

Holloway Lodging Real Estate Investment Trust

Consolidated Financial Statements
December 31, 2007 and 2006

February 28, 2008

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of **Holloway Lodging Real Estate Investment Trust** (the "REIT") have been prepared by the REIT's management. The financial statements have been prepared in accordance with accounting principles generally accepted in Canada and contain estimates based on management's judgment. Internal control systems are maintained by management to provide reasonable assurances that assets are safeguarded and financial information is reliable.

The Board of Trustees of the REIT is responsible for ensuring that management fulfils its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements and the accompanying management discussion and analysis. The Board of Trustees carries out this responsibility principally through its Audit Committee.

The Audit Committee is appointed by the Board of Trustees and all of its members are independent. It meets with the REIT's management and auditors and reviews internal control and financial reporting matters to ensure that management is properly discharging its responsibilities before submitting the financial statements to the Board of Trustees for approval.

(signed) "Glenn Squires"
Chief Executive Officer

(signed) "Tracy Sherren"
Chief Financial Officer

February 28, 2008

Auditors' Report

To the Trustees of Holloway Lodging Real Estate Investment Trust

We have audited the consolidated balance sheets of **Holloway Lodging Real Estate Investment Trust** ("Holloway Lodging REIT" or the "REIT") as at December 31, 2007 and 2006 and the consolidated statements of unitholders' equity, income and comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the REIT's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the REIT as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "*PricewaterhouseCoopers LLP*"

Chartered Accountants

Holloway Lodging Real Estate Investment Trust

Consolidated Balance Sheets

December 31, 2007 and 2006

	2007	2006
	\$	\$
Assets		
Current assets		
Cash and cash equivalents (note 13)	22,894,439	31,982,672
Restricted cash (note 5)	2,322,933	—
Accounts receivable	3,828,493	1,546,975
Loan receivable from a related party	158,910	—
Inventories	427,958	341,562
Prepaid expenses and deposits	2,868,726	1,532,633
	<hr/>	<hr/>
	32,501,459	35,403,842
Capital reserve	2,409,626	1,720,429
Mezzanine loan receivable (note 6)	14,413,000	8,000,000
Property and equipment (note 7)	362,548,159	91,200,153
Other assets (note 8)	1,289,066	1,477,541
Future income taxes (note 18)	2,055,000	—
	<hr/>	<hr/>
	415,216,310	137,801,965
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	8,859,914	5,698,219
Distributions payable	1,761,899	529,552
Accrued interest on convertible debentures	674,600	674,600
Current portion of obligations under capital leases (note 9)	369,039	96,509
Current portion of mortgages and loans payable (note 10)	4,359,149	1,535,676
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	16,024,601	8,534,556
Obligations under capital leases (note 9)	519,381	97,565
Mortgages and loans payable (note 10)	163,603,384	48,027,952
Convertible debentures (note 11)	61,263,394	15,379,667
	<hr/>	<hr/>
	241,410,760	72,039,740
Unitholders' equity (note 12)	173,805,550	65,762,225
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	415,216,310	137,801,965
Commitments (note 15)		
Approved by the Trustees		
(signed) "Walter Keyser" Trustee		(signed) "Wayne Watson" Trustee

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Unitholders' Equity

As at December 31, 2007 and 2006

	Share capital \$	Units \$	Class B LP units \$	Contributed surplus \$	Equity component of convertible debentures \$	Accumulated income (losses) \$	Accumulated distributions \$	Total \$
Balance, December 31, 2005	300,000	—	—	—	—	—	—	300,000
Initial public offering, net of issuance costs	852,209	—	—	—	—	—	—	852,209
Unit-based compensation related to options	—	—	—	430,000	—	—	—	430,000
Units issued in exchange for shares	(1,152,209)	1,152,209	—	—	—	—	—	—
Creation of trust	—	—	—	10	—	—	—	10
Units issued by private placement, net of issuance costs	—	54,500,228	—	—	—	—	—	54,500,228
Units issued in property acquisitions	—	7,497,000	920,000	—	—	—	—	8,417,000
Equity component of convertible debentures, net of issuance costs	—	—	—	—	4,982,000	—	—	4,982,000
Units issued to trustees	—	62,645	—	—	—	—	—	62,645
Units issued to management	—	58,099	—	—	—	—	—	58,099
Net loss	—	—	—	—	—	(1,207,608)	—	(1,207,608)
Distributions	—	—	—	—	—	—	(2,632,358)	(2,632,358)
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	—	—	—	377,407	—	—	—	377,407
Exercise of options	—	18,797	—	(2,527)	—	—	—	16,270
Units issued, net of issuance costs, net of tax of \$1,468,000	—	94,689,048	—	—	—	—	—	94,689,048
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	—	253,000	(253,000)	—	—	—	—	—
Net income	—	—	—	—	—	1,520,036	—	1,520,036
Distributions	—	—	—	—	—	—	(15,173,661)	(15,173,661)
Balance, December 31, 2007	—	180,231,026	667,000	804,890	9,596,225	312,428	(17,806,019)	173,805,550

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Income and Comprehensive Income

