Holloway Lodging Real Estate Investment Trust

Consolidated Financial Statements
December 31, 2008 and 2007

March 11, 2009

Management's Responsibility for Financial Reporting

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

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

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

(signed) "Glenn Squires" Chief Executive Officer	(signed) "Tracy Sherren" Chief Financial Officer

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March 11, 2009

Auditors' Report

To the Trustees of
Holloway Lodging Real Estate Investment Trust

We have audited the consolidated balance sheets of **Holloway Lodging Real Estate Investment Trust** ("Holloway Lodging REIT" or the "REIT") as at December 31, 2008 and 2007 and the consolidated statements of unitholders' equity, operations and comprehensive income (loss) and cash flows for the years ended December 31, 2008 and 2007. These consolidated financial statements are the responsibility of the REIT's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the REIT as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years ended December 31, 2008 and 2007 in accordance with Canadian generally accepted accounting principles.

(signed) "*PricewaterhouseCoopers LLP*"

Chartered Accountants

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.

Holloway Lodging Real Estate Investment Trust
Consolidated Balance Sheet
As at December 31, 2008 and 2007

	2008 $	2007 $
Assets		
Current assets		
Cash and cash equivalents (note 15)	4,991,951	22,894,439
Capital reserve	1,552,737	980,467
Restricted cash	653,504	2,322,933
Accounts receivable	3,887,113	3,828,493
Loan receivable from a related party	–	158,910
Inventories	303,465	427,958
Prepaid expenses and deposits	2,238,765	2,868,726
Current portion of mezzanine loans receivable (note 6)	3,000,000	–
	16,627,535	33,481,926
Capital reserve – restricted	2,975,289	1,429,159
Loans receivable from related parties (note 5)	6,508,910	–
Mezzanine loans receivable (note 6)	9,663,000	14,413,000
Investments in hotel properties (note 7)	2,688,334	–
Property and equipment (note 8)	352,035,190	362,548,159
Other assets (note 9)	1,123,944	1,289,066
Future income taxes (note 21)	1,764,000	2,055,000
	393,386,202	415,216,310
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	9,418,698	8,859,914
Distributions payable	684,866	1,761,899
Accrued interest on convertible debentures	674,600	674,600
Current portion of obligations under capital leases (note 10)	338,249	369,039
Current portion of mortgages and loans payable (note 11)	5,155,110	4,359,149
	16,271,523	16,024,601
Obligations under capital leases (note 10)	528,132	519,381
Mortgages and loans payable (note 11)	159,665,899	163,603,384
Promissory notes payable (note 12)	3,368,334	–
Convertible debentures (note 13)	63,457,890	61,263,394
	243,291,778	241,410,760
Unitholders' Equity	150,094,424	173,805,550
	393,386,202	415,216,310

Commitments (note 17)

Approved by the Trustees

(signed) "Walter Keyser"
Trustee

(signed) "Wayne Watson"
Trustee

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Unitholders' Equity

As at December 31, 2008 and 2007

	Units $ (note 14)	Class B LP units $ (note 14)	Contributed surplus $	Equity component of convertible debentures $	Accumulated income (losses) $	Accumulated distributions $	Total $
Balance, December 31, 2006	63,270,181	920,000	430,010	4,982,000	(1,207,608)	(2,632,358)	65,762,225
Unit-based compensation related to options	–	–	377,407	–	–	–	377,407
Exercise of options	18,797	–	(2,527)	–	–	–	16,270
Units issued, net of issuance costs, net of tax of $1,468,000	94,689,048	–	–	–	–	–	94,689,048
Units issued in property acquisitions	22,000,000	–	–	–	–	–	22,000,000
Equity component of convertible debentures, net of issuance costs	–	–	–	4,614,225	–	–	4,614,225
Exchange of units	253,000	(253,000)	–	–	–	–	–
Net income	–	–	–	–	1,520,036	–	1,520,036
Distributions	–	–	–	–	–	(15,173,661)	(15,173,661)
Balance, December 31, 2007	180,231,026	667,000	804,890	9,596,225	312,428	(17,806,019)	173,805,550
Unit-based compensation related to options	–	–	471,473	–	–	–	471,473
Exercise of options	84,268	–	(57,601)	–	–	–	26,667
Units repurchased and cancelled	(292,784)	–	76,432	–	–	–	(216,352)
Issuance costs	(2,500)	–	–	–	–	–	(2,500)
Units issued to trustees (note 15)	67,828	–	–	–	–	–	67,828
Net loss	–	–	–	–	(5,080,470)	–	(5,080,470)
Distributions	–	–	–	–	–	(18,977,772)	(18,977,772)
Balance, December 31, 2008	180,087,838	667,000	1,295,194	9,596,225	(4,768,042)	(36,783,791)	150,094,424

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Operations and Comprehensive Income (Loss)

