Holloway Lodging Real Estate Investment Trust

Consolidated Financial Statements
December 31, 2011 and 2010 and January 1, 2010

March 13, 2012

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 International Financial Reporting Standards 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 consolidated financial statements to the Board of Trustees for approval.

(signed) *"Michael B. Rapps"*
Acting Chief Executive Officer

(signed) *"Jane Rafuse"*
Chief Financial Officer

March 13, 2012

Independent Auditor's Report

To the Trustees of
Holloway Lodging Real Estate Investment Trust

We have audited the accompanying consolidated financial statements of **Holloway Lodging Real Estate Investment Trust** and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2011 and December 31, 2010 and January 1, 2010 and the consolidated statements of loss, comprehensive loss, changes in equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
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 comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Holloway Lodging Real Estate Investment Trust and its subsidiaries as at December 31, 2011 and December 31, 2010 and January 1, 2010 and their financial performance and their cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

(signed) *"PricewaterhouseCoopers LLP"*

Chartered Accountants

PricewaterhouseCoopers LLP, Chartered Accountants
Summit Place, 1601 Lower Water Street, Suite 400, Halifax, Nova Scotia, Canada B3J 3P6
T: +1 (902) 491 7400, F: +1 (902) 422 1166

"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Financial Position

As at December 31, 2011 and 2010 and January 1, 2010

(in thousands of Canadian dollars)

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Assets			
Current assets			
Cash and cash equivalents (note 25)	2,455	830	3,786
Restricted cash	249	551	560
Capital reserve – internally restricted	128	921	912
Trade and other receivables (note 5)	3,974	2,962	3,125
Inventories	273	261	279
Prepaid expenses and deposits	1,841	2,617	4,493
Assets held-for-sale (note 7)	42,091	–	–
	51,011	8,142	13,155
Non-current assets			
Property and equipment (note 8)	167,177	236,200	240,238
Minority interest investments in hotel properties (note 9)	850	777	912
Loans receivable (note 10)	4,938	6,398	6,509
Capital reserve – restricted	3,662	5,440	4,691
Deferred income tax assets (note 23)	7,082	7,082	4,566
Other assets (note 11)	509	718	877
	184,218	256,615	257,793
Total assets	235,229	264,757	270,948
Liabilities			
Current liabilities			
Line of credit (note 12)	4,822	2,519	–
Trade payables and accrued liabilities (note 13)	8,545	8,595	8,494
Accrued interest on convertible debentures	1,516	675	675
Current portion of mortgages and loans payable (note 14)	14,328	49,047	41,770
Current portion of convertible debentures (note 15)	46,134	19,138	–
Current portion of obligations under finance leases (note 16)	80	132	285
Derivative liability (note 17)	–	34	105
Class B LP units (note 20)	9	34	147
Mortgages on assets held-for-sale (note 7)	23,156	–	–
	98,590	80,174	51,476
Non-current liabilities			
Mortgages and loans payable (note 14)	101,569	103,546	111,713
Convertible debentures (note 15)	–	49,597	65,935
Loan due to a related party (note 18)	14,768	–	–
Promissory notes payable (note 19)	–	3,203	3,405
Obligations under finance leases (note 16)	10	90	222
Derivative liability (note 17)	10	–	–
	116,357	156,436	181,275
Total liabilities	214,947	236,610	232,751
Equity	20,282	28,147	38,197
Total liabilities and equity	235,229	264,757	270,948

Approved by the Trustees

(signed) *"Michael B. Rapps"*
Trustee

(signed) *"James Howe"*
Trustee

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Loss

For the years ended December 31, 2011 and 2010

(in thousands of Canadian dollars)

	2011 $	2010 $
Hotel revenues		
Rooms	67,899	63,174
Food and beverage	7,138	6,958
Parking	1,348	1,434
Other	2,013	1,883
	78,398	73,448
Hotel expenses		
Departmental and overhead expenses	49,254	47,696
Property taxes and insurance	4,076	4,657
Management fees	1,889	1,818
Depreciation and amortization	9,903	10,188
	65,122	64,359
	13,276	9,089
Other (income) and expenses		
Interest on line of credit, mortgages and loans payable and loan due to a related party	11,074	10,826
Interest on convertible debentures	4,234	4,989
Accretion on convertible debentures, loan due to a related party, mortgages and deferred financing fees	3,274	3,093
Corporate and administrative	2,553	2,880
Investment income	(158)	(216)
Provision for impairment of loan receivable (note 10)	1,235	–
Provision for impairment of minority interest investments in hotel properties (note 9)	–	423
Provision for impairment of hotel properties (note 8)	3,265	–
Reversal of impairment of assets held-for-sale (note 7)	(2,567)	–
Loss on disposal of minority interest investments in hotel properties (note 8)	187	49
Loss on acquisition or disposal of hotel properties (note 6)	1,528	144
Fair value adjustment of Class B LP units and derivative liabilities (note 30)	(252)	(53)
Gain on repurchase of convertible debentures and settlement of promissory notes (notes 15 and 19)	(2,698)	–
Depreciation and amortization – trust assets	4	9
	21,679	22,144
Loss before income taxes	(8,403)	(13,055)
Recovery of deferred income taxes	–	(2,516)
Net loss for the year	(8,403)	(10,539)
Net loss attributable to:		
Unitholders and owners of Class B LP units	(8,403)	(10,539)

The accompanying notes are an integral part of these consolidated financial statements.

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Comprehensive Loss

For the years ended December 31, 2011 and 2010

(in thousands of Canadian dollars)

	2011 $	2010 $
Net loss for the year	(8,403)	(10,539)
Other comprehensive income (loss)		
Cumulative translation adjustments	97	(266)
Change in value of minority interest investments in hotel properties	303	609
Other comprehensive income for the year	400	343
Comprehensive loss for the year	(8,003)	(10,196)
Comprehensive loss attributable to:		
Unitholders and owners of Class B LP units	(8,003)	(10,196)

The accompanying notes are an integral part of these consolidated financial statements.

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Changes in Equity

For the years ended December 31, 2011 and 2010

(in thousands of Canadian dollars)

	Units (note 20) **$**	**Contributed surplus** **$**	**Deficit** **$**	**Accumulated other comprehensive income (loss)** **$**	**Total equity** **$**
Balance, January 1, 2010	180,088	1,359	(142,201)	(1,049)	38,197
Net loss for the period	–	–	(10,539)	–	(10,539)
Other comprehensive income	–	–	–	343	343
Unit-based compensation related to options	–	15	–	–	15
Exchange of units	131	–	–	–	131
Balance, December 31, 2010	180,219	1,374	(152,740)	(706)	28,147
Balance, January 1, 2011	180,219	1,374	(152,740)	(706)	28,147
Net loss for the period	–	–	(8,403)	–	(8,403)
Other comprehensive income				400	400
Unit-based compensation related to options	–	40	–	–	40
Units issued to trustees for services	98	–	–	–	98
Balance, December 31, 2011	180,317	1,414	(161,143)	(306)	20,282

The accompanying notes are an integral part of these consolidated financial statements.

Holloway Lodging Real Estate Investment Trust

Consolidated Statements of Cash Flows

For the years ended December 31, 2011 and 2010

(in thousands of Canadian dollars)

	2011 $	2010 $
Cash provided by (used in)		
Operating activities		
Net loss for the years	(8,403)	(10,539)
Adjustments for non-cash items (note 25)	14,067	11,352
	5,664	813
Changes in items of working capital (note 25)	597	2,037
Net cash generated from operating activities	6,261	2,850
Investing activities		
Decrease in restricted cash	302	9
Decrease (increase) in capital reserves	2,570	(758)
Proceeds from sale of minority interest investments in hotel properties	60	271
Proceeds from sale of hotel properties	18,103	–
Increase in minority interest investments in hotel properties	(18)	–
Additions to property and equipment	(2,627)	(3,594)
Net cash generated from (used in) investing activities	18,390	(4,072)
Financing activities		
Repayment of obligations under finance leases	(132)	(285)
Repayment of promissory notes payable	(129)	(239)
Increase in line of credit	2,304	2,519
Proceeds from mortgages and loans payable, net of deferred financing fees	717	10,120
Repayment of mortgages and loans payable	(14,941)	(13,849)
Proceeds from loan due to a related party	14,000	–
Repayment of loan due to a related party	(1,000)	–
Repayment of convertible debentures	(20,238)	–
Repurchase of convertible debentures	(3,607)	–
Net cash used in financing activities	(23,026)	(1,734)
Increase (decrease) in cash and cash equivalents	1,625	(2,956)
Cash and cash equivalents – Beginning of year	830	3,786
Cash and cash equivalents – End of year	2,455	830
Supplemental cash flow information		
Interest paid	14,617	15,746

The accompanying notes are an integral part of these consolidated financial statements.

(in thousands of Canadian dollars)

1 General information

Holloway Lodging Real Estate Investment Trust and its subsidiaries together ("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 REIT and its subsidiaries own and operate hotels. As at December 31, 2011, the REIT owned 19 hotels in Canada and one hotel in the United States with 2,183 guest rooms and suites and held minority ownership interests in five other hotels. The address of its registered office is 6009 Quinpool Road, 10th Floor, Halifax, Nova Scotia.

The results of operations for the year ended December 31, 2011 represent the operations of twenty hotels for the full year and two hotels for part of the year. The Radisson Suite hotel in Halifax, NS was sold on June 30, 2011 and the Holiday Inn Express in Halifax, NS was sold on August 15, 2011. For the year ended December 31, 2010, the REIT owned twenty-one hotels for the full year and one hotel for a portion of the year as the Super 8 Windsor, NS was acquired on June 1, 2010.

2 Basis of preparation and adoption of International Financial Reporting Standards

The REIT prepares its financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") as defined in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB") and to require publicly accountable enterprises to apply these standards effective for years beginning on or after January 1, 2011. Accordingly, these are the REIT's first annual consolidated financial statements prepared in accordance with IFRS as issued by the IASB. In these consolidated financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These consolidated financial statements have been prepared in compliance with IFRS. Subject to certain transition elections and exceptions disclosed in note 33, the REIT has consistently applied the accounting policies used in the preparation of its opening IFRS statement of financial position at January 1, 2010 throughout all periods presented, as if these policies had always been in effect. Note 33 discloses the impact of the transition to IFRS on the REIT's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the REIT's consolidated financial statements for the year ended December 31, 2010 prepared under Canadian GAAP.

These financial statements were approved for issue by the Board of Trustees for issue on March 13, 2012.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies

The significant accounting policies used in the preparation of these consolidated financial statements are as follows:

Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for minority interest investments in hotel properties, derivative liabilities and Class B LP units. The derivative liabilities and Class B LP units are measured at fair value through profit and loss and the minority interest investments in hotel properties are recognized at fair value through other comprehensive income.

The preparation of financial statements conforming to IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in applying certain accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

Consolidation

The financial statements consolidate the accounts of the REIT and its subsidiaries. Subsidiaries are those entities which the REIT controls by having the power to govern the financial and operating policies. Subsidiaries are fully consolidated from the date on which control is obtained by the REIT and are de-consolidated from the date that control ceases. Intercompany transactions, balances, income and expenses, and profits and losses are eliminated.

Foreign currency translation

i) Functional and presentation currency

Items included in the financial statements of each consolidated entity in the REIT group are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The functional currency and presentation of the REIT is the Canadian dollar.

The financial statements of entities that have a functional currency different from that of the REIT ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities - at the closing rate at the date of the statement of financial position and income and expenses - at the average rate of the period (as this is considered a reasonable approximation of the actual rates prevailing at the transaction dates). All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the transaction dates. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at exchange rates of monetary assets and liabilities denominated in currencies other than an entities' functional currency are recognized in the statement of loss in operating expenses.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held with banks and other short-term highly liquid investments with original maturities of three months or less.

Financial instruments

Financial assets and liabilities are recognized when the REIT becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the REIT has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

At initial recognition, the REIT classifies its financial instruments in the following categories:

i) Financial assets and liabilities at fair value through profit and loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term.

