

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Financial Statements

June 30, 2008

August 11, 2008

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 June 30, 2008

	June 30, 2008 \$	December 31, 2007 \$
Assets		
Current assets		
Cash and cash equivalents	8,593,397	22,894,439
Restricted cash	554,610	2,322,933
Accounts receivable	5,487,084	3,828,493
Loan receivable from a related party	158,910	158,910
Inventories	315,977	427,958
Prepaid expenses and deposits	2,692,299	2,868,726
	17,802,277	32,501,459
Capital reserve	3,513,673	2,409,626
Mezzanine loans receivable	14,413,000	14,413,000
Loan receivable from a related party (note 4)	6,350,000	–
Property and equipment (note 5)	357,826,849	362,548,159
Other assets	1,187,748	1,289,066
Future income taxes	1,813,000	2,055,000
	<u>402,906,547</u>	<u>415,216,310</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	8,652,055	8,859,914
Distributions payable	1,760,402	1,761,899
Accrued interest on convertible debentures	674,600	674,600
Current portion of obligations under capital leases (note 6)	319,192	369,039
Current portion of mortgages and loans payable (note 7)	4,741,709	4,359,149
	16,147,958	16,024,601
Obligations under capital leases (note 6)	497,674	519,381
Mortgages and loans payable (note 7)	161,279,564	163,603,384
Convertible debentures (note 8)	62,327,613	61,263,394
	240,252,809	241,410,760
Unitholders' equity	162,653,738	173,805,550
	<u>402,906,547</u>	<u>415,216,310</u>

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statement of Unitholders' Equity

For the six-month period ended June 30, 2007 and the six-month period ended June 30, 2008

	Units \$	Class B LP units \$	Contributed surplus \$	Equity component of convertible debentures \$	Accumulated income (losses) \$	Accumulated distributions \$	Total \$
Balance, December 31, 2006	63,270,181	920,000	430,010	4,982,000	(1,207,608)	(2,632,358)	65,762,225
Unit-based compensation related to options	-	-	194,584	-	-	-	194,584
Exercise of options	18,797	-	(2,527)	-	-	-	16,270
Units issued, net of issuance costs, net of tax of \$1,423,000	91,691,091	-	-	-	-	-	91,691,091
Units issued in property acquisitions	22,000,000	-	-	-	-	-	22,000,000
Equity component of convertible debentures, net of issuance costs	-	-	-	3,994,375	-	-	3,994,375
Exchange of units	46,000	(46,000)	-	-	-	-	-
Net income	-	-	-	-	2,294,310	-	2,294,310
Distributions	-	-	-	-	-	(4,602,265)	(4,602,265)
Balance, June 30, 2007	177,026,069	874,000	622,067	8,976,375	1,086,702	(7,234,623)	181,350,590
Unit-based compensation related to options	-	-	182,823	-	-	-	182,823
Units issued, net of issuance costs, net of tax of \$45,000	2,997,957	-	-	-	-	-	2,997,957
Equity component of convertible debentures, net of issuance costs	-	-	-	619,850	-	-	619,850
Exchange of units	207,000	(207,000)	-	-	-	-	-
Net income (loss)	-	-	-	-	(774,274)	-	(774,274)
Distributions	-	-	-	-	-	(10,571,396)	(10,571,396)
Balance, December 31, 2007	180,231,026	667,000	804,890	9,596,225	312,428	(17,806,019)	173,805,550
Unit-based compensation related to options	-	-	342,194	-	-	-	342,194
Units repurchased and cancelled	(239,424)	-	52,193	-	-	-	(187,231)
Issuance costs	(2,500)	-	-	-	-	-	(2,500)
Units issued to trustees	67,828	-	-	-	-	-	67,828
Net income (loss)	-	-	-	-	(808,345)	-	(808,345)
Distributions	-	-	-	-	-	(10,563,758)	(10,563,758)
Balance, June 30, 2008	180,056,930	667,000	1,199,277	9,596,225	(495,917)	(28,369,777)	162,653,738

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statement of Operations and and Comprehensive Income (Loss)

