

# **Holloway Lodging Real Estate Investment Trust**

Unaudited Consolidated Financial Statements  
**March 31, 2009**

May 7, 2009

### **Management's Report**

The accompanying unaudited interim consolidated financial statements of Holloway Lodging Real Estate Investment Trust are the responsibility of management. The unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The unaudited interim consolidated financial statements include some amounts and assumptions based on management's best estimates which have been derived with careful judgement.

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

(signed) "Glenn Squires"  
Chief Executive Officer

(signed) "Tracy Sherren"  
Chief Financial Officer

# Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Balance Sheet

As at March 31, 2009

	March 31, 2009 \$	December 31, 2008 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents (note 10)	4,320,834	4,991,951
Capital reserve	1,329,131	1,552,737
Restricted cash	665,098	653,504
Accounts receivable	4,205,237	3,887,113
Inventories	280,481	303,465
Prepaid expenses and deposits	2,640,908	2,238,765
Current portion of mezzanine loans receivable (note 4)	—	3,000,000
	13,441,689	16,627,535
<b>Capital reserve – restricted</b>	3,482,813	2,975,289
<b>Loans receivable from related parties</b> (note 3)	6,508,910	6,508,910
<b>Mezzanine loans and advances receivable</b> (note 4)	10,071,388	9,663,000
<b>Investments in hotel properties</b>	2,961,649	2,688,334
<b>Property and equipment</b> (note 5)	348,969,952	352,035,190
<b>Other assets</b>	1,048,279	1,123,944
<b>Future income taxes</b>	2,824,000	1,764,000
	389,308,680	393,386,202
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	8,748,999	9,418,698
Distributions payable	684,866	684,866
Accrued interest on convertible debentures	1,112,305	674,600
Current portion of obligations under capital leases (note 6)	332,625	338,249
Current portion of mortgages and loans payable (note 7)	5,279,110	5,155,110
	16,157,905	16,271,523
<b>Obligations under capital leases</b> (note 6)	448,912	528,132
<b>Mortgages and loans payable</b> (note 7)	159,697,041	159,665,899
<b>Promissory notes payable</b> (note 8)	3,377,498	3,368,334
<b>Convertible debentures</b> (note 9)	64,049,194	63,457,890
	243,730,550	243,291,778
<b>Unitholders' Equity</b>	145,578,130	150,094,424
	389,308,680	393,386,202

# Holloway Lodging Real Estate Investment Trust

## Unaudited Consolidated Statement of Unitholders' Equity

For the three-month periods ended March 31, 2009 and 2008

	Units \$	Class B LP units \$	Contributed surplus \$	Equity component of convertible debentures \$	Accumulated income (losses) \$	Accumulated distributions \$	Total \$
<b>Balance, December 31, 2007</b>	180,231,026	667,000	804,890	9,596,225	312,428	(17,806,019)	173,805,550
Unit-based compensation related to options		–	223,944	–	–	–	223,944
Units repurchased and cancelled	(239,424)	–	52,193	–	–	–	(187,231)
Issuance costs	(2,500)	–	–	–	–	–	(2,500)
Net loss	–	–	–	–	(780,505)	–	(780,505)
Distributions	–	–	–	–	–	(5,283,376)	(5,283,376)
<b>Balance, March 31, 2008</b>	179,989,102	667,000	1,081,027	9,596,225	(468,077)	(23,089,395)	167,775,882
Unit-based compensation related to options	–	–	247,529	–	–	–	247,529
Exercise of options	84,268	–	(57,601)	–	–	–	26,667
Units repurchased and cancelled	(53,360)	–	24,239	–	–	–	(29,121)
Units issued to trustees	67,828	–	–	–	–	–	67,828
Net loss	–	–	–	–	(4,299,965)	–	(4,299,965)
Distributions	–	–	–	–	–	(13,694,396)	(13,694,396)
<b>Balance, December 31, 2008</b>	180,087,838	667,000	1,295,194	9,596,225	(4,768,042)	(36,783,791)	150,094,424
Unit-based compensation related to options	–	–	17,917	–	–	–	17,917
Net loss	–	–	–	–	(2,479,612)	–	(2,479,612)
Distributions	–	–	–	–	–	(2,054,599)	(2,054,599)
<b>Balance, March 31, 2009</b>	180,087,838	667,000	1,313,111	9,596,225	(7,247,654)	(38,838,390)	145,578,130

# Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statement of Operations and Comprehensive Loss

