,429,919 | 8,429,919 |
| Total units reflecting exercise and conversion | <u>52,141,762</u> | <u>52,286,754</u> | <u>52,452,750</u> |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

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16 Compensation of key management

Key management includes the REIT's trustees, the Chief Executive Officer, the Chief Financial Officer and the former President and Chief Operating Officer, who ceased employment on March 17, 2010. Compensation awarded to key management included:

| | For the three months ended | |
|---|-----------------------------------|-----------------------|
| | March 31, 2011 | March 31, 2010 |
| Salaries and short-term employee benefits | 127 | 180 |
| Unit-based compensation | – | 15 |
| Termination benefits | – | 658 |
| Trustee fees | 39 | 30 |
| | <hr/> | <hr/> |
| | 166 | 883 |
| | <hr/> | <hr/> |

17 Supplemental cash flow information

Adjustments for non-cash items:

| | For the three months ended | |
|--|-----------------------------------|-----------------------|
| | March 31, 2011 | March 31, 2010 |
| | \$ | \$ |
| Unit-based compensation | – | 15 |
| Depreciation and amortization | 2,567 | 2,536 |
| Accretion on convertible debentures, mortgages and deferred financing fees | 942 | 679 |
| Fair value adjustment on Class B LP units and derivative liability | (32) | 177 |
| Recovery of deferred income taxes | – | (1,340) |
| | <hr/> | <hr/> |
| | 3,477 | 2,067 |
| | <hr/> | <hr/> |

Changes in items of working capital:

| | For the three months ended | |
|--|-----------------------------------|-----------------------|
| | March 31, 2011 | March 31, 2010 |
| | \$ | \$ |
| Trade and other receivables | (622) | (893) |
| Inventories | (7) | 37 |
| Prepaid expenses and deposits | (568) | 1,287 |
| Trade payable and accrued liabilities | 701 | 1,074 |
| Accrued interest on convertible debentures | 438 | 438 |
| | <hr/> | <hr/> |
| | (58) | 1,943 |
| | <hr/> | <hr/> |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

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(in thousands of Canadian dollars unless otherwise stated)

17 Supplemental cash flow information (continued)

Cash and cash equivalents are comprised of the following:

| | March 31, 2011 \$ | December 31, 2010 \$ | January 1, 2010 \$ |
|--------------------------------------|-------------------------|-----------------------------------|--------------------------|
| Cash on hand and balances with banks | 307 | 830 | 3,786 |
| Interest paid: | | | |
| | | For the three months ended | |
| | | March 31, | March 31, |
| | | 2011 | 2010 |
| | | \$ | \$ |
| Interest paid | | 3,510 | 3,483 |

18 Commitments and contingencies

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

19 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, 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 to Gross Book Value ("Debt to GBV") ratio defined as line of credit, mortgages and loans payable, obligations under finance leases, the face value of promissory notes and the face value of convertible debentures ("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 of deferred financing fees, fair value adjustments, and unit-based compensation (Earnings base) to mortgages, loans, promissory notes and finance lease interest and principal payments (Debt Service).

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

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19 Capital management (continued)

| | March 31, 2011 \$ | December 31, 2010 \$ | January 1, 2010 \$ |
|--|-------------------------|----------------------------------|-------------------------------------|
| Capital structure | | | |
| Line of credit | 3,564 | 2,519 | – |
| Derivative liability | 2 | 34 | 105 |
| Class B LP units | 34 | 34 | 147 |
| Obligations under finance leases | 185 | 222 | 507 |
| Mortgages and loans payable | 151,369 | 152,593 | 153,483 |
| Convertible debentures | 69,491 | 68,735 | 65,935 |
| Promissory notes payable | 3,212 | 3,203 | 3,405 |
| Total debt | 227,857 | 227,340 | 223,582 |
| Equity | 24,902 | 28,147 | 38,197 |
| Total capital | 252,759 | 255,487 | 261,779 |
| Ratios | | | |
| Total debt | 227,857 | 227,340 | 223,582 |
| Adjustment of convertible debentures to face value | 2,589 | 3,313 | 6,042 |
| Adjustment of promissory notes to face value | 101 | 110 | 147 |
| Debt | 230,547 | 230,763 | 229,771 |
| Gross book value | 403,762 | 402,802 | 399,149 |
| Debt to GBV | 57.1% | 57.3% | 57.6% |
| | | Trailing 12 months ended | |
| | | March 31, 2011 \$ | December 31, 2010 \$ |
| Earnings base | | 18,367 | 16,612 |
| Debt service | | 21,239 | 20,994 |
| Debt service coverage ratio | | 0.87 | 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 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 date, the mortgages have been classified as current liabilities. Waivers were received after the period end date and prior to the authorized and issuance of the financial statements. 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.