Financial instruments in this category are recognized initially and subsequently at fair value. Derivatives are also included in this category unless they are designated as hedges. The REIT has issued warrants and the conversion options on the convertible debentures qualify as derivative liabilities. The REIT's Class B LP units are also classified in this category. Gains and losses on re-measurement to fair value of warrants are included in fair value adjustment of Class B LP units and derivative liabilities.

ii) Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The REIT's available-for-sale assets comprise its minority interest investments in hotel properties.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains and losses arising from remeasurement are recognized in other comprehensive income except for exchange gains and losses on the translation of debt securities, which are recognized in the consolidated statement of income. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of income and are included in "gain or loss on disposition of minority investment in hotel property". Available-for–sale investments are classified as non-current, unless an investment matures within twelve months, or management expects to dispose of it within twelve months.

Investment income on available-for-sale investments is included in the statement of loss as investment income when the REIT's right to receive payment is established.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Financial instruments (continued)

iii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The REIT's loans and receivables, included in current assets due to their short-term nature comprise trade and other receivables, cash and cash equivalents, restricted cash and capital reserves – internally restricted. The REIT's loans and receivables, included in non-current assets comprise loans receivable and capital reserve – restricted. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment. The carrying amount of a loan receivable classified as impaired is reduced to the present value of estimated future cash flows discounted at the initial effective interest rate of the loan.

iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include line of credit, trade payables and accrued liabilities, accrued interest on convertible debentures, mortgages and loans payable, convertible debentures, obligations under finance leases, loan due to a related party and promissory notes payable. Trade payables and accrued liabilities are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method. Mortgages and loans payable and loan due to a related party are recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method. These are classified as current liabilities if payment is due within twelve months or if waiver for a covenant breach has not been received by the period end date. Otherwise, they are presented as non-current liabilities.

Impairment of financial assets

At each reporting date, the REIT assesses whether there is objective evidence that a financial asset is impaired.

The criteria used to determine if objective evidence of an impairment loss include:

i) significant financial difficulty of the obligor;
ii) delinquencies in interest or principal payments; and
iii) it becomes probable that the borrower will enter bankruptcy or other financial reorganization.

If such evidence exists, the REIT recognizes an impairment loss, as follows:

i) Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

ii) Available-for-sale investments: The impairment loss is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of loss. This amount represents the loss in accumulated other comprehensive income that is reclassified to the statement of loss.

Impairment losses on available-for-sale investments, when recorded in the statement of loss, are not reversed.

Inventories

Inventories consist of linen, food, beverages and other supplies. Inventories are stated at the lower of cost and net realizable value. Cost is determined using the first in, first out (“FIFO”) method. Net realizable value is the estimated replacement cost. If the carrying value exceeds the net realizable value, a write down is recognized.

Capital reserve

Capital reserves represent funds held by mortgagors (capital reserve – restricted) or funds internally restricted (capital reserve – internally restricted) for capital improvements to the hotel properties.

Minority interest investments in hotel properties

The minority interest investments in hotel properties represent equity ownership interests in five hotel partnerships or co-tenancies ranging from 6.00% to 19.06%. These investments are accounted for as available-for-sale investments and are accounted for at fair value at each reporting period with changes in value recognized in other comprehensive income. Significant or prolonged declines in fair value are removed from other comprehensive income and recognized in the statement of loss.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset’s carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the REIT and the cost can be measured reliably. Repairs and maintenance costs are charged to the statement of loss during the period in which they are incurred.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

The major categories of property and equipment are depreciated on a straight-line basis as follows:

Land lease	Term of the lease
Buildings and components	15 to 60 years
Furniture, fixtures and equipment	7 years
Paving	10 years
Signage	10 years
Landscaping	5 years
Computer equipment	3 years
Vehicles	3 years

The REIT allocates the amount initially recognized in respect of an item of property and equipment to its significant components and depreciates each component separately. Building components include core structure, HVAC/mechanical, roofing, elevators, windows/doors and other. The carrying amount of a replaced component is derecognized when replaced. Residual values, method of amortization and useful lives of the assets are reviewed annually and adjusted if appropriate.

Gains and losses on disposals of property and equipment are presented as gain or loss on disposal in the statement of loss.

Impairments on revaluation of property and equipment are presented as provision for impairment of hotel properties in the statement of loss.

Assets held-for-sale

Non-current assets are classified as assets held-for-sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. The assets are stated at the lower of carrying amount and fair value less costs to sell.

For those assets held-for-sale carried at fair value less costs to sell, the value is based on adjustments to the fair value for anticipated costs to dispose of the asset including any commissions, brokerage fees and legal costs.

Impairment of non-financial assets

Property and equipment are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units or 'CGUs'). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Value in use is defined as the present value of the expected future cash flows of the relevant asset or CGU, as determined by management.

The REIT evaluates impairment losses for potential reversals annually or when events or circumstances warrant such consideration.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

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 the present value of estimated future cash flows discounted at the initial effective interest rate of the loan and recorded as a provision for impairment of loans receivable in the statement of loss.

Other assets

Other assets consist of franchise fees and agreements. Application and initial 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 Agreements are amortized on a straight-line basis over the five-year term of the agreements.

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 finance leases and classified as property and equipment and obligations under finance leases. At the inception of the lease, the asset and the obligation under finance lease are recorded at the lesser of the fair value of the leased asset or the net present value of the minimum lease payments. Assets under finance 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.

Provisions

Provisions for legal or constructive obligations are recognized in the financial statements as liabilities when all of the following three criteria are met: (i) the REIT has a present legal or constructive obligation as a result of a past event; (ii) it is more likely than not that an outflow of resources will be required to settle the obligation; and (iii) the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted where the effect is material. The REIT does not have any significant provisions recorded at December 31, 2011.

Income tax

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 exceeded the "normal growth" rates as defined in the guidelines issued by the Department of Finance, the REIT became subject to tax in 2007.

Income tax comprises current and deferred taxes. Income tax is recognized in the statement of loss except to the extent that it relates to items recognized directly in other comprehensive income or directly in equity, in which case the income tax is also recognized directly in other comprehensive income or equity, respectively.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Income tax (continued)

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

In general, deferred tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not recognized if it arises from the initial recognition of goodwill or the initial recognition of an asset or liability in a transaction other than a business combination that, at the time of the transaction, affects neither accounting nor taxable profit nor loss. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except, in the case of subsidiaries, where the timing of the reversal of the temporary difference is controlled by the REIT and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the balance sheet date and are expected to apply when the deferred tax asset is realized or liability is settled. Deferred tax assets are recognized to the extent that is probable that future taxable profit will be available against which the deductible temporary differences can be utilized.

Deferred income tax assets and liabilities are presented as non-current.

Revenue

Revenue is generated primarily from room occupancy, food and beverage services and parking. Revenue is recognized when it is probable that the economic benefits will flow to the REIT, the service has been provided, the price for the services and costs can be measured reliably and collectability is reasonably assured.

REIT units

REIT units meet the definition of a financial liability as the redemption feature of the REIT units creates an unavoidable contractual obligation to pay cash (or another financial instrument such as notes payable if redemptions exceed $50 in a given month).

REIT units are considered to be "puttable instruments" because of the redemption feature. IFRS provides a very limited exemption to allow puttable instruments to be presented as equity provided certain criteria are met.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

REIT units (continued)

To be presented as equity, a puttable instrument must meet all of the following conditions: (i) it must entitle the holder to a pro-rata share of the entity's net assets in the event of the entity's dissolution; (ii) it must be in the class of instruments that is subordinate to all other instruments; (iii) all instruments in the class in (ii) must have identical features; (iv) other than the redemption feature, there can be no other contractual obligations that meet the definition of a liability; and (v) the expected cash flows for the instrument must be based substantially on the profit or loss of the entity or change in fair value of the instrument. This is called the "Puttable Instrument Exemption".

REIT units meet the Puttable Instrument Exemption criteria and accordingly are presented as equity in the consolidated financial statements. Distributions on REIT units are deducted from deficit. Earnings per unit are not presented as the REIT units meet the Puttable Instrument Exemption.

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 in equity.

Employee benefits

i) Unit-based compensation

The REIT grants unit options to certain employees, trustees, consultants and employees of Pacrim Hospitality Services Inc. Unit options vest equally over three years and expire after five years. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. The fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the tranche's vesting period by increasing contributed surplus based on the number of awards expected to vest. This number is reviewed at least annually, with any change in estimate being recognized immediately in compensation expense with a corresponding adjustment to contributed surplus.

ii) Termination benefits

The REIT recognizes termination benefits when it is demonstrably committed to terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal.

Accounting standards and amendments issued but not yet adopted

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted except IFRS 9 which is effective January 1, 2015. The REIT has not yet assessed the impact of these standards and amendments or determined whether it will early adopt them.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Accounting standards and amendments issued but not yet adopted (continued)

i) IFRS 9, *Financial Instruments,* was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit and loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated other comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement,* except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

ii) IFRS 10, *Consolidated Financial Statements,* requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, *Consolidation – Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements.*

iii) IFRS 11, *Joint Arrangements,* requires a venture to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venture will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entitles have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures,* and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers.*

iv) IFRS 12, *Disclosure of Interest in Other Entities,* establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosures that address the nature of, and risks associated with, an entity's interests in other entities.

v) IFRS 13, *Fair Value Measurement,* is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.

(in thousands of Canadian dollars)

3 Summary of significant accounting policies (continued)

Accounting standards and amendments issued but not yet adopted (continued)

vi) There have been amendments to existing standards, including IAS 27, *Separate Financial Statements (IAS 27),* and IAS 28, *Investments in Associates and Joint Ventures (IAS 28).* IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10-13.

vii) IAS 1, *Presentation of Financial Statements,* has been amended to require entities to separate items presented in OCI into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted.

viii) IFRS 7, *Financial Instruments: Disclosures,* has been amended to include additional disclosure requirements in the reporting of transfer transactions and risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitization of financial assets. The amendment is applicable for annual periods beginning on or after July 1, 2011, with earlier application permitted.

ix) IAS 12, *Income Taxes,* was amended to introduce an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. As a result of the amendment, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale when considering the expected manner or recovery or settlement. SIC 21, *Income Taxes – Recovery of Revalued Non-Depreciable Assets,* will no longer apply to investment properties carried at fair value. The amendment also incorporates into IAS 12 the remaining guidance previously contained in SIC 21, which is withdrawn. The amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted. The REIT has no investment property and therefore expects these amendments will have no impact on the consolidated financial statements.

(in thousands of Canadian dollars)

4 Critical accounting estimates and judgments

The preparation of financial statements requires management to use judgment in applying its accounting policies and estimates and assumptions about the future. Estimates and other judgments are continuously evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. The following discusses the most significant accounting judgments and estimates that the REIT has made in the preparation of the financial statements:

Critical accounting estimates

a) Property and equipment

On December 31, 2011, the REIT increased the carrying value of four CGUs to their fair value by $4,961 and decreased the carrying value of three CGUs by $8,226. The recoverable value of the CGUs is based on their value in use and is determined by recent independent third party appraisals, comparable sales transactions and internal models. A CGU is reviewed at the individual hotel level, the lowest level for which identifiable cash flows are largely independent when measuring the fair value of property and equipment. The fair value is determined based on the discounted future cash flows expected to be received from the property. The fair value amounts have been determined using ten-year cash flow projections and a capitalized terminal value calculation as approved by management of the REIT and made maximum use of observable inputs and outputs. For periods beyond the initial budget period, cash flows were extrapolated using growth rates determined to be reasonable for the specific market or hotel property to which they relate and do not exceed the anticipated long term average growth rates for the REIT's portfolio. Key assumptions included the following:

Discount rates	11% to 12.5%
Capitalization rates	9.5% to 10.5%
Growth rates	Consistent with industry and portfolio outlook

The fair value may not reflect the realizable value in the event a particular CGU is sold by the REIT.

These ranges are consistent with previous value in use calculations for the REIT's CGUs.

