

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Interim Financial Statements

For the six months ended June 30, 2003 and June 30, 2002

(Unaudited)

MANAGEMENT DISCUSSION AND ANALYSIS

In the first half of 2003, the war in Iraq, airline difficulties, SARS and the sluggish economy have negatively impacted Royal Host's operating results. The impact of these events became more severe as the year progressed. In response, Royal Host reduced distributions to unitholders in July 2003 from \$.06 per unit per month to \$.02 per unit per month bringing total expected distributions for calendar 2003 to \$.48 per unit. This reduction will preserve approximately \$1.1 million in cash per month for the REIT. Also, on a go forward basis, this will allow Royal Host to establish a more conservative pay out ratio relative to the cash that is generated from operations.

During the first six months of 2003, Royal Host's operating results were positively impacted by the acquisition of the Belleville, Trenton and Calgary hotels. The Belleville and Trenton hotels were acquired in July of 2002 and the Calgary hotel was purchased on April 1, 2003. Royal Host's six month results were also impacted by the expiration of the lease and take over of operations, for the Yellowknife hotel in November of 2002.

On April 1st 2003, Royal Host completed the purchase of the 160 room Calgary Best Western Village Park Inn. To help finance the purchase, the Belleville and Trenton hotels were mortgaged for gross proceeds of \$6.1 million. The mortgages are repayable after 10 years and have a rate of approximately 8.4% with a 20 year amortization.

Financial results for the three months ended June 30, 2003

HOSPITALITY REVENUES

Total hospitality revenues in the second quarter of 2003 increased by \$2.3 million or 6.7% compared to the same quarter in 2002. The increase was due to the inclusion of the Belleville, Trenton, Calgary and Yellowknife hotels' operating results in the second quarter of 2003.

ROOM REVENUES

Room revenues in the second quarter of 2003 increased by \$1.4 million compared to the second quarter of 2002 due to an increased number of rooms in the hotel portfolio resulting from the new acquisitions. For the portfolio as a whole however, revenue per available room ("RevPAR") decreased year-over-year by 3.9% to \$56.97 in the second quarter of 2003, as both occupancies and average daily rates declined by 0.9% and 3.1% respectively.

FOOD AND BEVERAGE

The addition of food and beverage operations at the new Belleville, Trenton, Calgary and Yellowknife properties resulted in food and beverage revenues being \$1.6 million higher in the second quarter of 2003 compared to the same quarter in 2002. As a result of the new additions, food and beverage revenues have increased to 20.4% of total revenues in the second quarter of 2003 from 17.2% for the same quarter of 2002.

OTHER HOSPITALITY REVENUES

Other hospitality revenues decreased by \$744,000 to \$3.8 million in the second quarter of 2003 from \$4.5 million in the same quarter of 2002. The decrease was due to reduced timeshare revenues and lower lease revenue associated with the expiration of the operating lease at the Yellowknife hotel on October 31, 2002.

HOSPITALITY EXPENSES

For the second quarter of 2003, total hospitality expenses increased by \$4.6 million compared to the second quarter of 2002. More than \$3.8 million of this increase was due to the addition of the operating results of the three newly acquired hotels and the takeover of the Yellowknife operations. Also,

approximately \$550,000 in one-time charges related to receivable allowances, severance and non-repeatable expenses were realized in the second quarter of 2003.

GROSS MARGIN

Gross margin decreased to 23.2% in the second quarter of 2003 from 31.5% in the same period of 2002. The three newly acquired hotels are partially responsible for the decrease in margins as they have a higher proportion of food and beverage revenues and consequently operate at lower margins than Royal Host's original portfolio. As was previously noted, expiration of the Yellowknife lease, which was in place for most of fiscal 2002, also had a negative impact on the gross margin in the second quarter of 2003. In 2002 the Yellowknife hotel was leased to a third party operator who paid Royal Host a flat lease amount of approximately \$500,000 per quarter. In 2003 Royal Host has recognized revenue and expenses from the Yellowknife hotel based on actual operating results. This has had the impact of reducing operating margins for Royal Host in 2003, since the lease revenue in 2002 had no associated costs.

OTHER (INCOME) AND EXPENSES

Total other (income) and expenses decreased by \$577,000 in second quarter 2003 compared to second quarter 2002. Major variances include: higher interest expense; increased trust administration; increased capital and other taxes; and a substantial recovery in future income taxes and an unrealized foreign currency loss (both non-cash items).

