



**Holloway**  
LODGING

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*Real Estate Investment Trust*

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE THREE MONTHS AND YEAR ENDED DECEMBER 31, 2010**

As at March 9, 2011

# Introduction

The following management's discussion and analysis ("MD&A") is a discussion of the results of operations and financial condition of Holloway Lodging Real Estate Investment Trust ("Holloway" or the "REIT") for the three months and year ended December 31, 2010 and should be read in conjunction with the audited consolidated financial statements of the REIT and the notes thereto as at and for the year ended December 31, 2010.

The financial statements of Holloway are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are presented in Canadian dollars. This MD&A includes forward-

looking information. Forward-looking information is subject to certain risks and uncertainties, which could result in actual results differing materially from the forward-looking information. See "FORWARD-LOOKING INFORMATION".

Additional information about the REIT filed with the applicable Canadian securities regulatory authorities, including the audited financial statements of the REIT and the notes thereto, are available at [www.sedar.com](http://www.sedar.com). The REIT's units and convertible debentures are traded on the TSX under the symbols HLR.UN, HLR.DB and HLR.DB.A, respectively.

## Overview

The year 2010 saw the emergence of a recovery in the Canadian hotel sector, which had experienced challenges through 2009. Hotel consulting group PKF reported on a national basis, revenue per available room ("RevPAR") increased by 5.6% in 2010, after experiencing a decline of 12.0% in 2009. For 2011, PKF is projecting RevPAR growth of 3.6%.

The results for the REIT reflect this recovery, as fourth quarter RevPAR increased by 14% while third quarter RevPAR grew by 5% versus the prior year. Improvements in business conditions resulted in sustained momentum for occupancy growth through the second half of 2010. Average room rates continue to be constrained by the proliferation of discounted third party internet booking sites along with an increase in room supply in many markets. On a full year basis, Atlantic, Western and U.S. regions showed an improvement in RevPAR compared to 2009.

According to statistics compiled by the Canadian Association of Oilwell Drilling Contractors, the average number of active oil rigs in 2010 increased by 49% compared to the prior year. Approximately 60% of Holloway's rooms are located in Alberta and as such are heavily dependent upon oil and gas exploration, drilling and servicing.

In addition to the increase in business for the REIT from the oil sector, there have been improved levels of business from an array of other segments including construction, corporate, group and leisure.

The Bank of Canada expects levels of business investment to continue to rebound strongly in 2011 due to financial and competitive conditions. The outlook for the REIT remains positive for future growth.

## Key Events – Q4

- Revenue for the fourth quarter increased 15% compared to the fourth quarter of 2009; occupancy increases were experienced in all regions;
- RevPAR increased 14% for the fourth quarter of 2010 compared to the fourth quarter of 2009; and
- The distributable loss decreased \$1.0 million from the fourth quarter of 2009 to \$0.5 million for the fourth quarter of 2010.

## SUMMARY OF SELECTED FINANCIAL INFORMATION

The following table provides key financial information for the past three years.

(in \$000's except per unit results, number of rooms, ADR and RevPAR)	2010	2009	2008
Hotel revenues	73,451	74,427	93,495
Total revenues (hotel and REIT interest income)	73,664	75,166	96,297
Net income (loss) and comprehensive income (loss)	(19,907)	(20,337)	(5,080)
Basic and diluted income (loss) per unit	(0.51)	(0.52)	(0.13)
Basic and diluted FFO per unit	(0.06)	0.01	0.29
Basic and diluted distributable income (loss) per unit	(0.04)	0.01	0.32
Distributions declared per unit	-	0.105	0.485
Total assets	342,362	358,211	393,386
Total indebtedness (line of credit, mortgages and loans payable, obligations under capital leases, convertible debentures and promissory notes)	227,272	223,330	232,513
Unitholders' equity	105,820	125,712	150,094
Number of rooms/suites*	2,386	2,320	2,423
Occupancy*	60.39%	55.45%	65.14%
ADR*	\$121.51	\$131.69	\$140.05
RevPAR*	\$73.38	\$73.02	\$ 91.23

\*Excludes discontinued operations.

## Overview of Holloway Lodging REIT, its Strategies and Objectives

Holloway 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. 2006 was the initial year of active operations for the REIT. As at December 31, 2010, the REIT owned 22 hotel properties with

2,386 guest rooms and suites and has equity ownership interests, ranging from 2.52% to 19.06% in six other hotels. The hotels in which the REIT has an equity ownership interest represent an additional 472 rooms.

### HOLLOWAY'S OPERATING STRATEGY AND OBJECTIVES

Holloway's principal business is to invest, directly or indirectly, in the ownership and operation of hotel properties. Management of the REIT has considerable expertise in hotel operations and management and possesses the resources necessary to maximize revenue and profits from its hotel portfolio. The REIT capitalizes on the hotel operating, development, finance, and transactional experience of its management and trustees.

The REIT's objectives are to:

- expand its asset base and increase its funds from operations through accretive acquisitions and internal growth initiatives;
- enhance the value of its assets to provide unitholders with long-term unit value through active asset management; and
- increase cash flow from operations in order to resume distributions to unitholders at the appropriate time.

# Hotel Portfolio

Holloway's portfolio consists primarily of limited service hotels with a small number of full service hotels. The table below provides details on the

twenty-two hotels wholly owned by Holloway as at December 31, 2010.

PROPERTY	LOCATION	NO. OF ROOMS
<b>Alberta</b>		
5 Calgary Downtown Suites & Spa Hotel	Calgary	302
Best Western	Grande Prairie	100
Holiday Inn	Grande Prairie	146
Northwest Inn	Slave Lake	99
Pomeroy Inn and Suites	Grande Prairie	152
Radisson Hotel and Suites	Fort McMurray	134
Super 8	Drayton Valley	60
Super 8	Grande Prairie	149
Super 8	High Level	81
Super 8	Slave Lake	58
Super 8	Three Hills	82
Super 8	Whitecourt	59
		<b>1,422</b>
<b>British Columbia</b>		
Holiday Inn Express	Kamloops	80
Super 8	Fort Nelson	142
Super 8	Fort St. John	93
		<b>315</b>
<b>New Brunswick</b>		
Holiday Inn Express and Suites	Moncton	151
<b>Northwest Territories</b>		
Super 8	Yellowknife	66
<b>Nova Scotia</b>		
Holiday Inn Express	Halifax	98
Radisson Suite Hotel	Halifax	104
Super 8	Truro	50
Super 8	Windsor	66
		<b>318</b>
<b>South Carolina - USA</b>		
Holiday Inn Express	Myrtle Beach	114
	<b>Total Rooms</b>	<b>2,386</b>

The table below provides details on the six hotels in which the REIT has minority equity ownership interests.

PROPERTY	LOCATION	PERCENT OWNERSHIP	NO. OF ROOMS
<b>British Columbia</b>			
Super 8	Langley	8.41%	81
<b>New Brunswick</b>			
Super 8	Dieppe	6.00%	85
<b>Newfoundland and Labrador</b>			
Super 8	St. John's	17.63%	82
<b>Nova Scotia</b>			
Super 8	Amherst	15.72%	50
<b>Ontario</b>			
Super 8	Barrie	2.52%	82
Super 8	Toronto	19.06%	92
			<b>174</b>
	<b>Total Rooms</b>		<b>472</b>

# Operating Results

The following table provides a summary of the operating results for the three months and year ended December 31, 2010 and 2009.

(in \$000's except number of units and per unit results)	Three months ended		Years ended	
	December 31, 2010	December 31, 2009	December 31, 2010	December 31, 2009
Hotel revenues	18,406	15,939	73,451	71,985
Hotel expenses	14,048	12,508	54,171	52,673
Hotel operating income	4,358	3,431	19,280	19,312
Other expenses	15,112	15,637	41,703	44,300
Provision for (recovery of) future income taxes	-	(413)	(2,516)	(3,056)
Loss from continuing operations for the period	(10,754)	(11,793)	(19,907)	(21,932)
Income from discontinued operations	-	1,361	-	1,595
Loss and comprehensive loss for the period	(10,754)	(10,432)	(19,907)	(20,337)
Weighted average basic units outstanding	39,135,216	39,135,216	39,135,216	39,135,216
Weighted average diluted units outstanding	39,135,216	39,135,216	39,135,216	39,135,216
Basic income (loss) per unit	(0.27)	(0.27)	(0.51)	(0.52)
Diluted income (loss) per unit	(0.27)	(0.27)	(0.51)	(0.52)
<b>Reconciliation to funds from operations (FFO)</b>				
Add/(deduct):				
Depreciation and amortization on real property	3,232	3,190	12,796	13,045
Provision for (recovery of) future income taxes, continuing operations	-	(413)	(2,516)	(3,056)
Loss (gain) loss on acquisition or disposal	84	(1,474)	193	(1,474)
Write-off and provision for impairment of investments in hotel properties	-	1,011	423	1,011
Provision for impairment of hotel property	6,768	-	6,768	-
Provision for impairment of mezzanine loans and advances	-	6,359	-	11,059
Provision for future income taxes, discontinued operations	-	89	-	254
<b>Funds from operations – basic and diluted</b>	<b>(670)</b>	<b>(1,670)</b>	<b>(2,243)</b>	<b>502</b>
Basic FFO per unit	(0.02)	(0.04)	(0.06)	0.01
Diluted FFO per unit	(0.02)	(0.04)	(0.06)	0.01
<b>Reconciliation to distributable income</b>				
Add/(deduct):				
Depreciation and amortization – trust and other assets	47	52	190	244
Accretion of mortgages, convertible debentures and deferred financing fees	800	669	3,093	2,528
Unit-based compensation	-	15	15	64
Unrealized foreign exchange gain	(139)	(86)	(242)	(737)
FF&E reserve	(552)	(480)	(2,204)	(2,233)
<b>Distributable income – basic and diluted</b>	<b>(514)</b>	<b>(1,500)</b>	<b>(1,391)</b>	<b>368</b>
Basic distributable income per unit	(0.01)	(0.04)	(0.04)	0.01
Diluted distributable income per unit	(0.01)	(0.04)	(0.04)	0.01
Distributions declared	-	-	-	0.105
<b>Reconciliation of cash flow from operating activities to distributable income</b>				
Cash flow from operating activities	510	(2,857)	2,850	357
Changes in non-cash working capital balances	(472)	1,837	(2,037)	2,244
FF&E reserve	(552)	(480)	(2,204)	(2,233)
<b>Distributable income</b>	<b>(514)</b>	<b>(1,500)</b>	<b>(1,391)</b>	<b>368</b>

# Q4 Operating Results

The results of operations for the three months ended December 31, 2010 and 2009 represent the continuing operations of twenty-two hotels for the

fourth quarter of 2010 and twenty- one hotels for the fourth quarter of 2009. The Super 8 hotel in Windsor, NS was acquired in June 2010.