As at December 31, 2007 and 2006

	2007	2006
	\$	\$
Hotel revenues		
Rooms	57,235,631	11,834,026
Other	12,515,006	3,557,677
	<u>69,750,637</u>	<u>15,391,703</u>
Hotel cost of sales	<u>22,339,607</u>	<u>5,427,835</u>
Hotel gross profit	<u>47,411,030</u>	<u>9,963,868</u>
Hotel operating expenses		
Sales and marketing	3,047,082	716,600
General and administrative	5,527,356	1,314,020
Maintenance, property taxes and insurance	9,097,504	1,970,956
Management and other fees	4,897,357	1,055,100
Depreciation and amortization	8,473,201	1,288,188
Land lease expense	2,274,655	836,163
Interest on mortgages and loans payable and accretion of deferred financing fees	7,952,450	862,694
Foreign exchange loss	186,565	—
	<u>41,456,170</u>	<u>8,043,721</u>
Income from hotel operations	<u>5,954,860</u>	<u>1,920,147</u>
Trust (income) expenses		
Interest income	(2,441,730)	(177,449)
General and administrative expenses	2,018,138	1,122,836
Expenditures related to abandoned property acquisitions	91,404	—
Depreciation and amortization	28,471	85,796
Debenture interest	3,368,004	674,600
Other interest	23,687	10,121
Accretion of discount on convertible debentures and deferred finance fees	1,448,683	441,667
Unit-based compensation	485,167	550,744
Reorganization expenses	—	419,440
	<u>5,021,824</u>	<u>3,127,755</u>
Income (loss) before income taxes	933,036	(1,207,608)
Recovery of future income taxes (note 18)	<u>587,000</u>	<u>—</u>
Net income (loss) and comprehensive income (loss) for the years	<u>1,520,036</u>	<u>(1,207,608)</u>
Income (loss) per unit (note 12)		
Basic	0.05	(0.18)
Diluted	0.05	(0.18)

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Cash Flows

As at December 31, 2007 and 2006

	2007	2006
	\$	\$
Cash provided by (used in)		
Operating activities		
Net income (loss) and comprehensive income for the years	1,520,036	(1,207,608)
Charges (credits) to income not involving cash		
Unit-based compensation	377,407	550,744
Depreciation and amortization	8,501,672	1,373,984
Accretion of mortgages and convertible debentures	1,337,277	359,671
Foreign exchange loss	186,565	–
Future income tax expense (recovery)	(587,000)	–
	<u>11,335,957</u>	<u>1,076,791</u>
Net change in non-cash working capital balances related to operations (note 13)	<u>574,149</u>	<u>2,102,796</u>
Cash flow from operating activities	<u>11,910,106</u>	<u>3,179,587</u>
Investing activities		
Increase in restricted cash	(2,322,933)	–
Increase in capital reserve	(689,197)	(1,720,429)
Issuance of a related party loan	(158,910)	–
Issuance of mezzanine loans	(6,413,000)	(8,000,000)
Acquisition of hotel properties (note 4)	(250,097,501)	(66,516,115)
Additions to property and equipment	(4,382,231)	(1,574,103)
Increase in other assets	(31,704)	(52,065)
Cash flow used in investing activities	<u>(264,095,476)</u>	<u>(77,862,712)</u>
Financing activities		
Repayment of capital lease obligations	(282,280)	(40,845)
Proceeds from mortgages and loans, net of finance fees	116,735,218	34,866,300
Repayment of mortgages and loans	(2,551,655)	(352,642)
Issuance of common shares of Holloway Capital Corporation, net of issuance costs, subsequently converted to units	–	852,209
Creation of trust	–	10
Issuance of units, net of issuance costs	93,221,048	54,500,228
Exercise of options	16,270	–
Issuance of convertible debentures, net of issuance costs	49,899,850	19,920,000
Deferred finance fees	–	(1,276,657)
Distributions paid to unitholders	(13,941,314)	(2,102,806)
Cash flow from financing activities	<u>243,097,137</u>	<u>106,365,797</u>
Net change in cash and cash equivalents during the years	<u>(9,088,233)</u>	<u>31,682,672</u>
Cash and cash equivalents – Beginning of years	<u>31,982,672</u>	<u>300,000</u>
Cash and cash equivalents – End of years	<u>22,894,439</u>	<u>31,982,672</u>

Supplemental cash flow information (note 13)

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

1 Basis of presentation, corporate reorganization 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 the Declaration of Trust on March 28, 2006. On April 3, 2006, Holloway Lodging REIT entered into an Arrangement Agreement with Holloway Capital Corporation (“HCC”), a capital pool company listed on the TSX Venture Exchange, in connection with its proposed qualifying transaction. The plan of arrangement and qualifying transaction involved three primary components:

- i) the reorganization of HCC into Holloway Lodging REIT by way of a plan of arrangement;
- ii) a private placement of trust units of Holloway Lodging REIT for gross proceeds to the REIT of \$860,000 at a price of \$2.00 per unit, after giving effect to the exchange of shares of HCC for units pursuant to the plan of arrangement on a one unit for five shares basis; and
- iii) the acquisition by Holloway Lodging REIT, through Holloway Lodging Limited Partnership (“Holloway Lodging LP”), an indirectly wholly-owned limited partnership, of a 50 room, three storey “Super 8” branded hotel in Truro, Nova Scotia from Truro Motel 8 Partnership, the vendor, for a purchase price of \$4.6 million.

On June 7, 2006, the plan of arrangement and qualifying transaction were completed. All of the issued and outstanding shares of HCC were transferred to the REIT in exchange for units based on the exchange ratio of one unit for five shares. All of the outstanding options to purchase shares of HCC were exchanged for unit options having identical terms, subject to adjustment of the number of units underlying the unit options and the exercise price of the unit options based on the exchange ratio of one unit for five shares.

The arrangement involving conversion to the REIT has been accounted for as a continuity of interests. Accordingly, these consolidated financial statements reflect the financial position, results of operations and cash flows as if the REIT had always carried on the business formerly carried on by HCC. All assets and liabilities are recorded at historical cost.

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 December 31, 2007, the REIT owned 21 hotels in Canada and 1 hotel in the United States with 2,424 guest rooms and suites.

2 Changes in accounting policies

Commencing with the first quarter of 2007, the REIT adopted five new accounting standards issued by the Accounting Standards Board: (i) Section 1530 Comprehensive Income; (ii) Section 3251 Equity; (iii) Section 3855 Financial Instruments – Recognition and Measurement; (iv) Section 3861 Financial Instruments – Disclosure and Presentation; and (v) Section 3865 Hedges.