The amount of the impairment loss is the amount by which the long-lived asset's carrying value exceeds its fair value. The future cash flows expected from the use and eventual disposition involve assumptions of occupancy, room rates, revenues, expenses, the residual or terminal value for the property and discount rates. In addition to these estimates, management assesses the effect of new competition in the individual markets and the hotel industry predictions for recovery from the recession. These estimates and assumptions are subject to change. Based on this information, management estimated that the range of reasonably possible values for the assets would be between $29,133 and $32,575 for the three CGUs that were increased in value and $27,270 and $30,326 for the three CGUs that were decreased in value using internal models.

Please refer to note 33 for further information regarding the carrying values of CGUs at transition to IFRS.

(in thousands of Canadian dollars)

4 Critical accounting estimates and judgments (continued)

b) Minority interest investments in hotel properties

At December 31, 2011, the REIT's minority interest investments in hotel properties were not traded in an active market and their fair value was estimated using valuation techniques. Valuations for these investments require the use of inputs and capitalization rates that cannot be derived from current market prices but are based on management estimates of appropriate amounts.

c) Derivative liabilities

The REIT recognizes derivative liabilities related to both the conversion option on convertible debentures and outstanding warrants issued with respect to the loan due to a related party. The fair values of these liabilities are determined using the Black-Scholes option model which uses inputs not directly observable in the market. Historic volatility in the pricing model serves as an estimate of the unit price volatility for option pricing purposes and actual volatility of unit price may differ materially. Estimates used for valuing employee options, warrants and options on convertible debentures range from 60% to 85% and are based either on internal models or market based indices.

d) Loans receivable

The carrying value of a loan receivable classified as impaired is determined using valuation techniques based on discounted future cash flows expected to be received from the loan. The estimated cash flows and the collectibility of the principal balance at maturity are subject to significant judgment and uncertainty.

e) Depreciation of property and equipment

The REIT records amortization on its property and equipment using the straight-line method over the estimated useful life of each category. If different estimated useful lives of the assets or amortization methods were used, the impact on the REIT's net loss could be material.

f) Income taxes

Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of loss, other comprehensive income, or directly in equity, as applicable, in the year that includes the date of enactment or substantive enactment. The estimates of future taxable income, the years when the temporary differences are expected to reverse and the tax rates in those years have an impact of the deferred income tax asset recorded on the statement of financial position.

(in thousands of Canadian dollars)

5 Trade and other receivables

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Trade receivables	3,358	2,495	1,804
Less: allowance for doubtful accounts	(166)	(83)	(130)
Trade receivables - net	3,192	2,412	1,674
Receivables from credit card companies	323	356	249
Other receivables	459	194	1,202
	3,974	2,962	3,125

6 Acquisition and disposal of hotel properties

On June 30, 2011, the REIT sold the Radisson Suite hotel in Halifax, Nova Scotia for gross proceeds of $12,324. The REIT recognized a loss on disposal of hotel property of $215. After repayment of the mortgage and closing costs, the net cash proceeds, including $963 released from capital reserves – restricted, were $6,125.

On August 15, 2011, the REIT sold the Holiday Inn Express hotel in Halifax, Nova Scotia for gross proceeds of $6,500. The REIT recognized a loss on disposal of hotel property of $1,314. After repayment of the mortgage and closing costs, the net cash proceeds were $2,744.

(in thousands of Canadian dollars)

6 Acquisition and disposal of hotel properties (continued)

On June 1, 2010, the REIT acquired the Super 8 hotel in Windsor, Nova Scotia. As Holloway had provided a $1,900 mezzanine loan to the hotel which was in default, the owners Winport Developments Limited Partnership, a related party, relinquished ownership to Holloway pursuant to a quit claim. Holloway assumed all the assets and liabilities of the hotel effective June 1, 2010. The excess of liabilities assumed over assets acquired of $47 was recorded as a loss on acquisition of hotel property. The acquisition has been accounted for under the purchase method and accordingly, the results of the operations of the hotel since the date of acquisition have been included in the consolidated statement of loss. The following table details the acquisition and how it was financed:

	$
Assets acquired	
Land	300
Building	2,400
Furniture, fixtures, equipment and other	340
Signage	10
Franchise fees	14
Other working capital and short-term liabilities assumed	(277)
	2,787
Financed by	
Assumed mortgage	2,834
Excess of liabilities over assets acquired	(47)
	2,787

7 Assets held-for-sale

Non-current assets are classified as assets held-for-sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. The assets are stated at the lower of carrying amount and fair value less costs to sell.

As at December 31, 2011, the management of the REIT had entered into agreements to sell the 5 Calgary Downtown Suites Hotel in Calgary, AB and the Radisson Hotel and Suites in Fort McMurray, AB with the closing of those potential sales anticipated to occur within 12 months. As a result, the net book value of the applicable assets and associated liabilities are presented as held-for-sale.

The REIT did not have any assets held-for-sale at December 31, 2010 or January 1, 2010. Mortgage liabilities associated with the assets held-for-sale were $23,156 at December 31, 2011. Subsequent to December 31, 2011, both hotels were sold and the mortgages repaid. Refer to note 32.

Management of the REIT assessed these CGUs for impairment or reversal of impairment because of changes in the competitive environment in regional markets, significantly improved or declining performance relative to forecasted results or noteworthy changes in the economic factors of the region in which the CGU operates.

(in thousands of Canadian dollars)

7 Assets held-for-sale (continued)

The fair value amounts have been estimated using 10 year cash flow projections and a capitalized terminal value calculation as approved by management of the REIT and made maximum use of observable inputs and outputs. For periods beyond the initial budget period, cash flows were extrapolated using growth rates determined to be reasonable for the specific market or hotel property to which they relate and do not exceed the anticipated long-term average growth rates for the REIT's portfolio. Key assumptions included the following:

Discount rates:	11% to 12.5%
Capitalization rates:	9.5% to 10.5%
Growth rates:	Consistent with industry and portfolio outlook

For those assets held-for-sale carried at fair value less costs to sell, the value is based on adjustments to the fair value for anticipated costs to dispose of the asset including any commissions, brokerage fees and legal costs.

The net book value of the assets classified as held-for-sale are as follows:

	As at December 31, 2011			
	Cost $	Accumulated impairment $	Accumulated depreciation $	Net book value $
Land	2,029	–	–	2,029
Building	46,555	(3,949)	(4,168)	38,438
Renovations in progress	165	–	–	165
Furniture, fixtures and equipment and other	4,276	(711)	(2,171)	1,394
Paving	75	(17)	(32)	26
Signage	31	–	(8)	23
Computer equipment and websites	294	–	(278)	16
	53,425	(4,677)	(6,657)	42,091

	For the year ended December 31, 2011			
	Opening net book value $	Reclassification of amounts held-for-sale $	Reversal of impairment $	Closing net book value $
Land	–	2,029	–	2,029
Building	–	35,960	2,478	38,438
Renovations in progress	–	165	–	165
Furniture, fixtures, equipment and other	–	1,308	86	1,394
Paving	–	23	3	26
Signage	–	23	–	23
Computer equipment and websites	–	16	–	16
	–	39,524	2,567	42,091

(in thousands of Canadian dollars)

8 Property and equipment

	For the year ended December 31, 2011							
	Opening net book value $	**Additions $**	**Disposals $**	**Depreciation $**	**Net book value of assets reclassified as held-for-sale $**	**Impairment adjustments $**	**Foreign exchange $**	**Closing net book value $**
Land	22,243	–	(2,933)	–	(2,029)	(2,012)	32	15,301
Land lease	418	–	–	(11)	–	–	–	407
Buildings	197,044	644	(14,726)	(5,617)	(35,960)	(1,000)	154	140,539
Renovations in progress	169	243	–	–	(165)	–	–	247
Furniture, fixtures, equipment and other	13,428	1,545	(1,432)	(3,547)	(1,308)	(300)	10	8,396
Paving	1,623	–	(66)	(251)	(23)	47	4	1,334
Landscaping	26	–	–	(6)	–	–	–	20
Signage	848	58	(72)	(120)	(23)	–	5	696
Computer equipment and websites	277	137	(7)	(169)	(16)	–	1	223
Vehicles	22	–	–	(8)	–	–	–	14
Tenant inducements	102	–	(102)	–	–	–	–	–
	236,200	2,627	(19,338)	(9,729)	(39,524)	(3,265)	206	167,177

(in thousands of Canadian dollars)

8 Property and equipment (continued)

	As at December 31, 2011			
	Cost $	Accumulated impairment losses $	Accumulated depreciation $	Net book value $
Land	26,015	(10,714)	–	15,301
Land lease	500	(28)	(65)	407
Buildings	244,512	(82,923)	(21,050)	140,539
Renovations in progress	247	–	–	247
Furniture, fixtures and equipment and other	25,561	(5,404)	(11,761)	8,396
Paving	3,056	(683)	(1,039)	1,334
Landscaping	32	–	(12)	20
Signage	986	–	(290)	696
Computer equipment and websites	1,320	–	(1,097)	223
Vehicles	180	–	(166)	14
	302,409	(99,752)	(35,480)	167,177

	For the year ended December 31, 2010					
	Opening net book value $	Additions $	Disposals $	Depreciation for the year $	Foreign exchange differences $	Closing net book value $
Land	22,031	318	–	–	(106)	22,243
Land lease	430	–	–	(12)	–	418
Buildings	200,256	2,808	–	(5,658)	(362)	197,044
Renovations in progress	706	(515)	–	–	(22)	169
Furniture, fixtures and equipment and other	13,419	3,334	(2)	(3,321)	(2)	13,428
Paving	1,856	26	–	(252)	(7)	1,623
Landscaping	16	14	–	(4)	–	26
Signage	872	98	(95)	(25)	(2)	848
Computer equipment and websites	413	205	–	(339)	(2)	277
Vehicles	94	–	–	(72)	–	22
Tenant inducements	145	–	–	(42)	(1)	102
	240,238	6,288	(97)	(9,725)	(504)	236,200

(in thousands of Canadian dollars)

8 Property and equipment (continued)

				As at December 31, 2010
	Cost $	Accumulated impairment losses $	Accumulated depreciation $	Net book value $
Land	30,936	(8,693)	–	22,243
Land lease	500	(28)	(54)	418
Buildings	305,456	(88,269)	(20,143)	197,044
Renovations in progress	169	–	–	169
Furniture, fixtures and equipment and other	30,417	(5,896)	(11,093)	13,428
Paving	3,214	(748)	(843)	1,623
Landscaping	32	–	(6)	26
Signage	1,025	–	(177)	848
Computer equipment and websites	1,513	–	(1,236)	277
Vehicles	179	–	(157)	22
Tenant inducements	146	–	(44)	102
	373,587	(103,634)	(33,753)	236,200

				As at January 1, 2010
	Cost $	Accumulated impairment losses $	Accumulated depreciation $	Net book value $
Land	30,689	(8,658)	–	22,031
Land lease	500	(28)	(42)	430
Buildings	303,107	(88,207)	(14,644)	200,256
Renovations in progress	706	–	–	706
Furniture, fixtures and equipment and other	27,088	(5,912)	(7,757)	13,419
Paving	3,194	(755)	(583)	1,856
Landscaping	18	–	(2)	16
Signage	1,025	–	(153)	872
Computer equipment and websites	1,311	–	(898)	413
Vehicles	179	–	(85)	94
Tenant inducements	145	–	–	145
	367,962	(103,560)	(24,164)	240,238

(in thousands of Canadian dollars)

8 Property and equipment (continued)

The net book value of assets under finance leases as at December 31, 2011 was $335 (December 31, 2010 - $675; January 1, 2010 - $945).

On transition to IFRS on January 1, 2010, the REIT recognized an impairment loss of $103,560 in deficit in respect of various CGUs. Management assessed all CGUs for impairment because of a significant decline in earnings and cash flows. Recoverable amount has been determined based on the value in use of each CGU based on combination of independent third party appraisals or the REIT's internal valuation models.

As at December 31, 2010, no adjustments were recognized.

As at December 31, 2011, the REIT recognized a reversal of previously recorded impairment losses of $4,961 and additional impairment losses of $8,226 in respect of various CGUs. Management of the REIT assessed these CGUs for impairment or reversal of impairment because of changes in the competitive environment in regional markets, significantly improved or declining performance relative to forecasted results or noteworthy changes in the economic factors of the region in which the CGU operates. Refer to note 4 for discussion regarding the use of estimates in determination of the values of the CGUs.