For the three-month periods ended March 31, 2009 and 2008

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	For the three-month period ended March 31, 2009 \$	For the three-month period ended March 31, 2008 \$
<b>Hotel revenues</b>		
Rooms	16,582,809	19,575,620
Other	2,745,018	3,132,293
	<hr/> 19,327,827	<hr/> 22,707,913
<b>Hotel expenses</b>		
Operating expenses	12,448,508	13,500,194
Property taxes and insurance	1,285,752	1,113,943
Management fees	494,814	589,278
	<hr/> 14,229,074	<hr/> 15,203,415
<b>Hotel operating income</b>	<hr/> 5,098,753	<hr/> 7,504,498
<b>Other (income) expenses</b>		
Interest on mortgages and other debt and accretion of deferred financing fees	2,889,661	2,875,918
Convertible debentures interest and accretion	1,845,945	1,808,351
Corporate and administrative	578,451	866,744
Interest income	(258,610)	(708,018)
Unrealized foreign exchange loss	193,234	141,797
Depreciation and amortization	3,389,684	3,261,211
	<hr/> 8,638,365	<hr/> 8,246,003
<b>Loss before income taxes</b>	(3,539,612)	(741,505)
<b>Provision for (recovery of) future income taxes</b>	<hr/> (1,060,000)	<hr/> 39,000
<b>Net loss and comprehensive loss for the periods</b>	<hr/> (2,479,612)	<hr/> (780,505)
<b>Basic and diluted loss per unit</b>	(0.06)	(0.02)

# Holloway Lodging Real Estate Investment Trust

## Unaudited Consolidated Statement of Cash Flows

For the three-month periods ended March 31, 2009 and 2008

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	For the three-month period ended March 31, 2009 \$	For the three-month period ended March 31, 2008 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net loss and comprehensive loss for the periods	(2,479,612)	(780,505)
Charges (credits) to income not involving cash		
Unit-based compensation	17,917	223,944
Depreciation and amortization	3,389,684	3,261,211
Accretion of mortgages and convertible debentures	597,606	520,768
Unrealized foreign exchange loss	193,234	141,797
Provision for (recovery of) future income taxes	(1,060,000)	39,000
	658,829	3,406,215
Net change in non-cash working capital balances related to operations (note 10)	(891,971)	(1,921,534)
<b>Cash flow from (used in) operating activities</b>	(233,142)	1,484,681
<b>Investing activities</b>		
(Increase) decrease in restricted cash	(11,594)	598,241
(Increase) decrease in capital reserves	(283,918)	(599,677)
Issuance of mezzanine loans and advances	(408,388)	-
Proceeds from repayment of mezzanine loans	3,000,000	-
Issuance of loan to a related party	-	(6,350,000)
Investment in hotel properties	(273,315)	-
Additions to property and equipment	(286,088)	(458,546)
<b>Cash flow from (used in) investing activities</b>	1,736,697	(6,809,982)
<b>Financing activities</b>		
Repayment of capital lease obligations	(84,843)	(124,177)
Proceeds from mortgages and loans, net of financing fees	1,162,549	(32,024)
Repayment of mortgages and loans payable	(1,197,779)	(1,012,034)
Units repurchased and cancelled	-	(187,231)
Issuance costs	-	(2,500)
Distributions paid to unitholders	(2,054,599)	(5,285,698)
<b>Cash flow from (used in) financing activities</b>	(2,174,672)	(6,643,664)
<b>Net change in cash and cash equivalents during the periods</b>	(671,117)	(11,968,965)
<b>Cash and cash equivalents – Beginning of periods</b>	4,991,951	22,894,439
<b>Cash and cash equivalents – End of periods</b>	4,320,834	10,925,474

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

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## 1 Basis of presentation and nature of operations

Holloway Lodging Real Estate Investment Trust (“Holloway Lodging REIT” or the “REIT”) is an open-ended real estate investment trust that was formed under the laws of the Province of Ontario pursuant to its Declaration of Trust on March 28, 2006.

The objectives of the REIT are: (a) to generate stable cash distributions on a tax efficient basis; (b) to expand its asset base and increase its funds from operations through accretive acquisitions and internal growth initiatives; and (c) to enhance the value of its assets to maximize long-term unit value through active management of its assets.

As at March 31, 2009, the REIT owned 21 hotels in Canada and 1 hotel in the United States with 2,423 guest rooms and suites and held minority ownership interests in nine hotels.