NET EARNINGS

Earnings in the second quarter of 2003 were \$636,000 compared to \$2.4 million in the same quarter of 2002.

CASH AVAILABLE FOR DISTRIBUTION

After adjusting for interest payments on convertible debentures and distributions on redeemable partnership units for the three months ended June 30, 2003, cash available for distribution was \$2.1 million compared to \$5.3 million in 2002. Distributions to unitholders, excluding distributions on redeemable partnership units, totaled \$4.5 million (\$4.5 million in 2002) for the same period.

	For the three months ended	
	June 30, 2003	June 30, 2002
	(\$000's)	(\$000's)
Cash available for distribution		
Net earnings	636	2,355
Add (deduct):		
Amortization of capital assets	4,281	4,562
Amortization of deferred financing fees	168	80
Unrealized loss on translation of foreign subsidiaries	212	-
Future income tax (recovery) expense	(1,281)	184
Cash available for distribution	4,016	7,181
Distributions on redeemable partnership units	(567)	(567)
Interest on 8% convertible debentures	(439)	(439)
Interest on 9.25% convertible debentures	(923)	(923)
Basic adjusted cash available for distribution	2,087	5,252
Per unit	\$ 0.08	\$ 0.21
Weighted average units outstanding	24,690,000	24,499,000

Financial results for the six months ended June 30th 2003

HOSPITALITY REVENUES

Total hospitality revenues in the first six months of 2003 increased by \$5.0 million or 8.3% compared to the same period in 2002. The increase was primarily due to the inclusion of the Belleville, Trenton and Yellowknife hotels' operating results in the first six months of 2003 and the Calgary Best Western beginning April 1, 2003.

ROOM REVENUES

For the first six months of 2003, room revenues increased by \$3.7 million due to the addition of rooms to the hotel portfolio. RevPAR was relatively unchanged at \$52.87 compared to \$52.97 during the same period in 2002, as occupancy increased by 2.9% and average daily rate decreased by 2.9% in 2003.

FOOD AND BEVERAGE

Year-over-year for the first six months of 2003, food and beverage revenues increased by approximately \$2.2 million, predominantly due to the addition of food and beverage operations at the Belleville, Trenton, Calgary and Yellowknife hotels.

OTHER HOSPITALITY REVENUES

Other hospitality revenues were \$870,000 lower at \$8 million in the first six months of 2003 compared to \$8.9 million in the same period of 2002. During the first half of 2002, Royal Host recognized \$1 million in lease revenue associated with the Yellowknife hotel, which was not recognized in the first half of 2003 due to the lease expiration on October 31, 2002. For the first six months of 2003, the Yellowknife hotel's actual operations were included in Royal Host's consolidated financial results.

Approximately 57% of other hospitality revenues is generated through the ownership and operation of hotel properties, with the remaining portion generated by other hospitality-related activities.

HOSPITALITY EXPENSES

Consolidating the operations of the four above-mentioned hotels into the Royal Host portfolio was primarily responsible for the \$8.1 million increase in hospitality expenses during the first six months of 2003. In addition, on a same store basis year-over-year cost increases were experienced in energy, insurance, labour and property taxes.

GROSS MARGIN

Gross margin decreased to 20.2% in the first six months of 2003 from 26.9% in the same period of 2002. Increased hospitality expenses were partially responsible for the decrease in margins. Expiration of the Yellowknife hotel lease had a negative impact on Royal Host's 2003 gross margin as the lease revenue in 2002 had no associated costs. One-time expenses booked in the second quarter of 2003 reduced margins as did the four additional hotel operations, which historically operate at lower margins than Royal Host's original portfolio.

OTHER (INCOME) AND EXPENSES

Total other (income) and expenses decreased by \$2.9 million in the first half of 2003 compared to 2002. Increases in mortgage interest, trust administration, amortization, capital and other taxes, an unrealized foreign currency loss and reduced interest income were offset by a \$3.7 million credit in future income taxes. Future income taxes, which are a non-cash item and an estimate, had a substantial recovery in the first half of 2003 compared to 2002.

NET LOSS

For the first six months of 2003, after deducting non-cash expenses of \$5.6 million, Royal Host recorded a loss of \$249,000.