For the years ended December 31, 2008 and 2007

	2008 $	2007 $
Hotel revenues		
Rooms	80,719,150	57,235,631
Other	12,775,499	12,515,006
	93,494,649	69,750,637
Hotel expenses		
Operating expenses	54,748,416	41,706,438
Property taxes and insurance	4,989,964	3,339,264
Management fees	2,439,623	2,137,859
	62,178,003	47,183,561
Hotel operating income	31,316,646	22,567,076
Other (income) expenses		
Interest on mortgages and other debt and accretion of deferred financing fees	11,532,598	7,976,137
Convertible debentures interest and accretion	7,238,305	4,816,687
Corporate and administrative	2,844,224	2,594,709
Interest income	(2,801,537)	(2,441,730)
Unrealized foreign exchange loss	1,019,566	186,565
Depreciation and amortization	13,272,960	8,501,672
Provision for impairment of mezzanine loans	3,000,000	–
	36,106,116	21,634,040
Income (loss) before income tax expenses	(4,789,470)	933,036
Provision for (recovery of) future income taxes (note 21)	291,000	(587,000)
Net income (loss) and comprehensive income (loss) for the years	(5,080,470)	1,520,036
Income (loss) per unit (note 14)		
Basic	(0.13)	0.05
Diluted	(0.13)	0.05

Holloway Lodging Real Estate Investment Trust
Consolidated Statements of Cash Flows
For the years ended December 31, 2008 and 2007

	2008 $	2007 $
Cash provided by (used in)		
Operating activities		
Net income (loss) and comprehensive income (loss) for the years	(5,080,470)	1,520,036
Charges (credits) to income not involving cash		
Unit-based compensation	471,473	377,407
Depreciation and amortization	13,272,960	8,501,672
Accretion of mortgages and convertible debentures	2,169,824	1,337,277
Unrealized foreign exchange loss	1,019,566	186,565
Provision for impairment of mezzanine loans	3,000,000	–
Future income tax expense (recovery)	291,000	(587,000)
	15,144,353	11,335,957
Net change in non-cash working capital balances related to operations (note 15)	1,187,445	574,149
Cash flow from operating activities	16,331,798	11,910,106
Investing activities		
Decrease (increase) in restricted cash	1,669,429	(2,322,933)
Increase in capital reserve	(2,118,400)	(689,197)
Issuance of loan to a related party	(6,350,000)	(158,910)
Issuance of mezzanine loans	(1,250,000)	(6,413,000)
Acquisition of hotel properties (note 4)	–	(250,097,501)
Proceeds from investment in hotel properties	680,000	–
Additions to property and equipment	(2,039,706)	(4,382,231)
Increase in other assets	(39,015)	(31,704)
Cash flow used in investing activities	(9,447,692)	(264,095,476)
Financing activities		
Repayment of capital lease obligations	(403,186)	(282,280)
Proceeds from mortgages and loans, net of financing fees	(47,570)	116,735,218
Repayment of mortgages and loans payable	(4,088,848)	(2,551,655)
Issuance of units, net of issuance costs	–	93,221,048
Units repurchased and cancelled	(216,352)	–
Exercise of options	26,667	16,270
Issuance of convertible debentures, net of issuance costs	(2,500)	49,899,850
Distributions paid to unitholders	(20,054,805)	(13,941,314)
Cash flow from (used in) financing activities	(24,786,594)	243,097,137
Net change in cash and cash equivalents during the years	(17,902,488)	(9,088,233)
Cash and cash equivalents – Beginning of years	22,894,439	31,982,672
Cash and cash equivalents – End of years	4,991,951	22,894,439

Supplemental cash flow information (note 15)

1 Basis of presentation and nature of operations

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

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

As at December 31, 2008, the REIT owned 21 hotels in Canada and 1 hotel in the United States with 2,423 guest rooms and suites, and held minority ownership interests in nine hotels.

2 Changes in accounting policies

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

Financial instruments

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

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

These new standards require disclosures related to the significance of financial instruments on the REIT's financial position and performance and the nature and extent of risk arising from financial instruments to which the REIT is exposed and how the REIT manages these risks. Disclosure recommended by the new handbook sections have been included in note 20 of these consolidated financial statements.

Capital disclosures

Section 1535, *Capital Disclosures*, establishes disclosure requirements about the REIT's capital and how it is managed. The purpose is to enable users of the financial statements to evaluate the REIT's objectives, policies and processes for managing capital. Disclosures recommended by the new handbook section have been included in note 19 of these consolidated financial statements.

Inventories

Section 3031, *Inventories*, replaces the existing standard for inventories, Section 3030, revising and enhancing disclosure and presentation requirements. There has been no impact as to how the REIT accounts for inventory, as the REIT values linen, food, beverages, guest supplies and amenities at the lower of cost, determined on a first-in, first-out basis, and net realizable value. The cost of inventories recognized as expense was $5,155,882 for the year ended December 31, 2008 (2007 - $4,411,313).