9 Minority interest investments in hotel properties

The REIT has minority interests in five hotels (December 31, 2010 – 6 hotels; January 1, 2010 – 8 hotels) ranging from 6.00% to 19.06%. The investments are accounted for as available-for-sale financial assets. During the year ended December 31, 2011, the REIT sold its investment in the Super 8 hotel in Barrie, ON for $61 and recognized a loss on sale $187. During the year ended December 31, 2010, the REIT recorded an impairment loss of $423 in the statement of loss on its investment in the Super 8 hotel in Toronto, ON and sold its investments in the Super 8 hotels in Ste-Foy and Trois-Rivières, QC for $272 and recognized a loss on sale of $49.

	For the years ended	
	December 31, 2011 $	December 31, 2010 $
Opening value	777	912
Provision for impairment recorded in the statement of loss	–	(423)
Sale of investment	(248)	(321)
Change in value recorded in the statement of comprehensive income	303	609
Additional investment	18	–
Ending value	850	777

(in thousands of Canadian dollars)

10 Loans receivable

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Pacrim Hospitality Services Inc.	6,173	6,239	6,350
Less: Allowance	(1,235)	–	–
Net	4,938	6,239	6,350
Winport Developments Inc.	–	159	159
	4,938	6,398	6,509

The loan receivable from Pacrim Hospitality Services Inc. (“PHSI”), the company that manages the REIT’s hotels 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 on the units of the REIT (calculated in accordance with the loan agreement) plus 1%. The interest rate is currently 1%.

During and subsequent to the year-end, the REIT sold properties that were previously managed by PHSI. This has and will reduce the revenue stream PHSI receives from the REIT resulting in, management believes, an increased credit risk associated with the full repayment of the loan on February 1, 2018. The terms of the loan agreement do not provide the REIT with access to financial information of PHSI and therefore the above is the only objective factor the REIT had to consider. Because of this increased credit risk the REIT has provided an allowance of $1,235 against the loan. Management's assessment is largely based on estimated cash flows that will not occur until 2018, and, therefore, there is significant uncertainty associated both with the amount of the allowance recorded and the remaining carrying value of the loan.

The loan receivable from Winport Developments Inc (“Winport”) bore interest at 11% per annum and was due December 31, 2011. On December 21, 2011, the loan receivable was settled for a nominal amount. PHSI and Winport were related to the REIT up to December 31, 2011 when Glenn Squires, an officer of PHSI and Winport, resigned as CEO of the REIT.

(in thousands of Canadian dollars)

11 Other assets

	Franchise fees $	Agreements $	Total $
As at January 1, 2010			
Cost	854	500	1,354
Accumulated amortization	(227)	(250)	(477)
Net book value	627	250	877
For the year ended December 31, 2010			
Opening net book value	627	250	877
Additions	22	–	22
Amortization for the year	(82)	(99)	(181)
Closing net book value	567	151	718
As at December 31, 2010			
Cost	876	500	1,376
Accumulated amortization	(309)	(349)	(658)
Net book value	567	151	718
For the year ended December 31, 2011			
Opening net book value	567	151	718
Disposals	(31)	–	(31)
Amortization for the year	(79)	(99)	(178)
Closing net book value	457	52	509
As at December 31, 2011			
Cost	845	500	1,313
Accumulated amortization	(388)	(448)	(804)
Net book value	457	52	509

(in thousands of Canadian dollars)

12 Line of credit

The REIT has two available lines of credit for $5,000 and $500. As at December 31, 2011, the REIT had drawn $4,822 (December 31, 2010 - $2,519; January 1, 2010 - $nil) of the $5,000 line of credit. This line of credit bears interest at prime plus 2.5%, is payable on demand and is secured by a demand collateral mortgage and charge on the Holiday Inn Express in Kamloops, BC. The amount available to be drawn on the $500 line of credit is $465 which is net of outstanding letters of credit (December 31, 2010 - $465; January 1, 2010 - $465).

Certain of the covenants on the $5,000 line of credit were in violation at December 31, 2011. The REIT obtained a waiver from the lender subsequent to December 31, 2011.

Following the sale of two hotels disclosed in note 32, the amount outstanding on the $5,000 line of credit has been reduced to $2,972 as of February 29, 2012.

13 Trade payables and accrued liabilities

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Trade payables	2,555	2,840	2,654
Accrued land lease	1,993	1,779	1,729
Accrued expenses and liabilities	3,997	3,976	4,111
	8,545	8,595	8,494

14 Mortgages and loans payable

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Mortgages payable, bearing interest at a weighted average rate of 6.68% (December 31, 2010 - 6.75%; January 1, 2010 - 6.82%) and maturing on various dates from April, 2012 to July, 2017. Individual first charges on all but one of the hotel properties have been pledged as security for individual mortgages.	116,460	153,630	154,446
Other	–	4	39
	116,460	153,634	154,485
Less: deferred financing fees	563	1,041	1,002
Less: current portion	14,328	49,047	41,770
	101,569	103,546	111,713

(in thousands of Canadian dollars)

14 Mortgages and loans payable (continued)

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

	$
Year ending December 31, 2012	14,344
2013	3,288
2014	3,511
2015	8,662
2016	11,128
Thereafter	75,527

The following table summarizes significant changes in mortgages and loans payable for the years ended December 31, 2011 and 2010:

	For the years ended	
	December 31, 2011	December 31, 2010
Beginning balance	152,593	153,483
New debt	966	10,500
Assumption of mortgage	–	2,834
Deferred financing fees	(478)	(341)
Repayment of debt	(14,125)	(13,844)
Transfer to mortgages on assets held-for-sale	(23,156)	–
Impact of foreign exchange	97	(39)
Ending balance	115,897	152,593

In July 2011, the REIT refinanced a mortgage secured by the Super 8 hotel in Yellowknife, NWT. The REIT increased the outstanding mortgage balance by $765 and reduced the annual interest rate by 0.75%. This mortgage will mature in July 2016. In August 2011, the REIT refinanced a mortgage secured by the Super 8 hotel in Truro, NS. The outstanding mortgage balance remained the same while the interest rate decreased by 0.75%. This mortgage will mature in September 2016. In December 2011, the REIT refinanced a mortgage secured by the Super 8 hotel in Drayton Valley, AB. The outstanding balance increased by $200 and the interest rate is floating at the 90 day bankers' acceptance rate plus 501 basis points.

In March 2010, the REIT refinanced the mortgages on the Holiday Inn Express and Radisson Suite hotels in Halifax, NS at an interest rate of 6.6% for a five year term.

15 Convertible debentures

On August 1, 2006, the REIT issued $20,238 in convertible, redeemable debentures with an interest rate of 8.0%. The debentures were repaid in full on July 29, 2011.

(in thousands of Canadian dollars except unit amounts)

15 Convertible debentures (continued)

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 were to mature on June 30, 2012. 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.

The convertible debentures were valued at their estimated fair value according to the terms and conditions in place at the time of their issuance. The difference between the gross proceeds and the estimated fair value of the debt of $5,300 on the August 1, 2006 issuance, $4,150 on the June 21, 2007 issuance and $644 on the July 18, 2007 issuance represents the value of the conversion feature of the debentures and accordingly, has been recorded as a derivative liability. In accordance with IFRS, an obligation to issue units associated with the REIT's convertible debentures is classified as a derivative liability and measured at fair value with any subsequent changes in value recognized in the statement of loss. These changes in value are included in fair value adjustment of Class B LP units and derivative liabilities.

On April 27, 2011, the REIT initiated a Normal Course Issuer Bid ("NCIB") to repurchase, over the 12 months commencing on April 29, 2011 and ending on April 28, 2012, up to $5,184 of its issued and outstanding 6.5% convertible debentures due June 30, 2012, such amount representing 10% of the REIT's public float as of April 26, 2011. During the year ended December 31, 2011, the REIT purchased and cancelled $5,184 face value of the convertible debentures at a cost of $3,518 (average cost of $67.86 per $100 face value – price not in thousands). The REIT recorded a gain on repurchase of convertible debentures of $1,550 which represents the difference between the book value at the time of repurchase and the amount paid.

The REIT has the option to repay the principal amount of the debentures, in whole or in part, at maturity or redeem the debentures, in whole or in part, at or prior to 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 (calculated in accordance with the trust indenture). On December 22, 2011, the REIT announced that it would redeem all outstanding 6.5% convertible unsecured debentures in full on January 23, 2012 and that it would satisfy the redemption price of the debentures by issuing REIT units in lieu of cash, in accordance with the terms of the trust indenture. The debentures were redeemed on January 23, 2012. Refer to note 32.

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Debt component	42,345	61,988	61,988
Accretion of convertible debentures	3,932	7,515	5,295
Deferred financing fees	(143)	(768)	(1,348)
	46,134	68,735	65,935
Less: current portion	46,134	19,138	–
	–	49,597	65,935

(in thousands of Canadian dollars except unit amounts)

15 Convertible debentures (continued)

The following table summarizes significant changes in convertible debentures for the years ended December 31, 2011 and 2010:

	For the years ended	
	December 31, 2011 $	December 31, 2010 $
Beginning balance	68,735	65,935
Accretion of discount and deferred financing fees	2,699	2,800
Repayment of debentures at maturity	(20,238)	–
Repurchase and cancellation of debentures under NCIB	(5,062)	–
Ending balance	46,134	68,735

16 Obligations under finance leases

The REIT has various finance lease obligations for computer equipment, signage, furniture and hotel equipment.

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Present value of future minimum lease payments	90	222	507
Less: current portion of principal payments	80	132	285
	10	90	222

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

	$
Year ending December 31, 2012	84
Year ending December 31, 2013	10
Future minimum lease payments	94
Less: amounts representing interest at a weighted average rate of 9.9%	4
Present value of future minimum lease payments	90

The leases outstanding at December 31, 2011 bear interest at a weighted average annual rate of 9.9% (December 31, 2010 – 10.52%; January 1, 2010 – 10.33%). During the years ended December 31, 2011 and December 31, 2010, the REIT did not enter into any new finance leases.

(in thousands of Canadian dollars except unit amounts)

17 Derivative liabilities

Conversion option on convertible debentures

The amount recognized as a current derivative liability of $nil (December 31, 2010 – $34; January 1, 2010 - $105) results from the periodic revaluation of the conversion option related to the REIT's convertible debentures. The conversion option is subject to periodic revaluation with the subsequent adjustment reflected in the statement of loss. As at December 31, 2011, the term remaining on conversion option was 0.1 years as the REIT had advised the debentureholders that the 6.5% convertible debentures would be redeemed on January 23, 2012. The Black-Scholes option pricing model was used for the purposes of the valuation with the following assumptions:

As at December 31, 2011	June 2007 Issuance	July 2007 Overallotment
End of period unit price	$0.09	$0.09
Exercise price of conversion option	$6.15	$6.15
Term remaining on conversion option (years)	0.1	0.1
Volatility	60%	60%
Annual distribution	–	–
Discount rate	0.87%	0.87%

As at December 31, 2010	August 2006 Issuance	June 2007 Issuance	July 2007 Overallotment
End of period unit price	$0.33	$0.33	$0.33
Exercise price of conversion option	$5.40	$6.15	$6.15
Term remaining on conversion option (years)	0.66	1.5	1.5
Volatility	91.74%	98.92%	98.92%
Annual distribution	–	–	–
Discount rate	1.18%	1.33%	1.33%

As at January 1, 2010	August 2006 Issuance	June 2007 Issuance	July 2007 Overallotment
End of period unit price	$0.44	$0.44	$0.44
Exercise price of conversion option	$5.40	$6.15	$6.15
Term remaining on conversion option (years)	1.67	2.5	2.5
Volatility	89.63%	75.29%	75.29%
Annual distribution	–	–	–
Discount rate	1.24%	1.83%	1.83%

Expected volatility used in the pricing model is based on an assessment of the historical volatilities of comparable lodging and hospitality REITs in North America. Historical volatilities of several different REITs were examined over different historical time frames.