The new standards prescribe how financial instruments are to be recognized depending on their classification. Depending on financial instruments’ classification, changes in subsequent measurements are recognized in net income or comprehensive income.

If a financial instrument is measured at fair value, changes in its fair value usually shall be recognized in the period in which the change occurs, with some exceptions, such as for cash flow hedges and available for sale investments. For investments designated as being available for sale, changes in the fair value shall be recorded directly in Unitholder’s

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

2 Changes in accounting policies (continued)

Equity in a separate account called "Other Comprehensive Income" until the asset disappears or is impaired. At that time, the gains and losses are transferred to the Statement of Income.

The REIT has implemented the following classifications:

- Cash and cash equivalents are classified as "Financial Assets Held for Trading". These financial assets are marked-to-market through net income at each period end.
- Accounts receivable are classified as "Loans and Receivables". After their initial fair value measurement, they are measured at amortized cost using the effective interest method.
- Accounts payable, capital leases, convertible debentures, mortgages and loans payable are classified as "Other Financial Liabilities". After their initial fair value measurement, they are measured at amortized cost net of transaction costs using the effective interest method.

These new standards have been applied without restatement of prior period amounts. Upon initial application, all adjustments to the carrying amount of financial assets and liabilities are recognized as an adjustment to the opening balance of unitholders' equity or accumulated other comprehensive income, depending on the classification of existing assets or liabilities. No adjustment was required by the REIT upon initial application of the new standards.

Due to the adoption of these new accounting policies, as at January 1, 2007, deferred finance fees were netted against the related mortgages and loans payable and convertible debentures. As a result, deferred finance fees decreased from \$1,190,245 to \$nil, mortgages and loans payable decreased from \$49,563,628 to \$49,222,500, and convertible debentures decreased from \$15,379,667 to \$14,530,550.

3 Significant accounting policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following policies:

a) Consolidation

The consolidated financial statements include the accounts of the REIT and its wholly-owned subsidiaries, Holloway Lodging Limited Partnership, Holloway Lodging II Limited Partnership, HL Trust, HL General Partner Inc., Holloway Lodging Canada, Inc., Holloway Lodging US Inc., HL US General Partner, Inc. and HL (1290 Paradise Circle) US LP. Any reference to the "REIT" throughout these consolidated financial statements refers to the REIT and its subsidiaries. All transactions between the REIT and its subsidiaries have been eliminated.

b) Cash and cash equivalents

Cash and cash equivalents include cash on hand, balances with banks and highly liquid temporary investments with original maturities of three months or less.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

3 Significant accounting policies (continued)

c) Inventories

Inventories consist of linen, food, beverages and other supplies. Inventories are valued at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis.

d) Capital reserve

The capital reserve account represents funds held by mortgagors or funds internally restricted for improvements to the properties.

e) Property and equipment

Property and equipment, including land, building, furniture, fixtures and equipment, are stated at cost less accumulated amortization or estimated net recoverable amount, adjusted for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

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

Land lease	Term of the lease
Buildings	40 years
Furniture, fixtures and equipment	7 years
Paving	10 years
Signage	10 years
Landscaping	5 years
Computer equipment	3 years
Vehicles	3 years

f) Impairment of long-lived assets

The REIT's long-lived assets, consisting of property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset might not be recoverable. Long-lived assets are reviewed at the individual hotel level, the lowest level for which identifiable cash flows are largely independent, when testing for and measuring impairment. A two-step process is used to assess the impairment of long-lived assets held for use, with the first step determining when impairment is recognized and the second step measuring the amount of the impairment. Impairment losses are recognized when the carrying amount of long-lived assets exceeds the sum of the undiscounted cash flows expected to result from their use and eventual disposition and are measured as the amount by which the long-lived asset's carrying amount exceeds its fair value.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

3 Significant accounting policies (continued)

g) Other assets

Other assets consist of franchise fees and agreements. Franchise fees are amortized on a straight-line basis over the term of the franchise agreement and the amortization is included in depreciation and amortization in these consolidated financial statements. The Non-competition, Right of First Opportunity and Participation Agreement (note 14) is amortized on a straight-line basis over the five year term of the agreement. In 2006, prior to the adoption of the new standards for financial instruments (note 2), deferred finance fees were included in other assets and were amortized on a straight-line basis over the term of the related debt. The amortization was included in depreciation and amortization expense.

h) Leases

Leases entered into by the REIT in which substantially all of the benefits and risks of ownership are transferred to the REIT are recorded as capital leases and classified as property and equipment and obligations under capital leases. Obligations under capital leases reflect the present value of future lease payments, discounted at an appropriate interest rate and are reduced by lease payments net of imputed interest. Assets under capital leases are amortized based on the estimated useful life of the asset. All other leases are classified as operating leases and lease payments are expensed in the period in which they are incurred.

i) Revenue recognition

Revenues are generated primarily from room occupancy, food and beverage services and parking. Revenues are recognized when the services are provided and collection is reasonably assured.

j) Income taxes

The REIT is taxed as a mutual fund trust for income tax purposes. Pursuant to the Declaration of Trust, the trustees of the REIT will make distributions or designate all taxable income earned by the REIT to unitholders. The unitholders will include or deduct, as appropriate, such distributions and designations for income tax purposes.