## REVENUE

(in \$000's)	Three months ended		
	December 31, 2010	December 31, 2009	Variance
Room revenue	15,516	13,247	2,269
Other revenue	2,890	2,692	198
<b>Total</b>	<b>18,406</b>	<b>15,939</b>	<b>2,467</b>

## Room Revenue - Key Performance Measures

Region	Three months ended						
	December 31, 2010			December 31, 2009			RevPAR Change
	Occ.	ADR	RevPAR	Occ.	ADR	RevPAR	
Atlantic Canada (\$Cdn)	59.32%	\$109.46	\$64.93	57.48%	\$108.47	\$62.35	4.1%
Western Canada (\$Cdn)	62.54%	\$119.84	\$74.95	48.39%	\$133.10	\$64.41	16.4%
United States (\$US)	38.77%	\$68.22	\$26.45	35.29%	\$63.83	\$22.52	17.5%
<b>Weighted Average Total (\$Cdn)</b>	<b>60.77%</b>	<b>\$116.31</b>	<b>\$70.68</b>	<b>49.32%</b>	<b>\$125.83</b>	<b>\$62.06</b>	<b>13.9%</b>

The Atlantic Canada RevPAR increased 4.1% for the three months ended December 31, 2010, compared to the three months ended December 31, 2009. The increase is attributed to higher occupancy and rate in both Moncton and Truro and an occupancy increase in suburban Halifax.

In Moncton, there was an encouraging improvement in demand and rate versus last year due to various business expansions and projects which are taking place in the greater Moncton area. The market has continued to perform well, despite a significant increase in room supply over the last several years.

In Halifax, there was an increase in demand in the suburban market while in downtown the demand declined versus the prior year. In suburban Halifax, the higher demand was accompanied by a decline in rates due to the business mix and the proportion of business generated from discounted third party internet booking sites. The downtown market had less group and government business which was offset by individual travellers paying higher rates.

The result is that the downtown Halifax market had a slight RevPAR decline versus the prior year.

In Truro, there were improvements in both occupancy and rate due to successful implementation of several packages and pricing strategies.

Four of the REIT hotels in Atlantic Canada exceeded their fair market share in the fourth quarter.

The Western Canada RevPAR increased 16.4% compared to the fourth quarter of 2009. There was solid occupancy growth in almost all of the markets with exceptional growth in Slave Lake, Three Hills, Fort Nelson and Drayton Valley. There was also very strong occupancy growth in Calgary, Whitecourt, Fort St. John and Grande Prairie. There were lower rates in most of the markets experiencing occupancy growth. However, the strength of the occupancy increases resulted in significant year over year RevPAR gains.

Alberta and British Columbia benefitted from resurgence in demand from a multitude of sources. In Slave Lake, there was demand growth due to pipeline construction work. Three Hills benefitted from crew business relating to alternative energy projects taking place in the area. In Fort Nelson, Fort St. John, Whitecourt and Drayton Valley, the markets experienced increases in energy related exploration and well servicing.

In Grande Prairie, there has been increased demand from corporate and crew business as well as from sports teams and social organizations. Activity surrounding oil and gas well servicing has also increased versus the prior year.

In Calgary, there were increases in both corporate and group business. Fort McMurray experienced higher levels of corporate business.

Several of the REIT's hotels in the Western region increased their market share and most achieved in excess of fair share.

RevPAR for the Holiday Inn Express in Myrtle Beach, South Carolina increased 17.5% compared to the prior year. There was growth in both demand and rate as a result of increased leisure and group business.

## Other Revenue

Higher food and beverage revenue in Fort McMurray and Grande Prairie accounted for the increase in other revenue.

## Expenses

(in \$000's)	Three months ended		
	December 31, 2010	December 31, 2009	Variance
Operating expenses	12,420	11,076	1,344
Property taxes and insurance	1,179	1,103	76
Management fees	449	329	120
<b>Total</b>	<b>14,048</b>	<b>12,508</b>	<b>1,540</b>

## Operating Expenses

Operating expenses include wages, supplies and overhead expenses such as repairs and maintenance, sales and marketing and administrative expenses related to the operations of the hotels. These expenses have increased \$1.3 million when comparing the three months ended

December 31, 2010 to the same period in 2009. The increase is primarily attributed to the increased occupancy in the hotels, and having one additional hotel in 2010 versus 2009, due to the acquisition of the Super 8 Windsor in June 2010.

## Property Taxes and Insurance

Property taxes and insurance expenses have increased marginally for the three months ended December 31, 2010 compared to the fourth quarter

of 2009 due to property tax increases in a few markets and having one additional hotel in 2010 versus 2009.

## Management Fees

Management fees are based on the hotel revenues which are higher for the fourth quarter of 2010 compared to the fourth quarter of 2009.

## HOTEL OPERATING INCOME

The following table provides the REIT's hotel operating margins for its portfolio for the three months ended December 31, 2010 and 2009.

(in \$000's except percentages, # of rooms available and HOI per available room)	Three months ended		
	December 31, 2010	December 31, 2009	Variance
Hotel revenues	18,406	15,939	2,467
Hotel operating expenses	12,420	11,076	1,344
Hotel gross margin	5,986	4,863	1,123
Percentage	32.5%	30.5%	2.0%
Hotel overhead expenses <sup>(1)</sup>	1,628	1,432	196
Hotel operating income (HOI)	4,358	3,431	927
Hotel operating income margin	23.7%	21.5%	2.2%
Number of rooms available	219,512	213,440	6,072
<b>HOI per available room</b>	<b>\$19.85</b>	<b>\$16.07</b>	<b>\$3.78</b>

<sup>(1)</sup> Hotel overhead expenses include property taxes, insurance and management fees.

Hotel operating income per available room increased by \$3.78 to \$19.85 from \$16.07 for the three months ended December 31, 2010 and 2009, respectively. The hotel operating income

margin increased to 23.7% from 21.5%. The increase is attributed to the revenue increase as a consequence of increased occupancy and the resultant economies of scale.

## OTHER INCOME AND EXPENSES

(in \$000's)	Three months ended		
	December 31, 2010	December 31, 2009	Variance
Interest on mortgages and other debt	2,728	2,729	(1)
Accretion on convertible debentures, mortgages and deferred financing fees	800	669	131
Interest on convertible debentures	1,247	1,247	-
Corporate and administrative	455	544	(89)
Interest income	(110)	(79)	(31)
Unrealized foreign exchange gain	(139)	(86)	(53)
Loss on disposal	84	-	84
Provision for impairment of hotel property	6,768	-	6,768
Write-off and provision for impairment of investments in hotel properties	-	1,011	(1,011)
Provision for impairment of mezzanine loans and advances	-	6,359	(6,359)
Depreciation and amortization	3,279	3,243	36
<b>Total</b>	<b>15,112</b>	<b>15,637</b>	<b>(525)</b>

### Interest on Mortgages and Other Debt

Interest on mortgages and other debt has remained the same for the three months ended December 31, 2010 compared to the three months ended

December 31, 2009. The extra interest cost from having one additional hotel was offset by the declining mortgage balances on the portfolio.

### Interest on Convertible Debentures

The total interest on the convertible debentures was \$1.2 million for the fourth quarters of 2010

and 2009 as the face value of the debentures payable is the same.

### Accretion on Convertible Debentures, Mortgages and Deferred Financing Fees

The total of the non-cash accretion of the discount on the convertible debentures, mortgages and deferred financing fees has increased \$0.1 million to \$0.8 million for the fourth quarter of 2010 compared to \$0.7 million for the fourth quarter of

2009, as the non-cash accretion on the convertible debentures has increased. The accretion increases over the term to the maturity dates of the debentures.

### Corporate and Administrative

Corporate administrative expenses decreased \$0.1 million for the three months ended December 31, 2010 compared to the three months ended

December 31, 2009, due to lower expenses for wages and consulting fees.

### Interest Income

During the three months ended December 31, 2010 and 2009, the REIT generated interest income of

\$0.1 million and \$0.1 million respectively from loans receivable.

### Unrealized Foreign Exchange Gain/Loss

The unrealized foreign exchange gain/loss represents the conversion of the US-denominated

mortgage on the Holiday Inn Express in Myrtle Beach into Canadian dollars.

### Depreciation and Amortization

Depreciation and amortization has increased marginally for the three months ended

December 31, 2010 compared to the fourth quarter of 2009.

### Loss on Disposal

The loss on disposal of \$0.1 million primarily represents the cost of obsolete franchise items such as signage, as a result of new brand standards

introduced by IHG and Wyndham, the franchisors for Holiday Inn and Super 8 brands.

### Provision for Impairment of Hotel Property

The REIT recorded a provision for impairment of \$6.8 million during the three months ended December 31, 2010 on the Northwest Inn located in Slave Lake, AB, as the performance of the hotel no longer supported its carrying value. Under

Canadian GAAP, the provision represents the difference between the carrying amount and the discounted estimated future cash flows from the hotel.

## Funds from Operations (“FFO”)

FFO for the three months ended December 31, 2010 was (\$0.7) million (-\$0.02) basic and diluted FFO per unit) compared to (\$1.7) million (-\$0.04)

basic and diluted FFO per unit) for the same period in 2009.

## Distributable Income

Distributable income was (\$0.5) million (-\$0.01 basic and diluted distributable income per unit) for the three months ended December 31, 2010 compared to (\$1.5) million (-\$0.04 basic and diluted distributable income per unit) for the same period in 2009. Distributable income will fluctuate due to market conditions, the seasonality in the hospitality

industry and the timing of acquisitions and disposals.

The following table shows the reconciliation between standardized distributable cash and distributable income for the three months ended December 31, 2010 and 2009, respectively.

(in \$000's)	Three months ended	
	December 31, 2010	December 31, 2009
Net Cash Provided by Operating Activities	510	(2,857)
Capital expenditures including acquisitions and other assets	(553)	(486)
<b>Standardized Distributable Cash</b>	<b>(43)</b>	<b>(3,343)</b>
<u>Reconciliation to Distributable Income:</u>		
<b>Standardized Distributable Cash</b>	<b>(43)</b>	<b>(3,343)</b>
Capital expenditures in excess of (less than) FF&E reserve	1	6
Changes in non-cash working capital balances	(472)	1,837
<b>Distributable Income</b>	<b>(514)</b>	<b>(1,500)</b>

## CASH FLOW FOR THE THREE MONTHS ENDED DECEMBER 31, 2010 AND 2009

During the three months ended December 31, 2010, the REIT's cash and cash equivalents increased by \$0.5 million from \$0.3 million to \$0.8 million primarily as a result of revenue increases and the resultant cash flow from operations.

For the comparative period in 2009, cash and cash equivalents increased by \$3.3 million from \$0.5 million to \$3.8 million primarily as a result of the sale of the Wingate by Wyndham in Calgary.