(in thousands of Canadian dollars except unit amounts)

17 Derivative liabilities (continued)

Warrants

The amount recognized as a long-term derivative liability of $10 (December 31, 2010 and January 1, 2010 - $nil) represents the value of the outstanding warrants issued with respect to the loan due to a related party (note 18). The warrants are measured at fair value with any subsequent changes in value recognized in the statement of loss. The Black-Scholes option pricing model was used for valuing the 2,100 outstanding warrants with the following assumptions:

As at December 31, 2011	
End of period unit price	$0.09
Exercise price of warrants	$0.40
Term remaining on warrants (years)	2.58
Volatility	60%
Annual distribution	–
Discount rate	0.99%

Expected volatility used in the pricing model is based on an assessment of the historical volatilities of comparable lodging and hospitality REITs in North America. Historical volatilities of several different REITs were examined over different historical time frames.

18 Loan due to a related party

On June 15, 2011, the REIT entered into an agreement with a related party, Geosam Capital Inc. ("Geosam") as administrative agent for itself and a third party, to collectively provide a non-revolving bridge loan in an amount up to $20,000. On July 29, 2011 the REIT drew $14,000 of the loan to repay the 8.0% convertible debentures.

The loan matures on March 31, 2013 and bears interest at an annual rate of 12.5%, payable monthly. The REIT may repay the loan in whole, or in part, without premium or penalty at any time prior to the maturity date.

The loan is secured by a general security agreement over the assets of the REIT and fixed charge second or third mortgages on the Holiday Inn Express Kamloops, BC, Holiday Inn Express Moncton, NB, 5 Calgary Downtown Suites Hotel Calgary, AB, Super 8 Yellowknife, NWT, Super 8 Windsor, NS, Super 8 Three Hills, AB and Super 8 Truro, NS.

The mandatory repayment provisions of the loan stipulate that the REIT must apply 75% of the sale proceeds of any asset, net of mortgage repayments, and 100% of all offering proceeds from the issuance of debt or equity securities to the loan amount outstanding.

As required by the loan agreement, the REIT issued warrants to the lender to purchase 150 units for every $1,000 drawn on the loan. At the time of drawing 2,100 warrants were issued. The warrants are exercisable for three years from the date of issuance and have an exercise price of $0.40, subject to reduction under certain anti-dilution rights to a minimum price of $0.135.

(in thousands of Canadian dollars)

18 Loan due to a related party (continued)

On August 30, 2011, the REIT repaid $1,000 of the loan amount outstanding following the sale of the Holiday Inn Express in Halifax, Nova Scotia. One of the lenders agreed to waive its $1,000 repayment for a fee of $100.

The loan was valued at its estimated fair value according to the terms and conditions in place at the time of issuance. The difference between the gross proceeds and the estimated fair value of the debt of $202 represents the value of the warrants and accordingly, was recorded as a derivative liability. The difference between the recorded value of the loan and its face value is being accreted to interest expense, using the effective interest rate method, over the term of the loan.

The following table summarizes significant changes in the loan for the years ended December 31, 2011 and 2010:

	For the years ended	
	December 31, 2011 $	December 31, 2010 $
Beginning balance	–	–
Fair value at issuance	13,798	–
Accretion	170	–
Transfer of promissory notes (note 19)	1,800	–
Repayment of debt	(1,000)	–
Ending balance	14,768	–

Subsequent to December 31, 2011, the loan was repaid in full. Refer to note 32.

19 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 minority interest investments in hotel properties. The notes were assigned by Winport Developments Limited Partnership to its partners/owners. The partners include various Dynamic mutual funds, a Gluskin Sheff mutual fund, Canadian Mortgage Capital Corporation, Holloway Investments Inc., and SLC Development Corporation, a related party. The $3,000 promissory note bore interest at 6% per year until December 22, 2011 and 12% per year, thereafter. The $552 note does not bear interest and therefore was discounted by $183 at December 22, 2008, representing the net present value of the implicit interest. The discount was being accreted to interest expense over five years, the expected term of the promissory notes. The principal of the notes is repayable on the sale of Holloway's ownership interests or the sale of the underlying properties.

On December 21, 2011, Holloway settled the remaining interest-bearing promissory note in the amount of $2,778 for $1,800 which was added to the loan due to a related party (note 18). The difference of $978 between the outstanding principal amount of the interest-bearing promissory notes and the settlement amount was recorded as a gain on settlement of promissory notes.

(in thousands of Canadian dollars except unit amounts)

19 Promissory notes payable (continued)

On December 21, 2011, Holloway repurchased the non-interest-bearing promissory notes in the amount of $458 for a cash payment of $129. The difference of $329 between the outstanding principal amount of the non-interest–bearing promissory notes and the settlement amount was recorded as a gain on settlement of promissory notes.

The following table summarizes significant changes in promissory notes payable for the years ended December 31, 2011 and 2010:

	For the years ended	
	December 31, 2011 $	December 31, 2010 $
Beginning balance	3,203	3,405
Accretion of discount	33	37
Repayment of debt	–	(239)
Transfer to loan due to a related party	(1,800)	–
Cash payment	(129)	–
Gain on settlement of promissory notes	(1,307)	–
Ending balance	–	3,203

20 Units

The REIT is authorized to issue an unlimited number of units ("units" or "REIT units") for the consideration of and on the terms and conditions according to its 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 and are not issued or traded with a par value.

Issued and outstanding units

The following presents the number of units issued and outstanding and the related ascribed values as at December 31, 2011, December 31, 2010 and January 1, 2010:

	Number of units issued and outstanding	Ascribed value $
	REIT units	REIT units
Balance, January 1, 2010	38,801,716	180,088
Exchange of Class B LP units for REIT units	230,000	131
Balance, December 31, 2010	39,031,716	180,219
Issuance of units to trustees for services	359,166	98
Balance, December 31, 2011	39,390,882	180,317

(in thousands of Canadian dollars except unit amounts)

20 Units (continued)

REIT units can be redeemed by unitholders at the lesser of: i) 90% of the weighted average market price of the units during the 10 day trading period ending immediately prior to the day on which the units were surrendered for redemption; and ii) 100% of the closing price on the redemption date. The monthly limit for cash redemptions is $50. The REIT does not expect any significant redemptions.

On April 27, 2011, the REIT initiated a NCIB to repurchase over the 12 month period commencing on April 29, 2011 and ending on April 28, 2012, up to 2,508,122 of its issued and outstanding REIT units, such amount representing 10% of the REIT's public float as of April 26, 2011. As of December 31, 2011 the REIT had contracted to purchase 20,500 units at $0.12 per unit under the NCIB with a settlement date of January 5, 2012.

On January 23, 2012, the REIT issued 714,224,023 units pursuant to the redemption of the 6.5% convertible debentures. At February 29, 2012 the REIT has 753,570,405 REIT units outstanding. Refer to note 32.

Class B Limited Partnership units ("Class B LP units")

The REIT's Class B LP units are presented as a liability at fair value. As the Class B LP units are convertible on a one-for-one basis for REIT units, the fair value reflects the market value of the outstanding Class B LP units based on the applicable closing price of REIT units.

Changes in the liability are presented as "fair value adjustment of Class B LP units and derivative liabilities" in the statement of loss. The number of Class B LP units outstanding at December 31, 2011 was 103,500 (December 31, 2010 - 103,500; January 1, 2010 - 333,500).

The following table provides the total units outstanding including the Class B LP units as well as the impact of outstanding options and warrants, if exercised, and the conversion of convertible debentures into REIT units.

	December 31, 2011	December 31, 2010	January 1, 2010
REIT units outstanding	39,390,882	39,031,716	38,801,716
Class B LP units outstanding	103,500	103,500	333,500
Options outstanding (exercisable)	457,760	973,841	1,139,837
Warrants outstanding (exercisable)	2,100,000	–	–
Conversion of convertible debentures (conversion price $5.40)	–	3,747,778	3,747,778
Conversion of convertible debentures (conversion price $6.15)[1]	7,586,992	8,429,919	8,429,919
Total units reflecting exercise and conversion	49,639,134	52,286,754	52,452,750

[1] Represents conversion of convertible debentures at the option of the holders. The REIT redeemed the debentures on January 23, 2012 by issuing 714,224,023 units. Refer to note 32.

(in thousands of Canadian dollars except unit amounts)

20 Units (continued)

Options

Movements in the number of unit options outstanding and their related weighted average exercise prices are as follows:

	2011		2010	
	Average exercise price in $ per unit	Options	Average exercise price in $ per unit	Options
At January 1	4.18	973,841	4.04	1,302,256
Granted	0.23	548,000	–	–
Forfeited	4.60	(273,749)	3.62	(328,415)
Expired	4.15	(424,999)	–	–
At December 31	1.42	823,093	4.18	973,841

Out of the 823,093 outstanding options (2010 – 973,841), 457,760 options were exercisable (2010 – 973,841).

Unit options outstanding at the end of the year have the following expiry date and exercise prices:

Expiry date	Exercise price in $ per unit	Units 2011	Units 2010
February 2011	1.00	–	79,999
November 2011	4.88	–	545,000
March 2012	4.88	26,666	36,666
March 2013	3.69	248,427	312,176
October 2016	0.23	548,000	–
		823,093	973,841

The weighted average fair value of options granted during 2011 determined using the Black-Scholes valuation model was $0.17 per option. The significant inputs into the model were the exercise price of $0.23 based on the 5 day weighted average unit price at the grant date, the closing stock price on the issuance date of $0.25, volatility of 85%, dividend/distribution, yield of 0%, an expected option life of five years and an annual risk-free interest rate of 2.3%. Volatility used in the pricing model for employee options is based on a historic volatility of the previous trading results of the REIT's units to obtain a standard deviation of unit price. The total expense recognized in the statement of loss for unit options granted to the trustees and employees was $40.

(in thousands of Canadian dollars expect unit amounts)

21 Expenses by nature

	For the years ended	
	December 31, 2011 $	December 31, 2010 $
Food, beverage and service costs	4,665	4,524
Materials, supplies, repairs and utilities	11,244	11,113
Salaries, wages and employee benefits	22,947	22,835
Insurance	492	562
Property taxes	3,615	4,143
Land lease	2,116	1,888
Management fees	1,889	1,818
Royalty and franchise fees	5,169	4,940
Legal and other fees	2,074	1,690
Depreciation and amortization	9,907	10,197
Interest and financing costs	18,523	18,849
Provision for and reversal of impairments, gain or loss on acquisition or disposals and gain on repurchase or settlement of liabilities	950	472
Other	3,368	3,688
	86,959	86,719

22 Wages and employee benefits expense

Wages and employee benefits expense:

	For the years ended	
	December 31, 2011	December 31, 2010
Salaries and wages	20,418	19,930
Benefits	2,204	2,050
RRSP/pension expense	37	41
Trustee fees (cash-based payment)	67	147
Unit-based compensation	188	15
Termination benefits	33	652
	22,947	22,835

(in thousands of Canadian dollars expect unit amounts)

22 Wages and employee benefits expense (continued)

Compensation of key management:

Key management includes the REIT's trustees, the former Chief Executive Officer who resigned December 31, 2011, the former Chief Financial Officer who resigned July 7, 2011 and the former President and Chief Operating Officer, who ceased employment on March 17, 2010. Compensation awarded to key management included:

	For the years ended	
	December 31, 2011	December 31, 2010
Salaries and benefits	542	552
Consulting fees – interim CFO	32	–
Unit-based compensation (options and units issued to trustees and key management for services)	175	15
Termination benefits	–	658
Trustee fees (cash-based payment)	67	147
	816	1,372

23 Income taxes

Reconciliation of total tax expense

The effective rate on the REIT's loss before income tax differs from the expected amount that would arise using the combined statutory income tax rates. A reconciliation of the difference is as follows:

	For the years ended	
	December 31, 2011	December 31, 2010
Loss before income taxes	(8,403)	(6,528)
Income tax rate	50.00%	50.00%
Income tax recovery at the combined statutory income tax rate	(4,202)	(6,528)
Non-taxable portion of capital (gains) and losses	353	(24)
Non-deductible unit based compensation	94	8
Impact of unused tax losses and deductible temporary differences not recognized as deferred tax assets	2,441	4,004
Impact on deferred tax asset of change in future tax rate due to the plan to convert to a corporation	1,271	–
Other	43	24
Income tax recovery	–	(2,516)

(in thousands of Canadian dollars expect unit amounts)

23 Income taxes (continued)

Deferred tax

Components of the net deferred income tax assets are as follows:

	December 31, 2010 $	Recognized in net loss $	December 31, 2011 $
Deferred income tax assets			
Deferred financing fees	456	(456)	–
Non-capital losses	7,899	(538)	7,361
Deferred income tax liabilities			
Convertible debentures	(1,273)	1,081	(192)
Deferred financing fees	–	(87)	(87)
Net deferred income tax asset	7,082	–	7,082

	January 1, 2010 $	Recognized in net loss $	December 31, 2010 $
Deferred income tax assets			
Deferred financing fees	1,615	(1,159)	456
Non-capital losses	5,216	2,683	7,899
Deferred income tax liabilities			
Convertible debentures	(2,265)	992	(1,273)
Net deferred income tax asset	4,566	2,516	7,082

The REIT has recognized deferred tax assets of $7,361 for which it is probable there will be sufficient taxable profits from operations and reversals of taxable temporary differences to facilitate utilization of the underlying tax deductible amounts.