Under the provisions of Bill C-52, Budget Implementation Act, 2007, which was substantively enacted on June 12, 2007, the REIT, as a publicly traded income trust, is considered a specified investment flow-through ("SIFT"). As the REIT has exceeded the "normal growth" rates as defined in the guidelines issued by the Department of Finance, the REIT will be subject to tax commencing in the current year. Accordingly, future income tax will be recorded based on temporary differences expected to reverse in the future at the substantively enacted tax rates, which will be in effect at the time the temporary differences are expected to reverse.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

3 Significant accounting policies (continued)

j) Income taxes (continued)

Certain of the REIT's subsidiaries are corporations and are subject to income taxes. These subsidiaries use the liability method to account for income taxes, under which future income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities, and are measured using the substantively enacted income tax rates and laws that are expected to be in effect in the years in which the future income tax assets or liabilities are expected to be settled or realized. The effect of changes in income tax rates on future income tax assets and liabilities is recognized in the period in which the change occurs. Valuation allowances are recorded unless it is more likely than not that a future income tax asset will be realized.

k) Earnings per unit

Basic earnings per unit is computed based on the weighted average number of units outstanding during the reporting period. The REIT follows the treasury stock method in computing diluted earnings per unit.

l) Unit-based compensation

The REIT accounts for unit options issued under its unit option plan using the fair value method. Under this method, compensation expense is measured at fair value at the grant date using the Black-Scholes option pricing model and is recognized over the vesting period. Option pricing models require the input of highly subjective assumptions including the expected volatility. Changes in the assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the REIT's unit options.

m) Management estimates

The presentation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

n) Foreign currency translation

Monetary assets and liabilities of integrated foreign operations are translated into Canadian dollars at the rate of exchange in effect at the balance sheet date. Other non-monetary assets and non-monetary liabilities are translated at rates of exchange in effect when the assets were acquired or liabilities incurred. Revenues and expenses are translated at the average monthly rates of exchange during the year and depreciation and amortization is translated at rates of exchange consistent with the assets to which they relate. Gains or losses on translation of integrated foreign operations are recognized in income.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

3 Significant accounting policies (continued)

o) Future accounting changes

The Canadian Institute of Chartered Accountants has issued accounting standards that become effective for the REIT on January 1, 2008: Section 1535, Capital Disclosures; Section 3031, Inventories; Section 3862, Financial Instruments – Disclosures; Section 3863, Financial Instruments – Presentation.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital. Further disclosure by the REIT will be required by this standard.

Section 3031 will replace Section 3030, *Inventories*, revising and enhancing disclosure and presentation requirements. This new section will limit the choices in which to calculate carrying values and will provide new disclosure requirements. There will be no impact in how the REIT accounts for inventory; however, there will be additional disclosure requirements.

Section 3862 and 3863 will replace Section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements and carrying forward unchanged its presentation requirements. These new sections will place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Based on the financial instruments currently held by the REIT and the disclosure already made, it is not expected that the revised sections will have a significant impact on the financial statements.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

4 Hotel acquisitions

Holloway Lodging REIT acquired the following hotels, restaurant operations and parking lots in 2006 and 2007. The acquisitions have been accounted for under the purchase method and accordingly, the results of operations of each of the hotels since the dates of acquisition have been included in the consolidated statement of income. The following table details the acquisitions and how they were financed.

	2006							
Hotel	Super 8	Holiday Inn Express	Holiday Inn Express	Radisson	Super 8	5 Calgary Downtown	Wingate Inn	Super 8
Location	Truro, NS	Halifax, NS	Moncton, NB	Halifax, NS	Drayton Valley, AB	Calgary, AB	Calgary, AB	Yellowknife, NT
Date of acquisition	June 7	August 4	August 4	August 4	August 4	August 23	September 1	September 29
	\$	\$	\$	\$	\$	\$	\$	\$
Assets acquired								
Land	500,000	1,000,000	1,300,000	1,500,000	400,000	-	3,000,000	800,000
Buildings	3,435,421	4,189,065	4,480,949	8,889,596	5,773,584	27,208,500	10,610,935	6,230,612
Furniture, fixtures and equipment	450,000	990,000	1,520,000	1,040,000	382,812	2,200,000	1,030,000	924,000
Paving	135,000	75,000	150,000	20,000	75,000	67,000	400,000	175,000
Signage	30,000	45,000	45,000	45,000	-	-	75,000	70,000
Computer equipment	2,586	8,974	25,104	7,756	23,030	24,000	34,358	2,421
Assets under capital lease	-	51,609	57,104	221,455	-	-	-	-
Franchise fee	25,058	-	117,462	19,877	17,159	-	41,253	23,427
Working capital	21,935	40,352	104,381	56,316	28,415	500	58,454	24,540
	4,600,000	6,400,000	7,800,000	11,800,000	6,700,000	29,500,000	15,250,000	8,250,000
Financed by								
Cash	3,680,000	2,202,910	3,778,039	4,652,166	6,700,000	24,001,000	13,252,000	8,250,000
Mortgages assumed	-	3,775,202	3,947,700	6,409,064	-	-	-	-
Obligations under capital leases assumed	-	51,888	74,261	108,770	-	-	-	-
Difference in fair value and carrying value of mortgages payable	-	370,000	-	630,000	-	-	-	-
Issuance of REIT or LP units	920,000	-	-	-	-	5,499,000	1,998,000	-
	4,600,000	6,400,000	7,800,000	11,800,000	6,700,000	29,500,000	15,250,000	8,250,000

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

4 Hotel acquisitions (continued)

	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	-	-	-	-	-	-	-
	<u>22,750,000</u>	<u>10,000,000</u>	<u>11,500,000</u>	<u>11,100,000</u>	<u>29,200,000</u>	<u>44,700,000</u>	<u>1,500,000</u>	<u>35,900,000</u>	<u>30,300,000</u>
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
	<u>22,750,000</u>	<u>10,000,000</u>	<u>11,500,000</u>	<u>11,100,000</u>	<u>29,200,000</u>	<u>44,700,000</u>	<u>1,500,000</u>	<u>35,900,000</u>	<u>30,300,000</u>

