

# **Holloway Lodging Real Estate Investment Trust**

Unaudited Consolidated Financial Statements  
**September 30, 2008**

November 13, 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 September 30, 2008 and December 31, 2007

	September 30, 2008 \$	December 31, 2007 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	7,941,147	22,894,439
Restricted cash	576,802	2,322,933
Accounts receivable	5,005,230	3,828,493
Loan receivable from a related party	158,910	158,910
Inventories	365,008	427,958
Prepaid expenses and deposits	2,331,273	2,868,726
Mezzanine loan receivable	1,250,000	—
	<u>17,628,370</u>	<u>32,501,459</u>
<b>Capital reserve</b>	4,030,907	2,409,626
<b>Mezzanine loans receivable</b>	14,413,000	14,413,000
<b>Loan receivable from a related party</b> (note 4)	6,350,000	—
<b>Property and equipment</b> (note 5)	355,034,663	362,548,159
<b>Other assets</b>	1,172,406	1,289,066
<b>Future income taxes</b>	1,071,000	2,055,000
	<u>399,700,346</u>	<u>415,216,310</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	9,584,369	8,859,914
Distributions payable	1,761,130	1,761,899
Accrued interest on convertible debentures	1,112,305	674,600
Current portion of obligations under capital leases (note 6)	343,000	369,039
Current portion of mortgages and loans payable (note 7)	4,944,748	4,359,149
	<u>17,745,552</u>	<u>16,024,601</u>
<b>Obligations under capital leases</b> (note 6)	571,045	519,381
<b>Mortgages and loans payable</b> (note 7)	160,229,522	163,603,384
<b>Convertible debentures</b> (note 8)	62,884,221	61,263,394
	<u>241,430,340</u>	<u>241,410,760</u>
<b>Unitholders' equity</b>	158,270,006	173,805,550
	<u>399,700,346</u>	<u>415,216,310</u>

# Holloway Lodging Real Estate Investment Trust

## Unaudited Consolidated Statement of Unitholders' Equity

For the nine-month period ended September 30, 2008 and the year ended December 31, 2007

	Units \$	Class B LP units \$	Contributed surplus \$	Equity component of convertible debentures \$	Accumulated income (losses) \$	Accumulated distributions \$	Total \$
<b>Balance, December 31, 2006</b>	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	-	-	286,001	-	-	-	286,001
Exercise of options	18,797	-	(2,527)	-	-	-	16,270
Units issued, net of issuance costs, net of tax of \$1,468,000	94,698,110	-	-	-	-	-	94,698,110
Units issued in property acquisitions	22,000,000	-	-	-	-	-	22,000,000
Equity component of convertible debentures, net of issuance costs	-	-	-	4,614,225	-	-	4,614,225
Exchange of units	46,000	(46,000)	-	-	-	-	-
Net income	-	-	-	-	3,571,647	-	3,571,647
Distributions	-	-	-	-	-	(9,887,965)	(9,887,965)
<b>Balance, September 30, 2007</b>	180,033,088	874,000	713,484	9,596,225	2,364,039	(12,520,323)	181,060,513
Unit-based compensation related to options	-	-	91,406	-	-	-	91,406
Issuance costs	(9,062)	-	-	-	-	-	(9,062)
Exchange of units	207,000	(207,000)	-	-	-	-	-
Net income (loss)	-	-	-	-	(2,051,611)	-	(2,051,611)
Distributions	-	-	-	-	-	(5,285,696)	(5,285,696)
<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	-	-	462,111	-	-	-	462,111
Exercise of options	84,268	-	(57,601)	-	-	-	26,667
Units repurchased and cancelled	(288,144)	-	72,633	-	-	-	(215,511)
Issuance costs	(2,500)	-	-	-	-	-	(2,500)
Units issued to trustees	67,828	-	-	-	-	-	67,828
Net income (loss)	-	-	-	-	(27,247)	-	(27,247)
Distributions	-	-	-	-	-	(15,846,892)	(15,846,892)
<b>Balance, September 30, 2008</b>	180,092,478	667,000	1,282,033	9,596,225	285,181	(33,652,911)	158,270,006