The estimated recovery periods for the deferred tax balances are as follows:

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Deferred tax assets			
Deferred tax assets to be recovered within 12 months	6,445	994	1,159
Deferred tax assets to be recovered after more than 12 months	916	7,361	5,672
Deferred tax liabilities			
Deferred tax liabilities to be settled within 12 months	(279)	(1,081)	(992)
Deferred tax liabilities to be settled after more than 12 months	–	(192)	(1,273)
	7,082	7,082	4,566

(in thousands of Canadian dollars expect unit amounts)

23 Income taxes (continued)

Deductible temporary differences and unused tax losses for which no deferred tax assets have been recognized are attributable to the following:

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Non-capital losses	12,644	7,748	4,978
Realized capital losses	6,503	7,057	–
Loans receivable	618	80	7,087
Minority interest investments in hotel properties	151	547	636
Property and equipment and assets held-for-sale	84,568	82,990	78,521
Other assets	44	317	248
Other	77	72	129
	104,605	98,811	91,599

The REIT has incurred Canadian non-capital loss carry forwards which expire in the following years:

Year of expiry	Loss $
2026	1,043
2027	2,837
2028	4,519
2029	6,402
2030	6,699
2031	5,294
Total	26,794

The REIT's US subsidiary has incurred non-capital loss carry forwards which expire in the following years:

Year of expiry	USD loss $
2027	243
2028	341
2029	549
2030	637
2031	343
Total	2,113

(in thousands of Canadian dollars expect unit amounts)

24 Seasonality

The REIT's financial results for any individual quarter are not necessarily indicative of results to be expected for the full year. Revenues from hotel operations tend to fluctuate throughout the year. The REIT's third quarter revenues are generally the strongest and the first, second and fourth quarter revenues are generally comparable.

25 Supplemental cash flow information

Adjustments for non-cash items:

	For the years ended	
	December 31, 2011 $	December 31, 2010 $
Unit-based compensation	188	15
Depreciation and amortization	9,907	10,197
Accretion on mortgages, convertible debentures, loan due to a related party, deferred financing fees and warrants	3,274	3,093
Loss on disposal of minority interest investments in hotel properties	187	49
Loss on acquisition or disposal of hotel properties	1,528	144
Gain on repurchase of convertible debentures and settlement of promissory notes	(2,698)	–
Provision for impairment of loan receivable	1,235	–
Provision for impairment of hotel properties	3,265	–
Reversal of impairment on assets held-for-sale	(2,567)	–
Fair value adjustment of Class B LP units and derivative liabilities	(252)	(53)
Recovery of deferred income taxes	–	(2,516)
Provision for impairment on minority interest investments in hotel properties	–	423
	14,067	11,352

Changes in items of working capital:

	For the years ended	
	December 31, 2011 $	December 31, 2010 $
Trade and other receivables	(787)	(525)
Inventories	(12)	19
Prepaid expenses and deposits	776	1,871
Trade payables and accrued liabilities	(221)	672
Accrued interest on convertible debentures	841	–
	597	2,037

(in thousands of Canadian dollars expect unit amounts)

25 Supplemental cash flow information (continued)

Cash and cash equivalents are comprised of the following:

	December 31, 2011 $	December 31, 2010 $	January 1, 2009 $
Cash on hand and balances with banks	2,455	830	3,786

26 Agreements

Hotel Management Agreement

Pacrim Hospitality Services Inc.

On June 7, 2006, the REIT entered into a long-term management agreement with Pacrim Hospitality Services Inc. (“PHSI”), a related party until December 31, 2011, 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, 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 $30 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 certain reservation services for the REIT’s hotels. A commission of up to 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.

(in thousands of Canadian dollars)

26 Agreements (continued)

Pacrim Hospitality Services Inc. (continued)

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 paid to Pomeroy in consideration of the assignment (note 10).

Upon certain change of control events, as set out in the Hotel Management Agreement, PHSI is entitled to terminate the entire Hotel Management Agreement upon 60 days prior written notice to Holloway Lodging Limited Partnership and the REIT and to receive a lump sum payment of $1,500 in connection with such termination, without detracting from any other remedies available to it under the terms of the Hotel Management Agreement. In addition, PHSI shall be entitled to receive a one-time fee in the amount of the aggregate outstanding principal and accrued and unpaid interest on the loan as of the termination date of the Hotel Management Agreement. Such fee shall be withheld by Holloway Lodging Limited Partnership and used directly to repay the loan in full.

On July 7, 2010, pursuant to the acquisition of the Super 8 hotel in Windsor, Nova Scotia, PHSI agreed to defer its management and accounting fees until June 30th of each calendar year. PHSI is entitled to receive a payment calculated as 3/5th of 50% of the hotel's "free cash flow" for the prior twelve months (thirteen months for 2010-2011). Free cash flow is defined as net operating income less first mortgage debt service and 3% of total revenues for reserve for replacement. The payment is due on or before July 25th of each year. Any unpaid balance of the fees will be applied against the principal balance of the loan receivable from PHSI (note 10). The terms of the agreement will be revisited annually before June 30th for the foregoing twelve months.

Non-competition, Right of First Opportunity and Participation Agreement

On June 22, 2007, the REIT entered into a non-competition, right of first opportunity and participation agreement with Pomeroy Gold Ltd. The agreement has a five year term 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.

(in thousands of Canadian dollars)

27 Contingencies and commitments

Contingencies

In the course of the REIT's ordinary activities, the REIT is involved in administrative proceedings, litigations and claims. The REIT believes that either there are valid defences to any actions or that the outcome will not have a material impact on the REIT's consolidated financial position or results of operations.

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	
Royalty fee	5% - 6%
Marketing assessment	1.5% - 2%
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%
To Best Western International, Inc.	
Annual dues	$54

Operating leases

The REIT has various equipment operating leases at several properties.

The minimum annual lease payments over the next five years, after considering the subsequent events detailed in note 32, are as follows:

	Operating leases $
Year ending December 31, 2012	108
2013	49
2014	38
2015	26
2016	18

(in thousands of Canadian dollars)

27 Contingencies and commitments (continued)

Land lease

The REIT 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. The REIT is required to pay an annual ground lease participation fee 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 fee, recorded for 2011 and 2010 was $2,116 and $1,888, respectively.

On January 12, 2012, the REIT closed the sale of its leasehold interest in the 5 Calgary in Calgary, AB. Refer to subsequent events note 32.

Lease revenue

The REIT is committed to lease space in some of its hotels to outside parties. The minimum annual revenue from future rentals, after considering the subsequent events detailed in note 32, is expected to be as follows:

	$
Year ending December 31, 2012	371
2013	286
2014	174
2015	145

(in thousands of Canadian dollars)

28 Related party transactions

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

Pacrim Hospitality Services Inc. and Winport Developments Inc. are considered related parties, until December 31, 2011, the resignation date of Glenn Squires, Holloway's former CEO.

	December 31, 2011 $	December 31, 2010 $
Pacrim Hospitality Services Inc. (PHSI), a company in which a former member of management has a significant ownership interest		
Hotel management, accounting and related fees	2,352	2,462
Head office rent and office operating expenses	126	112
Reimbursable expenses related to hotels managed under reduced fee	448	481
Reservation services commissions paid to Intergy, a division of PHSI	318	379
Interest income on loan receivable	62	63
Capital purchasing fees and project management fees capitalized to property and equipment	95	41
Included in accounts payable and accrued liabilities	214	270
Winport Developments Inc., a company in which a former member of management has a significant ownership interest		
Interest income on loan	17	17
Superior Lodging Corp., a company in which a trustee is a member of management and has an ownership interest		
Royalty fees	527	459
Included in accounts payable and accrued liabilities	37	–
Geosam Capital Inc., a company in which one trustee has a significant ownership interest		
Interest expense on loan	707	–
Waiver fee	100	–
Geosam Investments Limited, a company in which a direct relative of one trustee has a significant ownership interest		
Consulting fees	65	–
Included in accounts payable and accrued liabilities	39	–

29 Segment reporting

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

(in thousands of Canadian dollars)

29 Segment reporting (continued)

Geographical information

	For the years ended	
	December 31, 2011 $	December 31, 2010 $
Revenues		
Canada	76,392	71,523
United States	2,012	1,928
	78,404	73,451

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Property and equipment			
Canada	160,882	229,990	234,739
United States	6,295	6,210	5,499
	167,177	236,200	240,238

30 Financial instruments and fair values

Measurement categories, fair values, valuation methods and assumptions

As explained in note 3, financial assets and liabilities have been classified into categories that determine their basis of measurement and, for items measured at fair value, whether changes in fair value are recognized in the statement of loss or comprehensive loss. Those categories are: fair value through profit or loss; loans and receivables; available-for-sale assets; and, for liabilities, amortized cost. The following table shows the carrying values of assets and liabilities for each of these categories at December 31, 2011 and 2010 and January 1, 2010.

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

	December 31, 2011		December 31, 2010		January 1, 2010	
	Carrying value $	Fair value $	Carrying value $	Fair value $	Carrying value $	Fair value $
Assets						
Loans and receivables						
Cash and cash equivalents	2,455	2,455	830	830	3,786	3,786
Restricted cash	249	249	551	551	560	560
Capital reserve – internally restricted	128	128	921	921	912	912
Capital reserve – restricted	3,662	3,662	5,440	5,440	4,691	4,691
Trade and other receivables	3,974	3,974	2,962	2,962	3,125	3,125
Loans receivable	4,938	2,256	6,398	2,461	6,509	2,214
	15,406	12,724	17,102	13,165	19,583	15,288
Available-for-sale						
Minority interest investments in hotel properties	850	850	777	777	912	912
Liabilities						
Amortized cost						
Line of credit	4,822	4,822	2,519	2,519	–	–
Trade payables and accrued liabilities	8,545	8,545	8,595	8,595	8,494	8,494
Accrued interest on convertible debentures	1,516	1,516	675	675	675	675
Mortgages and loans payable	139,053	134,797	152,593	150,318	153,483	152,929
Convertible debentures	46,134	21,930	68,735	50,775	65,935	44,254
Obligations under finance leases	90	90	222	222	507	507
Loan due to a related party	14,768	14,768	–	–	–	–
Promissory notes payable	–	–	3,203	3,203	3,405	3,405
	214,928	186,468	236,542	216,307	232,499	210,264
Fair value through profit and loss						
Derivative liabilities	10	10	34	34	105	105
Class B LP units	9	9	34	34	147	147
	19	19	68	68	252	252

The carrying value of the following items approximate their fair value due to the immediate or short-term maturities of these financial instruments: cash and cash equivalents, restricted cash, capital reserves – internally restricted and restricted, trade and other receivables, line of credit, trade payables and accrued liabilities and accrued interest on convertible debentures.