(in \$000's)	Three months ended	
	December 31, 2010	December 31, 2009
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net loss and comprehensive loss from continuing operations for the periods	(10,754)	(11,793)
Charges (credits) to income not involving cash		
Unit-based compensation	-	15
Depreciation and amortization	3,279	3,243
Accretion of mortgages, convertible debentures and deferred financing fees	800	669
Loss on disposal	84	-
Provision for impairment of mezzanine loans and advances	-	6,359
Provision for impairment of investments in hotel properties	-	1,011
Provision for impairment of hotel property	6,768	-
Unrealized foreign exchange gain	(139)	(86)
Recovery of future income taxes	-	(413)
Subtotal	38	(995)
Net change in non-cash working capital balances related to operations	472	(1,977)
Cash flow from discontinued operations	-	115
<b>Cash flow from (used in) operating activities</b>	<b>510</b>	<b>(2,857)</b>
<b>Investing activities</b>		
Decrease (increase) in restricted cash	17	10
Decrease (increase) in capital reserves, continuing operations	442	(169)
Decrease (increase) in capital reserves, discontinued operations	-	(585)
Proceeds from sale of property, discontinued operations	-	15,636
Increase in mezzanine loans and advances receivable	-	(30)
Additions to property and equipment and other assets	(553)	(486)
<b>Cash flow from (used in) investing activities</b>	<b>(94)</b>	<b>14,376</b>
<b>Financing activities</b>		
Repayment of capital lease obligations	(64)	(96)
Increase in deferred financing fees, continuing operations	(100)	(29)
Repayment of mortgages and loans payable, continuing operations	(1,271)	(1,175)
Repayment of mortgage payable, discontinued operations	-	(6,912)
Repayment of promissory notes	(17)	-
Increase in line of credit	1,519	-
<b>Cash flow from (used in) financing activities</b>	<b>67</b>	<b>(8,212)</b>
<b>Net change in cash and cash equivalents during the periods</b>	<b>483</b>	<b>3,307</b>
<b>Cash and cash equivalents, continuing operations – beginning of periods</b>	<b>347</b>	<b>151</b>
<b>Cash and cash equivalents, discontinued operations – beginning of periods</b>	<b>-</b>	<b>328</b>
	<b>347</b>	<b>479</b>
<b>Cash and cash equivalents, continuing operations – end of periods</b>	<b>830</b>	<b>3,756</b>
<b>Cash and cash equivalents, discontinued operations – end of periods</b>	<b>-</b>	<b>30</b>
	<b>830</b>	<b>3,786</b>

## OPERATING ACTIVITIES

Operations provided \$0.5 million in cash for the three months ended December 31, 2010. The cash flow before changes in working capital items provided \$0.04 million in cash. Changes in working capital items provided \$0.5 million in cash as accounts receivable decreased \$0.8 million and accounts payable and accrued liabilities increased \$0.2 million. These sources were offset by an increase in prepaid expenses and deposits of \$0.1 million and a decrease in the accrued interest on the convertible debentures of \$0.4 million.

## INVESTING ACTIVITIES

Investing activities utilized \$0.1 million during the three months ended December 31, 2010. Additions to property and equipment of \$0.5 million were made at a number of hotels. The REIT's capital reserves for replacement decreased \$0.4 million and were the source of funds for a majority of the additions.

## FINANCING ACTIVITIES

Financing activities provided \$0.1 million during the three months ended December 31, 2010. The REIT made principal repayments on its mortgage debt and loans payable of \$1.3 million. The REIT drew \$1.5 million on one of its lines of credit during the fourth quarter of 2010. The REIT paid a fee of \$0.1 million related to the term sheet to finance the repayment of the convertible debentures maturing August 1, 2011.

Operations utilized \$2.9 million in cash for the three months ended December 31, 2009. The cash flow before changes in working capital items used \$1.0 million in cash. Changes in working capital items utilized \$2.0 million in cash as prepaid expenses and deposits increased \$2.0 million, accounts payable and accrued liabilities decreased \$0.6 million and accrued interest on convertible debentures decreased \$0.4 million. These uses of cash were offset by the reduction in accounts receivable of \$1.0 million.

Investing activities provided \$14.4 million during the three months ended December 31, 2009 due to the net proceeds on the sale of the Wingate by Wyndham in Calgary of \$15.6 million. Additions to property and equipment of \$0.5 million were made at a number of hotels. In addition, the REIT's capital reserves for replacement increased \$0.7 million.

Financing activities utilized \$8.2 million during the three months ended December 31, 2009. The REIT made principal repayments on its continuing operations' mortgage debt and loans payable of \$1.2 million and repaid the mortgage on the Wingate by Wyndham of \$6.9 million during the fourth quarter of 2009.

# 2010 Operating Results

The results of operations for the years ended December 31, 2010 represent the operations of twenty-one hotels for the entire year and the Super 8 in Windsor, NS for seven months of 2010.

## REVENUE

(in \$000's)	Years ended		
	December 31, 2010	December 31, 2009	Variance
Room revenue	63,174	61,837	1,337
Other revenue	10,277	10,148	129
<b>Total</b>	<b>73,451</b>	<b>71,985</b>	<b>1,466</b>

## Room Revenue - Key Performance Measures

Region	Years ended						RevPAR Change
	December 31, 2010			December 31, 2009			
	Occ.	ADR	RevPAR	Occ.	ADR	RevPAR	
Atlantic Canada (\$Cdn)	69.36%	\$115.90	\$80.39	67.32%	\$119.12	\$80.19	0.2%
Western Canada (\$Cdn)	58.60%	\$125.27	\$73.41	52.93%	\$137.78	\$72.92	0.7%
United States (\$US)	53.91%	\$81.93	\$44.17	53.48%	\$81.26	\$43.45	1.6%
<b>Weighted Average Total (\$Cdn)</b>	<b>60.39%</b>	<b>\$121.51</b>	<b>\$73.38</b>	<b>55.45%</b>	<b>\$131.69</b>	<b>\$73.02</b>	<b>0.5%</b>

The Atlantic Canada RevPAR has increased 0.2% for the year ended December 31, 2010 compared to the year ended December 31, 2009, due to an increase in occupancy in Moncton which was offset by a decline in average rates across the region.

The Halifax market had similar demand levels compared to the prior year with a moderate rate decline experienced in the suburban market.

Four of the REIT hotels in Atlantic Canada exceeded their fair market share in 2010.

The Western Canada RevPAR has increased 0.7% for the year ended December 31, 2010 compared to the year ended December 31, 2009. The majority of the hotels in the Western region experienced

occupancy growth in 2010 compared to the prior year. These increases were offset by rate declines throughout the region, especially in Slave Lake, High Level, Grande Prairie and Fort McMurray.

Several of the REIT's hotels in the Western region increased levels of market share and most achieved in excess of their fair market share.

The REIT experienced greater year on year revenue growth in the second half of the year than the first six months of 2010.

RevPAR for the Holiday Inn Express in Myrtle Beach, South Carolina increased 1.6%. Leisure and group business experienced a decline in the first half of the year but has since rebounded.

## Other Revenue

Higher food and beverage revenue in Fort McMurray accounted for the increase in other revenue.

## Expenses

(in \$000's)	Years ended		Variance
	December 31, 2010	December 31, 2009	
Operating expenses	47,696	46,236	1,460
Property taxes and insurance	4,657	4,627	30
Management fees	1,818	1,810	8
<b>Total</b>	<b>54,171</b>	<b>52,673</b>	<b>1,498</b>

## Operating Expenses

Operating expenses include wages, supplies and overhead expenses such as repairs and maintenance, sales and marketing and administrative expenses related to the operations

of the hotel. These expenses have increased \$1.5 million when comparing the year ended December 31, 2010 to the same period in 2009, as the result of increased occupancy.

## Property Taxes and Insurance

Property taxes and insurance expenses have increased marginally for the year ended December 31, 2010 compared to 2009, due to having one

additional hotel for the last seven months of 2010 versus 2009.

## Management Fees

Management fees are based on the hotel revenues which are higher for the year ended December 31, 2010 compared to the same period in 2009.

## HOTEL OPERATING INCOME

The following table provides the REIT's operating margins for its portfolio for the year ended December 31, 2010 and 2009.

(in \$000's except percentages, number of rooms available and HOI per available room)	Years ended		Variance
	December 31, 2010	December 31, 2009	
Hotel revenues	73,451	71,985	1,466
Hotel operating expenses	47,696	46,236	1,460
Hotel gross margin	25,755	25,749	6
Percentage	35.1%	35.8%	(0.7%)
Hotel overhead expenses <sup>(2)</sup>	6,475	6,437	38
Hotel operating income (HOI)	19,280	19,312	(32)
Hotel operating income margin	26.2%	26.8%	(0.6%)
Number of rooms available	860,924	846,800	14,124
<b>HOI per available room</b>	<b>\$22.39</b>	<b>\$22.81</b>	<b>(\$0.42)</b>

<sup>(2)</sup> Hotel overhead expenses include property taxes, insurance and management fees.

Hotel operating income per available room decreased by \$0.42 to \$22.39 for the year ended December 31, 2010 from \$22.81 for the year ended December 31, 2009. The hotel operating income margin decreased to 35.1% from 35.8%. The decrease is attributable to the revenue decline

primarily as a consequence of lower average rates, and as such has a greater impact on operating margins. Operations do not have the same ability to cut costs for wages and supplies with rooms sold at reduced rates as would be the case with reduced occupancy.

## OTHER INCOME AND EXPENSES

(in \$000's)	Years ended		
	December 31, 2010	December 31, 2009	Variance
Interest on mortgages and other debt	10,826	10,997	(171)
Accretion on convertible debentures, mortgages and deferred financing fees	3,093	2,578	515
Interest on convertible debentures	4,989	4,989	-
Corporate and administrative	2,880	2,173	707
Interest income	(213)	(739)	526
Unrealized foreign exchange gain	(242)	(737)	495
Loss on acquisition or disposal	193	-	193
Provision for impairment of hotel property	6,768	-	6,768
Provision for impairment of investments in hotel properties	423	1,011	(588)
Provision for impairment of mezzanine loans and advances	-	11,059	(11,059)
Depreciation and amortization	12,986	12,969	17
<b>Total</b>	<b>41,703</b>	<b>44,300</b>	<b>(2,597)</b>

### Interest on Mortgages and Other Debt

Interest on mortgages and other debt has decreased \$0.2 million to \$10.8 million for the year ended December 31, 2010 compared to \$11.0

million for the same period in 2009 due to the decline in the mortgage principal balance.

### Accretion on Convertible Debentures, Mortgages and Deferred Financing Fees

The total of the non-cash accretion of the discount on the convertible debentures, mortgages and deferred financing fees has increased \$0.5 million to \$3.1 million for 2010 compared to \$2.6 million for

the same period in 2009, as the non-cash accretion on the convertible debentures increases as the period to maturity decreases.

### Interest on Convertible Debentures

The total interest on the convertible debentures was \$5.0 million for 2010 and 2009.

### Corporate and Administrative

Corporate administrative expenses were \$2.9 million for the year ended December 31, 2010 and \$2.2 million for the year ended December 31, 2009. The increase is primarily a result of severance expenses of \$0.7 million and legal expenses of \$0.2

million over last year related to the proposed corporate conversion. On March 19, 2010, the REIT announced the departure of its President and Chief Operating Officer.

## Interest Income

During the year ended December 31, 2010 and 2009, the REIT generated interest income of \$0.2 million and \$0.7 million respectively from loans receivable and the investment of cash balances.

Lower interest revenue was earned on the loan to Pacrim Hospitality Services Inc. as the interest rate on this loan declined to 1% during the fourth quarter of 2009.

## Unrealized Foreign Exchange Gain/Loss

The unrealized foreign exchange gain/loss represents the conversion of the US-denominated

mortgage on the Holiday Inn Express in Myrtle Beach into Canadian dollars.

## Depreciation and Amortization

Depreciation and amortization has increased marginally for the year ended

December 31, 2010 compared to the same period of 2009.

## Loss on Acquisition or Disposal

The loss on disposal of \$0.2 million includes \$0.1 million cost of obsolete franchise items such as signage as a result of new brand standards introduced by IHG and Wyndham. In addition, during the second quarter of 2010, the REIT sold its minority equity investments in the Super 8 hotels in Ste-Foy and Trois-Rivieres, Quebec and incurred a loss on disposal of \$0.06 million. On June 1, 2010, the owners of the Super 8 hotel in Windsor, NS,

Winport Developments Limited Partnership, a related party relinquished ownership of the hotel to Holloway pursuant to a quit claim. Holloway had provided a \$1.9 million mezzanine loan to the property which was in default. Holloway assumed all the assets and liabilities of the hotel. As the net liabilities exceeded the net assets, the REIT recorded a \$0.05 loss on acquisition

## Provision for Impairment of Hotel Property

The REIT recorded a provision for impairment of \$6.8 million during 2010 on the Northwest Inn located in Slave Lake, AB, as the performance of the hotel no longer supported its carrying value.