# Holloway Lodging Real Estate Investment Trust

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

For the three and nine-month periods ended September 30, 2008 and 2007

	Three months ended		Nine months ended	
	September 30, 2008 \$	September 30, 2007 \$	September 30, 2008 \$	September 30, 2007 \$
<b>Hotel revenues</b>				
Rooms	22,729,830	21,021,579	62,722,135	38,919,248
Other	3,018,198	3,836,939	9,402,855	8,573,849
	25,748,028	24,858,518	72,124,990	47,493,097
<b>Hotel cost of sales</b>	7,573,293	7,216,625	21,616,087	15,079,825
<b>Hotel gross profit</b>	18,174,735	17,641,893	50,508,903	32,413,272
<b>Hotel operating expenses</b>				
Sales and marketing	1,022,616	1,011,342	2,883,149	2,020,649
General and administrative	1,902,012	1,827,241	5,638,726	3,601,921
Maintenance, property taxes and insurance	3,076,407	2,732,382	9,783,146	5,916,303
Management and other fees	1,772,934	1,811,184	4,987,112	3,275,433
Depreciation and amortization	3,341,012	3,034,889	9,884,874	5,272,628
Land lease expense	713,388	669,673	1,824,478	1,770,853
Interest on mortgages and loans payable and accretion of deferred financing fees	2,840,747	2,896,832	8,593,935	5,094,856
Unrealized foreign exchange loss	200,428	–	329,162	–
	14,869,544	13,983,543	43,924,582	26,952,643
<b>Income from hotel operations</b>	3,305,191	3,658,350	6,584,321	5,460,629
<b>Trust (income) expenses</b>				
Interest income	(692,140)	(865,862)	(2,095,478)	(1,723,214)
General and administrative expenses	503,217	572,792	1,777,232	1,498,485
Expenditures related to abandoned property acquisitions	31,733	(126,405)	45,080	91,404
Depreciation and amortization	9,973	7,953	27,751	20,209
Debenture interest	1,247,225	1,331,442	3,774,582	2,282,444
Other interest	–	(178)	243	23,681
Accretion of discount on convertible debentures and deferred financing fees	562,169	436,854	1,636,047	764,972
Unit-based compensation	119,916	91,417	462,111	286,001
	1,782,093	1,448,013	5,627,568	3,243,982
<b>Income before income taxes</b>	1,523,098	2,210,337	956,753	2,216,647
<b>Provision for future income taxes</b>	742,000	933,000	984,000	551,000
<b>Net income (loss) and comprehensive income (loss) for the periods</b>	781,098	1,277,337	(27,247)	1,665,647
<b>Income per unit</b>				
Basic	0.02	0.03	(0.00)	0.07
Diluted	0.02	0.03	(0.00)	0.07

# Holloway Lodging Real Estate Investment Trust

## Unaudited Consolidated Statement of Cash Flows

For the three and nine-month periods ended September 30, 2008 and 2007

	Three months ended		Nine months ended	
	September 30, 2008 \$	September 30, 2007 \$	September 30, 2008 \$	September 30, 2007 \$
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net income (loss) for the periods	781,098	1,277,337	(27,247)	1,665,647
Charges (credits) to income not involving cash				
Unit-based compensation	119,916	91,417	462,111	286,001
Depreciation and amortization	3,350,985	3,042,838	9,912,625	5,292,837
Accretion of mortgages and convertible debentures	542,396	561,923	1,600,847	881,391
Future income tax expense	742,000	933,000	984,000	551,000
Unrealized foreign exchange loss	200,428	–	329,162	–
	5,736,823	5,906,515	13,261,498	8,676,876
Net change in non-cash working capital balances related to operations (note 9)	2,106,676	(87,388)	512,385	(411,694)
<b>Cash flow from operating activities</b>	<b>7,843,499</b>	<b>5,819,127</b>	<b>13,773,883</b>	<b>8,265,182</b>
<b>Investing activities</b>				
Decrease (increase) in restricted cash	(22,192)	–	1,746,131	(2,800,283)
Increase in capital reserve	(517,234)	(498,690)	(1,621,281)	(71,514)
Issuance of loan to a related party	–	–	(6,350,000)	(158,910)
Issuance of mezzanine loans	(1,250,000)	(1,500,000)	(1,250,000)	(6,413,000)
Acquisition of hotel properties (note 3)	–	(11,472,416)	–	(245,575,010)
Increase in other assets	(31,500)	–	(39,015)	(62,513)
Additions to property and equipment	(277,325)	(1,185,120)	(1,766,068)	(3,893,748)
<b>Cash flow used in investing activities</b>	<b>(2,098,251)</b>	<b>(14,656,226)</b>	<b>(9,280,233)</b>	<b>(258,974,978)</b>
<b>Financing activities</b>				
Repayment of capital lease obligations	(80,261)	(101,988)	(310,493)	(171,196)
Proceeds from mortgages and loans, net of financing fees	–	267,887	–	116,870,449
Repayment of mortgages and loans payable	(1,033,218)	(788,581)	(3,097,444)	(1,577,187)
Issuance of units, net of issuance costs	–	2,295,727	(2,500)	93,234,502
Units repurchased and cancelled	(28,280)	–	(215,511)	–
Exercise of options	26,667	–	26,667	16,270
Issuance of convertible debentures, net of issuance costs	–	6,587,350	–	49,899,850
Distributions paid to unitholders	(5,282,406)	(4,970,299)	(15,847,661)	(8,655,617)
<b>Cash flow from (used in) financing activities</b>	<b>(6,397,498)</b>	<b>3,290,096</b>	<b>(19,446,942)</b>	<b>249,617,071</b>
<b>Net change in cash and cash equivalents during the periods</b>	<b>(652,250)</b>	<b>(5,547,003)</b>	<b>(14,953,292)</b>	<b>(1,092,725)</b>
<b>Cash and cash equivalents – Beginning of periods</b>	<b>8,593,397</b>	<b>36,436,950</b>	<b>22,894,439</b>	<b>31,982,672</b>
<b>Cash and cash equivalents – End of periods</b>	<b>7,941,147</b>	<b>30,889,947</b>	<b>7,941,147</b>	<b>30,889,947</b>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2008 and 2007