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

The methods and assumptions used in estimating the fair value of other financial assets and liabilities are as follows:

- Minority interest investments in hotel properties: The fair value is determined using internal valuation techniques. The REIT uses an earnings approach based on the hotel's recent operating performance to determine the value of the investment and deducts the outstanding debt on the hotel property.
- Mortgages and loans payable, obligations under finance leases and loan due to a related party: The fair value is determined using internal valuation techniques which incorporate the discounted future cash flows using discount rates that reflect current market conditions for debt instruments with similar interest rates, terms and risk. The fair values do not necessarily represent the amounts the REIT might pay in actual market transactions.
- Convertible debentures: The fair value is determined based on the closing trading price on the TSX at December 31, 2011, December 31, 2010 and December 31, 2009 for the opening value on January 1, 2010.
- Derivative liabilities: The fair value of the conversion option on convertible debentures and warrants is determined using the Black-Scholes option pricing model. Refer to note 17.
- Class B LP units: The fair value is determined based on the closing trading price of the REIT's units on the TSX at December 31, 2011, December 31, 2010 and December 31, 2009 for the opening value on January 1, 2010 as the Class B LP units are convertible into REIT units.

Fair value hierarchy

The following table classifies financial assets and liabilities that are recognized on statement of financial position at fair value in a hierarchy that is based on the significance of the inputs used in making the measurements. The levels in the hierarchy are:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices);
- Level 3 – Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

Fair value hierarchy (continued)

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Level 1			
Class B LP units	9	34	147
Level 2			
Derivative liabilities	10	34	105
Level 3			
Minority interest investments in hotel properties	850	777	912

Risk management

The REIT's activities expose it to a variety of financial risk: interest rate risk, credit risk, currency risk and liquidity risk. Senior management is responsible for setting acceptable levels of risk and reviewing risk management activities as necessary.

The Board Trustees and the REIT's Declaration of Trust provide principles for overall risk management. The REIT's overall risk management program seeks to minimize potential adverse effects on the REIT's financial performance.

a) 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 primarily using fixed rate debt so cash flow is not impacted significantly by a change in interest rates. The REIT has $11,053 in mortgages maturing in the next 12 months excluding mortgages on assets held-for-sale. The weighted average interest rate on its mortgages payable is 6.68% (December 31, 2010 - 6.75%; January 1, 2010 – 6.82%) with a weighted average maturity of 4.9 years (December 31, 2010 - 4.7 years; January 1, 2010 – 5.4 years).

The convertible debentures have a weighted average interest rate of 6.5% (December 31, 2010 - 6.9%; January 1, 2010 – 6.9%) and a weighted average maturity of 0.1 years as the REIT redeemed the convertible debentures on January 23, 2012 (December 31, 2010 - 1.2 years; January 1, 2010 – 2.2 years).

The REIT has one mortgage at a floating rate equivalent to the 90 day bankers' acceptance rate plus 501 basis points. The REIT's lines of credit are at floating rates. For the year ended December 31, 2011, a 1% change in interest rates would change the net loss by $41 (year ended December 31, 2010 - $3).

b) Credit risk

The credit risk on cash and cash equivalents is limited because the counter-parties are banks with high credit-ratings assigned by international credit-rating agencies.

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

Risk management (continued)

b) Credit risk (continued)

The amount of trade and other receivables disclosed on the balance sheet of $3,974 is net of allowance for doubtful accounts, estimated by management based on prior experience and their assessment of the current economic environment.

Historically, there have been no significant collection issues and the REIT does not believe it is subject to any significant concentration of credit risk. The hotel management company is responsible for assessing the credit worthiness of customers requesting credit and listings of trade receivables are reviewed by them and discussed with operations personnel on a monthly basis.

The allowance for doubtful accounts is generally recorded for trade receivable balances outstanding for more than 120 days. Amounts charged to the allowance are generally written off when there is no expectation of recovering additional cash.

The following table sets forth details of trade and other receivables and the related allowance for doubtful accounts:

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Trade and other receivables under 30 days aged	854	1,867	1,503
Trade and other receivables over 30 days aged	3,286	1,178	1,752
Less: Allowance for doubtful accounts	(166)	(83)	(130)
	3,974	2,962	3,125

The REIT is exposed to credit risk on its loans receivable (note 10).

c) Currency risk

The REIT earns revenue and incurs expenses in US currency from its hotel in Myrtle Beach, South Carolina, US, and as such, is subject to fluctuations as a result of foreign exchange rate variations. The REIT manages its exposure to currency risk by billing for its services in the US 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. The REIT does not hedge foreign currency exposures. However, a $0.01 change in the US dollar exchange rate will change the cumulative translation adjustments recognized in other comprehensive income by $18 (year ended December 31, 2010 - $43).

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

Risk management (continued)

d) 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 agreements and its capital management requirements and objectives. Cash flow forecasting is performed at the hotel level and aggregated in head office.

The REIT has $11,012 in mortgages that mature in the next 12 months excluding those classified as held-for-sale. The REIT expects to refinance its maturing mortgages at similar or better terms with existing or other lenders.

The REIT has $46,660 face value of convertible debentures included in current liabilities. On January 23, 2012, the REIT redeemed the debentures by issuing 714,224,023 units to the debentureholders. See note 32.

The REIT monitors and forecasts its cash balances and cash flows generated from operations to meet its required obligations. At December 31, 2011, the REIT had drawn $4,822 (December 31, 2010 - $2,519; January 1, 2010 - $nil) from its available lines of credit of $5,500. At February 29, 2012 the amount drawn had been reduced to $2,972.

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

The table below analyzes the REIT's non-derivative financial liabilities into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

	December 31, 2011			
	Less than 3 months	**3 months to 1 year**	**2 to 5 years**	**Over 5 years**
Line of credit	4,822	–	–	–
Trade payables and accrued liabilities	8,545	–	–	–
Accrued interest on convertible debentures	1,516	–	–	–
Mortgages and loans payable	842	13,501	26,589	75,528
Convertible debentures	46,134	–	–	–
Obligations under finance leases	20	60	10	–
Mortgages on assets held-for-sale	23,156	–	–	–
Loan due to a related party	–	–	14,768	–

(in thousands of Canadian dollars)

30 Financial instruments and fair values (continued)

Risk management (continued)

				December 31, 2010
	Less than 3 months	3 months to 1 year	2 to 5 years	Over 5 years
Line of credit	2,519	–	–	–
Trade payables and accrued liabilities	8,595	–	–	–
Accrued interest on convertible debentures	675	–	–	–
Mortgages and loans payable	1,277	29,230	40,557	82,570
Convertible debentures	–	19,138	49,597	–
Obligations under finance leases	33	99	90	–
Promissory notes payable	–	–	3,203	–

				January 1, 2010
	Less than 3 months	3 months to 1 year	2 to 5 years	Over 5 years
Trade payables and accrued liabilities	8,494	–	–	–
Accrued interest on convertible debentures	675	–	–	–
Mortgages and loans payable	1,174	12,427	54,793	86,091
Convertible debentures	–	–	65,935	–
Obligations under finance leases	71	214	222	–
Promissory notes payable	–	–	3,405	–

31 Capital management

The REIT defines capital as the aggregate of 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, 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, redeem or repay debt and/or issue or redeem units or sell assets to reduce debt.

(in thousands of Canadian dollars)

31 Capital management (continued)

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

- a debt to gross book value ("Debt to GBV") ratio defined as line of credit, mortgages and loans payable, loan due to a related party, obligations under finance leases, the face value of promissory notes, the face value of convertible debentures, derivative liabilities and Class B LP units ("Debt") divided by total assets plus impairment losses, depreciation and amortization ("GBV"). The REIT's Declaration of Trust states that the REIT's Debt to GBV should not exceed 60%; and

- a debt service coverage ratio defined as earnings before interest, income taxes, depreciation, amortization, non-cash accretion, fair value adjustments for Class B LP units and derivative liabilities, gains or losses on the repurchase of convertible debentures and unit-based compensation ("earnings base") to the sum of the annual principal and interest payments on mortgages, loans, promissory notes and finance leases ("debt service").

	December 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Capital structure			
Line of credit	4,822	2,519	–
Derivative liabilities	10	34	105
Class B LP units	9	34	147
Obligations under finance leases	90	222	507
Mortgages and loans payable	115,897	152,593	153,483
Mortgages on assets held-for-sale	23,156	–	–
Loan due to a related party	14,768	–	–
Convertible debentures	46,134	68,735	65,935
Promissory notes payable	–	3,203	3,405
Total debt	204,886	227,340	223,582
Equity	20,282	28,147	38,197
Total capital	225,168	255,487	261,779
Ratios			
Total debt	204,886	227,340	223,582
Adjustment of convertible debentures to face value	526	3,313	6,042
Adjustment of promissory notes to face value	–	110	147
Debt	205,412	230,763	229,771
Gross book value	382,599	402,802	399,149
Debt to GBV	53.7%	57.3%	57.6%

	For the years ended	
	December 31, 2011 $	December 31, 2010 $
Earnings base	20,269	16,612
Debt service	20,625	20,994
Debt service coverage ratio	0.98	0.79

(in thousands of Canadian dollars)

31 Capital management (continued)

The REIT is also subject to financial covenants on its mortgages payable, the majority of which are measured on an annual basis and include customary terms and conditions for borrowings of this nature. These include the debt service coverage ratio presented above. Some of these covenants were in violation at the period-end dates. All of the mortgages which were in violation of financial covenants at December 31, 2011 mature within the next twelve months and have been classified as current liabilities. The carrying amount of these mortgages is $11,259 (December 31, 2010 - $10,627; January 1, 2010 - $37,018). A portion of the mortgage on the Holiday Inn Express in Moncton, NB matured on December 14, 2011 but was extended beyond such date. Subsequent to the end of the period the lender, Roynat Capital, delivered to the REIT a Notice of Intention to enforce security, although it agreed to forbear from doing so provided the REIT complies with certain conditions, including refinancing the mortgage with another lender by April 15, 2012. The REIT has signed a letter of interest to refinance this mortgage with another lender.

As a result of discussions with its lenders and the receipt of a waiver on the covenant breach on the line of credit subsequent to December 31, 2011, management believes the other mortgages with covenant breaches will not be called prior to maturity.

32 Subsequent events

On January 12, 2012, the REIT closed the sale of its leasehold interest on the 5 Calgary Downtown Suites hotel in Calgary, AB. At December 31, 2011, the REIT reversed a previously recognized impairment of $2,567. The REIT received net proceeds after repayment of the mortgage and estimated closing costs of approximately $6,900 and anticipates receiving an additional $500 on the release of a holdback for certain contingencies related to the sale. Under the terms of the REIT's loan due to a related party, the REIT is required to repay a least 75% of the net proceeds resulting from the sale on the loan due to a related party. The REIT repaid $5,500 on the loan due to a related party.

On January 23, 2012, the REIT redeemed the remaining $46,660 principal amount of the 6.5% convertible debentures by issuing 714,224,023 units to the debentureholders. The number of REIT units issued to the debentureholders was determined by dividing the aggregate principal amount of the debentures outstanding by 95% of the weighted average trading price per unit for the 20 consecutive trading days ending on the fifth trading day preceding the redemption date (the "current market price"). The 20 trading day period commenced on and included December 15, 2011 and ended on and included January 16, 2012. The current market price was determined to be approximately $0.069 (rounded) and the units were issued to the debentureholders at a conversion price of $0.065 (rounded).

On February 1, 2012, the REIT closed the sale of the Radisson Suites hotel in Fort McMurray, AB. The REIT expects to record a gain on the sale of approximately $4,100. The REIT received net proceeds after repayment of the mortgage and estimated closing costs of approximately $11,100 cash proceeds and a vendor take-back mortgage of $3,000. The vendor take-back mortgage has a one-year term and bears interest at 10%. Under the terms of the REIT's loan due to a related party, the REIT is required to repay at least 75% of the net proceeds resulting from the sale on the credit facility. The REIT repaid the remaining $9,300 on the loan due to a related party and it has been repaid in full. The REIT also repaid $1,600 on its line of credit.