Under Canadian GAAP, the provision represents the difference between the carrying amount and the discounted estimated future cash flows from the hotel.

## Provision for Impairment of Investments in Hotel Properties

The REIT recorded a provision for impairment of \$0.4 million during the year ended December 31, 2010 on its minority investment in the Super 8 in Toronto, ON which represents the total cost of this investment. The performance of the hotel no longer supported the carrying value of the investment.

During the year ended December 31, 2009, the REIT recorded a provision for impairment on its minority investment in the Super 8 in Langley, BC and wrote off its investment of \$0.5 million in the Super 8 in Midland, ON as it relinquished its ownership interest in the Midland hotel.

## Provision for Impairment of Mezzanine Loans and Advances

In 2009, the REIT recorded a provision for impairment of \$11.1 million on the mezzanine loans and advances to the Yorkland Hotel in Toronto, ON and the Super 8 hotel in Windsor, NS.

During the second quarter of 2010, the Yorkland Hotel was sold by the receiver. The proceeds of the sale were not sufficient to provide for any recovery on the mezzanine loan and advances.

## Income from Discontinued Operations

The REIT's income from discontinued operations during the 2010 was nil compared with \$1.6 million for the prior year, which represents the income

from the Wingate by Wyndham hotel in Calgary, AB, which was sold in July, 2009.

## Funds from Operations ("FFO")

FFO for the year ended December 31, 2010 was (\$2.2) million (-\$0.06 basic and diluted FFO per unit) compared to \$0.5 million (\$0.01 basic and diluted FFO per unit) for the same period in 2009. The main causes for the decline in FFO are one-time

corporate and administrative expenses of \$0.7 million, a decrease in interest income of \$0.5 million, a decrease in the foreign exchange gain of \$0.5 million and an increase in accretion expense of \$0.5 million.

## Distributable Income

Distributable income was (\$1.4) million (-\$0.04 basic and diluted distributable income per unit) for the year ended December 31, 2010 compared to \$0.4 million (\$0.01 basic and diluted distributable income per unit) for the same period in 2009. Distributable income will fluctuate due to market and economic conditions, the seasonality in the

hospitality industry and the timing of acquisitions and disposals.

The following table shows the reconciliation between standardized distributable cash and distributable income for the year ended December 31, 2010 and 2009, respectively.

(in \$000's)	Years ended	
	December 31, 2010	December 31, 2009
Net Cash Provided by Operating Activities	2,850	357
Capital expenditures including acquisitions and other assets	(3,594)	(1,545)
<b>Standardized Distributable Cash</b>	<b>(744)</b>	<b>(1,188)</b>
<u>Reconciliation to Distributable Income:</u>		
<b>Standardized Distributable Cash</b>	<b>(744)</b>	<b>(1,188)</b>
Capital expenditures in excess of (less than) FF&E reserve	1,390	(688)
Changes in non-cash working capital balances	(2,037)	2,244
<b>Distributable Income</b>	<b>(1,391)</b>	<b>368</b>

## CASH FLOW FOR THE YEAR ENDED DECEMBER 31, 2010 AND 2009

During the year ended December 31, 2010, the REIT's cash and cash equivalents decreased by \$3.0 million from \$3.8 million to \$0.8 million primarily as a result of capital improvements at several hotels,

one-time corporate expenses and mortgage repayments. For the comparative period in 2009, cash and cash equivalents decreased by \$1.2 million from \$5.0 million to \$3.8 million.

(in \$000's)	Year ended	
	December 31, 2010	December 31, 2009
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net loss and comprehensive loss from continuing operations for the years	(19,907)	(21,932)
Charges (credits) to income not involving cash		
Unit-based compensation	15	64
Depreciation and amortization	12,986	12,969
Accretion on mortgages, convertible debentures and deferred financing fees	3,093	2,578
Loss on acquisition or disposal	193	-
Unrealized foreign exchange gain	(242)	(737)
Provision for impairment of investments in hotel properties	423	1,011
Provision for impairment of mezzanine loans and advances	-	11,059
Provision for impairment of hotel property	6,768	-
Recovery of future income taxes	(2,516)	(3,056)
Subtotal	813	1,956
Net change in non-cash working capital balances related to operations	1,988	(2,719)
Cash flow from discontinued operations	49	1,120
<b>Cash flow from (used in) operating activities</b>	<b>2,850</b>	<b>357</b>
<b>Investing activities</b>		
Decrease (increase) in restricted cash	9	93
Decrease (increase) in capital reserves	(758)	(1,746)
Increase in mezzanine loans and advances receivable	-	(885)
Proceeds from repayment of mezzanine loan	-	3,000
Proceeds from sale of (increase in) investments in hotel properties	271	(283)
Proceeds from sale of property, discontinued operations	-	15,636
Additions to property and equipment and other assets	(3,594)	(1,545)
<b>Cash flow from (used in) investing activities</b>	<b>(4,072)</b>	<b>14,270</b>
<b>Financing activities</b>		
Increase in line of credit	2,519	-
Repayment of capital lease obligations	(285)	(350)
Proceeds from mortgages and loans payable, net of deferred financing fees	10,120	1,040
Repayment of mortgages and loans payable, continuing operations	(13,849)	(4,589)
Repayment of mortgage and capital leases, discontinued operations	-	(7,140)
Repayment of promissory notes	(239)	-
Distributions paid to unitholders	-	(4,794)
<b>Cash flow from (used in) financing activities</b>	<b>(1,734)</b>	<b>(15,833)</b>
<b>Net change in cash and cash equivalents during the years</b>	<b>(2,956)</b>	<b>(1,206)</b>
<b>Cash and cash equivalents, continuing operations – beginning of years</b>	<b>3,756</b>	<b>4,860</b>
<b>Cash and cash equivalents, discontinued operations – beginning of years</b>	<b>30</b>	<b>132</b>
	<b>3,786</b>	<b>4,992</b>
<b>Cash and cash equivalents, continuing operations – end of years</b>	<b>830</b>	<b>3,756</b>
<b>Cash and cash equivalents, discontinued operations – end of years</b>	<b>-</b>	<b>30</b>
	<b>830</b>	<b>3,786</b>

## OPERATING ACTIVITIES

Operations provided \$2.9 million in cash for the year ended December 31, 2010. This is a significant improvement compared to the prior year which was \$0.4 million. The cash flow before changes in working capital items provided \$0.8 million in cash. Changes in working capital items provided an additional \$2.0 million in cash as prepaid expenses and deposits decreased \$1.9 million and accounts payable and accrued liabilities increased \$0.6 million. These sources of cash were offset by the increase in accounts receivable of \$0.5 million.

## INVESTING ACTIVITIES

Investing activities utilized \$4.1 million during the year ended December 31, 2010. Additions to property and equipment of \$3.6 million were made at Holiday Inn Express hotels in Myrtle Beach, Halifax and Kamloops and at a number of other hotels. In addition, the REIT's capital reserves for replacement increased \$0.8 million, including a \$1.0 million reserve arranged in conjunction with the refinancing of the Radisson hotel in Halifax, NS. Holloway received proceeds of \$0.3 million from the sale of its minority equity ownership investments in two hotels.

Investing activities generated \$14.3 million during the year ended December 31, 2009. The REIT

## FINANCING ACTIVITIES

Financing activities utilized \$1.7 million during the year ended December 31, 2010. The REIT made principal repayments on its mortgage debt and loans payable of \$13.8 million, which included \$8.9 million for the mortgages on the Holiday Inn Express and Radisson Suite hotels in Halifax which were re-financed during the first quarter. The REIT received \$10.1 million, net of financing fees, from new mortgages placed on these two properties. Holloway drew \$2.5 million on one of its available lines of credit during year. Pursuant to the sale of its minority equity ownership in two hotels, the REIT repaid \$0.2 million on the promissory notes.

Cash flow from operations was \$0.4 million for the year ended December 31, 2009 reflecting the cash generated by the hotels and the corporate operations of the REIT. The cash flow before changes in working capital items provided \$2.0 million in cash. Changes in working capital items utilized \$2.7 million as prepaid expenses and deposits increased \$2.3 million and accounts payable and accrued liabilities decreased \$1.3 million while accounts receivable decreased \$0.9 million. The cash flow from discontinued operations provided \$1.1 million in cash.

received \$3.0 million in February, 2009 as a result of the repayment of one of its mezzanine loans. These proceeds were offset by a \$1.7 million increase in Holloway's capital reserves for replacement and \$0.9 million in additional advances to The Yorkland Hotel in Toronto, ON and the Super 8 in Windsor, NS where the REIT had provided mezzanine loans. The REIT also provided \$0.3 million to hotels in which it has minority ownership interests. Additions to property and equipment of \$1.5 million were made at a number of the hotels. The net proceeds from the sale of the Wingate by Wyndham in Calgary were \$15.6 million.

Financing activities utilized \$15.8 million during the year ended December 31, 2009. The REIT obtained an additional \$1.0 million net of financing fees in mortgage financing on the Radisson Hotel and Suites in Fort McMurray, AB. The REIT made principal repayments on its mortgage debt and loans payable of \$4.6 million and paid distributions to unitholders of \$4.8 million. Regular principal repayments on the mortgage on the Wingate hotel before the sale and the repayment on closing utilized \$7.1 million in cash.

# Balance Sheet

The following table outlines the significant changes in the consolidated balance sheet from December 31, 2009 to December 31, 2010.

(in \$000's)	As at December 31, 2010	As at December 31, 2009	Increase (Decrease)	Explanation
<b>Assets</b>				
Cash and cash equivalents	830	3,756	(2,926)	See the "Cash flow for the Year Ended December 31, 2010 and 2009" in the previous section.
Accounts receivable	2,962	2,438	524	The increase is primarily due to an increase in the balances on billing accounts for hotel customers and the number of guests in-house at the hotels at December 31.
Prepaid expenses and deposits	2,608	4,479	(1,871)	The decrease is primarily due to a refund of the \$1.9 million on deposit at December 31, 2009 for the potential acquisition for The Yorkland Hotel, which was terminated in 2010 and the deposit refunded.
Capital reserve - restricted	5,440	4,691	749	The increase is related to the capital reserve contributions held by the mortgage lenders including an additional \$1.0 million arranged in conjunction with the Radisson Suite Hotel Halifax refinancing.
Property and equipment	313,374	326,465	(13,091)	The decrease is the net of additions of \$6.7 million (including the Super 8 in Windsor, NS of \$3.1 million) and the depreciation for the year of \$12.8 million and the provision for impairment on the Northwest Inn in Slave Lake, AB of \$6.8 million.
Investments in hotel properties	1,217	1,961	(744)	The decrease is a result of the sale of the investments in two properties and the provision for impairment on the Super 8 hotel in Toronto, ON recorded in 2010 which reduced the balance by \$0.3 million and \$0.4 million, respectively.
Future income taxes	7,082	4,566	2,516	The future income tax asset represents temporary differences between income or losses for accounting purposes and income or losses for tax purposes which are expected to reverse in the future.
<b>Liabilities and Unitholders' Equity</b>				
Line of credit	2,519	-	2,519	Holloway drew \$2.5 million on one of its available lines of credit during 2010.
Accounts payable and accrued liabilities	8,595	7,856	739	The increase is primarily a result of increases in accounts payable and accruals due to increased occupancy in the hotels.
Current portion of mortgages and loans payable	41,034	4,953	36,081	The balance has increased as Holloway has five mortgages maturing in 2011 as well as one maturing in 2012 that was re-classified to current as a result of not obtaining a waiver, which was required due to loan covenant violations.
Current portion of convertible debentures	19,138	-	19,138	The 8% debentures which mature August 1, 2011 have been reclassified to current liabilities.
Mortgages and loans payable	111,559	148,530	(36,971)	The balance of long-term mortgages and loans payable has decreased as six mortgages are now included in current liabilities.
Convertible debentures	49,597	65,935	(16,338)	The decrease is due to the reclassification to current liabilities of the debentures that mature in 2011 and the accretion on the convertible debentures.
Unitholders' equity	105,820	125,712	(19,892)	The decrease represents the loss for the year ended December 31, 2010.