## 2 Significant accounting policies

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

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

### Changes in accounting standards

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

#### *Goodwill and Intangible Assets*

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

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

### 3 Loans receivable from related parties

The REIT has a \$6.35 million loan, advanced February 1, 2008 receivable from Pacrim Hospitality Services Inc., a company in which a member of management and trustee has a significant ownership interest. The loan is unsecured, has a ten-year term, 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.

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

### 4 Mezzanine loans and advances receivable

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

	<b>March 31, 2009</b>	<b>December 31, 2008</b>
	\$	\$
Winport Developments Limited Partnership, a related party, and Pacrim North York Limited Partnership, principal balance due November 3, 2011, with \$8.0 million bearing interest at 12% and \$1.5 million bearing interest at 11%	9,500,000	9,500,000
Winport Development Limited Partnership, a related party, and Pacrim North York Limited Partnership, principal balance due January 13, 2009, bearing interest at 12%	1,250,000	1,250,000
RegWin Hotel Ltd., principal balance due January 19, 2012, bearing interest at 12%, repaid on February 5, 2009	–	3,000,000
Windsor 8 Motel Limited, principal balance due January 19, 2012, bearing interest at 12%	1,913,000	1,913,000
Additional advances to Winport Developments Limited Partnership and Pacrim North York Limited Partnership, non-interest bearing with no set terms of repayment	388,388	–
Additional advance to Windsor 8 Motel Limited, non-interest bearing with no set terms of repayment	20,000	–
	<u>13,071,388</u>	<u>15,663,000</u>
Less: Current portion	–	3,000,000
Less: Provision for impairment	<u>3,000,000</u>	<u>3,000,000</u>
	<u>10,071,388</u>	<u>9,663,000</u>

The REIT believes that the loans to Winport Development Limited Partnership and Pacrim North York Limited Partnership are impaired. The loans are in default and the REIT has issued a demand notice for payment. The loans have been written down to the estimated fair value of the REIT's underlying security. Significant judgment was exercised by management in making this estimate. As such, actual losses will differ from the estimate and the differences could be material.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

## 5 Property and equipment

	<b>March 31, 2009</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Land	32,216,832	–	32,216,832
Land lease	500,000	32,964	467,036
Buildings	304,862,952	15,189,225	289,673,727
Renovations in progress	276,499	–	276,499
Furniture, fixtures, equipment and other	30,127,222	8,650,848	21,476,374
Paving	3,619,378	734,516	2,884,862
Landscaping	22,984	2,706	20,278
Signage	1,044,751	199,221	845,530
Computer equipment and website	1,770,481	1,017,342	753,139
Vehicles	353,467	174,391	179,076
Tenant inducements	211,919	35,320	176,599
	<b>375,006,485</b>	<b>26,036,533</b>	<b>348,969,952</b>

  

	<b>December 31, 2008</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Land	32,216,832	–	32,216,832
Land lease	500,000	30,037	469,963
Buildings	304,904,833	13,282,864	291,621,969
Renovations in progress	220,541	–	220,541
Furniture, fixtures and equipment	29,940,422	7,549,543	22,390,879
Paving	3,619,378	644,063	2,975,315
Landscaping	22,984	1,656	21,328
Signage	1,008,114	173,139	834,975
Computer equipment and websites	1,759,212	870,297	888,915
Vehicles	353,467	146,190	207,277
Tenant inducements	211,920	24,724	187,196
	<b>374,757,703</b>	<b>22,722,513</b>	<b>352,035,190</b>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

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## 6 Obligations under capital leases

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

	<b>March 31, 2009</b>	<b>December 31, 2008</b>
	\$	\$
Present value of future minimum lease payments	781,537	866,381
Less: Current portion	332,625	338,249
	<u>448,912</u>	<u>528,132</u>

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

	\$
Reminder of 2009	302,694
Year ending December 31, 2010	330,343
Year ending December 31, 2011	143,981
Year ending December 31, 2012	85,580
Year ending December 31, 2013	20,598
Thereafter	<u>20,574</u>
Future minimum lease payments	903,770
Less: Amounts representing interest at a weighted average rate of 10.51%	<u>122,233</u>
Present value of future minimum lease payments	<u>781,537</u>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

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## 7 Mortgages and loans payable