(in thousands of Canadian dollars)

33 Transition to IFRS

The effect of the REIT's transition to IFRS, described in note 2, is summarized in this note as follows:

i. Transition elections and exemptions;

ii. Reconciliation of equity, net loss and comprehensive loss as previously reported under Canadian GAAP to IFRS;

iii. Adjustments to the statement of cash flows;

iv. Additional reconciliations of key balances as previously reported under Canadian GAAP to IFRS; and

v. Explanatory notes.

The REIT has applied the following transition exceptions and exemptions to full retrospective application of IFRS:

i) Transition elections and exemptions

IFRS 1 – *First time adoption of IFRS ("IFRS 1")*

Generally, the conversion to IFRS requires an entity to present its financial statements as if it had always reported under IFRS. IFRS 1 provides guidance on the initial adoption of IFRS and provides certain exceptions and exemptions to full retrospective application of IFRS which an entity may elect. The key exceptions and exemptions elected by the REIT are as follows:

(in thousands of Canadian dollars)

33 Transition to IFRS (continued)

i) Transition elections and exemptions (continued)

IFRS 1 – *First time adoption of IFRS ("IFRS 1")* (continued)

Business combinations - IFRS 1 provides the option to apply IFRS 3, *Business Combinations*, retrospectively or prospectively from the transition date January 1, 2010. Applying the standard retrospectively would require restatement of all business combinations that occurred prior to the transition date. The REIT elected not to retrospectively apply IFRS 3 to business combinations that occurred prior to its transition date and such business combinations have not been restated.

Cumulative translation adjustments - Retrospective application of IFRS would require the REIT to determine the cumulative currency translation differences in accordance with IAS 21, *The Effects of Changes in Foreign Exchange Rates*, from the date a subsidiary or equity method investee was formed or acquired. IFRS 1 permits cumulative translation gains and losses to be reset to zero at the transition date. The REIT elected to reset all cumulative translation gains and losses to zero in opening deficit at its transition date.

Borrowing costs - IAS 23, *Borrowing Costs*, requires an entity to capitalize the borrowing costs related to all qualifying assets for which the commencement date for capitalization is on or after January 1, 2009. At transition to IFRS, the REIT elected not to retroactively apply this standard. Borrowing costs prior to the transition date were expensed.

Deemed cost of property and equipment – IFRS 1 allows an entity to measure an item of property and equipment at its fair value at the transition date and use that fair value as its deemed cost at the transition date. The REIT elected to revalue certain items of property and equipment to fair value at the transition date and as such, recognized a reduction of $16,644 in deficit.

Estimates – IFRS 1 requires an entity's estimates at the date of transition to IFRS to be consistent with estimates made for the same date in accordance with previous GAAP unless there is objective evidence that those estimates were in error. At transition to IFRS, the REIT had applied all estimates made under previous GAAP consistently for the same dates presented in the financial statements.

Share based payments – The REIT will not apply IFRS 2 *Share-based Payments* to any equity instruments that were granted on or before November 7, 2002, or to equity instruments granted after November 7, 2002 that vested before January 1, 2010.

(in thousands of Canadian dollars)

33 Transition to IFRS (continued)

ii) Reconciliation of equity, net loss and comprehensive loss as previously reported under Canadian GAAP to IFRS

Equity

	Note 33 (v)	December 31, 2010 $	January 1, 2010 $
Unitholders' equity as reported under Canadian GAAP		105,820	125,712
IFRS adjustments increase (decrease):			
Exchange of Class B LP units	e	131	–
Impact of earnings adjustments		9,368	–
Property and equipment:			
Revaluation	a	16,644	16,644
Impairment	b	(103,560)	(103,560)
Adjustment to fair value of minority interest investments in hotel properties	c	(440)	(1,049)
Fair value adjustment of conversion option on convertible debentures	d	(105)	(105)
Fair value adjustment of Class B LP units	e	(147)	(147)
Impact of foreign exchange	f	436	702
Equity as reported under IFRS		28,147	38,197

(in thousands of Canadian dollars)

33 Transition to IFRS (continued)

ii) Reconciliation of equity, net loss and comprehensive loss as previously reported under Canadian GAAP to IFRS (continued)

Net loss and comprehensive loss

	Note 33 (v)	Year ended December 31, 2010 $
Net loss and comprehensive loss as reported under Canadian GAAP		(19,907)
Decrease (increase) in net loss for:		
Reduction of depreciation on revaluation and impairment of property and equipment	a,b	2,789
Reversal of hotel impairment loss under Canadian GAAP	b	6,768
Fair value adjustment of conversion option on convertible debentures	d	72
Fair value adjustment of Class B LP units	e	(19)
Reversal of unrealized foreign exchange gains under Canadian GAAP	f	(242)
		9,368
Net loss under IFRS		(10,539)
Increase (decrease) in other comprehensive loss for:		
Changes in minority interest investments in hotel properties	c	609
Cumulative foreign exchange adjustments	f	(266)
Comprehensive loss under IFRS		(10,196)

iii) Adjustments to the statement of cash flows

The transition from Canadian GAAP to IFRS had no significant impact on the cash flows generated by the REIT except that the previously unrecognized fair value adjustments on the Class B LP units and the derivative liability included in the determination of net loss are now included as an adjustment for non-cash items on the statement of cash flows.

In addition, under IFRS changes in the translation of the REIT's foreign operation are recognized in other comprehensive income and not on the statement of loss. Under Canadian GAAP, unrealized foreign exchange gains or losses were included on the statement of loss and were included as an adjustment for non-cash items on the statement of cash flows.

(in thousands of Canadian dollars)

33 Transition to IFRS (continued)

iv) Additional reconciliations of key balances as previously reported under Canadian GAAP to IFRS

a) Deficit:

	Note 33 (v)	December 31, 2010 $	January 1, 2010 $
Deficit as reported under Canadian GAAP		(45,012)	(25,105)
IFRS adjustments increase (decrease):			
Accumulated distributions reclassified to deficit	g	(40,893)	(40,893)
Impairment of property and equipment	b	(103,560)	(103,560)
Revaluation of property and equipment	a	16,644	16,644
Reduction of depreciation expense on revaluation and impairment of property and equipment	a,b	2,789	–
Reversal of hotel impairment loss recognized under Canadian GAAP	b	6,768	–
Portion of the equity component of convertible debentures reclassified to deficit	d	9,490	9,490
Portion of the Class B LP units reclassified to deficit		520	520
Fair value adjustment of conversion option on convertible debentures	d	72	–
Conversion and fair value adjustment of Class B LP units	e	(19)	–
Reversal of foreign exchange gain recognized under Canadian GAAP		(242)	–
Adjustments for impact of foreign exchange	f	703	703
Total deficit as reported under IFRS		(152,740)	(142,201)

b) Property and equipment:

	Note 33 (v)	December 31, 2010 $	January 1, 2010 $
Property and equipment as reported under Canadian GAAP		313,374	326,465
IFRS adjustments increase (decrease):			
Revaluation	a	16,644	16,644
Impairment	b	(103,560)	(103,560)
Reversal of hotel impairment loss recognized under Canadian GAAP	b	6,768	–
Change in accumulated depreciation	b	2,789	–
Foreign exchange	f	185	689
Property and equipment as reported under IFRS		236,200	240,238

(in thousands of Canadian dollars)

33 Transition to IFRS (continued)

iv) Additional reconciliations of key balances as previously reported under Canadian GAAP to IFRS (continued)

c) Minority interest investments in hotel properties

	Note 33 (v)	December 31, 2010 $	January 1, 2010 $
Minority interest investments in hotel properties as reported under Canadian GAAP		1,217	1,961
IFRS adjustments increase (decrease):			
Fair value adjustment recognized on transition in other comprehensive income	c	(1,049)	(1,049)
Fair value adjustment recognized in other comprehensive income during the period	c	(145)	–
Sale of investments in hotel properties		295	–
Recovery in value	c	36	–
Recognition of impairment in net loss	c	423	–
		(440)	(1,049)
Minority interest investments in hotel properties as reported under IFRS		777	912

v) Explanatory notes

a) In accordance with IFRS transitional provisions, the REIT elected to use fair value as deemed cost for certain of its property and equipment resulting in an increase of $16,644 to its fair value of $105,769 at January 1, 2010. The fair value of the property and equipment was determined by third party independent appraisals as well as the REIT's internal valuation models which incorporated estimates of discounted future cash flows and market based discount and capitalization rates.

(in thousands of Canadian dollars)

33 Transition to IFRS (continued)

v) Explanatory notes (continued)

b) An impairment loss of $103,560 relating to property and equipment was recognized in deficit at January 1, 2010. This adjustment arose because under IFRS the recoverable amount used in recognizing and measuring an impairment is the higher of the asset's fair value less costs to sell and its value in use. Under Canadian GAAP, the recoverable amount used to determine whether recognition of an impairment loss is required is the undiscounted future cash flows expected from its use and eventual disposition. At December 31, 2010, an impairment loss of $6,768 was recognized under Canadian GAAP. This loss was reversed under IFRS as the impairment amounts associated with the property were recognized directly in equity on transition at January 1, 2010.

For the purposes of determining the specific impairment adjustments, each hotel property and the associated assets were considered a separate CGU.

The recoverable amount of each CGU is based on its value in use and was derived using a combination of independent third party appraisals or the REIT's internal valuation models which incorporated estimates of discounted future cash flows for a ten year period.

The use of CGU specific discount rates was derived based on independent third party market and opinion surveys specific to the geographic location of the CGU, the economic environment in which it operates and the specific hotel property.

The following are key assumptions used in the value in use calculations:

Discount rates: 9% to 13%
Capitalization rates: 10% to 12%
Growth rates: Consistent with management forecasts and industry reports.

All discount rates and cash flows are pre tax and reflect the risks and growth estimates in relation to the specific CGU.

As a result of the impairment loss, the decrease in depreciation expense is recognized over the estimated useful life of the applicable components of property and equipment and is reflected in the statement of loss.

(in thousands of Canadian dollars)

33 Transition to IFRS (continued)

v) Explanatory notes (continued)

c) In accordance with IFRS, minority interest investments in hotel properties are considered available-for-sale financial instruments and are measured at fair value with changes in fair value recognized in other comprehensive income ("OCI"). Significant or prolonged declines in fair value are removed from OCI and recognized in the statement of loss. Under Canadian GAAP, these investments were measured at cost with a provision for other than temporary impairment recognized in the statement of loss. The adjustments to the carrying value of the investments to recognize this difference were ($1,049) at January 1, 2010 and ($440) at December 31, 2010.

d) In accordance with IFRS, an obligation to issue units associated with the REIT's convertible debentures is classified as a derivative liability and measured at fair value with any subsequent changes in value recognized in the statement of loss. The REIT has recorded these changes as a "fair value adjustment of derivative liability". Under Canadian GAAP, this conversion option was classified as a separate component of equity at the issuance date and changes in fair value were not recognized. This change increased liabilities at January 1, 2010 by $105 and $34 at December 31, 2010 and decreased equity by $105 at January 1, 2010.

e) In accordance with IFRS, the REIT is required to reclassify the outstanding Class B LP units as a liability measured at fair value with changes recognized in the statement of loss. The REIT has recorded these changes as a "fair value adjustment of Class B LP units". Under Canadian GAAP, the Class B LP units were classified as a separate component of equity and changes in fair value were not recognized. This change increased liabilities at January 1, 2010 by $147 and $34 at December 31, 2010 and change to equity of $147.

f) In accordance with IFRS, the REIT now translates assets and liabilities of its foreign subsidiary using the exchange rate as at the balance sheet date with gains or losses recorded as cumulative translation adjustments in other comprehensive income. Under Canadian GAAP, the adjustments related to the translation of this foreign subsidiary were recognized through the statement of loss, at the historical rate for non-monetary assets and liabilities and the current rate for monetary assets and liabilities. As a result of this change, an adjustment of $703 was recognized in deficit at January 1, 2010 and ($266) at December 31, 2010.

g) On transition to IFRS, amounts previously recognized as a separate component of equity related to accumulated distributions paid to unitholders were reclassified to the opening deficit balance at January 1, 2010 and December 31, 2010.