# Quarterly Results

The following table provides a summary of the quarterly operating results:

(in \$000's except per unit results)	Q4	Q4	Q3	Q3	Q2	Q2	Q1	Q1
	2010	2009	2010	2009	2010	2009	2010	2009
Total revenues	18,516	16,018	21,211	19,977	17,314	18,007	16,621	18,722
Hotel revenues	18,406	15,939	21,173	19,800	17,291	17,782	16,581	18,464
Hotel expenses	14,048	12,508	14,486	13,588	13,028	12,897	12,587	13,680
Hotel operating income	4,358	3,431	6,687	6,212	4,263	4,885	3,994	4,784
Other (income) expenses	15,112	15,637	8,556	7,842	9,044	12,434	9,013	8,387
Future income tax expense (recovery)	-	(413)	-	(412)	(1,176)	(1,131)	(1,340)	(1,100)
Net income (loss) for the period from continuing operations	(10,754)	(11,793)	(1,869)	(1,218)	(3,605)	(6,418)	(3,679)	(2,503)
Income from discontinued operations	-	1,361	-	79	-	132	-	23
Net income (loss) for the period	(10,754)	(10,432)	(1,869)	(1,139)	(3,605)	(6,286)	(3,679)	(2,480)
Per Unit Results:								
Basic and diluted loss per unit	(0.27)	(0.27)	(0.05)	(0.03)	(0.09)	(0.16)	(0.09)	(0.06)
Basic and diluted FFO per unit	(0.02)	(0.04)	0.04	0.04	(0.04)	0.02	(0.05)	(0.01)
Basic and diluted distributable income per unit	(0.01)	(0.04)	0.04	0.04	(0.02)	0.01	(0.04)	0.00
Occupancy	60.77%	49.32%	69.94%	61.95%	56.60%	54.82%	53.81%	55.72%
ADR	\$116.31	\$125.83	\$122.53	\$131.87	\$122.01	\$132.49	\$125.75	\$135.98
RevPAR	\$70.68	\$62.06	\$85.70	\$81.69	\$69.06	\$72.63	\$67.67	\$75.77

## Capital Structure

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, optimizing the cost of capital, funds its business strategies and builds long-term unitholder value.

In managing its capital structure, the REIT monitors performance throughout the year to ensure anticipated working capital requirements and capital expenditures are funded from operations, available cash on deposit and, where applicable, bank borrowings. The REIT will make adjustments to its capital structure to meet the objectives of the broader corporate strategy or in response to changes in economic conditions and risk. In order to maintain or adjust the capital structure, the REIT may issue debt and/or issue or redeem units.

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

- a Debt Service Coverage ratio defined as earnings before interest, income taxes, depreciation, amortization, impairment provision on hotel property, non-cash accretion of deferred financing fees and unit-based compensation (earnings base) to the sum of the annual principal and interest payments of mortgages, loans, promissory notes and capital leases (debt service); and
- a Debt to Gross Book Value (Debt to GBV) ratio defined as line of credit, mortgages and loans payable, obligations under capital leases, the face value of promissory notes and the face value of the convertible debentures (Debt) divided by total assets plus accumulated depreciation, amortization and impairments (GBV). The REIT's Declaration of Trust states that Holloway's debt to GBV should not exceed 60%.

<b>Capital Management</b> (in \$000's except ratios)	<b>As at December 31, 2010</b>	<b>As at December 31, 2009</b>
<b>Capital structure</b>		
Line of credit	2,519	-
Obligations under capital leases	222	507
Mortgages and loans payable	152,593	153,483
Convertible debentures	68,735	65,935
Promissory notes	3,203	3,405
<b>Total debt</b>	<b>227,272</b>	<b>223,330</b>
Unitholders' equity	105,820	125,712
<b>Total capital</b>	<b>333,092</b>	<b>349,042</b>
<b>Ratios</b>		
Total debt	227,272	223,330
Adjustment of convertible debentures to face value	3,347	6,147
Adjustment of promissory notes to face value	109	146
<b>Debt</b>	<b>230,728</b>	<b>229,623</b>
Gross book value	396,639	393,025
<b>Debt to GBV ratio</b>	<b>58.2%</b>	<b>58.4%</b>

	<b>Year ended December 31, 2010</b>	<b>Year ended December 31, 2009</b>
Earnings base	16,612	18,909
Debt service	20,994	21,520
<b>Debt service coverage ratio</b>	<b>0.79</b>	<b>0.88</b>

The total debt (including line of credit, obligations under capital leases, mortgages and loans payable and promissory notes) to gross book value ("GBV") was 40.0% at December 31, 2010 (December 31, 2009 – 40.1%) and the total debt plus the face value of the convertible debentures to GBV was 58.2% at December 31, 2010 (December 31, 2009 – 58.4%).

The REIT is also subject to financial covenants on its mortgages and loans payable, the majority of which are measured on an annual basis and include

customary terms and conditions for borrowings of this nature. These include the Debt Service ratio presented above. The REIT is in compliance with or has obtained waivers for all of its financial covenants except one. The two mortgages, on hotels in Fort McMurray and Drayton Valley with this lender are included in current liabilities and mature in October, 2011 and January, 2012. As a result of discussions with this lender, management believes the loans will not be called prior to maturity.

## **MORTGAGES PAYABLE**

As at December 31, 2010, the REIT had total mortgage debt outstanding of \$152.6 million, net of deferred financing fees of \$1.0 million compared to \$153.4 million outstanding at December 31, 2009.

The interest rates on the mortgages range from 5.88% to 9.06% per annum, with a weighted average interest rate of 6.75% per annum. There is no mortgage debt at floating rates. A first charge

on the majority of the properties is pledged as security for the mortgages. The mortgages mature on various dates from June, 2011 to July, 2017. The weighted average maturity is 4.7 years. On March

### CONVERTIBLE DEBENTURES PAYABLE

As at December 31, 2010 and 2009, Holloway had two series of debentures outstanding totaling \$72.1 million. The \$20.238 million, 8.0% debentures mature on August 1, 2011 and are convertible to REIT units at \$5.40 per unit. The \$51.844 million, 6.5% debentures mature on June 30, 2012 and are convertible to REIT units at \$6.15 per unit. The weighted average interest rate is 6.9% (December 31, 2009 – 6.9%) and the weighted average maturity is 1.2 years (December 31, 2009 – 2.2 years). The REIT has the option to repay the principal amount of the 6.5% debentures, in whole or in part, at maturity, by issuing the number of

### PROMISSORY NOTES PAYABLE

Pursuant to the purchase of equity ownership interests in a number of hotel properties on December 22, 2008, the REIT issued two promissory notes for \$3.0 million and \$0.5 million, respectively to Winport Developments Limited Partnership. The notes were assigned by Winport Developments Limited Partnership to its partners/owners. The partners include various Dynamic mutual funds, a Gluskin Sheff mutual fund, Canadian Mortgage Capital Corporation, Holloway Investments Inc., a related party and SLC Development Corporation, a related party.

The \$3.0 million promissory note bears interest at 6.0% per annum until December 22, 2011 and 12.0% per annum, thereafter. The \$0.5 million promissory note does not bear interest and was discounted by \$0.2 million at the date of issuance, representing the net present value of the implicit interest. The discount is being accreted to interest

### LINE OF CREDIT

The REIT has two available lines of credit for \$5.0 million and \$0.5 million. As at December 31, 2010, the REIT had drawn \$2.5 million of the \$5.0 million line of credit. This line of credit bears interest at

1, 2010, the REIT refinanced the two mortgages that were due to mature on April 1, 2010 at an interest rate of 6.6% for a five year term.

units calculated by dividing the aggregate principal amount by 95% of the current market price of the units on the maturity date. This alternative does not exist with the 8.0% debentures.

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

expense over five years, the expected term of the promissory notes. The principal of the promissory notes is repayable on the sale of Holloway's ownership interests or the sale of the underlying properties. During the third quarter of 2010, Holloway repaid \$0.2 million on the \$3.0 million promissory notes as a result of the sale of its interests in two hotels.

The notes mature on December 22, 2011, at which time the REIT can pay all or a portion of the notes in cash, by the issuance of units or extend the term of either or both of the notes at its sole discretion. As the REIT can extend the term of the notes, they are presented as a long-term liability in the financial statements.

prime plus 2.5%, is payable on demand and is secured by a demand collateral mortgage and charge on the Holiday Inn Express in Kamloops, BC.

## FINANCIAL COMMITMENTS

The following chart summarizes the REIT's future financial commitments as at December 31, 2010.

	2011	2012	2013	2014	2015	Thereafter
<b>(in \$000s)</b>						
Mortgages payable - principal	41,030	11,244	3,305	3,533	11,948	82,570
Mortgages payable - interest	9,985	7,318	6,673	6,445	5,787	8,203
Obligations under capital leases	147	85	10	-	-	-
Vehicle loans - principal	4	-	-	-	-	-
Convertible debentures - principal	20,238	51,844	-	-	-	-
Convertible debentures - interest	4,989	1,685	-	-	-	-
Land lease – minimum payment	123	123	123	123	123	5,968
Operating leases	112	45	24	20	7	-
Promissory notes – principal	-	-	3,312	-	-	-
Promissory notes – interest	171	333	325	-	-	-
<b>Total</b>	<b>76,799</b>	<b>72,677</b>	<b>13,772</b>	<b>10,121</b>	<b>17,865</b>	<b>96,741</b>

## Liquidity and Working Capital

Liquidity refers to the REIT's having or generating sufficient cash to meet its liabilities when due as well as to maintain compliance with liquidity covenants on financing agreements and its capital management requirements and objectives. The REIT regularly monitors and forecasts its cash balances and cash flows generated from operations. At December 31, 2010, the REIT had a working capital deficit of approximately \$64 million, including \$36 million in mortgage maturities and \$19 million in debenture maturities. Cash from operations will fluctuate due to the seasonality in the hospitality industry. At December 31, 2010, the REIT had drawn \$2.5 million on its available operating lines of credit which total \$5.5 million. With the Debt to GBV ratio at 58.2% at December 31, 2010, the REIT could incur additional indebtedness of approximately \$17 million and not exceed the 60% Debt to GBV ratio. This calculation assumes the additional indebtedness results in a corresponding increase in the assets of the REIT.

The REIT has \$25.4 million of mortgages maturing in 2011. The REIT expects to refinance its maturing mortgages at similar or better terms with existing or other lenders.

The REIT also has \$20.2 million in convertible debentures that mature on August 1, 2011. The REIT has a signed term sheet to finance the repayment of the debentures. The Board and management continue to explore other alternatives to raise funds to repay the debenture holders which may include other debt financing, the sale of certain properties or some combination, thereof.