For the three and six-month periods ended June 30, 2008 and 2007

	Three months ended		Six months ended	
	June 30, 2008 \$	June 30, 2007 \$	June 30, 2008 \$	June 30, 2007 \$
Hotel revenues				
Rooms	20,416,685	10,505,105	39,992,305	17,897,669
Other	3,252,364	2,482,523	6,384,657	4,736,910
	23,669,049	12,987,628	46,376,962	22,634,579
Hotel cost of sales	7,157,755	4,452,992	14,042,793	7,863,202
Hotel gross profit	16,511,294	8,534,636	32,334,169	14,771,377
Hotel operating expenses				
Sales and marketing	921,144	552,641	1,860,533	1,009,309
General and administrative	1,900,292	981,945	3,736,713	1,774,680
Maintenance, property taxes and insurance	3,367,143	1,689,070	6,706,739	3,183,921
Management and other fees	1,629,730	839,536	3,214,179	1,464,249
Depreciation and amortization	3,291,347	1,281,809	6,543,861	2,237,741
Land lease expense	660,617	630,302	1,111,091	1,101,180
Interest on mortgages and loans payable and accretion of deferred financing fees	2,877,514	1,244,321	5,753,188	2,198,024
Unrealized foreign exchange (gain) loss	(31,111)	—	128,735	—
	14,616,676	7,219,624	29,055,039	12,969,104
Income from hotel operations	1,894,618	1,315,012	3,279,130	1,802,273
Trust (income) expenses				
Interest income	(695,320)	(416,325)	(1,403,338)	(857,352)
General and administrative expenses	631,214	496,082	1,274,015	925,689
Expenditures related to abandoned property acquisitions	13,347	6,349	13,347	217,809
Depreciation and amortization	9,082	7,683	17,779	12,256
Debenture interest	1,247,225	515,211	2,527,357	951,001
Other interest	—	18,783	243	23,859
Accretion of discount on convertible debentures and deferred financing fees	545,659	175,223	1,073,878	328,117
Unit-based compensation	118,250	107,084	342,194	194,584
	1,869,457	910,090	3,845,475	1,795,963
Income (loss) before income taxes	25,161	404,922	(566,345)	6,310
Provision for future income taxes	(203,000)	382,000	(242,000)	382,000
Net income (loss) and comprehensive income (loss) for the periods	(177,839)	786,922	(808,345)	388,310
Income (loss) per unit				
Basic	(0.01)	0.04	(0.02)	0.02
Diluted	(0.01)	0.04	(0.02)	0.02

Holloway Lodging Real Estate Investment Trust

Unaudited Consolidated Statement of Cash Flows

For the three and six-month periods ended June 30, 2008 and 2007

	Three months ended		Six months ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
	\$	\$	\$	\$
Cash provided by (used in)				
Operating activities				
Net income (loss) for the periods	(177,839)	786,922	(808,345)	388,310
Charges (credits) to income not involving cash				
Unit-based compensation	118,250	107,084	342,194	194,584
Depreciation and amortization	3,300,429	1,289,492	6,561,640	2,249,997
Accretion of mortgages and convertible debentures	537,683	174,206	1,058,451	319,468
Unrealized foreign exchange (gain) loss	(31,111)	-	128,735	-
Future income tax expense (recovery)	203,000	(382,000)	242,000	(382,000)
	3,950,412	1,975,704	7,524,675	2,770,359
Net change in non-cash working capital balances related to operations (note 9)	346,041	16,820	(1,594,290)	(324,306)
Cash flow from operating activities	4,296,453	1,992,524	5,930,385	2,446,053
Investing activities				
Decrease (increase) in restricted cash	1,170,082	(2,800,283)	1,768,323	(2,800,283)
(Increase) decrease in capital reserve	(504,370)	286,012	(1,104,047)	427,176
Issuance of loan to a related party	-	(158,910)	(6,350,000)	(158,910)
Issuance of mezzanine loans	-	-	-	(4,913,000)
Acquisition of hotel properties (note 3)	-	(210,560,619)	-	(233,457,508)
Increase in other assets	(7,515)	(13,552)	(7,515)	(62,513)
Additions to property and equipment	(880,196)	(1,618,196)	(1,488,744)	(3,353,712)
Cash flow used in investing activities	(221,999)	(214,865,548)	(7,181,983)	(244,318,750)
Financing activities				
Repayment of capital lease obligations	(106,055)	(37,834)	(230,232)	(69,208)
Proceeds from mortgages and loans, net of financing fees	(8,364)	105,193,517	(40,388)	116,602,562
Repayment of mortgages and loans payable	(1,012,555)	(440,657)	(2,023,838)	(788,606)
Issuance of units, net of issuance costs	-	90,945,938	(2,500)	90,938,775
Units repurchased and cancelled	-	-	(187,231)	-
Exercise of options	-	16,270	-	16,270
Issuance of convertible debentures, net of issuance costs	-	43,312,500	-	43,312,500
Distributions paid to unitholders	(5,279,557)	(1,905,605)	(10,565,255)	(3,685,318)
Cash flow from (used in) financing activities	(6,406,531)	237,084,129	(13,049,444)	246,326,975
Net change in cash and cash equivalents during the periods	(2,332,077)	24,211,105	(14,301,042)	4,454,278
Cash and cash equivalents – Beginning of periods	10,925,474	12,225,845	22,894,439	31,982,672
Cash and cash equivalents – End of periods	8,593,397	36,436,950	8,593,397	36,436,950