	March 31, 2009 \$	December 31, 2008 \$
Mortgages payable, bearing interest at a weighted average rate of 6.77% (December 31, 2008 - 6.76%) and maturing on various dates from April, 2010 to July, 2017. Individual first charges on most of the hotel properties have been pledged as security for individual mortgages	166,062,691	165,919,967
Vehicle loans payable, bearing interest at a weighted average rate of 7.63% (December 31, 2008 - 7.62%) and maturing on various dates from April, 2010 to April, 2011	84,172	98,834
	166,146,863	166,018,801
Less: Deferred financing fees	1,170,712	1,197,792
Less: Current portion	5,279,110	5,155,110
	<u>159,697,041</u>	<u>159,665,899</u>

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

	\$
Reminder of 2009	3,908,068
Year ending December 31, 2010	13,944,407
Year ending December 31, 2011	36,529,630
Year ending December 31, 2012	18,822,212
Year ending December 31, 2013	2,924,628
Thereafter	90,017,918

## 8 Promissory notes payable

On December 22, 2008, the REIT issued two promissory notes for \$3.0 million and \$551,613, respectively, payable to Winport Developments Limited Partnership to finance the acquisition of the investments in hotel properties. The \$3.0 million promissory note bears interest at 6% per year until December 22, 2011 and 12% per year, thereafter. The \$551,613 note does not bear interest and therefore has been discounted by \$183,279, representing the net present value of the implicit interest. The discount is being accreted to interest expense over five years, the expected term of the promissory notes. The principal of the notes is repayable on the sale of Holloway's ownership interests or the sale of the underlying properties.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

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## 9 Convertible debentures

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

On June 21, 2007, the REIT issued \$45,000,000 in convertible, redeemable debentures. The debentures bear interest at 6.5%, payable semi-annually on June 30<sup>th</sup> and December 31<sup>st</sup>, and mature in five years. The convertible debentures can be converted into units of the REIT at \$6.15 per unit at any time commencing two years and one day from the issuance date and ending on the date that is 15 days prior to the maturity date. On July 18, 2007, the REIT issued an additional \$6,844,000 in convertible, redeemable debentures with the same terms as the June 21, 2007 debentures, pursuant to the underwriters exercising their over-allotment option.

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

The convertible debentures have been valued at their estimated fair value at the time of issuance, according to the terms and conditions in place at the time. The difference between the gross proceeds and the estimated fair value of the debt of \$5,300,000 on the August 1, 2006 8% debentures, \$4,150,000 on the June 21, 2007 6.5% debentures and \$644,000 on the July 18, 2007 6.5% debentures represents the value of the conversion feature of the debentures and accordingly, has been recorded as a component of equity. The difference between the recorded value of the debt component of the debentures and their face value has been accounted for as a discount on the issuance of the debt and is being accreted to interest expense, using the effective interest rate method, over the terms of the debentures.

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

	<b>March 31, 2009</b>	<b>December 31, 2008</b>
	\$	\$
Debt component	61,988,000	61,988,000
Accretion of convertible debentures	3,803,963	3,336,996
Deferred financing fees	(1,742,769)	(1,867,106)
	<u>64,049,194</u>	<u>63,457,890</u>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

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## 10 Supplemental cash flow information

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

	<b>For the three-month period ended March 31, 2009 \$</b>	<b>For the three-month period ended March 31, 2008 \$</b>
Accounts receivable	(318,124)	(1,699,222)
Inventories	22,984	77,829
Prepaid expenses and deposits	(402,143)	162,661
Accounts payable and accrued liabilities	(632,393)	(900,507)
Accrued interest on convertible debentures	437,705	437,705
	<u>(891,971)</u>	<u>(1,921,534)</u>

Cash and cash equivalents are comprised of the following:

	<b>March 31, 2009 \$</b>	<b>December 31, 2008 \$</b>
Cash on hand and balances with banks	<u>4,320,834</u>	<u>4,991,951</u>

## 11 Seasonality

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

## 12 Capital management

The REIT defines capital as the aggregate of unitholders' equity and interest-bearing debt. The objectives of the REIT's capital management program are to maintain a level of capital that complies with the investment and debt restrictions according to the REIT's Declaration of Trust, complies with existing debt covenants, provides a return to unitholders by delivering monthly cash distributions, 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 cash distributions, working capital requirements and capital expenditures are funded from operations, available cash on deposit and, where applicable, bank borrowings. The REIT will make adjustments to its capital structure to meet the objectives of the broader corporate strategy or in response to changes in economic conditions and risk. In order to maintain or adjust the capital structure, the REIT may issue debt and/or issue or redeem units.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