3 Significant accounting policies

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

a) Consolidation

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

b) Cash and cash equivalents

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

c) Inventories

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

d) Capital reserve

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

e) Investments in hotel properties

The investments in hotel properties represent equity ownership interests in nine hotel partnerships or co-tenancies ranging from 2.52% to 19.06%. The investments are accounted for using the cost method.

3 Significant accounting policies (continued)

f) Property and equipment

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

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

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

g) Impairment of long-lived assets

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

h) Impairment of loan receivable

Loans receivable are 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 amount of a loan receivable classified as impaired is reduced to its estimated fair value.

i) Other assets

Other assets consist of franchise fees and agreements. Franchise fees are amortized on a straight-line basis over the term of the franchise agreement and the amortization is included in depreciation and amortization in these consolidated financial statements. The Non-competition, Right of First Opportunity and Participation Agreement (note 16) is amortized on a straight-line basis over the five year term of the agreement.

3 Significant accounting policies (continued)

j) Leases

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

k) Revenue recognition

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

l) Income taxes

Under the provisions of Bill C-52, Budget Implementation Act, 2007, which was substantively enacted on June 12, 2007, the REIT, as a publicly traded income trust, is considered a specified investment flow-through (“SIFT”). As the REIT has exceeded the “normal growth” rates as defined in the guidelines issued by the Department of Finance, the REIT became subject to tax in 2007.

The REIT uses the asset and liability method of accounting for income taxes. Under the asset and liability 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. 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 those 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.

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

m) Earnings per unit

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

3 Significant accounting policies (continued)

n) Unit repurchases

If the REIT repurchases its own units as the result of a unit buy-back, those units are deducted from equity and the associated units are cancelled. No gain or loss is recognized and the consideration paid including any directly attributable incremental costs is recognized directly in unitholders' equity.

o) Unit-based compensation

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

The REIT recognizes all other unit-based payments to employees or trustees, including the issuance of units as compensation, at the fair market value of the units on the date of issuance.

p) Financial instruments

i) Financial instruments – recognition and measurement

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. All financial instruments are required to be measured at fair value on initial recognition, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other liabilities.

The REIT has implemented the following classifications:

- Class and cash equivalents are classified as "Financial Assets Held for Trading". These financial assets are marked-to market through net income at each period end.

- Accounts receivable, loans receivable from related parties and mezzanine loans receivable are classified as "Loans and Receivables". After their initial fair value measurement, they are measured at amortized cost including transaction costs using the effective interest method.

- Accounts payable, capital leases, convertible debentures, mortgages and loans payable and promissory notes payable are classified as "Other Financial Liabilities". After their initial fair value measurement, they are measured at amortized cost net of transaction costs using the effective interest method.

3 Significant accounting policies (continued)

p) Financial instruments (continued)

ii) Comprehensive income

Under Section 1530, comprehensive income is comprised of net earnings and other comprehensive income (OCI) which generally would include unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign currently translation adjustments net of hedging arising from self-sustaining foreign operations, and changes in the fair value of the effective portion of cash flow hedging instruments. The REIT has no OCI, and therefore accumulated other comprehensive income is not presented as a new category of unitholders' equity.

q) Management estimates

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

r) Foreign currency translation

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

3 Significant accounting policies (continued)

Future changes to Canadian GAAP

Goodwill and Intangible Assets

The CICA has issued a new accounting standard, Section 3064 Goodwill and Intangible Assets, which establish new standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Section 1000 Financial Statement Concepts was also amended to provide consistency with Section 3064. The new and amended standards will be effective for the REIT's 2009 fiscal year. These new standards are not expected to have a material impact on the REIT's 2009 financial statements.

Business Combinations, Consolidated Financial Statements and Non-controlling Interests

The CICA has issued new accounting standards, Section 3064 Business Combinations, Section 1601 Consolidated Financial Statements and Section 1602 Non-controlling Interests which establish new standards for consolidated financial statements and business combinations. The definition of a business is expanded and described as an integrated set of activities and assets that are capable of being managed to provide a return to investors or economic benefits to owners, members or participants. Net assets, non-controlling interests and goodwill acquired in a business combination will be recorded at fair value. Non-controlling interests will be reported as a component of equity. In addition, acquisition costs will be expensed when incurred. The new and amended standards will be effective for the REIT's 2011 fiscal year. The objective of these new Sections is to harmonize Canadian GAAP with International Financial Reporting Standards. When these standards are adopted by the REIT, acquisition costs will be expensed through the income statement. Other impacts of these standards are still being assessed.