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20 Financial instruments

i) Fair value of financial instruments

The REIT's financial instruments consist of cash and cash equivalents, restricted cash, trade and other receivables, capital reserve, investments in hotel properties, line of credit, trade payables and accrued liabilities, derivative liability, Class B LP units, accrued interest on convertible debentures, obligations under finance leases, mortgages and loans payable, 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.

Investments in hotel properties, Class B LP units and derivative liability 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 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 the amounts the REIT might pay in actual market transactions. The fair value of the convertible debentures is the trading value at March 31, 2011 and December 31, 2010, respectively.

| | March 31, 2011 | | December 31, 2010 | | January 1, 2010 | |
|---|----------------|------------|-------------------|------------|-----------------|------------|
| | Carrying value | Fair value | Carrying value | Fair value | Carrying value | Fair value |
| Loans and receivables (cash and cash equivalents, restricted cash, capital reserve and trade and other receivables) | 10,617 | 10,617 | 10,704 | 10,704 | 13,074 | 13,074 |
| Available-for-sale investments (investments in hotel properties) | 777 | 777 | 777 | 777 | 912 | 912 |
| Financial liabilities (trade payables and accrued liabilities, line of credit, accrued interest on convertible debentures and obligations under finance leases) | 14,233 | 14,233 | 12,011 | 12,011 | 9,676 | 9,676 |
| Mortgages and loans payable | 151,369 | 146,788 | 152,593 | 150,318 | 153,483 | 152,929 |
| Convertible debentures | 69,493 | 52,535 | 68,769 | 50,775 | 66,040 | 44,254 |
| Class B LP units | 34 | 34 | 34 | 34 | 147 | 147 |

Holloway Lodging Real Estate Investment Trust

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20 Financial instruments (continued)

Fair value hierarchy

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

| | March 31, 2011 | | | December 31, 2010 | | | January 1, 2010 | | |
|---------------------------------|----------------|---------|---------|-------------------|---------|---------|-----------------|---------|---------|
| | Level 1 | Level 2 | Level 3 | Level 1 | Level 2 | Level 3 | Level 1 | Level 2 | Level 3 |
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Investments in hotel properties | – | – | 777 | – | – | 777 | – | – | 912 |
| Derivative liability | – | 2 | – | – | 34 | – | – | 105 | – |
| Class B LP units | – | 34 | – | – | 34 | – | – | 147 | – |

i) 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.

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 \$34,975 in mortgages maturing in the next 12 months. The weighted average interest rate on its mortgages payable is 6.75% (December 31, 2010 – 6.75%; January 1, 2010 – 6.82%) with a weighted average maturity of 4.5 years (December 31, 2010 – 4.7 years; January 1, 2010 – 5.4 years).

The convertible debentures have a weighted average interest rate of 6.9% (December 31, 2010 and January 1, 2010 – 6.9%) and a weighted average maturity of 1.0 years (December 31, 2010 – 1.2 years; January 1, 2010 – 2.2 years).

The REIT has no long-term debt at floating rates. The REIT's lines of credits are at floating rates. For the three months ended March 31, 2011, a 1% change in interest rates would change the net loss by \$9 (year ending December 31, 2010 – \$3).

