

Holloway Lodging Real Estate Investment Trust

Consolidated Financial Statements
December 31, 2009 and 2008

March 9, 2010

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) "*W. Glenn Squires*"
Chief Executive Officer

(signed) "*Tracy Sherren*"
Chief Financial Officer

March 9, 2010

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, 2009 and 2008 and the consolidated statements of unitholders' equity, operations and comprehensive loss and cash flows for the years ended December 31, 2009 and 2008. 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, 2009 and 2008 and the results of its operations and its cash flows for the years ended December 31, 2009 and 2008 in accordance with Canadian generally accepted accounting principles.

(signed) "*PricewaterhouseCoopers LLP*"

Chartered Accountants

Holloway Lodging Real Estate Investment Trust

Consolidated Balance Sheets

As at December 31, 2009 and 2008

(in thousands of dollars)

	2009 \$	2008 \$
Assets		
Current assets		
Cash and cash equivalents (note 14)	3,756	4,992
Capital reserve	912	1,553
Restricted cash	560	654
Accounts receivable	2,438	3,376
Inventories	280	303
Prepaid expenses and deposits	4,479	2,239
Current portion of mezzanine loans receivable (note 5)	—	3,000
Assets of discontinued operations (note 15)	717	—
	13,142	16,117
Capital reserve – restricted	4,691	2,975
Loans receivable from related parties (note 4)	6,509	6,509
Mezzanine loans and advances receivable (note 5)	—	10,174
Investments in hotel properties (note 6)	1,961	2,688
Property and equipment (note 7)	326,465	352,035
Other assets (note 8)	877	1,124
Future income taxes (note 21)	4,566	1,764
	358,211	393,386
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	7,856	9,419
Distributions payable	—	685
Accrued interest on convertible debentures	675	675
Current portion of obligations under capital leases (note 9)	285	338
Current portion of mortgages and loans payable (note 10)	4,953	5,155
Liabilities of discontinued operations (note 15)	638	—
	14,407	16,272
Obligations under capital leases (note 9)	222	528
Mortgages and loans payable (note 10)	148,530	159,666
Promissory notes payable (note 11)	3,405	3,368
Convertible debentures (note 12)	65,935	63,458
	232,499	243,292
Unitholders' Equity	125,712	150,094
	358,211	393,386

Commitments (note 17)

Approved by the Trustees

(signed) _____

(signed) _____

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Unitholders' Equity

As at December 31, 2009 and 2008

(in thousands of dollars)

	Units \$ (note 13)	Class B LP units \$ (note 13)	Contributed surplus \$	Equity component of convertible debentures \$	Accumulated income (losses) \$	Accumulated distributions \$	Total \$
Balance, December 31, 2007	180,231	667	805	9,596	312	(17,806)	173,805
Unit-based compensation related to options	–	–	472	–	–	–	472
Exercise of options	84	–	(58)	–	–	–	26
Units repurchased and cancelled	(293)	–	76	–	–	–	(217)
Issuance costs	(2)	–	–	–	–	–	(2)
Units issued to trustees (note 14)	68	–	–	–	–	–	68
Net loss	–	–	–	–	(5,080)	–	(5,080)
Distributions	–	–	–	–	–	(18,978)	(18,978)
Balance, December 31, 2008	180,088	667	1,295	9,596	(4,768)	(36,784)	150,094
Unit-based compensation related to options	–	–	64	–	–	–	64
Net loss	–	–	–	–	(20,337)	–	(20,337)
Distributions	–	–	–	–	–	(4,109)	(4,109)
Balance, December 31, 2009	180,088	667	1,359	9,596	(25,105)	(40,893)	125,712

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Operations and Comprehensive Loss

For the years ended December 31, 2009 and 2008

(in thousands of dollars except per unit amounts)