International Financial Reporting Standards

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. As such, the REIT will be required to prepare IFRS financial statements for interim and fiscal periods beginning in 2011. Work is currently underway to evaluate the impact conversion to IFRS will have on the REIT's financial statements.

4 Hotel acquisitions

Holloway Lodging REIT acquired the following hotels, restaurant operations and parking lots in 2007. There were no hotels acquired in 2008. The acquisitions have been accounted for under the purchase method and accordingly, the results of operations of each of the hotels since the dates of acquisition have been included in the consolidated statement of income. The following table details the acquisitions and the purchase price allocations:

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

4 Hotel acquisitions (continued)

	2007								
Hotel	**Super 8**	**Super 8**	**Super 8**	**Staff House**	**Super 8**	**Super 8 Parking Lot**	**Sorrentino's Restaurant**	**Holiday Inn Express**	**Holiday Inn Express**
Location	**High Level, AB**	**Whitecourt, AB**	**Fort Nelson, BC**	**Fort Nelson, BC**	**Fort St. John, BC**	**Fort St. John, BC**	**Grande Prairie, AB**	**Kamloops, BC**	**Myrtle Beach, South Carolina US**
Date of acquisition	**June 22**	**June 22**	**June 22**	**June 22**	**June 22**	**June 22**	**June 22**	**September 12**	**November 2**
	$	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**
Assets acquired									
Land	500,000	420,000	1,950,000	75,000	1,600,000	1,000,000	-	1,500,000	1,047,200
Buildings	9,464,523	7,894,958	15,683,294	250,000	9,538,712	-	-	8,741,235	6,532,725
Furniture, fixtures and equipment	810,000	590,000	1,420,000	-	930,000	-	399,043	800,000	542,640
Paving	167,516	94,585	233,145	-	359,120	-	-	150,000	95,200
Signage	50,000	50,000	50,000	-	50,000	-	-	30,000	28,560
Computer equipment	25,794	8,991	44,844	-	27,262	-	-	31,584	33,320
Vehicles	-	-	50,139	-	49,835	-	-	-	-
Vehicle loans assumed	-	-	(48,072)	-	(46,468)	-	-	-	-
Assets under capital lease	26,689	59,319	47,230	-	40,459	-	10,787	-	-
Obligations under capital leases assumed	(17,219)	(62,774)	(35,939)	-	(32,231)	-	(9,830)	-	-
Franchise fees	35,162	17,581	39,557	-	40,216	-	-	35,933	-
Agreements	37,535	27,340	65,802	-	43,095	-	-	-	-
Working capital	-	-	-	-	-	-	-	11,248	2,755
	11,100,000	9,100,000	19,500,000	325,000	12,600,000	1,000,000	400,000	11,300,000	8,282,400
Financed by									
Cash	10,069,000	8,254,766	17,688,784	294,813	11,429,676	1,000,000	400,000	11,300,000	3,925,411
Mortgage assumed	-	-	-	-	-	-	-	-	4,356,989
Issuance of REIT or LP units	1,031,000	845,234	1,811,216	30,187	1,170,324	-	-	-	-
	11,100,000	9,100,000	19,500,000	325,000	12,600,000	1,000,000	400,000	11,300,000	8,282,400

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

5 Loans receivable from related parties

The REIT has a $6.35 million loan, advanced February 1, 2008 receivable from Pacrim Hospitality Services Inc., a company in which a member of management and trustee has a significant ownership interest. The loan is unsecured, has a ten-year term, is repayable at any time without penalty and bears interest at 13% per annum during the first six months of the term and at the lesser of 13% and the trailing three-month yield plus 1% on Holloway's units thereafter.

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

6 Mezzanine loans receivable

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

	2008 $	2007 $
Winport Developments Limited Partnership, a related party, and Pacrim North York Limited Partnership, principal balance due November 3, 2011, with $8.0 million bearing interest at 12% and $1.5 million bearing interest at 11% (note 24)	9,500,000	9,500,000
Winport Development Limited Partnership, a related party, and Pacrim North York Limited Partnership, principal balance due January 13, 2009, bearing interest at 12% (note 24)	1,250,000	–
RegWin Hotel Ltd., principal balance due January 19, 2012[1], bearing interest at 12%, repaid on February 5, 2009	3,000,000	3,000,000
Windsor 8 Motel Limited, principal balance due January 19, 2012, bearing interest at 12%	1,913,000	1,913,000
	15,663,000	14,413,000
Less: Current portion	3,000,000	–
Less: Provision for impairment	3,000,000	–
	9,663,000	14,413,000

[1] The underlying property was sold by agreement dated October 8, 2008 and amendment dated December 12, 2008 and the loan was collected in full on February 5, 2009.

The REIT believes that the loans to Winport Development Limited Partnership and Pacrim North York Limited Partnership are impaired. The loans are in default and the REIT has issued a demand notice for payment (note 24). The loans have been written down to the estimated fair value of the REIT's underlying security. Significant judgment was exercised by management in making this estimate. As such, actual losses will differ from the estimate and the differences could be material.