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

4 Hotel acquisitions (continued)

Hotel	2007								
	Super 8	Super 8	Super 8	Staff House	Super 8	Super 8 Parking Lot	Sorrentino's Restaurant	Holiday Inn Express	Holiday Inn Express
Location	High Level, AB	Whitecourt, AB	Fort Nelson, BC	Fort Nelson, BC	Fort St. John, BC	Fort St. John, BC	Grande Prairie, AB	Kamloops, BC	Myrtle Beach, South Carolina US
Date of acquisition	June 22	June 22	June 22	June 22	June 22	June 22	June 22	September 12	November 2
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Assets acquired									
Land	500,000	420,000	1,950,000	75,000	1,600,000	1,000,000	-	1,500,000	1,047,200
Buildings	9,464,523	7,894,958	15,683,294	250,000	9,538,712	-	-	8,741,235	6,532,725
Furniture, fixtures and equipment	810,000	590,000	1,420,000	-	930,000	-	399,043	800,000	542,640
Paving	167,516	94,585	233,145	-	359,120	-	-	150,000	95,200
Signage	50,000	50,000	50,000	-	50,000	-	-	30,000	28,560
Computer equipment	25,794	8,991	44,844	-	27,262	-	-	31,584	33,320
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	-	-	35,933	-
Agreements	37,535	27,340	65,802	-	43,095	-	-	-	-
Working capital	-	-	-	-	-	-	-	11,248	2,755
	11,100,000	9,100,000	19,500,000	325,000	12,600,000	1,000,000	400,000	11,300,000	8,282,400
Financed by									
Cash	10,069,000	8,254,766	17,688,784	294,813	11,429,676	1,000,000	400,000	11,300,000	3,925,411
Mortgage assumed	-	-	-	-	-	-	-	-	4,356,989
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	11,300,000	8,282,400

In addition to the purchase price paid to the vendors, as allocated above, the REIT incurred an additional \$5.9 million (2006 - \$1.1 million) in other acquisition and closing costs, which were primarily allocated to the buildings.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

5 Restricted cash

In connection with mortgage financing for one of the properties acquired during the year, the REIT has issued a standby letter of credit in the amount of \$2,322,933 in favour of the mortgage lender, secured by the restricted cash. The mortgage lender requires that certain renovations to this property, that are to be made by the former owner under the terms of the purchase and sale agreement, are completed, after which the letter of credit will be released and the cash will become unrestricted.

6 Mezzanine loans receivable

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

	2007 \$	2006 \$
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	8,000,000
RegWin Hotel Ltd., principal balance due January 19, 2012, bearing interest at 12%	3,000,000	–
Windsor 8 Motel Limited, principal balance due January 19, 2012, bearing interest at 12%	1,913,000	–
	<u>14,413,000</u>	<u>8,000,000</u>

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

7 Property and equipment

	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>
	2006		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Land	8,251,895	-	8,251,895
Land lease	500,000	6,365	493,635
Buildings	72,009,416	692,601	71,316,815
Renovations in progress	1,173,480	-	1,173,480
Furniture, fixtures and equipment	8,779,768	482,029	8,297,739
Paving	1,097,500	41,360	1,056,140
Signage	324,153	11,929	312,224
Computer equipment and websites	342,508	44,283	298,225
	<u>92,478,720</u>	<u>1,278,567</u>	<u>91,200,153</u>

Amortization expense for the year ended December 31, 2007 was \$8,376,030 (2006 - \$1,278,567).

As at December 31, 2007, the REIT held assets under capital leases with a cost of \$1,462,950 (2006 - \$344,671) and accumulated amortization of \$181,930 (2006 - \$25,826).

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

8 Other assets

	2007		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	\$
Agreements	500,000	48,122	451,878
Franchise fees	923,261	86,073	837,188
	<u>1,423,261</u>	<u>134,195</u>	<u>1,289,066</u>

	2006		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	\$
Deferred finance fees (note 2)	1,276,657	86,412	1,190,245
Franchise fees	296,301	9,005	287,296
	<u>1,572,958</u>	<u>95,417</u>	<u>1,477,541</u>

9 Obligations under capital leases

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

	2007	2006
	\$	\$
Present value of future minimum lease payments	888,420	194,074
Less: Current portion	<u>369,039</u>	<u>96,509</u>
	<u>519,381</u>	<u>97,565</u>

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

	\$
Year ending December 31, 2008	452,398
2009	316,199
2010	226,676
2011	42,437
2012	<u>—</u>
Future minimum lease payments	1,037,710
Less: Amounts representing interest	<u>149,290</u>
Present value of future minimum lease payments	<u>888,420</u>

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

10 Mortgages and loans payable

	2007 \$	2006 \$
Mortgages payable, bearing interest at a weighted average rate of 6.76% (2006 – 6.78%) 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	169,199,091	49,563,628
Vehicle loans payable, bearing interest at a weighted average rate of 7.62% and maturing on various dates from January, 2009 to April, 2011	163,090	–
	169,362,181	49,563,628
Less: Deferred finance fees	1,399,648	–
Less: Current portion	4,359,149	1,535,676
	<u>163,603,384</u>	<u>48,027,952</u>

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

	\$
Year ending December 31, 2008	4,359,149
2009	5,135,003
2010	13,911,974
2011	36,452,051
2012	17,657,155

11 Convertible debentures

On August 1, 2006, the REIT issued \$20,238,000 in convertible, redeemable debentures. The debentures bear interest at 8% 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% 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 Consolidated Financial Statements

December 31, 2007 and 2006

11 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.