CASH AVAILABLE FOR DISTRIBUTION

After adjusting for interest payments on convertible debentures and distributions on redeemable partnership units, for the first six month of 2003, cash available for distribution was \$1.5 million compared to \$5.9 million in 2002. Distributions to unitholders, excluding distributions on redeemable partnership units, totaled \$8.9 million (\$8.8 million in 2002) for the same period. The difference between cash available and distributions of \$7.4 million was financed out of borrowing and working capital. This has been done to accommodate level monthly distributions to unitholders throughout the year and is a common practice with REIT'S and other income trusts. Royal Host's business is highly cyclical throughout the calendar year, with the first quarter of the year being the slowest and the third quarter the most profitable. Consequently, it is not unusual for the REIT to finance distributions in the first half of the year since approximately 50% of the REIT'S annual cashflow is generated in the third quarter of the year.

	For the six months ended	
	June 30, 2003	June 30, 2002
	(\$000's)	(\$000's)
Cash available for distribution		
Net loss	(249)	(8)
Add (deduct):		
Amortization of capital assets	8,793	8,586
Amortization of deferred financing fees	352	408
Unrealized loss on translation of foreign subsidiaries	212	-
Future income tax (recovery) expense	(3,730)	235
Cash available for distribution	5,378	9,221
Distributions on redeemable partnership units	(1,135)	(1,135)
Interest on 8% convertible debentures	(872)	(872)
Interest on 9.25% convertible debentures	(1,836)	(1,308)
Basic adjusted cash available for distribution	1,535	5,906
Per Unit	\$ 0.06	\$ 0.24
Weighted Average Units Outstanding	24,669,000	24,312,000

BALANCE SHEET

Assets

Current Assets

Cash and short-term investments decreased from \$16.1 million at December 31, 2002 to \$3.9 million at June 30, 2003 a reduction of \$12.2 million. A portion of this reduction relates to the purchase of the Calgary Best Western Village Park Inn which was completed on April 1st, 2003 and approximately \$8.2 million in capital expenditures.

At June 30, 2003, total current assets decreased by \$6.9 million from December 31, 2002, consisting of the aforementioned decrease in total cash, decrease in accounts and notes receivable, offset by increases in property under development, inventories, deposits and prepaids and future income taxes.

All of these changes are due to normal business activities. The increase in property under development relates to the construction of the Royal Private Residence Club ("PRC") at the Grand Okanagan Lakefront Resort and Conference Center in Kelowna.

Restricted Cash

For 2003, Royal Host adopted the practice of classifying restricted cash held by lenders as a non-current item. At June 30, 2003 restricted cash of \$4.2 million (December 31, 2002 - \$4.2 million) represents a substantial portion of the year's capital expenditure requirements for certain hotels.

Purchase of Capital Assets

On April 1, 2003, Royal Host purchased the Calgary Best Western Village Park Inn, adding 160 guestrooms, for a purchase price of \$12.8 million. The operating results for this hotel were included in Royal Host's financial statements in the second quarter of 2003.

Capital Assets

Throughout the first half of 2003, Royal Host continued to make substantial investments to its existing properties. Total spending on capital expenditures was approximately \$8.2 million in the first half of 2003 versus \$2.2 million in the same period of 2002.

Liabilities and Equity

Current Liabilities

The current portion of mortgages and other debt increased to \$43.6 million at June 30, 2003 from \$36.3 million at December 31, 2002.

Mortgages and Other Debt

During the first six months of 2003, Royal Host's long-term portion of debt increased by \$9 million to \$113.9 million from \$104.9 million at December 31, 2002. Total mortgages and other debt increased by \$16.3 million to \$157.5 million at June 30, 2003 compared to \$141.2 million at December 31, 2002. During the first half of 2003, Royal Host obtained debt financing totaling \$18.3 million, with funds advanced of \$14.2 million as at June 30, 2003.

Equity

During 2003, Royal Host's equity decreased by \$12.4 million to \$190.3 million at June 30, 2003 from \$202.7 million at December 31, 2002. This decrease was mainly due to equity distributions and interest paid on convertible debentures.

LIQUIDITY AND CAPITAL RESOURCES

Royal Host continues to maintain a reasonable level of liquidity, with a \$3.9 million cash balance and \$4.9 million in undrawn bank lines at the end of June 30, 2003. In addition Royal Host has signed a mortgage term sheet with a lender to advance approximately an additional \$8.0 million to the REIT. This transaction is expected to close in the third quarter of 2003. The REIT also has additional borrowing capacity as the debt to gross book value stood at 33.8% at quarter end compared to a maximum allowable of 45%.