	2009 \$	2008 \$
Hotel revenues		
Rooms	61,837	77,063
Other	10,148	12,269
	<u>71,985</u>	<u>89,332</u>
Hotel expenses		
Operating expenses	46,236	52,544
Property taxes and insurance	4,627	4,842
Management fees	1,810	2,315
	<u>52,673</u>	<u>59,701</u>
Hotel operating income	<u>19,312</u>	<u>29,631</u>
Other (income) expenses		
Interest on mortgages and other debt	10,997	11,107
Interest on convertible debentures	4,989	5,022
Accretion on convertible debentures, mortgages and deferred financing fees	2,578	2,162
Corporate and administrative	2,173	2,844
Interest income	(739)	(2,802)
Unrealized foreign exchange loss (gain)	(737)	1,020
Depreciation and amortization	12,969	12,770
Provision for impairment of mezzanine loans and advances	11,059	3,000
Provision for impairment of investments in hotel properties	1,011	-
	<u>44,300</u>	<u>35,123</u>
Loss before income taxes from continuing operations	(24,988)	(5,492)
Provision for (recovery of) future income taxes (note 21)	(3,056)	65
Loss from continuing operations	(21,932)	(5,557)
Income from discontinued operations (note 15)	1,595	477
Net loss and comprehensive loss for the years	<u>(20,337)</u>	<u>(5,080)</u>
Loss per unit (note 13)		
Basic	(0.52)	(0.13)
Diluted	(0.52)	(0.13)

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Cash Flows

For the years ended December 31, 2009 and 2008

(in thousands of dollars)

	2009 \$	2008 \$
Cash provided by (used in)		
Operating activities		
Net loss and comprehensive loss from continuing operations for the years	(21,932)	(5,557)
Charges (credits) to income not involving cash		
Unit-based compensation	64	471
Depreciation and amortization	12,969	12,770
Accretion of mortgages and convertible debentures	2,578	2,162
Unrealized foreign exchange loss (gain)	(737)	1,020
Provision for impairment of mezzanine loans and advances	11,059	3,000
Provision for impairment of investments in hotel properties	1,011	-
Provision for (recovery of) future income taxes	(3,056)	65
	1,956	13,931
Net change in non-cash working capital balances related to operations (note 14)	(2,719)	1,055
Cash flow from discontinued operations	1,120	1,346
Cash flow from operating activities	357	16,332
Investing activities		
Decrease (increase) in restricted cash	93	1,669
Increase in capital reserves, continuing operations	(1,260)	(2,067)
Issuance of loan to a related party	-	(6,350)
Issuance of mezzanine loans and advances	(885)	(1,250)
Proceeds from repayment of mezzanine loan	3,000	-
Investments in hotel properties	(283)	680
Additions to property and equipment, continuing operations	(1,422)	(1,951)
Increase in other assets, continuing operations	-	(34)
Increase in other assets, discontinued operations	-	(5)
Additions to property and equipment, discontinued operations	(123)	(89)
Decrease (increase) in capital reserve, discontinued operations	99	(51)
Proceeds from sale of property, discontinued operations	15,636	-
Increase in capital reserve, discontinued operations	(585)	-
Cash flow from (used in) investing activities	14,270	(9,448)
Financing activities		
Repayment of capital lease obligations	(350)	(403)
Proceeds from mortgages and loans, net of financing fees, continuing operations	1,040	(48)
Repayment of mortgages and loans payable, continuing operations	(4,589)	(3,806)
Issuance costs	-	(2)
Units repurchased and cancelled	-	(216)
Exercise of options	-	27
Distributions paid to unitholders	(4,794)	(20,055)
Repayment of mortgages and capital leases, discontinued operations	(7,140)	(283)
Cash flow used in financing activities	(15,833)	(24,786)
Net change in cash and cash equivalents during the years	(1,206)	(17,902)
Cash and cash equivalents, continuing operations – Beginning of periods	4,860	22,755
Cash and cash equivalents, discontinued operations – Beginning of periods	132	139
	4,992	22,894
Cash and cash equivalents, continuing operations – End of periods	3,756	4,860
Cash and cash equivalents, discontinued operations – End of periods	30	132
	3,786	4,992

Supplemental cash flow information (note 14)

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

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

As at December 31, 2009, the REIT owned 20 hotels in Canada and 1 hotel in the United States with 2,320 guest rooms and suites and held minority ownership interests in eight other hotels.

2 Changes in accounting policies

In the first quarter of 2009, the REIT adopted the following new Handbook Sections issued by the Canadian Institute of Chartered Accountants (“CICA”).

Goodwill and intangible assets

Section 3064, Goodwill and Intangible Assets, establishes 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. These new standards have no impact on the REIT’s 2009 financial statements.

Financial instruments

In June 2009, the Canadian Accounting Standards Board (“AcSB”) issued amendments to Section 3862, Financial Instruments – Disclosures, to require enhanced disclosures about the relative reliability of the data, or “inputs”, that an entity uses in measuring the fair values of its financial instruments. The new requirements are effective for annual financial statements for fiscal years ending after September 30, 2009. The additional disclosures are included in note 20.