	2007 \$	2006 \$
Debt component	61,988,000	14,938,000
Accretion of convertible debentures	1,606,938	441,667
Deferred finance fees	(2,331,544)	—
	<u>61,263,394</u>	<u>15,379,667</u>

12 Unitholders' equity

The REIT is authorized to issue an unlimited number of units ("REIT units") for the consideration of, and on the terms and conditions determined by, the Declaration of Trust. Each REIT unit is transferable and represents an equal undivided beneficial interest in any distribution from the REIT. All REIT units are of the same class and have equal rights and privileges.

Reorganization of Holloway Capital Corporation ("HCC")

Pursuant to the qualifying transaction and plan of arrangement completed on June 7, 2006, the common shares of HCC with a carrying value of \$1,152,209 were exchanged for REIT units on the basis of one REIT unit for every five common shares of HCC resulting in the issuance of 1,600,000 REIT units to current shareholders of HCC. The arrangement involving conversion to the REIT has been accounted for as a continuity of interests.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

12 Unitholders' equity (continued)

Issued and outstanding units

The following presents the number of shares and units issued and outstanding, and the related ascribed values, for the years ended December 31, 2007 and 2006:

	Number of units issued and outstanding				Ascribed value \$			
	Common shares	REIT Units	Class B LP Units	Total	Common shares	REIT Units	Class B LP Units	Total
Balance, December 31, 2005	3,000,000	-	-	3,000,000	300,000	-	-	300,000
Shares issued for cash, net of issuance costs	5,000,000	-	-	5,000,000	852,209	-	-	852,209
Adjustment for exchange ratio of 5 shares to 1 unit	(6,400,000)	-	-	(6,400,000)	-	-	-	-
Units issued in exchange for shares	(1,600,000)	1,600,000	-	-	(1,152,209)	1,152,209	-	-
Units issued for cash, net of issuance costs	-	12,919,677	-	12,919,677	-	54,500,228	-	54,500,228
Units issued for property acquisitions	-	1,666,000	460,000	2,126,000	-	7,497,000	920,000	8,417,000
Units issued to trustees for services	-	12,001	-	12,001	-	62,645	-	62,645
Units issued to management for services	-	11,130	-	11,130	-	58,099	-	58,099
Balance, December 31, 2006	-	16,208,808	460,000	16,668,808	-	63,270,181	920,000	64,190,181
Exercise of options	-	3,334	-	3,334	-	18,797	-	18,797
Units issued for cash, net of issuance costs, net of tax of \$1,468,000	-	18,338,000	-	18,338,000	-	94,689,048	-	94,689,048
Units issued in property acquisitions	-	4,143,175	-	4,143,175	-	22,000,000	-	22,000,000
Exchange of units	-	126,500	(126,500)	-	-	253,000	(253,000)	-
Balance, December 31, 2007	-	38,819,817	333,500	39,153,317	-	180,231,026	667,000	180,898,026

Included in accounts payable and accrued liabilities is \$107,760 (2006 - \$nil) in accrued trustees' fees that will be paid by the issuance of REIT units.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

12 Unitholders' equity (continued)

Class B limited partnership units

On June 7, 2006, in connection with the acquisition of the Truro Super 8 Motel, Holloway Lodging LP issued 460,000 Class B Limited Partnership units ("exchangeable LP units") with a value of \$920,000 to the vendor, Truro Motel 8 Partnership. The exchangeable LP units are exchangeable for units of the REIT on a one-for-one basis pursuant to an exchange agreement entered into between the REIT, Holloway Lodging LP and Truro Motel 8 Partnership. The REIT also issued special voting units to the vendor such that the vendor, as holder of the exchangeable LP units, would hold the economic and voting equivalent of the REIT units.

On April 20, 2007, 23,000 Class B Limited Partnership units and on November 29, 2007, 103,500 Class B Limited Partnership units were exchanged for units of the REIT.

Unit options

HCC had a share option plan under which officers and directors were eligible to receive share options. On February 17, 2006, HCC granted 800,000 options at an exercise price of \$0.20 per share expiring on February 17, 2011. These options vested upon granting. As a result of the plan of arrangement, these options to purchase shares of HCC were exchanged for REIT unit options having identical terms, subject to adjustment of the number of units underlying the unit options and the exercise price of the unit options based on the exchange ratio of one REIT unit for five shares. After reflecting the exchange, there were 160,000 options outstanding with an exercise price of \$1.00. The total number of REIT units reserved under option for issuance may not exceed 10% of the units outstanding.

On November 30, 2006, 645,000 REIT unit options were granted to employees and trustees of the REIT at an exercise price of \$4.88 per unit expiring on November 30, 2011. These options vest over a three-year period.

On April 2, 2007, 62,000 REIT unit options were granted to employees of Pacrim Hospitality Services Inc. for services at an exercise price of \$4.88 per unit expiring on April 2, 2012. These options vest over a three-year period.

The compensation expense for the options issued was determined based on the fair value of the options at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2007	2006
Expected option life	5 years	4.4 years
Risk-free interest rate	4.5%	4.3 %
Dividend yield	9.0%	6.4%
Expected volatility	35%	58%

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

12 Unitholders' equity (continued)

Unit options (continued)

Option activity for the year ended December 31, 2007 and 2006 was as follows:

	Number	2007 Weighted average exercise price \$	Number	2006 Weighted average exercise price \$
Outstanding, beginning of year	805,000	4.11	–	–
Granted	62,000	4.88	805,000	4.11
Exercised	(3,334)	4.88	–	–
Outstanding, end of year	863,666	4.16	805,000	4.11

The weighted average grant-date fair value of options granted during 2007 and 2006 was \$0.76 and \$1.40 per option.