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

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 June 30, 2008, the REIT owned 21 hotels in Canada and 1 hotel in the United States with 2,423 guest rooms and suites.

2 Significant accounting policies

The accompanying unaudited consolidated financial statements have been prepared in accordance with the requirements of the Canadian Institute of Chartered Accountants (CICA) Handbook Section 1751, “Interim Financial Statements”. Accordingly, certain information and note disclosure normally included in annual financial statements prepared in accordance with Canadian generally accepted accounting principles have been omitted or condensed. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the REIT for the year ended December 31, 2007.

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, 2007.

Changes in accounting standards

In the first quarter of 2008, the REIT adopted the following new Handbook Sections issued by CICA.

Financial instruments

Section 3862, *Financial instruments – Disclosures*, modifies the disclosure requirements for financial instruments that were included in Section 3861, *Financial Instruments – Disclosure and Presentation*.

Section 3863, *Financial Instruments – Presentation*, carries forward unchanged the presentation requirements of the previous Section 3861, *Financial Instruments – Disclosure and Presentation*.

These new standards require disclosures related to the significance of financial instruments on the REIT’s financial position and performance and the nature and extent of risk arising from financial instruments to which the REIT is exposed and how the REIT manages these risks. Disclosure recommended by the new handbook sections have been included in note 12 of these interim consolidated financial statements.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

2 Significant accounting policies (continued)

Capital disclosures

Section 1535, *Capital Disclosures*, establishes disclosure requirements about the REIT's capital and how it is managed. The purpose is to enable users of the financial statements to evaluate the REIT's objectives, policies and processes for managing capital. Disclosures recommended by the new handbook section have been included in note 11 of these interim consolidated financial statements.

Inventories

Section 3031, *Inventories*, replaces the existing standard for inventories, Section 3030, revising and enhancing disclosure and presentation requirements. There has been no impact as to how the REIT accounts for inventory, as the REIT values linen, food, beverages and guest supplies and amenities at the lower of cost, determined on a first-in, first-out basis, and net realizable value. The cost of inventories recognized as expense was \$1,260,563 for the three months ended June 30, 2008 (three months ended June 30, 2007 - \$941,891) and \$2,541,971 for the six months ended June 30, 2008 (six months ended June 30, 2007 - \$1,669,509).

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

3 Hotel acquisitions

Holloway Lodging REIT acquired the following hotels, restaurant operations and parking lots during the six months ended June 30, 2007. The acquisitions have been accounted for using the purchased method, and accordingly, the results of operations of the hotels since the dates of acquisition have been included in the consolidated statement of operations. The following table details the acquisitions and purchase price allocations:

	2007								
Hotel	Radisson	Super 8	Super 8	Northwest Inn	Best Western	Holiday Inn	Holiday Inn Parking Lot	Pomeroy Inn & Suites	Super 8
Location	Fort McMurray, AB	Three Hills, AB	Slave Lake, AB	Slave Lake, AB	Grande Prairie, AB	Grande Prairie, AB	Grande Prairie, AB	Grande Prairie, AB	Grande Prairie, AB
Date of acquisition	January 31	April 13	June 22	June 22	June 22	June 22	June 22	June 22	June 22
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Assets acquired									
Land	2,000,000	1,160,000	500,000	3,930,000	1,600,000	2,050,000	1,000,000	2,100,000	1,400,000
Buildings	19,400,000	7,556,217	10,247,174	6,223,043	26,325,629	39,198,411	-	30,412,020	27,013,944
Furniture, fixtures and equipment	1,250,000	1,082,000	580,000	693,000	1,000,000	2,920,000	-	3,040,000	1,490,000
Paving	-	144,000	65,856	94,080	101,949	167,680	500,000	128,838	220,844
Signage	-	25,000	50,000	50,000	50,000	50,000	-	50,000	50,000
Computer equipment	100,000	10,000	16,593	64,840	30,675	84,936	-	41,326	38,284
Vehicles	-	-	13,500	-	-	-	-	-	107,808
Vehicle loans assumed	-	-	-	-	-	-	-	-	(98,047)
Assets under capital lease	-	-	-	107,107	53,864	158,294	-	341,277	57,266
Obligations under capital leases assumed	-	-	-	(107,946)	(35,873)	(80,329)	-	(326,801)	(54,489)
Franchise fees	-	13,552	-	-	27,417	83,353	-	42,904	5,345
Agreements	-	-	26,877	45,876	46,339	67,655	-	70,436	69,045
Working capital	-	9,231	-	-	-	-	-	-	-
	22,750,000	10,000,000	11,500,000	11,100,000	29,200,000	44,700,000	1,500,000	35,900,000	30,300,000
Financed by									
Cash	22,750,000	8,000,000	10,431,847	10,069,000	26,487,821	40,548,137	1,500,000	32,565,506	27,485,650
Issuance of REIT or LP units	-	2,000,000	1,068,153	1,031,000	2,712,179	4,151,863	-	3,334,494	2,814,350
	22,750,000	10,000,000	11,500,000	11,100,000	29,200,000	44,700,000	1,500,000	35,900,000	30,300,000

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

3 Hotel acquisitions (continued)

Hotel	2007						
	Super 8	Super 8	Super 8	Staff House	Super 8	Super 8 Parking Lot	Sorrentino's Restaurant
	High Level, AB	Whitecourt, AB	Fort Nelson, BC	Fort Nelson, BC	Fort St. John, BC	Fort St. John, BC	Grande Prairie, AB
	June 22	June 22	June 22	June 22	June 22	June 22	June 22
	\$	\$	\$	\$	\$	\$	\$
Assets acquired							
Land	500,000	420,000	1,950,000	75,000	1,600,000	1,000,000	-
Buildings	9,464,523	7,894,958	15,683,294	250,000	9,538,712	-	-
Furniture, fixtures and equipment	810,000	590,000	1,420,000	-	930,000	-	399,043
Paving	167,516	94,585	233,145	-	359,120	-	-
Signage	50,000	50,000	50,000	-	50,000	-	-
Computer equipment	25,794	8,991	44,844	-	27,262	-	-
Vehicles	-	-	50,139	-	49,835	-	-
Vehicle loans assumed	-	-	(48,072)	-	(46,468)	-	-
Assets under capital lease	26,689	59,319	47,230	-	40,459	-	10,787
Obligations under capital leases assumed	(17,219)	(62,774)	(35,939)	-	(32,231)	-	(9,830)
Franchise fees	35,162	17,581	39,557	-	40,216	-	-
Agreements	37,535	27,340	65,802	-	43,095	-	-
Working capital	-	-	-	-	-	-	-
	11,100,000	9,100,000	19,500,000	325,000	12,600,000	1,000,000	400,000
Financed by							
Cash	10,069,000	8,254,766	17,688,784	294,813	11,429,676	1,000,000	400,000
Issuance of REIT or LP units	1,031,000	845,234	1,811,216	30,187	1,170,324	-	-
	11,100,000	9,100,000	19,500,000	325,000	12,600,000	1,000,000	400,000

In addition to the purchase price paid to the vendors, as allocated above, the REIT incurred an additional \$5.0 million in other acquisition and closing costs, which were primarily allocated to the buildings.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

4 Loan receivable from a related party

On February 1, 2008, Pacrim Hospitality Services Inc. (“PHSI”) acquired the contract related to the management of ten of the REIT’s hotel properties located in northern Alberta and British Columbia from Pomeroy Hospitality Ltd. (“Pomeroy”). The REIT acquired the hotels (the “Pomeroy Hotels”) from affiliates of Pomeroy in June 2007. As of February 1, 2008, all of the REIT’s hotels are managed by PHSI.