Credit risk and fair value of financial assets and financial liabilities

On January 20, 2009, the Emerging Issues Committee (“EIC”) of the AcSB issued EIC Abstract 173, Credit Risk and Fair Value of Financial Assets and Liabilities, which establishes guidance requiring an entity to consider its own credit risk as well as the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities, including derivative instruments. This interpretation must be applied retrospectively without restatement of prior years. The adoption of this interpretation did not have a significant impact on the REIT’s 2009 financial statements.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

3 Significant accounting policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) 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 eight hotel partnerships or co-tenancies ranging from 2.52% to 19.06%. The investments are accounted for using the cost method. When there has been a loss in value that is other than a temporary decline, an impairment loss is recognized.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

3 Significant accounting policies (continued)

f) Property and equipment

Property and equipment, including land, buildings, 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 loans 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.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

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.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

3 Significant accounting policies (continued)

m) Earnings per unit

Basic earnings per unit are 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.

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.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

3 Significant accounting policies (continued)

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:

- Cash and cash equivalents are classified as “Financial Assets Held-for-Trading”. These financial assets are marked-to-market through net income at each period end.
- Accounts receivable, 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.

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 currency 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 OCI is not presented as a category of unitholders’ equity.

q) Management estimates

The presentation of financial statements in accordance with GAAP 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. Significant estimates are required in the determination of future cash flows and probabilities in assessing the recoverability of hotel properties and other long-term assets, the valuation of mezzanine loans and advances receivable, the determination of useful lives for depreciation and amortization purposes, the fair value of financial instruments for disclosure purposes, the value of conversion options in convertible debentures, the value of unit options and the determination of future income tax assets and liabilities. Actual results could differ from these estimates.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

3 Significant accounting policies (continued)

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.

Future changes to Canadian GAAP

Business Combinations, Consolidated Financial Statements and Non-Controlling Interests

The CICA has issued new accounting standards, Section 1582 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 ("IFRS"). 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 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.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

4 Loans receivable from related parties

The REIT has a \$6,350 loan 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, is due on February 1, 2018, is repayable 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 has declined to 0% with the suspension of distributions, the interest rate became 1% on October 1, 2009.

The REIT has a \$159 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.

5 Mezzanine loans and advances receivable

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

	2009 \$	2008 \$
Winport Developments Limited Partnership, a related party, and Pacrim North York Limited Partnership, principal balance due November 3, 2011, with \$8,000 million bearing interest at 12% and \$1,500 million bearing interest at 11%	9,500	9,500
Winport Developments Limited Partnership, a related party, and Pacrim North York Limited Partnership, principal balance due January 13, 2009, bearing interest at 12%	1,250	1,250
Accrued interest on loans to Winport Developments Limited Partnership and Pacrim North York Limited Partnership to December 31, 2008	504	511
Additional advances to Winport Developments Limited Partnership and Pacrim North York Limited Partnership, non-interest bearing with no set terms of repayment and other expenses	852	—
RegWin Hotel Ltd., principal balance due January 19, 2012, bearing interest at 12%, repaid on February 5, 2009	—	3,000
Windsor 8 Motel Limited, principal balance due January 19, 2012, bearing interest at 12%	1,913	1,913
Additional advances to Windsor 8 Motel Limited, non-interest bearing with no set terms of repayment	40	—
	<hr/> 14,059	<hr/> 16,174
Less: Current portion	—	3,000
Less: Provision for impairment	<hr/> 14,059	<hr/> 3,000
	<hr/> —	<hr/> 10,174

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

5 Mezzanine loans and advances receivable (continued)

The REIT believes that the loans and advances to Winport Developments Limited Partnership and Pacrim North York Limited Partnership are impaired. The loans are in default and the REIT issued a demand notice for payment on February 20, 2009. On August 6, 2009, a court-appointed receiver on behalf of the first mortgagee for the property was named, with a mandate to sell the property and maximize the return to the debt-holders. The REIT's loans have been written down to zero as the REIT does not expect to realize on its security.

The REIT believes that the loans and advances to Windsor 8 Motel Limited are impaired. The loan is in default. The REIT is progressing with a quit claim to acquire the property in 2010. As the appraised value of the property is approximately equal to the first mortgage debt on the property, the REIT's mezzanine loan has been written down to zero.