Based on the overall cash generation capability and overall financial position, while there can be no assurance, management believes the REIT will be able to meet its financial obligations as they become due.

# Unit Information

The following table provides the total units outstanding (including the Class B limited partnership units of Holloway Lodging Limited Partnership, a subsidiary of the REIT which are

convertible into units of the REIT) as well as the impact of outstanding options, if exercised and the conversion of convertible debentures to REIT units.

	As at December 31, 2010	As at December 31, 2009
Units outstanding	39,135,216	39,135,216
Options outstanding (exercisable)	973,841	1,139,837
Conversion of convertible debentures (conversion price \$5.40)	3,747,778	3,747,778
Conversion of convertible debentures (conversion price \$6.15)	8,429,919	8,429,919
<b>Total units reflecting exercise and conversion</b>	<b>52,286,754</b>	<b>52,452,750</b>

## UNITHOLDER RIGHTS PLAN

In November, 2008, Holloway's Board of Trustees adopted a Unitholder Rights Plan. The purpose of the rights plan is to provide the Board sufficient time to develop and implement alternatives intended to maximize value for all unitholders in the event of an unsolicited bid for Holloway and to enhance Holloway's ability to prevent unfair acquisition tactics. The Board's actions were not related to any specific acquisition proposal. Holloway is unaware of any take-over bid activity underway at this time. The rights plan is also not intended to, and would not hinder full and fair

offers for Holloway that are made to all unitholders. In particular, the rights plan contains a standard "permitted bid" exclusion that makes it inapplicable to a take-over bid made to all unitholders that is open for acceptance for at least 60 days and otherwise complies with customary "permitted bid" requirements. The Unitholder Rights Plan was approved by unitholders at the 2008 Annual General Meeting of the REIT held on May 12, 2009 and is effective for three years from the date of unitholder approval.

# Non-GAAP Lodging Industry Performance Indicators

The following describes the key performance measures and financial indicators commonly used by lodging REITs.

## OCCUPANCY, AVERAGE DAILY RATE AND REVENUE PER AVAILABLE ROOM

The key performance measures used to measure performance in the lodging industry are occupancy, average daily rate ("ADR") and revenue per available room ("RevPAR"). These are non-GAAP measures.

Occupancy represents the number of rooms sold

compared to the total number of rooms in the hotel. Average daily rate is defined as room revenue divided by the number of rooms occupied/sold. RevPAR for any given period is defined as total room revenue divided by the total number of rooms in the hotel multiplied by the number of days in the period. RevPAR is relevant as

it is the most commonly used indicator of market performance for hotels and represents the combination of the ADR and the average occupancy

## FUNDS FROM OPERATIONS (“FFO”)

Funds from operations (“FFO”) is a non-GAAP financial measure commonly used in the lodging industry. The calculations presented may differ from similar calculations reported by other entities and accordingly, may not be comparable. The Real Property Association of Canada (“REALpac”) defines FFO as net income excluding depreciation and amortization on real property, extraordinary items, gains or losses on the sale of assets, provisions for

## DISTRIBUTABLE INCOME

Distributable income is another non-GAAP financial measure commonly used by real estate investment trusts as an indication of financial performance. The definition of distributable income is defined in the REIT’s Declaration of Trust and is summarized below. Distributable income reflects the ability of the REIT to earn income and make cash distributions to unitholders. It should not be seen as a measurement of liquidity or a substitute for comparable metrics prepared in accordance with GAAP. Distributable income may differ from similar calculations reported by other entities and accordingly, may not be comparable.

Distributable income is defined as the consolidated net income of the REIT and its subsidiaries for the period computed in accordance with GAAP adjusted for the following items:

- add backs:
  - depreciation and amortization;
  - impairment of hotel property;
  - future income tax expense;
  - losses on dispositions of assets;
  - amortization of any net discount on long-term debt assumed from vendors of

rate achieved during a period. RevPAR does not include food and beverage or other ancillary revenues generated by a hotel.

impairment and future income taxes. Holloway calculates FFO in accordance with this definition. FFO provides another useful measure of the REIT’s performance as net income incorporates depreciation and amortization on real estate assets, which may not necessarily occur and is based on historical cost accounting. FFO should not be construed as an alternative to net income or cash flow from operating activities.

- properties at rates of interest less than fair value; and
- amortization of deferred financing fees;
- deductions:
  - reserve for replacement of FF&E;
  - future income tax credits;
  - interest on convertible debentures to the extent not already deducted in computing net income;
  - gains on dispositions of assets; and
  - amortization of any net premium on long-term debt assumed from vendors of properties at rates of interest greater than fair value;
- other adjustments as determined by the Trustees of the REIT in their discretion:
  - non-cash unit-based compensation; and
  - unrealized gains or losses on foreign exchange.

Readers should refer to the table “OPERATING RESULTS” for the three months and years ended December 31, 2010 and 2009 for the reconciliation of net income to FFO and to distributable income.

## CSA DISTRIBUTABLE CASH

This MD&A is in all material respects in accordance with the recommendations provided in the CICA's publication *Standardized Distributable Cash in Income Trusts and Other Flow-Through Entities: Guidance on Preparation and Disclosure*.

Standardized distributable cash is defined as the periodic cash flows from operating activities as reported in the financial statements in accordance with GAAP, including the effects of changes in non-cash working capital and any operating cash flows

provided from or used in discontinued operations less adjustments for:

- total capital expenditures as reported in the GAAP financial statements; and
- restrictions on distributions arising from compliance with financial covenants restrictive at the date of the calculation of standardized distributable cash and limitations arising from the existence of a minority interest in a subsidiary.

## HOTEL OPERATING INCOME

Hotel operating income, a commonly used non-GAAP measure of performance in the lodging industry, is defined as hotel revenues less hotel

expenses. Hotel operating income measures hotel results before interest and depreciation and amortization.

# Related Party Agreements

## HOTEL MANAGEMENT AGREEMENT

On June 7, 2006, the REIT entered into a long-term management agreement with Pacrim Hospitality Services Inc. ("PHSI"), a related party, to manage certain 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, 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 per hotel which currently ranges from \$23 to \$33 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 and website development and maintenance 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.

On June 22, 2007, the 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. On February 1, 2008, PHSI acquired management of ten of the REIT's hotel properties located in northern Alberta and British Columbia from Pomeroy. The REIT acquired the hotels (the "Pomeroy Hotels") from affiliates of Pomeroy in June, 2007. 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 \$6.35 million 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 receive reimbursable expenses plus a base

management fee for the Pomeroy Hotels that is significantly lower than the base management fee payable under the previous hotel management agreement with Pomeroy until the REIT generates distributable income that exceeds certain targets.

In order to facilitate the assignment, the REIT loaned PHSI the funds 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 the lesser of 13% and the trailing three-month yield plus 1% on Holloway's units thereafter. As the yield on Holloway's units declined to 0% with the suspension of distributions, the interest rate on the loan became 1% effective October 1, 2009.

Upon certain change of control events, as set out in the Hotel Management Agreement, PHSI is entitled to terminate the entire Hotel Management Agreement upon 60 days prior written notice to Holloway Lodging Limited Partnership and the REIT and to receive a lump sum payment of \$1.5 million in connection with such termination, without detracting from any other remedies available to it

under the terms of the Hotel Management Agreement. In addition, PHSI shall be entitled to receive a one-time fee in the amount of the aggregate outstanding principal and accrued and unpaid interest on the loan as of the termination date of the Hotel Management Agreement. Such fee shall be withheld by Holloway Lodging Limited Partnership and used directly to repay the loan in full.

On July 7, 2010, pursuant to the acquisition of the Super 8 hotel in Windsor, NS, PHSI agreed to defer its management and accounting fees until June 30<sup>th</sup> of each calendar year. PHSI is entitled to receive a payment calculated as 3/5<sup>th</sup> of 50% of the hotel's "free cash flow" for the prior twelve months (thirteen months for 2010-2011). Free cash flow is defined as net operating income less first mortgage debt service and 3% of total revenues for reserve for replacement. The payment is due on or before July 25<sup>th</sup> of each year. Any unpaid balance of the fees will be applied against the principal of the loan receivable from PHSI. The terms of the agreement will be revisited annually before June 30<sup>th</sup> for the foregoing twelve months.

## Legal Proceedings

In the course of the REIT's ordinary activities, the REIT is involved in administrative proceedings, litigations and claims. The REIT believes that either there are valid defences to any actions or that the

outcome will not have a material impact on the REIT's consolidated financial position or results of operations.

## Significant Accounting Policies

### 2010 CHANGES TO CANADIAN GAAP

Management of the REIT monitors new accounting pronouncements issued by the Canadian Institute of Chartered Accountants ("CICA") to assess the applicability and impact on the financial statements

and note disclosures of the REIT. No new accounting standards have been adopted by Holloway during 2010.

## FUTURE CHANGES TO CANADIAN GAAP

### International Financial Reporting Standards (“IFRS”)

On February 13, 2008, the Canadian Accounting Standards Board (AcSB) confirmed the mandatory changeover date to International Financial Reporting Standards (“IFRS”) for all Canadian profit-oriented publicly accountable entities. This means that the REIT will be required to prepare IFRS financial statements for interim periods and fiscal years beginning in 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the REIT for the year ended December 31, 2010 and the opening balance sheet date of January 1, 2010. The REIT has completed an assessment of the key differences between Canadian GAAP as currently applied by Holloway and IFRS. The assessment includes a summary of the key decisions that have been made regarding accounting policy and reporting changes under IFRS and key IFRS disclosure requirements. The REIT expects that the conversion to IFRS will adversely impact certain lending covenants and ratios given the value adjustments at conversion as described below. Interest and debt service coverage ratios are not

expected to be materially impacted. While the adoption of IFRS will not have an impact on the determination of cash flows from operations, the REIT does expect it to affect reported financial position and results of operations as further described below.

The International Accounting Standards Board continuously reviews and amends numerous IFRS accounting standards that may be applicable to the REIT. The evaluation of any potential impact on the REIT’s consolidated financial statements will be an ongoing process as new standards and amendments to existing standards may be issued during the transitional period.