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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 September 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 nine-month periods ended September 30, 2008 and 2007

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## 2 Significant accounting policies (continued)

### Changes in accounting standards (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, 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 \$1,240,855 for the three months ended September 30, 2008 (three months ended September 30, 2007 - \$1,416,358) and \$3,782,826 for the nine months ended September 30, 2008 (nine months ended September 30, 2007 - \$3,085,867).

# Holloway Lodging Real Estate Investment Trust

## Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2008 and 2007

### 3 Hotel acquisitions

Holloway Lodging REIT acquired the following hotels, restaurant operations and parking lots during the nine months ended September 30, 2007. The acquisitions have been accounted for using the purchase 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 the purchase price allocations:

Hotel	Radisson	Super 8	Super 8	Northwest Inn	Best Western	Holiday Inn	Holiday Inn Parking Lot	Pomeroy Inn & Suites
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
Date of acquisition	January 31	April 13	June 22	June 22	June 22	June 22	June 22	June 22
	\$	\$	\$	\$	\$	\$	\$	\$
<b>Assets acquired</b>								
Land	2,000,000	1,160,000	500,000	3,930,000	1,600,000	2,050,000	1,000,000	2,100,000
Building	19,400,000	7,556,217	10,247,174	6,223,043	26,325,629	39,198,411	-	30,412,020
Furniture, fixtures and equipment	1,250,000	1,082,000	580,000	693,000	1,000,000	2,920,000	-	3,040,000
Paving	-	144,000	65,856	94,080	101,949	167,680	500,000	128,838
Signage	-	25,000	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
Vehicles	-	-	13,500	-	-	-	-	-
Vehicle loans assumed	-	-	-	-	-	-	-	-
Assets under capital lease	-	-	-	107,107	53,864	158,294	-	341,277
Obligations under capital leases assumed	-	-	-	(107,946)	(35,873)	(80,329)	-	(326,801)
Franchise fees	-	13,552	-	-	27,417	83,353	-	42,904
Agreements	-	-	26,877	45,876	46,339	67,655	-	70,436
Working capital	-	9,231	-	-	-	-	-	-
	<b>22,750,000</b>	<b>10,000,000</b>	<b>11,500,000</b>	<b>11,100,000</b>	<b>29,200,000</b>	<b>44,700,000</b>	<b>1,500,000</b>	<b>35,900,000</b>
<b>Financed by</b>								
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
Issuance of REIT units	-	2,000,000	1,068,153	1,031,000	2,712,179	4,151,863	-	3,334,494
	<b>22,750,000</b>	<b>10,000,000</b>	<b>11,500,000</b>	<b>11,100,000</b>	<b>29,200,000</b>	<b>44,700,000</b>	<b>1,500,000</b>	<b>35,900,000</b>