7 Investments in hotel properties

On December 22, 2008, the REIT acquired beneficial equity ownership interests in nine hotels located in Canada and an assignment of $680,000 in cash proceeds from Winport Developments Limited Partnership, a related party at the exchange amount of $3.55 million. The equity ownership percentages range from 2.52% to 19.06%. The investments are accounted for using the cost method. As part of the transaction, Winport Developments Limited Partnership assigned its right to receive $680,000 in proceeds from the sale of Winport Developments Limited Partnership's equity ownership interest in RegWin Hotel Partnership to the REIT. The $680,000 was received on December 23, 2008. The cost of the investments has been reduced by $183,279 representing the discount on one of the promissory notes used to finance the purchase of these investments (note 12).

8 Property and equipment

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

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

Amortization expense for the year ended December 31, 2008 was $13,086,374 (2007 - $8,376,030).
As at December 31, 2008, the REIT held assets under capital leases with a cost of $1,813,125 (2007 - $1,462,950) and accumulated amortization of $514,495 (2007 - $181,930).

All of the hotel properties have been pledged as security for first mortgages (note 11) or undrawn lines of credit.

9 Other assets

			2008
	Cost **$**	**Accumulated amortization** **$**	**Net** **$**
Agreements	500,000	148,748	351,252
Franchise fees	930,776	186,511	744,265
Other	31,500	3,073	28,427
	1,462,276	338,332	1,123,944

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

10 Obligations under capital leases

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

	2008 **$**	**2007** **$**
Present value of future minimum lease payments	866,381	888,420
Less: Current portion	338,249	369,039
	528,132	519,381

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

	$
Year ending December 31, 2009	412,378
2010	327,134
2011	143,957
2012	85,557
2013	20,575
Thereafter	20,528
Future minimum lease payments at	1,010,129
Less: Amounts representing interest at a weighted average rate of 10.55%	143,748
Present value of future minimum lease payments	866,381

11 Mortgages and loans payable

	2008 $	2007 $
Mortgages payable, bearing interest at a weighted average rate of 6.76% (2007 - 6.76%) and maturing on various dates from April, 2010 to July, 2017. Individual first charges on most of the hotel properties have been pledged as security for individual mortgages	165,919,967	169,199,091
Vehicle loans payable, bearing interest at a weighted average rate of 7.62% (2007 - 7.62%) and maturing on various dates from April, 2010 to April, 2011	98,834	163,090
	166,018,801	169,362,181
Less: Deferred finance fees	1,197,792	1,399,648
Less: Current portion	5,155,110	4,359,149
	159,665,899	163,603,384

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

	$
Year ending December 31, 2009	5,155,110
2010	13,915,833
2011	36,498,737
2012	17,682,571
2013	2,919,403
Thereafter	89,847,147

12 Promissory notes payable

On December 22, 2008, the REIT issued two promissory notes for $3.0 million and $551,613, respectively, payable to Winport Developments Limited Partnership to finance the acquisition of the investments in hotel properties (note 7). The $3.0 million promissory note bears interest at 6% per year until December 22, 2011 and 12% per year, thereafter. The $551,613 note does not bear interest and therefore has been discounted by $183,279, representing the net present value of the implicit interest. The discount is being accreted to interest expense over five years, the expected term of the promissory notes. The principal of the notes are repayable on the sale of Holloway's ownership interests or the sale of the underlying properties.

13 Convertible debentures

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

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

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

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

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

	2008 **$**	**2007** **$**
Debt component	61,988,000	61,988,000
Accretion of convertible debentures	3,336,996	1,606,938
Deferred finance fees	(1,867,106)	(2,331,544)
	63,457,890	61,263,394

14 Unitholders' equity

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

Issued and outstanding units

The following presents the number of units issued and outstanding, and the related ascribed values, for the years ended December 31, 2008 and 2007:

	Number of units issued and outstanding			Ascribed value $		
	REIT Units	Class B LP Units	Total	REIT Units	Class B LP Units	Total
Balance, December 31, 2006	16,208,808	460,000	16,668,808	63,270,181	920,000	64,190,181
Exercise of options	3,334	–	3,334	18,797	–	18,797
Units issued for cash, net of issuance costs, net of tax of $1,468,000	18,338,000	–	18,338,000	94,689,048	–	94,689,048
Units issued in property acquisitions	4,143,175	–	4,143,175	22,000,000	–	22,000,000
Exchange of units	126,500	(126,500)	–	253,000	(253,000)	–
Balance, December 31, 2007	38,819,817	333,500	39,153,317	180,231,026	667,000	180,898,026
Exercise of options	26,667	–	26,667	84,268	–	84,268
Units repurchased and cancelled	(63,100)	–	(63,100)	(292,784)	–	(292,784)
Units issued to trustees	18,332	–	18,332	67,828	–	67,828
Issuance costs	–	–	–	(2,500)	–	(2,500)
Balance, December 31, 2008	38,801,716	333,500	39,135,216	180,087,838	667,000	180,754,838

Class B limited partnership units

The Class B Limited Partnership units ("exchangeable LP units") are exchangeable for units of the REIT on a one-for-one basis pursuant to an exchange agreement. Special voting units are also issued to the Class B LP holders such that the exchangeable LP units hold the economic and voting equivalent of the REIT units.