Under the terms of an agreement among the REIT, PHSI and Pomeroy, Pomeroy assigned its interest in the hotel management agreement between Pomeroy and the REIT to PHSI on February 1, 2008 in return for a \$6,350,000 one-time payment from PHSI. At the same time, the existing hotel management agreement between the REIT and PHSI was amended to include the Pomeroy Hotels. Among other things, the amended hotel management agreement between the REIT and PHSI provides that PHSI is entitled to a base management fee for the Pomeroy hotels that is significantly lower than the base management fee currently payable under the existing hotel management agreement until the REIT generates distributable income that exceeds certain targets.

In order to facilitate the assignment, the REIT loaned PHSI the funds that were paid to Pomeroy in consideration of the assignment. This loan has a ten-year term, is pre-payable at any time without penalty and bears interest at 13% per annum during the first six months of the term and at the lesser of 13% and the trailing three-month yield plus 1% on Holloway’s units thereafter.

5 Property and equipment

			June 30, 2008
	Cost \$	Accumulated amortization \$	Net \$
Land	32,216,832	–	32,216,832
Land lease	500,000	24,184	475,816
Buildings	304,847,066	9,461,798	295,385,268
Renovations in progress	48,120	–	48,120
Furniture, fixtures, equipment and other	29,371,724	5,353,494	24,018,230
Tenant inducements	368,490	6,032	362,458
Paving	3,638,313	462,438	3,175,875
Signage	985,344	124,579	860,765
Computer equipment and websites	1,643,150	582,889	1,060,261
Vehicles	315,212	91,988	223,224
	373,934,251	16,107,402	357,826,849

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

5 Property and equipment (continued)

		December 31, 2007	
	Cost	Accumulated amortization	Net
	\$	\$	\$
Land	32,216,832	–	32,216,832
Land lease	500,000	18,331	481,669
Buildings	304,283,875	5,653,060	298,630,815
Renovations in progress	292,359	–	292,359
Furniture, fixtures and equipment	28,664,483	3,243,794	25,420,689
Paving	3,638,313	280,434	3,357,879
Signage	929,774	76,728	853,046
Computer equipment and websites	1,369,521	341,189	1,028,332
Vehicles	307,599	41,061	266,538
	<u>372,202,756</u>	<u>9,654,597</u>	<u>362,548,159</u>

6 Obligations under capital leases

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

	June 30, 2008	December 31, 2007
	\$	\$
Present value of future minimum lease payments	816,866	888,420
Less: Current portion	<u>319,192</u>	<u>369,039</u>
	<u>497,674</u>	<u>519,381</u>

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

	\$
Remainder of 2008	206,292
Years ending December 31, 2009	355,730
2010	262,332
2011	87,658
2012	24,471
Thereafter	<u>19,824</u>
Future minimum lease payments	956,307
Less: Amounts representing interest at a weighted average rate of 11.44%	<u>139,441</u>
Present value of future minimum lease payments	<u>816,866</u>

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

7 Mortgages and loans payable

	June 30, 2008 \$	December 31, 2007 \$
Mortgages payable, bearing interest at a weighted average rate of 6.76% (2007 - 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	167,210,059	169,199,091
Vehicle loans payable, bearing interest at a weighted average rate of 7.62% (December 31, 2007 - 7.62%) and maturing on various dates from January, 2009 to April, 2011	127,335	163,090
	167,337,394	169,362,181
Less: Deferred financing fees	1,316,121	1,399,648
Less: Current portion	4,741,709	4,359,149
	<u>161,279,564</u>	<u>163,603,384</u>

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

	\$
Remainder of 2008	2,228,318
Years ending December 31, 2009	5,137,978
2010	13,895,185
2011	36,453,477
2012	17,660,366
Thereafter	91,962,070

8 Convertible debentures

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

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

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

8 Convertible debentures (continued)

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.