During the year ended December 31, 2009, the REIT recorded an additional provision for impairment of \$11,059 (2008 - \$3,000).

6 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 in cash proceeds from Winport Developments Limited Partnership, a related party, at the exchange amount of \$3,552. 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 in proceeds from the sale of Winport Developments Limited Partnership's equity ownership interest in RegWin Hotel Partnership to the REIT. The \$680 was received on December 23, 2008. The cost of the investments has been reduced by \$183, representing the discount on one of the promissory notes used to finance the purchase of these investments (note 11).

The REIT has recorded a provision for impairment of \$549 against its investment in the Super 8 in Langley, BC, which represents the total cost of this investment.

In addition, the REIT wrote off its investment of \$462 in the Super 8 in Midland, ON, as it has relinquished its ownership interest in this hotel.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

7 Property and equipment

	2009		
	Cost	Accumulated	Net
	\$	amortization	\$
	\$	\$	\$
Land	29,217	—	29,217
Land lease	500	42	458
Buildings	294,179	20,002	274,177
Renovations in progress	684	—	684
Furniture, fixtures and equipment and other	29,403	11,450	17,953
Paving	3,315	875	2,440
Landscaping	18	2	16
Signage	1,122	252	870
Computer equipment and websites	1,799	1,388	411
Vehicles	353	259	94
Tenant inducements	212	67	145
	360,802	34,337	326,465

	2008		
	Cost	Accumulated	Net
	\$	amortization	\$
	\$	\$	\$
Land	32,217	—	32,217
Land lease	500	30	470
Buildings	304,905	13,283	291,622
Renovations in progress	221	—	221
Furniture, fixtures and equipment and other	29,941	7,550	22,391
Paving	3,619	644	2,975
Landscaping	23	2	21
Signage	1,008	173	835
Computer equipment and websites	1,759	870	889
Vehicles	353	146	207
Tenant inducements	212	25	187
	374,758	22,723	352,035

Amortization expense for the year ended December 31, 2009 was \$12,759 (2008 - \$13,086).

As at December 31, 2009, the REIT held assets under capital leases with a cost of \$1,798 (2008 - \$1,813) and accumulated amortization of \$853 (2008 - \$514).

All of the hotel properties have been pledged as security for first mortgages (note 10) or undrawn lines of credit.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

8 Other assets

	2009		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	\$
Agreements	500	250	250
Franchise fees	854	227	627
	<u>1,354</u>	<u>477</u>	<u>877</u>
	2008		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	\$
Agreements	500	149	351
Franchise fees	931	186	745
Other	31	3	28
	<u>1,462</u>	<u>338</u>	<u>1,124</u>

9 Obligations under capital leases

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

	2009	2008
	\$	\$
Present value of future minimum lease payments	507	866
Less: Current portion	<u>285</u>	<u>338</u>
	<u>222</u>	<u>528</u>

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

	\$
Year ending December 31, 2010	324
2011	147
2012	84
2013	10
2014	—
Thereafter	<u>—</u>
Future minimum lease payments	565
Less: Amounts representing interest at a weighted average rate of 10.33%	<u>58</u>
Present value of future minimum lease payments	<u>507</u>

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

10 Mortgages and loans payable

	2009 \$	2008 \$
Mortgages payable, bearing interest at a weighted average rate of 6.82% (2008 - 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	154,446	165,920
Vehicle loans payable, bearing interest at a weighted average rate of 7.66% (2008 - 7.62%) and maturing on various dates from April, 2010 to April, 2011	39	99
	<hr/> 154,485	<hr/> 166,019
Less: Deferred finance fees	1,002	1,198
Less: Current portion	4,953	5,155
	<hr/> 148,530	<hr/> 159,666

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

	\$
Year ending December 31, 2010	4,953
2011	30,360
2012	19,187
2013	3,315
2014	3,543
Thereafter	93,127

11 Promissory notes payable

On December 22, 2008, the REIT issued two promissory notes for \$3,000 and \$552, respectively, payable to Winport Developments Limited Partnership to finance the acquisition of the investments in hotel properties (note 6). The \$3,000 promissory note bears interest at 6% per year until December 22, 2011 and 12% per year, thereafter. The \$552 note does not bear interest and therefore has been discounted by \$183, 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.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

12 Convertible debentures

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

On June 21, 2007, the REIT issued \$45,000 in convertible, redeemable debentures. The debentures bear interest at 6.5%, payable semi-annually on June 30th and December 31st and mature in five years. The convertible debentures can be converted into units of the REIT at \$6.15 per unit at any time commencing two years and one day from the issuance date and ending on the date that is 15 days prior to the maturity date. On July 18, 2007, the REIT issued an additional \$6,844 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 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 units calculated by dividing the aggregate principal amount by 95% of the current market price of the units on the maturity date.