The following table summarizes information about options outstanding and exercisable at December 31, 2007:

Weighted average exercise price per unit \$	Number outstanding	Weighted average exercise price per unit \$	Weighted average remaining contractual life (years)	Number exercisable
1.00	160,000	1.00	3.1	160,000
4.88	703,666	4.88	3.9	447,333
	863,666	4.16	3.8	607,333

Weighted average number of units

The basic and diluted weighted average number of units outstanding was as follows:

	2007 (units)	2006 (units)
Basic	28,643,005	6,732,826
Diluted	28,760,887	6,732,826

For the year ended December 31, 2006, the diluted weighted average number of units outstanding is the same as the basic weighted average number of units outstanding, as the REIT had a net loss and the exercise of potentially dilutive securities would be anti-dilutive.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

13 Supplemental cash flow information

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

	2007	2006
	\$	\$
Accounts receivable	(2,281,518)	(1,546,975)
Inventories	(86,396)	(6,669)
Prepaid expenses and deposits	(1,336,093)	(1,532,633)
Accounts payable and accrued liabilities	4,278,156	4,514,473
Accrued interest on convertible debentures	-	674,600
	<u>574,149</u>	<u>2,102,796</u>

Cash and cash equivalents are comprised of the following:

	2007	2006
	\$	\$
Cash on hand and balances with banks	22,894,439	13,982,672
Short-term investments	-	18,000,000
	<u>22,894,439</u>	<u>31,982,672</u>

14 Agreements

Hotel Management Agreement

Pacrim Hospitality Services Inc.

On June 7, 2006, Holloway Lodging REIT entered into a long-term management agreement with Pacrim Hospitality Services Inc. ("PHSI"), a related party, to manage the hotels purchased by the REIT, with an initial term of ten years and an automatic renewal for successive five year terms commencing on the last day of the initial term. PHSI is entitled to a base management fee of 3% of gross hotel revenues, an incentive fee commencing January 1, 2007, a purchasing fee of 4% of the cost of exceptional operating supplies and furniture, fixtures and equipment, a construction fee of 3% of the cost of construction materials, labour and equipment in connection with any construction or capital expenditures and an accounting fee ranging from \$15,000 to \$32,400 per year depending on the size of the hotel when accounting services are provided by PHSI. In addition, Intergy, a division of PHSI, provides central reservation services for the hotels purchased by the REIT. A commission of 10% is paid on reservations made through Intergy.

On November 24, 2006, the parties entered into an amending agreement such that the initial term with respect to each hotel shall commence on the date on which the REIT acquires the hotel for a term of ten years and automatic renewals for successive five-year terms.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

14 Agreements (continued)

Pomeroy Hospitality Ltd.

On June 22, 2007, Holloway Lodging REIT entered into a management agreement with Pomeroy Hospitality Ltd. ("Pomeroy") to manage ten hotels purchased by the REIT, with a term of five years. Pomeroy is entitled to a base management fee of 3% of gross room revenue plus 2.5% of earnings before interest, income taxes, depreciation and amortization on a consolidated basis for all of the hotels, provided that the total management fee does not exceed 4% of gross room revenue. In addition, Pomeroy is entitled to accounting and payroll processing fees per hotel ranging from \$27,600 to \$38,545 per year.

Development Agreement

On June 7, 2006, Holloway Lodging REIT entered into a long-term development agreement with Winport Developments Inc. ("Winport"), a related party, to provide mezzanine financing to Winport and to have the option to purchase properties developed by Winport. The agreement has an initial term of ten years with an automatic renewal for five year terms thereafter. On October 6, 2006, the development agreement was assigned to Winport Developments Limited Partnership, a related party. On May 15, 2007, Winport Developments Inc. was re-instated as an approved developer and recipient of mezzanine loans.

Non-competition, Right of First Opportunity and Participation Agreement

On June 22, 2007, Holloway Lodging REIT entered into a non-competition, right of first opportunity and participation agreement with Pomeroy Gold Ltd. The agreement has a term of five years and provides for (a) limitations on the development of hotels within a defined area without the consent of each party to the agreement; (b) the right of first opportunity for Holloway to purchase certain hotels; and (c) the right for Holloway to invest in certain Pomeroy developments.

15 Commitments

Lease revenue

The REIT is committed to lease areas of certain hotel facilities to outside parties. The minimum annual revenue from future rentals is expected to be as follows:

	\$
For the year ending December 31, 2008	726,719
2009	621,934
2010	471,740
2011	350,939
2012	152,801

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

15 Commitments (continued)

Franchise agreements

The following fees are payable under the terms of the various franchise agreements covering certain of the hotel properties:

	As a % of gross room revenue
To Super 8 Motels, Inc.	
Royalty fee	5%
Marketing assessment	3%
To Holiday Hospitality Franchising Inc. Group (for Holiday Inns)	
Royalty fee	5%
Marketing assessment	2% - 2.5%
Reservation assessment	1%
To Radisson Hotels International, Inc.	
Royalty fee	4% - 5%
Marketing assessment	2%
Reservation assessment	2%
To Wingate Inns International, Inc.	
Royalty fee	4.5%
Marketing assessment	4%
To Pomeroy Inn & Suites Inc.	
Royalty fee	5%
Marketing assessment	3%

Operating leases

The REIT has various equipment operating leases at several properties.