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(Unaudited)

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20 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 \$3,585 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 receivable 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:

| | March 31, 2011 | December 31, 2010 | January 1, 2010 |
|--|---------------------------|------------------------------|----------------------------|
| | \$ | \$ | \$ |
| Trade and other receivables under 30 days aged | 2,566 | 1,867 | 1,503 |
| Trade and other receivables over 30 days aged | 1,139 | 1,178 | 1,752 |
| Less: Allowance for doubtful accounts | (120) | (83) | (130) |
| | <u>3,585</u> | <u>2,962</u> | <u>3,125</u> |

The REIT is exposed to credit risk on its loans receivable from related parties (note 7). Management reviews the results and cash flows of these entities on a monthly basis.

Holloway Lodging Real Estate Investment Trust

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(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

20 Financial instruments (continued)

ii) Risk management (continued)

c) 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 foreign currency gain or loss on translation of foreign operation recognized in other comprehensive income by \$43 (year ended December 31, 2010 - \$43).

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.

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 finance leases. The REIT has \$34,975 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 \$20,238 in convertible debentures that mature on August 1, 2011. The REIT has a signed term sheet to finance the repayment of the debentures. The Board and management continue to explore other alternatives to raise funds to repay the debenture holders which may include other debt financing, the sale of certain properties, or some combination thereof.

The REIT monitors and forecasts its cash balances and cash flows generated from operations to meet its required obligations. At March 31, 2011, the REIT had drawn \$3,564 (December 31, 2010 - \$2,519; January 1, 2010 - \$nil) 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.

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For the three months ended March 31, 2011 and 2010

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21 Income taxes

The following table is a reconciliation of expected income taxes recoverable at the statutory tax rate to the amounts recognized in the consolidated statements of income for the three month periods ended March 31, 2011 and 2010:

| | March 31, 2011 | March 31, 2010 |
|--|---------------------------|---------------------------|
| | \$ | \$ |
| Income before income taxes | (3,240) | (4,653) |
| Income tax rate | 50.00% | 48.25% |
| | (1,620) | (2,245) |
| Non-deductible stock option expense | – | 7 |
| Unused tax losses and deductible temporary differences not recognized as tax assets | 1,790 | 875 |
| Other | (170) | 23 |
| Income tax recovery | – | (1,340) |

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

| | March 31, 2011 | December 31, 2010 | January 1, 2010 |
|---------------------------------|---------------------------|------------------------------|----------------------------|
| | \$ | \$ | \$ |
| Deferred tax assets | | | |
| Deferred financing fees | 320 | 456 | 1,615 |
| Non-capital losses | 7,734 | 7,899 | 5,216 |
| | 8,054 | 8,355 | 6,831 |
| Deferred tax liabilities | | | |
| Convertible debentures | (972) | (1,273) | (2,265) |
| | 7,082 | 7,082 | 4,566 |

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

(Unaudited)

For the three months ended March 31, 2011 and 2010

(in thousands of Canadian dollars unless otherwise stated)

21 Income taxes (continued)

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

| | March 31, 2011 \$ | December 31, 2010 \$ | January 1, 2010 \$ |
|---------------------------------|-------------------------|----------------------------|--------------------------|
| Non-capital losses | 10,453 | 7,748 | 4,978 |
| Realized capital losses | 6,795 | 7,057 | – |
| Impaired loans receivable | 80 | 80 | 7,087 |
| Investments in hotel properties | 539 | 547 | 636 |
| Property and equipment | 83,966 | 82,990 | 78,521 |
| Other assets | 439 | 317 | 248 |
| Other | 82 | 72 | 129 |
| | <u>102,354</u> | <u>98,811</u> | <u>91,599</u> |

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 |
| | <u>21,500</u> |

The REIT's US subsidiary has incurred US non-capital loss carryforwards which expire in the following years:

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

22 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. Certain of the REIT's hotels in Alberta and British Columbia generate higher revenue in the first quarter from oil and gas drilling activities.

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23 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

| | March 31, 2011 \$ | March 31, 2010 \$ |
|-------------------------------|-------------------------|-------------------------|
| Revenues | | |
| Canada | 18,484 | 16,307 |
| United States | 301 | 274 |
| | <hr/> 18,785 | <hr/> 16,581 |
| Property and equipment | | |
| Canada | 228,077 | 232,269 |
| United States | 6,179 | 6,535 |
| | <hr/> 234,256 | <hr/> 238,804 |