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 on the August 1, 2006 8% debentures, \$4,150 on the June 21, 2007 6.5% debentures and \$644 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.

	2009	2008
	\$	\$
Debt component	61,988	61,988
Accretion of convertible debentures	5,295	3,337
Deferred finance fees	(1,348)	(1,867)
	<u>65,935</u>	<u>63,458</u>

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

13 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, 2009 and 2008:

	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, 2007	38,819,817	333,500	39,153,317	180,231	667	180,898
Exercise of options	26,667	—	26,667	84	—	84
Units repurchased and cancelled	(63,100)	—	(63,100)	(293)	—	(293)
Units issued to trustees	18,332	—	18,332	68	—	68
Issuance costs	—	—	—	(2)	—	(2)
Balance, December 31, 2008	<u>38,801,716</u>	<u>333,500</u>	<u>39,135,216</u>	<u>180,088</u>	<u>667</u>	<u>180,755</u>
Balance, December 31, 2009	<u>38,801,716</u>	<u>333,500</u>	<u>39,135,216</u>	<u>180,088</u>	<u>667</u>	<u>180,755</u>

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.

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.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

13 Unitholders' equity (continued)

Unit options (continued)

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

Option activity for the years ended December 31, 2009 and 2008 was as follows:

	2009		2008	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Outstanding, beginning of year	1,302,256	4.04	863,666	4.16
Granted	—	—	489,867	3.69
Exercised	—	—	(26,667)	1.00
Forfeited	—	—	(24,610)	4.88
Outstanding, end of year	1,302,256	4.04	1,302,256	4.04

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

The following table summarizes information about options outstanding and exercisable at December 31, 2009:

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	1.1	133,333
4.88	681,666	4.88	1.9	681,666
3.69	487,257	3.69	3.2	324,838
	1,302,256			1,139,837

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

13 Unitholders' equity (continued)

Weighted average number of units

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

	2009 (units)	2008 (units)
Basic	39,135,216	39,132,025
Diluted	39,135,216	39,132,025

14 Supplemental cash flow information

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

	2009 \$	2008 \$
Accounts receivable	882	(59)
Inventories	21	124
Prepaid expenses and deposits	(2,271)	630
Accounts payable and accrued liabilities	(1,351)	492
	<hr/> 2,719	<hr/> 1,187

Cash and cash equivalents are comprised of the following:

	2009 \$	2008 \$
Cash on hand and balances with banks	<hr/> 3,756	<hr/> 4,992

Non-cash transaction

During the year ended December 31, 2008, accrued trustee fees of \$68 were settled by the issuance of units.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

15 Discontinued operations

On October 5, 2009, the REIT sold the Wingate by Wyndham in Calgary, AB (the “Wingate”) for total proceeds of \$16,500. The REIT recognized a gain on the sale of \$1,474. After repayment of the mortgage and closing costs, net cash proceeds were \$8,596. The operating income from the property after July 31, 2009 accrued to the purchaser.

Accordingly, the operations of the Wingate have been included in discontinued operations on the consolidated statement of operations and comprehensive loss and are reflected as assets and liabilities of discontinued operations of the consolidated balance sheet.

Discontinued operations for the years ended December 31, 2009 and 2008 are as follows:

	<u>Years ended</u>	
	December 31, 2009	December 31, 2008
	\$	\$
Hotel revenues	2,442	4,163
Hotel expenses	1,474	2,477
	<hr/>	<hr/>
Hotel operating income	968	1,686
	<hr/>	<hr/>
Interest on mortgages and other debt and accretion of deferred financing fees	273	480
Depreciation and amortization	320	503
Gain on sale of property	(1,474)	—
	<hr/>	<hr/>
	(881)	983
	<hr/>	<hr/>
Income before income taxes	1,849	703
	<hr/>	<hr/>
Provision for future income taxes	254	226
	<hr/>	<hr/>
Income from discontinued operations	1,595	477
	<hr/>	<hr/>

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

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 \$23 to \$34 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 \$6,350 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 4).