OUTLOOK

The short term outlook for the hospitality industry remains challenging at best, due to economic turmoil, the impact of "SARS" and political uncertainties. Despite these factors, Royal Host's RevPAR compared favorably against the industry as a whole in the first half of 2003. As we move forward into the future, Royal Host's objective is to maintain a strong position of liquidity, reduce its cost structure and continue to maintain the quality of its' portfolio through renovations while looking for accretive hotel acquisitions. Management remains optimistic about Royal Host's long term prospects.

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Consolidated Interim Balance Sheets
\$000's (Unaudited)

	As At	
	June 30, 2003	December 31, 2002
	<u> </u>	<u> </u>
ASSETS		
Current Assets		
Cash and short-term investments	3,884	16,106
Accounts and notes receivable	8,591	9,430
Deposits and prepaid expenses	4,765	3,783
Inventories	4,076	3,885
Property under development	1,880	340
Future income taxes	3,620	195
	<u>26,816</u>	<u>33,739</u>
Restricted Cash (Note 3)	4,228	4,159
Capital Assets (Note 5)	340,124	327,818
Long-term Notes Receivable and Other Assets	5,119	5,012
	<u>376,287</u>	<u>370,728</u>
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	21,629	18,366
Current portion of mortgages and other debt (Note 6)	43,591	36,307
Current portion of capital leases (Note 7)	931	1,208
Distributions payable	1,672	1,667
Other current liabilities	1,771	2,118
	<u>69,594</u>	<u>59,666</u>
Mortgages and Other Debt (Note 6)	113,902	104,933
Capital Leases (Note 7)	825	1,125
Future Income Taxes	487	792
Deferred Revenue	1,200	1,478
Equity (Note 8)	190,279	202,734
	<u>376,287</u>	<u>370,728</u>

See accompanying Notes to Consolidated Interim Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Consolidated Interim Statements of Net (Loss) Income
For the three and six months ended June 30, 2003 and June 30, 2002
\$000's (Unaudited)

	Three Months Ended		Six Months Ended	
	June, 30 2003	June, 30 2002	June, 30 2003	June, 30 2002
Hospitality Revenues				
Rooms	24,876	23,446	45,248	41,600
Food and beverage	7,377	5,808	12,610	10,368
Other hospitality revenues	3,832	4,576	8,024	8,892
	36,085	33,830	65,882	60,860
Hospitality Expenses	27,717	23,166	52,584	44,470
Gross Margin	8,368	10,664	13,298	16,390
Other (Income) and Expenses				
Interest income	(30)	(136)	(113)	(219)
Interest on mortgages and other debt	3,514	3,117	6,656	6,422
Trust administration	685	444	1,145	841
Capital and other taxes	183	58	232	125
Future income taxes (recovery)	(1,281)	184	(3,730)	235
Amortization	4,449	4,642	9,145	8,994
Loss on translation of foreign subsidiaries	212	-	212	-
	7,732	8,309	13,547	16,398
Net (Loss) Income (Note 4)	636	2,355	(249)	(8)
Per unit net (loss) income				
- basic (Note 4)	(0.05)	0.02	(0.17)	(0.14)
- diluted (Note 4)	(0.05)	0.02	(0.17)	(0.14)

See accompanying Notes to Consolidated Interim Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Consolidated Interim Statements of Cash Flows
For the three and six months ended June 30, 2003 and June 30, 2002
\$000's (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
CASH PROVIDED BY (USED IN)				
Operating Activities				
Net (loss) income	636	2,355	(249)	(8)
Items not affecting cash:				
Amortization of capital assets	4,281	4,562	8,793	8,586
Future income tax (recovery) expense	(1,281)	184	(3,730)	235
Funds from operations (Note 2)	<u>3,636</u>	<u>7,101</u>	<u>4,814</u>	<u>8,813</u>
Change in non-cash working capital:				
Decrease (increase) in accounts and notes receivable	(289)	(1,903)	839	120
Increase in deposits and prepaid expenses	(743)	(116)	(982)	(476)
Increase in inventories	(264)	(113)	(191)	(28)
Increase in accounts payable and accrued liabilities	2,818	2,270	3,263	2,677
(Decrease) increase in other current liabilities and deferred revenue	(159)	201	(625)	(143)
Amortization of deferred finance costs	168	80	352	408
	<u>5,167</u>	<u>7,520</u>	<u>7,470</u>	<u>11,371</u>
Financing Activities				
Additions to mortgages and other debt	7,560	-	18,963	-
Principal repayments on mortgages and other debt and capital leases	(2,294)	(1,103)	(3,417)	(20,888)
Payments on trust units under employee unit purchase plan	37	22	74	22
Issuance of convertible debentures	-	-	-	40,000
Equity financing issue costs	-	(157)	-	(1,879)
Equity distributions (Note 8(b))	(6,164)	(6,161)	(12,275)	(11,743)
	<u>(861)</u>	<u>(7,399)</u>	<u>3,345</u>	<u>5,512</u>
Investing Activities				
(Increase) decrease restricted cash (Note 3)	120	756	(69)	653
Capital expenditures	(5,227)	(1,145)	(20,969)	(2,224)
Property under development	(773)	-	(1,540)	-
Increase in long-term notes receivable and other assets	324	(683)	(459)	(1,062)
	<u>(5,556)</u>	<u>(1,072)</u>	<u>(23,037)</u>	<u>(2,633)</u>
Net Change in Cash and Short-term Investments	(1,250)	(951)	(12,222)	14,250
Cash and Short-term Investments, beginning of period	5,134	24,208	16,106	9,007
Cash and Short-term Investments, end of period	3,884	23,257	3,884	23,257