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

14 Unitholders' equity (continued)

Unit options

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

On March 5, 2008, 473,685 REIT unit options were granted to trustees and employees of the REIT and 16,182 REIT unit options were issued to employees of Pacrim Hospitality Services Inc. for services at an exercise price of $3.69 per unit expiring on March 5, 2013. These options vest over a three-year period.

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

	2008	2007
Expected option life	5 years	5 years
Risk-free interest rate	3.75%	4.5%
Dividend yield	10.0%	9.0%
Expected volatility	35%	35%

Option activity for the year ended December 31, 2008 and 2007 was as follows:

	2008		2007	
	Number	Weighted average exercise price $	Number	Weighted average exercise price $
Outstanding, beginning of year	863,666	4.16	805,000	4.11
Granted	489,867	3.69	62,000	4.88
Exercised	(26,667)	1.00	(3,334)	4.88
Forfeited	(24,610)	4.88	–	
Outstanding, end of year	1,302,256	4.04	863,666	4.16

The weighted average grant-date fair value of options granted during 2008 and 2007 was $0.38 and $0.76 per option.

14 Unitholders' equity (continued)

The following table summarizes information about options outstanding and exercisable at December 31, 2008:

Weighted average exercise price per unit $	Number outstanding	Weighted average exercise price per unit $	Weighted average remaining contractual life (years)	Number exercisable
1.00	133,333	1.00	2.1	133,333
4.88	681,666	4.88	2.9	671,666
3.69	487,257	3.69	4.2	162,419
	1,302,256			967,418

Weighted average number of units

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

	2008 (units)	2007 (units)
Basic	39,132,025	28,643,005
Diluted	39,132,025	28,760,887

15 Supplemental cash flow information

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

	2008 $	2007 $
Accounts receivable	(58,620)	(2,281,518)
Inventories	124,493	(86,396)
Prepaid expenses and deposits	629,961	(1,336,093)
Accounts payable and accrued liabilities	491,611	4,278,156
	1,187,445	574,149

Cash and cash equivalents are comprised of the following:

	2008 $	2007 $
Cash on hand and balances with banks	4,991,951	22,894,439

Non-cash transaction

During the year, accrued trustee fees of $67,828 were settled by the issuance of units.

16 Agreements

Hotel Management Agreement

Pacrim Hospitality Services Inc.

On June 7, 2006, Holloway Lodging REIT entered into a long-term management agreement with Pacrim Hospitality Services Inc. (“PHSI”), a related party, to manage the hotels purchased by the REIT, with an initial term of ten years and an automatic renewal for successive five year terms commencing on the last day of the initial term. PHSI is entitled to a base management fee of 3% of gross hotel revenues, an incentive fee commencing January 1, 2007, calculated as tiered percentages of the amount by which the REIT exceeds its budgeted distributable income for the year, a purchasing fee of 4% of the cost of exceptional operating supplies and furniture, fixtures and equipment, a construction fee of 3% of the cost of construction materials, labour and equipment in connection with any construction or capital expenditures and an accounting fee ranging from $20,000 to $35,400 per year per hotel depending on the size of the hotel when accounting services are provided by PHSI. In addition, Intergy, a division of PHSI, provides central reservation services for the hotels purchased by the REIT. A commission of 10% is paid on reservations made through Intergy.

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

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 that were paid to Pomeroy in consideration of the assignment (note 5).

Development Agreement

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

16 Agreements (continued)

Non-competition, Right of First Opportunity and Participation Agreement

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

17 Commitments

Lease revenue

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

	$
For the year ending December 31, 2009	857,772
2010	842,202
2011	674,706
2012	464,653
2013	240,632

Franchise agreements

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

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

17 Commitments (continued)

Operating leases

The REIT has various equipment operating leases at several properties.