Work on the detailed analysis of the impacts is substantially complete and preliminary adjustments to financial statements as at January 1, 2010 are currently being reviewed and finalized. The activities, deadlines and status of the major components of Holloway’s transition plan to IFRS are presented in the following table:

ACTIVITY	DEADLINE	STATUS
<p><b>Accounting Policies:</b></p> <ul style="list-style-type: none"> <li>Review accounting policy alternatives and determine selection.</li> <li>Document and implement policies.</li> </ul>	Decisions made on policy elections in Q3, 2010.	Team has reviewed alternatives and compiled documentation. Management and Audit Committee have formalized and approved all accounting policy elections.
<p><b>Information Technology and Data Systems:</b></p> <ul style="list-style-type: none"> <li>The REIT will use existing accounting systems for IFRS. Additional data gathering will be required for disclosures.</li> </ul>	Additional system requirements and reports completed in Q4, 2010.	Team has compiled documentation and finalized testing of system changes. The process for recording and documenting conversions under IFRS at the date of transition has been finalized.
<p><b>Internal Control Over Financial Reporting:</b></p> <ul style="list-style-type: none"> <li>The REIT will modify its internal controls as required as a result of the policy changes selected. Additional controls may need to be implemented as a result of policy selections.</li> </ul>	Work continues; to be completed in Q1, 2011.	Team has reviewed existing controls and continues to implement additional controls as a result of policy selections.
<p><b>Disclosure Controls and Procedures:</b></p> <ul style="list-style-type: none"> <li>The REIT will modify its disclosure controls as required as a result of the policy changes selected. Additional controls may need to be implemented as a result of policy selections.</li> </ul>	Updated controls to be in place in Q1, 2011.	Team has reviewed existing controls and continues to implement additional controls as a result of policy selections. Summary for review by management and Audit Committee to be completed in Q1, 2011.
<p><b>Financial Reporting Expertise:</b></p> <ul style="list-style-type: none"> <li>IFRS expertise includes existing internal resources, additional resources hired and the use of an external audit firm.</li> </ul>	Team fully in place Q2, 2010.	<p>Existing staff have been tasked with IFRS functions over the last year. Full time resources added in Q2, 2010 to lead implementation and complete detailed scoping and analysis.</p> <p>Key supporting staff attended training courses on IFRS and are engaged in transitional testing and review of financial statement impacts. All senior management and Audit Committee members have reviewed requirements and policy changes for implementation of IFRS.</p>
<p><b>Business Activities:</b></p> <ul style="list-style-type: none"> <li>Financial Covenants</li> <li>Declaration of Trust Implications.</li> </ul>	<p>Lenders advised of differences in Q4, 2010.</p> <p>Summary report created in Q3, 2010.</p>	<p>All lenders have been notified of potential impacts to existing lending covenants as a result of transition to IFRS.</p> <p>Declaration of Trust implications have been reviewed by management and the Audit Committee with concurrence by our external auditors.</p>
<p><b>Taxation and Reporting</b></p> <ul style="list-style-type: none"> <li>Review impacts on presentation and measurement of income taxes and document potential changes to future disclosure.</li> </ul>	Work continues; to be completed in Q1, 2011.	Detailed analysis of potential impacts on income tax reporting and measurement continues by internal staff and third party tax advisors.

The REIT has identified the significant differences between IFRS and Canadian GAAP in relation to the REIT's primary financial statement items. The REIT has made its conclusions on the selection of

### ***Property, Plant and Equipment***

The REIT's property and equipment are accounted for under IAS-16 Property, Plant and Equipment. Under IFRS, the REIT may choose the cost model or the revaluation model. Under the cost model, each component of property, plant and equipment is carried at cost less accumulated depreciation and any impairment. Under the revaluation model, the hotel properties will be revalued periodically. Gains are recorded as a separate component of unitholders' equity. Losses are netted against any previously recorded gains. If the loss exceeds the previously recognized gains, the excess is recorded

### ***IFRS 1 – First-time adoption of IFRS***

In general, the conversion to IFRS requires an entity to present its financial statements as if it had always reported under IFRS. IFRS 1 provides guidance on the initial adoption of IFRS and provides certain exceptions and exemptions which an entity may elect. Under IFRS 1, an entity may record individual items of its property, plant and equipment at fair value on transition to IFRS. The fair value will be the new cost or deemed cost. The REIT intends to make this election for certain hotel properties as at January 1, 2010. The REIT largely finalized the asset valuation process during the latter part of 2010. A

### ***Impairment***

Under IFRS, an entity is required to recognize an impairment loss if the recoverable amount is less than the carrying amount (net book value). The recoverable amount is defined as the higher of: a) the estimated fair value less costs to sell; or b) value in use. Value in use is defined as the present value of the estimated future cash flows from the use of the asset and from its disposal at the end of its useful life. When the recoverable amount is higher than the carrying amount, previously recognized impairment losses are reversed. Impairment losses cannot be reversed under Canadian GAAP.

accounting policies and the exceptions and exemptions available under IFRS 1. The key differences are described below.

in income. The cost model is generally consistent with Canadian GAAP in that separate components are recognized for each significant part of an asset and are carried at their cost less any accumulated depreciation and any accumulated impairment losses. However, requirements to identify different components of property, plant and equipment under IFRS are more explicit than those existing under Canadian GAAP. As a result the REIT has identified five or six additional components of its building assets. The REIT will use the cost model when preparing its financial statements under IFRS.

significant sample of the hotel portfolio has been subject to external valuation with the remainder being valued by management and validated externally following the same methodology. The fair value of each hotel was determined based upon a discounted cash flow method of valuation with some consideration given to comparable per room values. Capitalization rates and price per room values were established based on individual markets and where available, recent comparable hotel sales activity.

As discounted cash flows are used under IFRS, entities may have more impairments. IFRS also allows the reversal of an impairment loss when the recoverable amount is higher than the carrying value (to no more than what the depreciated amount of an asset would have been had the impairment not occurred). Based on the impairment testing requirements at the January 1, 2010 transition date the REIT expects that opening property and equipment balances will be reduced by approximately \$87 million (net of fair value increases to certain hotel properties).

### **Business Combinations**

Under IFRS, costs related to an acquisition must be expensed whereas under Canadian GAAP, these costs were capitalized as part of the asset. IFRS 1 allows entities to elect to implement the Business Combinations standard either: a) prospectively from

### **Trust Units**

Under GAAP, the REIT'S units are presented as equity. IAS 32 – Financial Instruments defines a financial instrument as a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Under IFRS, REIT units would likely be considered a liability as

the date of transition to IFRS; or b) retrospectively from a previous date onwards. The REIT has elected to apply the standard prospectively commencing January 1, 2011.

the Declaration of Trust requires the REIT to distribute its taxable income to unitholders. The REIT changed its Declaration of Trust at its Annual Meeting held on May 12, 2009 to eliminate the mandatory distribution. Thus, the REIT'S units are expected to be presented as equity under IFRS.

## **Critical Accounting Estimates**

Note 2 to the audited consolidated financial statements for the year ended December 31, 2010 provide a summary of the REIT'S significant accounting policies. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as 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. Management believes the estimates described below are the ones most subject to estimation and judgment in the REIT'S financial statements.

### **VALUATION OF HOTEL PROPERTIES**

GAAP requires that long-lived assets, consisting of property and equipment (hotel properties), be reviewed for impairment whenever events or changes in circumstances indicate 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 and measuring for impairment. A two-step process is used to assess the impairment of long-lived assets held for use, with the first step determining when an impairment is recognized and the second step measuring the amount of the impairment. Impairment losses are recognized when the net book value of the long-lived asset exceeds the sum of the undiscounted cash flows expected to result from their use and eventual disposition. The amount of the impairment loss is the amount by which the long-lived asset'S carrying value exceeds its fair value.

The future cash flows expected from the use and eventual disposition involve assumptions of

occupancy, room rates, revenues, expenses and the residual or terminal value for the property. In addition to these estimates, management assessed the effect of new competition in the individual markets and the hotel industry predictions for recovery from the recession. These estimates and assumptions are subject to change.

During the year ended December 31, 2010, the REIT recorded an impairment loss on a hotel property of \$6.8 million as a result of an annual impairment test of all of its long-lived assets. Management determined that the carrying amount of the Northwest Inn in Slave Lake, AB exceeded its fair value at December 2010 as the carrying amount exceeded the sum of the undiscounted cash flows expected to result from its use and eventual disposition. The amount of the impairment loss is the amount by which the carrying value exceeds the discounted cash flows of the hotel. This non-cash loss is included in earnings as a provision for impairment of hotel property.

## VALUATION OF LOANS RECEIVABLE

GAAP requires that loans receivable be classified as impaired when, in the opinion of management, there is a reasonable doubt as to the timely collection of principal, interest and the underlying

security of the loan. The carrying value of a loan receivable classified as impaired is reduced to its estimated fair value.

## VALUATION OF INVESTMENTS IN HOTEL PROPERTIES

GAAP requires the carrying value of investments to be reduced when there has been a significant adverse change in the expected timing or amount of future cash flows. The REIT has equity ownership interests in six hotel partnerships or co-tenancies ranging from 2.52% to 19.06%. The investments are

accounted for using the cost method. During the year ended December 31, 2010, the REIT recorded a provision for impairment of \$0.4 million on its investment in the Super 8 in Toronto, ON, which represents the total cost of this investment.

## AMORTIZATION OF PROPERTY AND EQUIPMENT

The REIT records amortization on its property and equipment using the straight-line method over the estimated useful life of each category. The two largest categories are buildings which are amortized up to 40 years and furniture, fixtures and

equipment, which are amortized up to 7 years. If the estimated useful life of the assets or different amortization methods were used, the impact on the REIT's net income could be material.

## FAIR VALUE OF MORTGAGES AND DEBENTURES PAYABLE

Management determines and discloses the fair value of the REIT's mortgages and debentures payable in the notes to the financial statements. Management uses an internally developed model to estimate fair value based on discounting the future payments based on current market rates. The

estimated current market rate is based on management's experience in obtaining similar financings and the current market conditions. Changes in the current market for credit, interest rates and credit spreads will impact the estimates used and the fair values reported.

## INCOME TAXES

Under the provisions of Bill C-52, Budget Implementation Act, 2007, the REIT became a specified investment flow-through ("SIFT") and became subject to tax in 2007 due to exceeding the growth guidelines as outlined in Act. The REIT uses the asset and liability method for accounting for income taxes. Under this method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases (temporary differences). Future tax assets and liabilities are measured using enacted or

substantively enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of enactment or substantive enactment.

The estimates of future taxable income, the years when the temporary differences are expected to reverse and the tax rates in those years have an impact of the future income tax asset recorded on the balance sheet.

# Disclosure Controls and Procedures and Internal Controls over Financial Reporting

Holloway maintains disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in reports filed or submitted under applicable securities legislation is accumulated and communicated to management, including the Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”), as appropriate to allow timely decisions regarding required public disclosure. During 2010, Holloway’s management evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in *National Instrument 52-109, Certification of Disclosure in Issuers’ Annual and Interim Filings*), under the supervision of, and with the participation of the CEO and CFO. As at December 31, 2010, based on the evaluation, the CEO and CFO have concluded that the REIT’s disclosure controls and procedures were appropriately designed and were operating effectively.

Management is also responsible for establishing and maintaining internal controls over financial reporting, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. During 2010, Holloway’s management also evaluated the design and operating effectiveness of the internal controls over financial reporting (as defined in *National Instrument 52-109, Certification of Disclosure in*

*Issuers’ Annual and Interim Filings*), using the Committee of Sponsoring Organizations Internal Control – Integrated Framework, under the supervision of, and with the participation of the CEO and CFO. As at December 31, 2010, based on the evaluation, the CEO and CFO have concluded that the REIT’s internal controls over financial reporting were appropriately designed and were operating effectively.

It is important to note that all systems of internal controls and procedures can only provide reasonable, rather than absolute assurance that all control issues will be detected. Misstatement and errors may not be detected and controls can be circumvented by collusion among individuals or management override. In addition, the design of any system of control is also based upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future events.

Holloway continues to review and document its disclosure controls and procedures, including its internal controls over financial reporting so as to enhance the effectiveness of its systems of controls and procedures.

## Tax Rules for Income Trusts

On October 31, 2006, The Minister of Finance (Canada) announced proposals (the “SIFT Proposals”) to amend the Tax Act to change the taxation regime applicable to certain “specified investment flow-through” entities (“SIFTs”), including certain income trusts and their investors. 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 SIFT. Under Bill

C-52, certain distributions from a SIFT will no longer be deductible in computing a SIFT’s taxable income, and a SIFT will be subject to tax on such distributions at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation. Distributions paid by a SIFT as returns of capital generally will not be subject to the tax.