See accompanying Notes to Consolidated Interim Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Notes to Consolidated Interim Financial Statements
As at June 30, 2003 and June 30, 2002
(Unaudited)

1. GENERAL INFORMATION

Royal Host Real Estate Investment Trust ("Royal Host") was created pursuant to the Declaration of Trust dated August 27, 1997. Royal Host is an unincorporated closed-end mutual fund trust established for the purpose of investing in hotel properties and hospitality businesses, under specified guidelines as defined under the Declaration of Trust.

These consolidated interim financial statements follow the same accounting policies and methods as the most recent annual financial statements. These financial statements include all adjustments necessary to present fairly the results for the interim period. Certain information and footnote disclosures normally included in the year-end consolidated financial statements have been condensed or omitted. In the opinion of Management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. Operating results for the six months ended June 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003 due to the seasonal nature of operations. These interim financial statements should be read in conjunction with the most recent annual financial statements and notes included in Royal Host's annual report for the year ended December 31, 2002.

2. NON-GAAP MEASURES REPORTING

Funds from operations are calculated as the equivalent of earnings before the amortization of capital assets and future income tax (recovery) expense. This amount is determined in accordance with the Canadian Institute of Public and Private Real Estate Companies ("CIPREC") guidelines and is intended to present the funds generated before changes in the non-cash balance sheet operating accounts. It essentially displays the funds generated using the accrual basis of accounting. Readers are cautioned that funds from operations are not a defined measure of performance under Canadian generally accepted accounting principles ("GAAP"). Royal Host's calculation of funds from operations may be different than the calculation used by other entities.

3. RESTRICTED CASH

Restricted cash is \$4,228,000 (December 31, 2002 - \$4,159,000) representing funds on deposit with lenders for future planned capital expenditures within the next 12 months.

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Notes to Consolidated Interim Financial Statements
As at June 30, 2003 and June 30, 2002
(Unaudited)

4. PER UNIT COMPUTATIONS

There were 24,713,807 trust units outstanding as at June 30, 2003 (2002 – 24,565,601). Per unit computations are based on the weighted average number of trust units outstanding for the period, after adjusting the net (loss) earnings for payments on the convertible debentures of \$2,708,000 (2002 - \$2,180,000) and payments on the redeemable partnership units of \$1,135,000 (2002 - \$1,135,000).

For the six months ended:

	June 30, 2003			June 30, 2002		
	(\$000's)	Weighted Average Units (000's)	Per Unit	(\$000's)	Weighted Average Units (000's)	Per Unit
Loss						
Net loss	(249)			(8)		
Less:						
Distributions on redeemable partnership units	(1,135)			(1,135)		
Interest on 8% convertible debentures	(872)			(872)		
Interest on 9.25% convertible debentures	(1,836)			(1,308)		
Basic loss	(4,092)	24,669	(0.17)	(3,323)	24,312	(0.14)
Unit options		907			907	
Unit option repurchase		(1,721)			(1,375)	
Diluted loss	(4,092)	23,855	(0.17)	(3,323)	23,844	(0.14)

For the three months ended:

	June 30, 2003			June 30, 2002		
	(\$000's)	Weighted Average Units (000's)	Per Unit	(\$000's)	Weighted Average Units (000's)	Per Unit
(Loss) Earnings						
Net Earnings	636			2,355		
Less:						
Distributions on redeemable partnership units	(567)			(567)		
Interest on 8% convertible debentures	(439)			(439)		
Interest on 9.25% convertible debentures	(923)			(923)		
Basic (loss) earnings	(1,293)	24,690	(0.05)	426	24,499	0.02
Unit options		907			-	
Unit option repurchase		(1,788)			-	
Diluted (loss) earnings	(1,293)	23,809	(0.05)	426	24,499	0.02

In computing the diluted loss per unit for the six months ended June 30, 2003 and 2002, the convertible debentures and redeemable partnership units had an anti-dilutive impact on earnings and therefore did not impact the calculation.