	June 30, 2008 \$	December 31, 2007 \$
Debt component	61,988,000	61,988,000
Accretion of convertible debentures	2,445,324	1,606,938
Deferred financing fees	(2,105,711)	(2,331,544)
	62,327,613	61,263,394

9 Supplemental cash flow information

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

	Three months ended		Six months ended	
	June 30, 2008 \$	June 30, 2007 \$	June 30, 2008 \$	June 30, 2007 \$
Accounts receivable	40,631	(617,059)	(1,658,591)	(638,043)
Inventories	34,152	(170,549)	111,981	(215,334)
Prepaid expenses and deposits	13,766	(1,331,792)	176,427	(1,337,775)
Accounts payable and accrued liabilities	695,197	1,659,337	(224,107)	1,794,723
Accrued interest on convertible debentures	(437,705)	476,883	-	72,123
	346,041	16,820	(1,594,290)	(324,306)

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

9 Supplemental cash flow information (continued)

Cash and cash equivalents are comprised of the following:

	June 30, 2008 \$	June 30, 2007 \$
Cash on hand and balances with banks	8,593,397	36,436,950
Short-term investments	—	—
	<hr/> 8,593,397	<hr/> 36,436,950

10 Seasonality

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

11 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.

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

- a Debt Service 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 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 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.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

11 Capital management (continued)

	June 30, 2008 \$	December 31, 2007 \$
Capital structure		
Obligations under capital leases	816,866	888,420
Mortgages and loans payable	166,021,273	167,962,533
Convertible debentures	62,327,613	61,263,394
	<hr/>	<hr/>
Total debt	229,165,752	230,114,347
Unitholders' equity	162,653,738	173,805,550
	<hr/>	<hr/>
Total capital	391,819,490	403,919,897
	<hr/>	<hr/>
Ratios		
Total debt	229,165,752	230,114,347
Adjustment of convertible debentures to face value	9,754,387	10,818,606
	<hr/>	<hr/>
Debt	238,920,139	240,932,953
Gross book value	419,459,977	425,005,102
Debt to GBV	57.0%	56.7%
	<hr/>	<hr/>
	June 30, 2008 \$	June 30, 2007 \$
For the twelve-month periods ended		
Earnings base	32,515,117	9,007,548
Debt service	20,591,360	5,840,946
Debt service ratio	1.58	1.54

The REIT is also subject to financial covenants in its mortgages and loan payable, which are measured on a quarterly and 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 all financial covenants.

Cash distributions to unitholders exceed the REIT's distributable income, as defined in the REIT's Declaration of Trust.

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

12 Financial instruments

The REIT's financial instruments consist of cash and cash equivalents, restricted cash, accounts receivable, mezzanine loans receivable, loan receivable from a related party, accounts payable and accrued liabilities, obligations under capital leases, mortgages and loans payable, and convertible debentures.

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

Investments included in the REIT's cash and cash equivalents earn interest at prevailing and fluctuating market rates. The REIT manages its exposure to interest rate risk through fixed rate lending and borrowing. The fixed rate loans receivable and debt are subject to interest rate pricing risk, as the value will fluctuate as a result of changes in market rates.

Credit risk

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

The amount of accounts receivable disclosed in the balance sheet of \$5,487,084 is net of allowances for bad debts, estimated by management based on prior experience and their assessment of the current economic environment. No customer accounts for more than 10% of the accounts receivable balance.

Historically there have been no collection issues and the REIT does not believe it is subject to any significant concentration of credit risk.

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

	June 30, 2008	December 31, 2007
	\$	\$
Accounts receivable under 30 days aged	3,969,209	2,110,453
Accounts receivable over 30 days aged	1,533,764	1,774,964
Less: Allowance for doubtful accounts	(15,889)	(56,924)
	<u>5,487,084</u>	<u>3,828,493</u>

Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the six-month periods ended June 30, 2008 and 2007

12 Financial instruments (continued)

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.

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. The REIT monitors its cash balances and cash flows generated from operations to meet 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.

Fair value of financial instruments

The carrying amounts reported in the balance sheet for accounts receivable, accounts payable and accrued liabilities, distributions payable and accrued interest on convertible debentures approximate fair values due to the immediate or short-term maturities of these financial instruments. The carrying value of the loans receivable and mortgages and loans payable approximates the fair value as interest rates are consistent with current rates. At June 2008, the 8% and 6.5% convertible debentures were trading at approximately 97% and 86% of face value, respectively.

Carrying value of financial instruments

	June 30, 2008	June 30, 2007
	\$	\$
Held for trading	9,148,007	39,237,233
Loans and receivables	26,408,994	15,256,928
Other financial liabilities	240,252,809	229,957,679