# Holloway Lodging Real Estate Investment Trust

## Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2008 and 2007

### 3 Hotel acquisitions (continued)

Hotel	Super 8	Super 8	Super 8	Super 8	Staff House	Super 8	Super 8 Parking Lot	Sorrentino's Restaurant	Holiday Inn Express
Location	Grande Prairie, AB	High Level, AB	Whitecourt, AB	Fort Nelson, BC	Fort Nelson, BC	Fort St. John, BC	Fort St. John, BC	Grande Prairie, AB	Kamloops, BC
Date of acquisition	June 22	June 22	June 22	June 22	June 22	June 22	June 22	June 22	September 12
	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>Assets acquired</b>									
Land	1,400,000	500,000	420,000	1,950,000	75,000	1,600,000	1,000,000	-	1,500,000
Building	27,013,944	9,464,523	7,894,958	15,683,294	250,000	9,538,712	-	-	8,741,235
Furniture, fixtures and equipment	1,490,000	810,000	590,000	1,420,000	-	930,000	-	399,043	800,000
Paving	220,844	167,516	94,585	233,145	-	359,120	-	-	150,000
Signage	50,000	50,000	50,000	50,000	-	50,000	-	-	30,000
Pool	-	-	-	-	-	-	-	-	-
Computer equipment	38,284	25,794	8,991	44,844	-	27,262	-	-	31,584
Vehicles	107,808	-	-	50,139	-	49,835	-	-	-
Vehicle loans assumed	(98,047)	-	-	(48,072)	-	(46,468)	-	-	-
Assets under capital lease	57,266	26,689	59,319	47,230	-	40,459	-	10,787	-
Obligations under capital leases assumed	(54,489)	(17,219)	(62,774)	(35,939)	-	(32,231)	-	(9,830)	-
Franchise fees	5,345	35,162	17,581	39,557	-	40,216	-	-	35,933
Agreements	69,045	37,535	27,340	65,802	-	43,095	-	-	-
Working capital	-	-	-	-	-	-	-	-	11,248
	<b>30,300,000</b>	<b>11,100,000</b>	<b>9,100,000</b>	<b>19,500,000</b>	<b>325,000</b>	<b>12,600,000</b>	<b>1,000,000</b>	<b>400,000</b>	<b>11,300,000</b>
<b>Financed by</b>									
Cash	27,485,650	10,069,000	8,254,766	17,688,784	294,813	11,429,676	1,000,000	400,000	11,300,000
Issuance of REIT units	2,814,350	1,031,000	845,234	1,811,216	30,187	1,170,324	-	-	-
	<b>30,300,000</b>	<b>11,100,000</b>	<b>9,100,000</b>	<b>19,500,000</b>	<b>325,000</b>	<b>12,600,000</b>	<b>1,000,000</b>	<b>400,000</b>	<b>11,300,000</b>

In addition to the purchase price paid to the vendors, as allocated above, the REIT incurred an additional \$5.4 million in other acquisition and closing costs, which were primarily allocated to the acquired buildings.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2008 and 2007

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## 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 re-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

	<b>September 30, 2008</b>		
	<b>Cost \$</b>	<b>Accumulated amortization \$</b>	<b>Net \$</b>
Land	32,216,832	–	32,216,832
Land lease	500,000	27,111	472,889
Buildings	304,857,892	11,368,511	293,489,381
Renovations in progress	120,831	–	120,831
Furniture, fixtures, equipment and other	29,686,289	6,446,085	23,240,204
Tenant inducements	368,490	24,128	344,362
Paving	3,619,378	553,169	3,066,209
Landscaping	19,187	606	18,581
Signage	985,344	148,795	836,549
Computer equipment and websites	1,755,846	723,633	1,032,213
Vehicles	315,212	118,600	196,612
	<b>374,445,301</b>	<b>19,410,638</b>	<b>355,034,663</b>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2008 and 2007

## 5 Property and equipment (continued)

		<b>December 31,</b>	
		<b>2007</b>	
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	<b>\$</b>	<b>amortization</b>	<b>\$</b>
		<b>\$</b>	<b>\$</b>
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, equipment and other	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.