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 LP 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 LP and used directly to repay the loan in full.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

16 Agreements (continued)

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. The agreements were terminated on March 9, 2010.

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, 2010	632
2011	460
2012	460
2013	370
2014	123

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

17 Commitments (continued)

Franchise agreements

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

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

Operating leases

The REIT has various equipment operating leases at several properties.

The REIT also has a long-term ground lease on the 5 Calgary Downtown Suites and Spa Hotel ("5 Calgary"). The ground lease expires on June 24, 2064. The amount of the annual ground lease payment varies with gross revenues and expenses. The minimum ground lease payments are \$10 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 2009 and 2008 was \$1,852 and \$2,333, respectively.

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

	Operating leases	Land lease	Total
	\$	\$	\$
Year ending December 31, 2010	77	123	200
2011	32	123	155
2012	21	123	144
2013	9	123	132
2014	4	123	127

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

18 Related party transactions

The information 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.

	2009	2008
	\$	\$
Pacrim Hospitality Services Inc., a company in which a member of management and trustee has a significant ownership interest		
Hotel management and related fees	2,523	2,754
Head office rent	108	98
Reimbursable expenses related to hotels managed under reduced fee	637	685
Interest income on loan receivable	618	760
Capital purchasing fees and project management fees capitalized to property and equipment	36	120
Distributions paid or payable on Class B limited partnership units	6	28
Intergy, a division of Pacrim Hospitality Services Inc.		
Reservation services commissions and related costs	369	463
Included in accounts receivable	-	144
Included in accounts payable and accrued liabilities	261	443
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
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	-	37
Interest income on loan	17	17
Included in accounts receivable	22	4

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

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, 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 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 mortgages, loans, promissory notes 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, promissory notes and the face value of convertible debentures (Debt) divided by total assets plus accumulated depreciation and amortization ("GBV"). The REIT's Declaration of Trust states that the REIT debt to GBV should not exceed 60%.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

19 Capital management (continued)

	2009 \$	2008 \$
Capital structure		
Obligations under capital leases	507	866
Mortgages and loans payable	153,483	164,821
Convertible debentures	65,935	63,458
Promissory notes	3,405	3,368
	<hr/>	<hr/>
Total debt	223,330	232,513
	<hr/>	<hr/>
Unitholders' equity	125,712	150,094
	<hr/>	<hr/>
Total capital	349,042	382,607
Ratios		
Total debt	223,330	232,513
Adjustment of convertible debentures to face value	6,147	8,624
Adjustment of promissory notes to face value	146	183
	<hr/>	<hr/>
Debt	229,623	241,320
	<hr/>	<hr/>
Gross book value, continuing operations	393,025	416,447
	<hr/>	<hr/>
Debt to GBV	58.4%	57.9%
	<hr/>	<hr/>
	2009 \$	2008 \$
Earnings base	18,909	32,020
Debt service	21,520	21,093
Debt service ratio	0.88	1.52

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, or has obtained waivers for all its financial covenants.

For 2008 and 2009, 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. On July 21, 2009, the REIT suspended distributions.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

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 and advances receivable, capital reserves, 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, accounts receivable, capital reserves, 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 cash flows 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, 2009 and 2008, respectively.

	2009		2008	
	\$		\$	
	Carrying value	Fair value	Carrying value	Fair value
Held for trading (cash, restricted cash and capital reserves)	9,919	9,919	10,174	10,174
Loans and receivables (accounts receivable)	2,438	2,438	3,376	3,376
Other financial liabilities (accounts payable and accrued liabilities, distributions payable and accrued interest on convertible debentures)	8,531	8,531	10,779	10,779
Obligations under capital leases	507	507	866	866
Mortgages and loans payable	153,483	152,929	164,821	179,289
Convertible debentures	75,531	44,254	73,054	43,832

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

20 Financial instruments (continued)

i) Fair value of financial instruments (continued)

Fair value hierarchy

Financial instruments recorded at fair value on the balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1: valuation based on quoted prices observed in active markets for identical assets or liabilities.
- Level 2: valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3: valuation techniques with significant unobservable market inputs.

A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value

The following table presents the financial instruments recorded at the fair value in the consolidated balance sheets, classified using the fair value hierarchy described above:

	2009			2008		
			\$			\$
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Financial assets						
Cash and cash equivalents	3,756	—	—	4,992	—	—
Capital reserves	5,603	—	—	4,528	—	—
Restricted cash	560	—	—	654	—	—

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.