As the REIT has exceeded the “normal growth” rates as defined in the guidelines issued by the Department of Finance, the REIT became subject to the tax commencing in 2007. Accordingly, the REIT has recorded future income tax based on temporary differences that are 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. Distributions from the REIT will be subject to the tax unless they qualify as returns of capital. Since inception, the REIT’s distributions have been 100% return of capital.

## Risks and Uncertainties

### RISKS RELATED TO THE BUSINESS OF THE REIT

#### Hotel Industry

The REIT directly or indirectly owns and operates hotels. As a result, the REIT is subject to the operating risks inherent in the hotel industry. In addition to the specific conditions discussed in more detail below, these risks include:

- cyclical downturns arising from changes in general and local economic conditions;
- changes in the level of business and commercial travel and tourism;
- increases in the supply of accommodations in local markets which may adversely affect the results of operations;
- competition from other hotels;
- the recurring need for renovation, refurbishment and improvement of hotel properties;
- changes in wages, product costs, energy costs, property taxes and construction and maintenance costs that may result from inflation, government regulations, changes in interest rates or currency fluctuations;
- availability of financing for operating and/or capital requirements;
- seasonal fluctuations in hotel operating income generated throughout the year;
- increases in operating costs due to inflation which may not necessarily be offset by increased room rates; and
- other factors, including medical concerns related to travelling to Canada, acts of terrorism, natural disasters, extreme weather conditions and labour shortages, work stoppages or disputes.

#### Competition

The hotel industry is highly competitive. The REIT’s properties face significant local competition from other hotels. Some of the competitors of the hotels in the REIT’s portfolio may have greater marketing and financial resources than the REIT. The number of competitive hotel properties in a particular area

could have a material adverse effect on the occupancy rates and average daily rate of properties in that particular area. New competitors entering markets in which the REIT operates can also adversely affect business levels.

#### Customer Concentration

In some of the markets in which the REIT operates, the customer base may be concentrated due to the type of industries established in those markets. The business levels achieved by the REIT in these

markets rely on the ongoing presence and financial stability of these customers. If these customers withdrew from these markets, the REIT could experience a decline in revenue.

## Changes to the Alberta Oil and Gas Royalties

A majority of the REIT's properties are located in the province of Alberta. In October 2007, the Government of Alberta released a new royalty framework which increased the royalties charged to oil and gas producers by the Government of Alberta. The increases are on a sliding scale basis based on the price of the related commodity. In November 2008, the Government of Alberta offered companies drilling certain new wells a one-time option of selecting new transitional royalty rates for the period from 2009 to 2013. All current wells moved to the new royalty framework on January 1, 2009. Companies that adopt the transitional rates will be required to shift to the new royalty framework on January 1, 2014.

On March 11, 2010, the Government of Alberta announced recommendations for royalty

adjustments. Among the changes are reduced maximum royalty rates at higher price levels to become effective January 1, 2011. The transitional royalty framework for oil and gas producers introduced in November 2008 will continue until its original announced expiration on December 31, 2013. Effective January 1, 2011, no new wells will be allowed to select the transitional royalty rates. Wells that have already selected the transitional royalty rates will have the option to stay with those rates or switch to the new rates effective January 1, 2011.

As the REIT's properties in Alberta derive a substantial portion of their revenue from customers in the oil and gas sector, any decline in activity in this sector could result in a decline in revenue for the REIT.

## Availability of Additional Capital

The acquisition of hotels, as well as ongoing renovations, refurbishment and improvements required to maintain and operate hotels, are capital intensive. The REIT sets aside a portion of revenues for the replacement of furniture, fixtures and equipment and capital improvements ("FF&E reserve"). Where the cost of capital improvements exceeds the capital reserve, or the cost of certain capital improvements reduces the reserve to significantly lower levels, the REIT will be required to fund these activities principally by incurring additional indebtedness or from operations.

Access to markets for additional borrowing depends on prevailing market conditions and the acceptability of the terms offered. If the REIT were unable to secure additional funding for acquisitions or required improvements, it would be required to curtail these activities, which could have an adverse effect on its results of operations and financial condition.

## Debt Financing

The REIT incurred debt in connection with the acquisition of its properties, including mortgage financing, capital leases and other borrowings. Therefore, the REIT is subject to the risks associated with debt financing, including the risks that cash flow from operations will be insufficient to meet required payments of principal and interest, the risk that existing debt will not be able to be refinanced or that terms of such refinancing will not be as favourable to the REIT and the risk that necessary capital expenditures for such purposes as renovations and other improvements will not be able to be financed on favourable terms or at all. In

such circumstances, if the REIT were in need of capital to repay indebtedness, it could be required to liquidate one or more of its hotel properties at times which may not permit realization of the maximum return on such investments or could be required to agree to additional financing on unfavourable terms. The REIT's financing agreements contain covenants that could restrict its ability to operate its business. If the REIT fails to comply with the restrictive covenants in its financing agreements, its lenders may be able to accelerate payment of the related debt. In connection with its financing agreements, the REIT

has granted security interests over the majority of its hotel properties. If the REIT is not able to meet

its debt service obligations, it risks the loss of some or all of its assets to foreclosure or sale.

## Dependence on and Relationship with Pacrim Hospitality Services Inc. (PHSI)

PHSI provides hotel management services to the REIT pursuant to the Hotel Management Agreement and the REIT depends on PHSI for all aspects of the day-to-day management of its hotels. There can be no assurance that if PHSI stopped providing these services, a suitable replacement would be found in a timely manner or at all.

In addition, PHSI is in the business of owning, acquiring and managing hotels independently of the REIT. These properties may in some circumstances compete with properties owned by the REIT. PHSI is not required to provide services exclusively to the REIT and may in some circumstances manage hotels on behalf of competitors of the REIT.

## RISKS RELATED TO REAL PROPERTY OWNERSHIP

### General

The REIT owns hotel properties and therefore, is subject to risks generally incident to the ownership of real property. The underlying value of the properties and the REIT's income depends on the ability of the REIT to maintain or increase revenues from the properties and to generate income in excess of operating expenses. Income from the properties may be adversely affected by changes in national or local economic conditions, changes in interest rates and in the availability, cost and terms of mortgage financing, the impact of present or future environmental legislation and compliance with environmental laws, the ongoing need for capital improvements, particularly in older structures, changes in real estate assessed values and property taxes payable on such values (including as a result of possible increased assessments as a result of the acquisition of the

properties by the REIT) and other operating expenses, changes in governmental laws, regulations, rules and fiscal policies, changes in zoning laws, civil unrest, acts of God, including earthquakes and other natural disasters and acts of terrorism or war (which may result in uninsured losses). When interest rates increase, the cost of acquiring, developing, expanding or renovating real property increases and real property values may decrease as the number of potential buyers decreases. Similarly, as financing becomes less available, it becomes more difficult to both acquire and sell real property. Finally, governments can, under eminent domain laws, expropriate or take real property for less compensation than an owner believes the property is worth. Almost all of these factors are beyond the REIT's control.

### Liquidity

Real estate investments are relatively illiquid, with the degree of liquidity generally fluctuating in relation to demand for and the perceived desirability of such investments. Such illiquidity may limit the REIT's ability to vary its portfolio promptly in response to changing economic or investment conditions. If the REIT were to need to

liquidate a property, the proceeds to the REIT might be significantly less than the aggregate carrying value of such property. In addition, by concentrating on hotel properties, the REIT is exposed to the adverse effects on that segment of the real estate market.

## Environmental Matters

The REIT and its properties are subject to various federal, provincial and municipal laws relating to environmental matters. These laws provide that the REIT could be liable for the costs of removal of certain hazardous, toxic or regulated substances released on or in the properties or disposed of at other locations sometimes regardless of whether the REIT knew of or was responsible for their presence. The failure to remove, remediate or otherwise address such substances or locations, if any, could adversely affect the REIT's ability to sell

such real estate or to borrow using such real estate as collateral and could potentially also result in claims against the REIT by private plaintiffs. In addition, environmental laws and regulations may change in the future and the REIT may become subject to more stringent environmental laws and regulations. Compliance with more stringent environmental laws and regulations could have a material adverse effect on the REIT's business, financing condition or results of operations.

## RISKS RELATED TO THE GENERAL ECONOMIC ENVIRONMENT

As with any commercial enterprise, the REIT is subject to risks associated with general economic conditions. These risks include the degree to which the overall economy is expanding or contracting, rate of inflation, unemployment rate, level of

consumer confidence and the effects of government initiatives. Any deterioration in general economic conditions may adversely affect business levels of the REIT.

## RISKS RELATED TO THE STRUCTURE OF THE REIT

The REIT's units trade on the TSX. The market price of the units may be affected by changes in the economy, changes in general market conditions, fluctuations in the market demand for equity securities and numerous other factors beyond the control of the REIT.

A holder of a unit does not hold a share of a body corporate. As holders of units, the unitholders do not have statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring "oppression" or "derivative" actions. The rights of unitholders are

based primarily on the REIT's Declaration of Trust. There is no statute governing the affairs of the REIT equivalent to the Business Corporations Act (Ontario) or the Canada Business Corporations Act which sets out the rights and entitlements of shareholders of corporations in various circumstances.

Additional information on these and other risks and uncertainties are described under "Risk Factors" in Holloway's Annual Information Form ("AIF"), dated March 26, 2010 which is available at [www.sedar.com](http://www.sedar.com).

# Outlook

According to the Bank of Canada, the recovery in Canada is proceeding broadly as anticipated, with a period of modest growth. Overall, the Bank projects the economy will expand by 2.4% in 2011 and 2.8 % in 2012 – a slightly firmer profile than had been anticipated in October, 2010. The Bank continues to expect the economy will return to full capacity by the end of 2012.

The contribution of government spending is expected to wind down this year, consistent with previously announced fiscal plans. The level of personal debt is expected to restrain the pace of consumption growth and residential investment. In contrast, business investment will likely continue to rebound strongly, owing to financial conditions and competitive pressures.

According to statistics compiled by the Canadian Association of Oilwell Drilling Contractors, the average number of active oil rigs in 2010 increased by 49% compared to the prior year.

Hotel consulting group PKF reported on a national basis, revenue per available room increased by 5.6% in 2010, after experiencing a decline of 12.0% in 2009. For 2011, PKF is projecting RevPAR growth of 3.6%.

These growth projections for the wider economy along with the strength of the specific sectors relative to the REIT's business are encouraging indicators for the REIT and the markets in which it operates.

## Forward-Looking Information

This MD&A contains forward-looking information within the meaning of applicable securities laws. Forward-looking information may relate to the REIT's future outlook and anticipated events or results and may include statements regarding the future financial position, property acquisition strategies and opportunities, business strategy, financial results and plans and objectives of the REIT. Particularly, statements regarding the REIT's future operating results, property acquisition strategies and opportunities and economic performance are forward-looking statements. In some cases, forward-looking information can be identified by terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or

similar expressions concerning matters that are not historical facts.

Forward-looking information is subject to certain facts, including risks and uncertainties, that could cause actual results to differ materially from what the REIT currently expects and there can be no assurance that such statements will prove to be accurate. Some of these risks and uncertainties are described under "Risk Factors" in Holloway's Annual Information Form ("AIF"), dated March 26, 2010 which is available at [www.sedar.com](http://www.sedar.com). The REIT does not intend to update or revise any such forward-looking information should its assumptions and estimates change.