The REIT also has a long-term ground lease on the 5 Calgary Downtown Suites and Spa Hotel ("5 Calgary"). The ground lease expires on June 24, 2064. The amount of the annual ground lease payment varies with gross revenues and expenses. The minimum ground lease payments are $10,255 per month until June 24, 2015. For the two periods beginning June 24, 2015 and June 24, 2040, the minimum annual ground lease payment will be adjusted based on the fair market value of the related land, free and unencumbered on those dates. The REIT is required to pay an annual ground lease participation liability related to the ground lease for 5 Calgary, which is equal to 25% of 5 Calgary's annual gross revenue reduced by property tax expense, the minimum ground lease payments for the year and an allowable deduction of 20% of gross revenues. The total ground lease expense, including the minimum ground lease payments and the ground lease participation liability, recorded for 2008 and 2007 was $2,333,114 and $2,274,655, respectively.

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

	Operating leases $	Land lease $	Total $
Year ending December 31, 2009	92,507	123,060	215,567
2010	62,679	123,060	185,739
2011	34,376	123,060	157,436
2012	17,030	123,060	140,090
2013	1,656	123,060	124,716

18 Related party transactions

The below details the related party transactions not previously disclosed in these financial statements, including amounts received or receivable, paid or payable and year-end balances.

	2008 $	2007 $
Pacrim Hospitality Services Inc., a company in which a member of management and trustee has a significant ownership interest		
Hotel management fees	2,297,181	1,350,105
Accounting fees	227,473	131,133
Reimbursable general and administrative expenses	52,468	38,993
Sales fees	145,841	–
Purchasing fees	31,965	–
Head office rent	98,240	30,000
Reimbursable expenses related to hotels purchased from Pomeroy	685,266	–
Interest income on loan receivable	759,912	–
Capital purchasing fees and project management fees capitalized to property and equipment	119,724	–
Distributions paid or payable on Class B limited partnership units	27,888	–
Intergy, a division of Pacrim Hospitality Services Inc.		
Reservation services commissions	430,176	152,851
Website development fees, capitalized	17,150	64,696
Website maintenance expenses	16,470	21,565
Included in accounts receivable	143,991	28,462
Included in accounts payable and accrued liabilities	443,056	169,260
Winport Developments Limited Partnership, a limited partnership in which a member of management and trustee and another trustee have ownership interests		
Interest income on mezzanine loans	1,170,492	1,026,223
Included in accounts receivable	511,066	93,950
Winport Developments Inc., a company in which a member of management and trustee has a significant ownership interest		
Renovations and project management fees capitalized to property and equipment	36,938	2,202,856
Interest income on loan	17,480	8,812
Included in accounts payable and accrued liabilities	4,394	1,485

19 Capital management

The REIT defines capital as the aggregate of unitholders' equity and interest-bearing debt. The objectives of the REIT's capital management program are to maintain a level of capital that complies with the investment and debt restrictions according to the REIT's Declaration of Trust, complies with existing debt covenants, provides a return to unitholders by delivering monthly cash distributions, optimizes the cost of capital, funds its business strategies and builds long-term unitholder value.

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

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

- a Debt Service coverage ratio defined as earnings before interest, income taxes, depreciation, amortization, non-cash accretion of deferred finance fees and unit-based compensation (Earnings base) to mortgage, loans and capital lease interest and principal payments (Debt Service); and

- a Debt to Gross Book Value (Debt to GBV) ratio defined as mortgages and loans payable, obligations under capital leases and the face value of convertible debentures (Debt) divided by total assets plus accumulated depreciation and amortization (GBV). This ratio cannot exceed 60% based on the REIT's Declaration of Trust.

19 Capital management (continued)

	2008 $	2007 $
Capital structure		
Obligations under capital leases	866,381	888,420
Mortgages and loans payable	164,821,009	167,962,533
Convertible debentures	63,457,890	61,263,394
Promissory notes	3,368,334	–
Total debt	232,513,614	230,114,347
Unitholders' equity	150,094,424	173,805,550
Total capital	382,608,038	403,919,897
Ratios		
Total debt	232,513,614	230,114,347
Adjustment of convertible debentures to face value	8,624,110	10,818,606
Adjustment of promissory notes to face value	183,279	–
Debt	241,321,003	240,932,953
Gross book value	416,447,047	425,005,102
Debt to GBV	57.9%	56.7%

	2008 $	2007 $
Earnings base	32,019,577	22,712,699
Debt service	21,093,105	14,011,587
Debt service ratio	1.52	1.62

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

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

20 Financial instruments

i) Fair value of financial instruments

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

The fair value of the REIT's, obligations under capital leases and mortgages and loans payable is based on discounted future cashflows using discount rates that reflect current market conditions for instruments with similar terms and risks. The fair values do not necessarily represent amounts the REIT might pay in actual market transactions. The fair value of the convertible debentures is the trading value at December 31, 2008 and 2007.