The REIT also has a long-term ground lease on the 5 Calgary Downtown Suites and Spa Hotel ("5 Calgary"). The ground lease expires on June 24, 2064. The amount of the annual ground lease payment varies with gross revenues and expenses. The minimum ground lease payments are \$10,255 per month until June 24, 2015. For the two periods beginning June 24, 2015 and June 24, 2040, the minimum annual ground lease payment will be adjusted based on the fair market value of the related land, free and unencumbered on those dates. The REIT is required to pay an annual ground lease participation liability related to the ground lease for 5 Calgary, which is equal to 25% of 5 Calgary's annual gross revenue reduced by property tax expense, the minimum ground lease payments for the year and an allowable deduction of 20% of gross revenues. The total ground lease expense, including the minimum ground lease payments and the ground lease participation liability, recorded for 2007 and for the period from acquisition of 5 Calgary to December 31, 2006 was \$2,274,655 and \$836,163, respectively.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

15 Commitments (continued)

Operating leases (continued)

The minimum annual lease payments over the next five years are as follows:

	Operating leases \$	Land lease \$	Total \$
Year ending December 31, 2008	242,471	123,060	365,531
2009	83,380	123,060	206,440
2010	28,629	123,060	151,689
2011	27,202	123,060	150,262
2012	14,630	123,060	137,690

16 Related party transactions

During the year, the REIT incurred hotel management fees of \$1,350,105 (2006 - \$432,943), accounting fees of \$131,133 (2006 - \$32,956) and reimbursable general and administrative expenses of \$38,993 (2006 - \$12,053) to Pacrim Hospitality Services Inc., a company in which a member of management and a trustee has a significant ownership interest. Included in accounts payable and accrued liabilities is \$121,805 (2006 - \$101,199) related to these fees and expenses.

During the year, the REIT incurred reservation services commissions of \$152,851 (2006 - \$96,322) and website development and maintenance fees of \$86,261, of which \$64,696 was capitalized, (2006 - \$nil) to Intergy, a division of Pacrim Hospitality Services Inc. Included in accounts payable and accrued liabilities is \$47,455 (2006 - \$43,455) related to these expenses.

During the year, the REIT capitalized \$2,202,856 (2006 - \$1,174,980) in charges billed by Winport Developments Inc., a company co-owned by a member of management and a trustee of the REIT, for renovations completed at the Holiday Inn Express in Halifax, NS and the Holiday Inn Express Inn and Suites in Moncton, NB. Included in accounts payable and accrued liabilities is \$nil (2006 - \$1,048,291) related to these charges. In addition, the REIT earned interest income from the mezzanine loan to Winport Developments Limited Partnership, a partnership managed by a trustee of the REIT, and the loan receivable from Winport Developments Inc. of \$1,026,223 (2006 - \$155,178). Included in accounts receivable is \$93,950 (2006 - \$84,164) related to this interest.

The above related party transactions have been measured at the exchange amount.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

17 Financial instruments

Fair value

Financial instruments consist of recorded amounts receivable which will result in future cash receipts, accounts payable and accrued liabilities, distributions payable, accrued interest, obligations under capital leases, mortgages and loans payable debt which will result in future cash outlays.

The REIT's carrying value of accounts receivable, accounts payable and accrued liabilities, distributions payable and accrued interest approximate their fair value due to the immediate or short-term nature of these instruments.

The carrying value of the mortgages and loans payable approximates the fair value as interest rates are consistent with current rates. The interest rates on two of the mortgages assumed exceeded current rates and a fair value adjustment has been reflected in these financial statements. The fair value of the convertible debentures approximates book value as they were issued recently.

Credit risk

The REIT is exposed to credit risk through accounts receivable. The REIT assesses its credit risk on a regular basis and does not anticipate significant credit losses.

Interest rate risk

The REIT manages its exposure to interest rate risk through fixed rate borrowings. The fixed rate debt is subject to interest rate pricing risk, as the value will fluctuate as a result of changes in market rates.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

18 Income taxes

The following table reconciles the expected income taxes payable (recoverable) at the statutory income tax rate to the amounts recognized in the consolidated statements of income and comprehensive income for the years ended December 31, 2007 and 2006:

	2007 \$	2006 \$
Income before income taxes	933,036	—
Income tax rate	35.12%	—
	<hr/>	<hr/>
	328,000	—
Future taxes resulting from a change in tax status with the enactment of Bill C-52	(937,000)	—
Non-deductible stock option expense	170,000	—
Non-deductible foreign exchange losses	33,000	—
Accretion of discount on convertible debentures	409,000	—
Impact of rate change	(626,000)	—
Other permanent differences	36,000	—
	<hr/>	<hr/>
	(587,000)	—
	<hr/>	<hr/>

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and future income tax liabilities at December 31, 2007 and 2006 that are expected to reverse in the future are presented below:

	2007 \$	2006 \$
Future income tax assets		
Unit issuance costs, finance fees and related	3,854,000	—
Tax losses carried forward	2,047,000	—
Other	244,000	—
	<hr/>	<hr/>
	6,145,000	—
	<hr/>	<hr/>
Future income tax liabilities		
Property and equipment – differences in net book value and undepreciated capital cost	3,811,000	—
Other	279,000	—
	<hr/>	<hr/>
	4,090,000	—
	<hr/>	<hr/>
Net future income tax asset	2,055,000	—
	<hr/>	<hr/>

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

18 Income taxes (continued)

	2007 \$	2006 \$
Recovery of future income taxes is comprised of:		
Future income taxes related to the substantive enactment of Bill C-52	937,000	—
Future income taxes related to the changes in the taxation rate	626,000	—
Future income taxes related to income and permanent differences	(976,000)	—
	<u>587,000</u>	<u>—</u>

19 Seasonality

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

20 Segmented information

In measuring performance, the REIT does not distinguish or group its operations on a geographical or any other basis and, accordingly, results have been aggregated into a single reportable segment.

Geographical information

	2007 \$	2006 \$
Revenues		
Canada	69,567,495	15,391,703
United States	183,142	—
	<u>69,750,637</u>	<u>15,391,703</u>
Property and equipment		
Canada	354,088,628	91,200,153
United States	8,459,531	—
	<u>362,548,159</u>	<u>91,200,153</u>

21 Subsequent events

Effective 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.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

21 Subsequent events (continued)

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 adjusted funds from operations that exceed 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.

On January 31, 2008, the restaurant at the Radisson Suite Hotel in Halifax, Nova Scotia was closed and the space leased to a local restaurateur.