## 12 Capital management (continued)

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

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

	<b>March 31, 2009</b>	<b>December 31, 2008</b>
	\$	\$
<b>Capital structure</b>		
Obligations under capital leases	781,537	866,381
Mortgages and loans payable	164,976,151	164,821,009
Convertible debentures	64,049,194	63,457,890
Promissory notes	3,377,498	3,368,334
Total debt	233,184,380	232,513,614
Unitholders' equity	145,578,130	150,094,424
Total capital	378,762,510	382,608,038
<b>Ratios</b>		
Total debt	233,184,380	232,513,614
Adjustment of convertible debentures to face value	8,032,806	8,624,110
Adjustment of promissory notes to face value	174,115	183,279
Debt	241,391,301	241,321,003
Gross book value	415,694,177	416,447,047
Debt to GBV	58.1%	57.9%
<b>Trailing 12 months ended</b>		
	<b>March 31, 2009</b>	<b>December 31, 2008</b>
	\$	\$
Earnings base	29,222,397	32,019,577
Debt service	21,214,087	21,093,105
Debt service ratio	1.38	1.52

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

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## 12 Capital management (continued)

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

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

## 13 Financial instruments

### i) Fair value of financial instruments

The REIT's financial instruments consist of cash and cash equivalents, restricted cash, accounts receivable, mezzanine loans receivable, capital reserve, loans receivable from related parties, accounts payable and accrued liabilities, distributions payable, accrued interest on convertible debentures, obligations under capital leases, mortgages and loans payable, promissory notes payable and convertible debentures. The REIT's cash and cash equivalents, restricted cash, accounts receivable, capital reserve, accounts payable and accrued liabilities, distributions payable and accrued interest on convertible debentures are carried at amortized cost, which approximates fair value due to the immediate or short-term maturities of these financial instruments.

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

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

## 13 Financial instruments (continued)

	March 31, 2009 \$		December 31, 2008 \$	
	Carrying value	Fair value	Carrying value	Fair value
Held for trading (cash, restricted cash and capital reserve)	9,797,876	9,797,876	10,173,481	10,173,481
Loans and receivables (accounts receivable)	4,205,237	4,205,237	3,887,113	3,887,113
Other financial liabilities (accounts payable and accrued liabilities, distributions payable and accrued interest)	10,546,170	10,546,170	10,778,164	10,778,164
Obligations under capital leases	781,537	781,537	866,381	866,381
Mortgages and loans payable	164,976,151	178,872,880	164,821,001	179,289,428
Convertible debentures	73,645,419	32,599,918	73,054,115	43,832,469

### ii) Risk management

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

#### Interest rate risk

The REIT is exposed to interest rate risk on its lending and borrowing activities. It manages its exposure to interest rate risk by using fixed rate debt so that cashflow is not impacted significantly by a change in interest rates. The REIT does not have any mortgages to be re-financed in 2009 and \$8.9 million to be re-financed in 2010. The weighted average interest rate on its mortgages payable is 6.77% (December 31, 2008 - 6.76%) with a weighted average maturity of 6.0 years (December 31, 2008 - 6.2 years). The convertible debentures have a weighted average interest rate of 6.9% (December 31, 2008 - 6.9%) and a weighted average maturity of 3.0 years (December 31, 2008 - 3.2 years).

At March 31, 2009, the REIT had no long-term debt at floating rates and thus, for the three months ended March 31, 2009, a 1% change in interest rates would not change the net income (loss).

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

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## 13 Financial instruments (continued)

### Credit risk

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

The amount of accounts receivable disclosed in the balance sheet of \$4,205,237 is net of allowances for bad debts, estimated by management based on prior experience and their assessment of the current economic environment.

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

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

	<b>March 31, 2009</b>	<b>December 31, 2008</b>
	\$	\$
Accounts receivable under 30 days aged	2,436,406	2,111,945
Accounts receivable over 30 days aged	1,892,047	1,860,410
Less: Allowance for doubtful accounts	(123,216)	(85,242)
	<u>4,205,237</u>	<u>3,887,113</u>

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

### Currency risk

The REIT incurs revenue and expenses in U.S. and Canadian currency, and as such, is subject to fluctuations as a result of foreign exchange rate variation. The REIT manages its exposure to currency risk by billing for its services in the U.S. in the underlying currency related to the expenditure. As this natural hedging effectively matches the revenue and expenses, the REIT's management considers there to be little currency risk. However, a \$0.01 change in the US dollar exchange rate will change the unrealized foreign exchange gain or loss by \$44,493 (December 31, 2008 - \$44,735).

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the three-month periods ended March 31, 2009 and 2008

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## 13 Financial instruments (continued)

### Liquidity risk

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