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 had \$8,905 maturing on April 1, 2010, which it re-financed on March 1, 2010 at a 6.6% interest rate. The weighted average interest rate on its mortgages payable is 6.82% (December 31, 2008 - 6.76%) with a weighted average maturity of 5.4 years (December 31, 2008 - 6.2 years). The convertible debentures have a weighted average interest rate of 6.9% (December 31, 2008 - 6.9%) and a weighted average maturity of 2.2 years (December 31, 2008 - 3.2 years).

At December 31, 2009, the REIT had no long-term debt at floating rates and thus, for the year ended December 31, 2009, a 1% change in interest rates would not change the net loss. The REIT's undrawn lines of credit are at floating rates.

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

20 Financial instruments (continued)

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 \$2,438 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:

	2009 \$	2008 \$
Accounts receivable under 30 days aged	1,503	2,112
Accounts receivable over 30 days aged	1,065	1,349
Less: Allowance for doubtful accounts	(130)	(85)
	<hr/> 2,438	<hr/> 3,376

The REIT is exposed to credit risk on its loans receivable from related parties and mezzanine loans and advances receivable (notes 4 and 5). Management reviews the results and cashflows of these entities on a monthly basis.

Currency risk

The REIT earns revenue and incurs 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 (December 31, 2008 - \$45).

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

20 Financial instruments (continued)

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, 2009, the REIT had undrawn lines of credit of \$5,500. In November 2008, distributions were reduced to \$0.0175 per unit per month (\$0.21 per unit annually) and on July 21, 2009, the REIT suspended distribution in order to conserve cash and satisfy its operating obligations, including principal repayments on its mortgages and loans payable and obligations under capital leases. Subsequent to December 31, 2009, the REIT re-financed the two mortgages totalling \$8,906 that were maturing on April 1, 2010. The new mortgages bear interest at 6.6% (the interest rate on maturing mortgages was 9.285%) and mature on March 1, 2015. The REIT does not have any other mortgages that mature in 2010. 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.

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, 2009 and 2008:

	2009 \$	2008 \$
Income before income taxes, including discontinued operations	(23,139)	(4,789)
Income tax rate	35.0%	32.5%
	(8,099)	(1,557)
Non-deductible stock option expense	22	153
Non-deductible foreign exchange losses	(386)	476
Non-deductible unrealized loan impairment	2,132	488
Accretion of discount on convertible debentures	685	562
Impact of rate change	651	-
Other permanent differences	124	169
Non-taxable portion of capital gain	(148)	-
Valuation allowance for capital losses	2,217	-
	(2,802)	291

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

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, 2009 and 2008 that are expected to reverse in the future are presented below:

	2009	2008
	\$	\$
Future income tax assets		
Unit issuance costs, finance fees and related	705	1,656
Tax losses carried forward	4,585	3,524
Other	101	235
	<hr/> 5,391	<hr/> 5,415
Future income tax liabilities		
Property and equipment – differences in net book value and undepreciated capital cost	775	3,651
Other	50	–
	<hr/> 825	<hr/> 3,651
Net future income tax asset	<hr/> 4,566	<hr/> 1,764
	 2009	 2008
	\$	\$
Recovery of future income taxes is comprised of:		
Future income taxes related to the changes in the taxation rate	(582)	–
Future income taxes related to income and permanent differences	(2,754)	185
Non-taxable foreign exchange translation loss	534	(476)
	<hr/> (2,802)	<hr/> (291)

22 Seasonality

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

Holloway Lodging Real Estate Investment Trust

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

(all dollar amounts are in thousands, except per unit amounts)

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

	2009	2008
	\$	\$
Revenues		
Canada	69,905	91,172
United States	2,080	2,323
	<hr/>	<hr/>
	71,985	93,495
	<hr/>	<hr/>
Property and equipment		
Canada	318,316	343,812
United States	8,149	8,223
	<hr/>	<hr/>
	326,465	352,035
	<hr/>	<hr/>

24 Subsequent event

Subsequent to December 31, 2009, the REIT re-financed the mortgages on its Holiday Inn Express Hotel and Radisson Suite Hotel in Halifax, Nova Scotia totalling \$10,500. The loans bear interest at 6.6%, were drawn on March 1, 2010 and mature on March 1, 2015. The additional funds, after repayment of the principal balance of \$8,940 on the maturing mortgages, totalled \$1,182 which will be used for capital improvements at the properties.