	<b>September 30,</b>	<b>December 31,</b>
	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
Present value of future minimum lease payments	914,045	888,420
Less: Current portion	<u>343,000</u>	<u>369,039</u>
	<u>571,045</u>	<u>519,381</u>

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

	<b>\$</b>
Remainder of 2008	117,258
Years ending December 31, 2009	402,702
2010	311,413
2011	131,952
2012	73,553
Thereafter	<u>34,112</u>
Future minimum lease payments	1,070,990
Less: Amounts representing interest at a weighted average rate of 10.69%	<u>156,945</u>
Present value of future minimum lease payments	<u>914,045</u>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2008 and 2007

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## 7 Mortgages and loans payable

	September 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	166,313,785	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 April 2010 to April 2011	113,219	163,090
	166,427,004	169,362,181
Less: Deferred financing fees	1,252,734	1,399,648
Less: Current portion	4,944,748	4,359,149
	<u>160,229,522</u>	<u>163,603,384</u>

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

	\$
Remainder of 2008	1,121,257
Years ending December 31, 2009	5,140,567
2010	13,899,679
2011	36,457,496
2012	17,665,396
Thereafter	92,142,609

## 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 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.

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 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.

	September 30, 2008 \$	December 31, 2007 \$
Debt component	61,988,000	61,988,000
Accretion of convertible debentures	2,884,274	1,606,938
Deferred financing fees	(1,988,053)	(2,331,544)
	<u>62,884,221</u>	<u>61,263,394</u>

## 9 Supplemental cash flow information

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

	Three months ended		Nine months ended	
	September 30, 2008 \$	September 30, 2007 \$	September 30, 2008 \$	September 30, 2007 \$
Accounts receivable	481,854	(2,226,851)	(1,176,737)	(2,864,894)
Inventories	(49,031)	32,526	62,950	(182,808)
Prepaid expenses and deposits	361,026	(222,365)	537,453	(1,560,140)
Accounts payable and accrued liabilities	875,122	1,911,605	651,014	3,706,328
Accrued interest on convertible debentures	437,705	417,697	437,705	489,820
	<u>2,106,676</u>	<u>(87,388)</u>	<u>512,385</u>	<u>(411,694)</u>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2008 and 2007

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## 9 Supplemental cash flow information (continued)

Cash and cash equivalents are comprised of the following:

	September 30, 2008 \$	September 30, 2007 \$
Cash on hand and balances with banks	7,941,147	30,889,947
Short-term investments	—	—
	<hr/> 7,941,147	<hr/> 30,889,947

## 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 nine-month periods ended September 30, 2008 and 2007

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## 11 Capital management (continued)

	September 30, 2008 \$	December 31, 2007 \$
<b>Capital structure</b>		
Obligations under capital leases	914,045	888,420
Mortgages and loans payable	165,174,270	167,962,533
Convertible debentures	62,884,221	61,263,394
Total debt	228,972,536	230,114,347
Unitholders' equity	158,270,006	173,805,550
Total capital	387,242,542	403,919,897
<b>Ratios</b>		
Total debt	228,972,536	230,114,347
Adjustment of convertible debentures to face value	9,197,779	10,818,606
Debt	238,170,315	240,932,953
Gross book value	419,400,853	425,005,102
Debt to GBV	56.8%	56.7%
	<b>September 30, 2008 \$</b>	<b>September 30, 2007 \$</b>
<b>For the twelve-month periods ended</b>		
Earnings base	32,237,215	17,105,985
Debt service	20,861,581	10,108,595
Debt service ratio	1.55	1.69

The REIT is also subject to financial covenants on its mortgages and loans 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 nine-month periods ended September 30, 2008 and 2007

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## 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 \$5,005,230 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:

	September 30, 2008 \$	December 31, 2007 \$
Accounts receivable under 30 days aged	3,496,127	2,110,453
Accounts receivable over 30 days aged	1,556,284	1,774,964
Less: Allowance for doubtful accounts	(47,181)	(56,924)
	<u>5,005,230</u>	<u>3,828,493</u>

# Holloway Lodging Real Estate Investment Trust

Notes to Unaudited Consolidated Financial Statements

For the nine-month periods ended September 30, 2008 and 2007

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## 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 September 30, 2008, the 8% and 6.5% convertible debentures were trading at approximately 90% and 81% of face value, respectively.

### Carrying value of financial instruments

	September 30, 2008 \$	September 30, 2007 \$
Held for trading	8,517,949	33,690,230
Loans and receivables	27,177,140	18,983,778
Other financial liabilities	241,430,340	237,668,495