		2008 $		**2007 $**
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Held for trading (cash, restricted cash and capital reserve)	10,173,481	10,173,481	27,626,988	27,626,988
Loans and receivables (accounts receivable)	3,887,113	3,887,113	3,828,493	3,828,493
Other financial liabilities (accounts payable and accrued liabilities, distributions payable and accrued interest)	10,778,164	10,778,164	11,296,413	11,296,413
Obligations under capital leases	866,381	866,381	888,420	888,420
Mortgages and loans payable	164,821,001	179,289,428	167,962,533	167,962,533
Convertible debentures	73,054,115	43,832,469	70,859,619	68,358,274

ii) Risk management

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

20 Financial instruments (continued)

Interest rate risk

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

At December 31, 2008, the REIT had no long-term debt at floating rates and thus, for the year ended December 31, 2008, a 1% change in interest rates would not change the net income (loss).

Credit risk

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

The amount of accounts receivable disclosed in the balance sheet of $3,887,113 is net of allowances for bad debts, estimated by management based on prior experience and their assessment of the current economic environment.

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

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

	2008 **$**	**2007** **$**
Accounts receivable under 30 days aged	2,111,945	2,110,453
Accounts receivable over 30 days aged	1,860,410	1,774,964
Less: Allowance for doubtful accounts	(85,242)	(56,924)
	3,887,113	2,828,493

The REIT is exposed to credit risk on its loans receivable from related parties and mezzanine loans receivable. The mezzanine loans are secured by a second or third charge on the property. Management reviews the results and cashflows of these entities on a monthly basis and will take steps to enforce its security when this is deemed appropriate. See subsequent events note 24.

20 Financial instruments (continued)

Currency risk

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

Liquidity risk

The REIT's objective is to have sufficient liquidity to meet liabilities when due, as well as to maintain compliance with liquidity covenants on financing contracts and its capital management requirements and objectives. At December 31, 2008, the RIET had undrawn lines of credit of $9.5 million. In November 2008, distributions were reduced to $0.0175 per unit per month ($0.21 per unit annually) in order to conserve cash and satisfy its operating obligations, including principal repayments. The REIT monitors and forecasts its cash balances and cash flows generated from operations to meet its requirements. Based on overall cash generation capacity and overall financial position, while there can be no assurance, management believes the REIT will be able to meet financial obligations as they come due while maintaining compliance with all financial covenants.

21 Income taxes

The following table reconciles the expected income taxes payable (recoverable) at the statutory income tax rate to the amounts recognized in the consolidated statements of income and comprehensive income for the years ended December 31, 2008 and 2007:

	2008 **$**	**2007** **$**
Income before income taxes	(4,789,470)	933,036
Income tax rate	32.5%	35.12%
	(1,557,000)	328,000
Future taxes resulting from a change in tax status with the enactment of Bill C-52	–	(937,000)
Non-deductible stock option expense	153,000	170,000
Non-deductible foreign exchange losses	476,000	33,000
Non-deductible unrealized loan impairment	488,000	–
Accretion of discount on convertible debentures	562,000	409,000
Impact of rate change	–	(626,000)
Other permanent differences	169,000	36,000
	291,000	(587,000)

21 Income taxes (continued)

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and future income tax liabilities at December 31, 2008 and 2007 that are expected to reverse in the future are presented below:

	2008 $	2007 $
Future income tax assets		
Unit issuance costs, finance fees and related	1,656,000	3,854,000
Tax losses carried forward	3,524,000	2,047,000
Other	235,000	244,000
	5,415,000	6,145,000
Future income tax liabilities		
Property and equipment – differences in net book value and undepreciated capital cost	3,651,000	3,811,000
Other	–	279,000
	3,651,000	4,090,000
Net future income tax asset	1,764,000	2,055,000

	2008 $	2007 $
Recovery of future income taxes is comprised of:		
Future income taxes related to the substantive enactment of Bill C-52	–	937,000
Future income taxes related to the changes in the taxation rate	–	626,000
Future income taxes related to income and permanent differences	185,000	(976,000)
Non-exchange foreign exchange translation loss	(476,000)	–
	(291,000)	587,000

22 Seasonality

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

23 Segmented information

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

Geographical information

	2008 $	2007 $
Revenues		
Canada	91,171,649	69,567,495
United States	2,323,000	183,142
	93,494,649	69,750,637
Property and equipment		
Canada	343,811,909	354,088,628
United States	8,223,281	8,459,531
	352,035,190	362,548,159

24 Subsequent events

On February 5, 2009, the mezzanine loan receivable from RegWin Hotel Ltd. of $3.0 million was repaid in full.

On February 20, 2009, the solicitors of the REIT issued a demand letter, on behalf of the REIT, to Winport Developments Limited Partnership, Pacrim North York Limited Partnership and 2113047 Ontario Inc. for payment of approximately $11.5 million, representing the principal, interest owed on the mezzanine loans receivable and legal fees. The mezzanine loans are in default and the borrower had until March 2, 2009 to make payment to the REIT.

Payment was not received and the REIT is determining its next steps to enforce its security.