In computing the diluted (loss) earnings per unit for the three months ended June 30, 2003 and 2002, the convertible debentures and redeemable partnership units had an anti-dilutive impact on earnings and therefore did not impact the calculation. For the three months ended June 30, 2002, unit options were also anti-dilutive and excluded from that calculation.

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Notes to Consolidated Interim Financial Statements
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(Unaudited)

5. CAPITAL ASSETS

	<i>(in \$000's)</i>		
	<u>Gross Book Value</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
June 30, 2003			
Land	41,365	-	41,365
Buildings	304,716	46,278	258,438
Furniture, fixtures and equipment	36,552	28,340	8,212
Furniture, fixtures and equipment under capital leases	5,810	2,566	3,244
Paving and other	1,283	368	915
	<u>389,726</u>	<u>77,552</u>	<u>312,174</u>
Properties under development	10,339	-	10,339
Intangible assets			
Franchise rights and management contracts	27,612	11,437	16,175
Customer lists and intellectual and human capital	7,270	5,834	1,436
	<u>434,947</u>	<u>94,823</u>	<u>340,124</u>
December 31, 2002			
Land	38,233	-	38,233
Buildings	294,237	42,185	252,052
Furniture, fixtures and equipment	35,486	25,758	9,728
Furniture, fixtures and equipment under capital leases	5,679	2,062	3,617
Paving and other	1,239	333	906
	<u>374,874</u>	<u>70,338</u>	<u>304,536</u>
Properties under development	4,051	-	4,051
Intangible assets			
Franchise rights and management contracts	27,655	10,196	17,459
Customer lists and intellectual and human capital	7,270	5,498	1,772
	<u>413,850</u>	<u>86,032</u>	<u>327,818</u>

All hotel properties are wholly-owned by Royal Host, except one hotel property representing less than 5% of total capital assets, which is jointly owned by Royal Host and the vendor. Pursuant to the Exchange Agreement dated September 11, 1998, the vendor has an option to exchange its 50% ownership interest for units of Royal Host. The valuation of such exchange is to be determined based on a specified industry average historic capitalization rate and the units of Royal Host are to be priced based on a 20 day weighted average trading price per unit. This specified capitalization rate is not determined with reference to a base-lending rate such as prime rate. This calculation has been taken into consideration in the diluted per unit calculations in Note 4 and determined to be anti-dilutive.

Royal Host purchased the Calgary Best Western Village Park Inn, adding 160 guestrooms, for a purchase price of \$12.8 million. This transaction closed on April 1, 2003.

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Notes to Consolidated Interim Financial Statements
As at June 30, 2003 and June 30, 2002

(Unaudited)

Under the Royal Host capital replacement reserve policy, 3% of total hotel revenue is deducted from cash to allow for the upkeep and renovation of the hotel properties. This policy may be amended from time to time at the discretion of the Trustees. On this basis, the reserve provided for the six months ended June 30, 2003 would have been \$1,877,000 (2002 - \$1,677,000). As Royal Host spent \$8,172,000, excluding the purchase price for the Best Western Village Park Inn and capital leases to June 30, 2003 (2002 - \$2,224,000) to renovate and reposition the hotel properties, the Trustees have determined that no reserve would be provided for the six months ended June 30, 2003 and 2002.

6. MORTGAGES AND OTHER DEBT

	<i>(in \$000's)</i>	
	June 30, 2003	December 31, 2002
Mortgages and other debt secured by hotel properties	157,493	141,240
Less current portion	43,591	36,307
Long-term obligations	113,902	104,933
Years ending June 30 <i>(in 000's)</i>		
2004	43,591	
2005	2,874	
2006	28,154	
2007	3,351	
2008	20,199	
Subsequent	59,324	
	157,493	
Supplementary Information:	June 30, 2003	June 30, 2002
Cash interest paid in the periods ending	6,397	6,352

On July 3, 2002, Royal Host completed financing arrangements in the amount of \$5,000,000, the proceeds to be used to renovate certain hotel properties. The loan is interest bearing at the bank's floating base rate. The loan is secured by first mortgages on the land and general security registered against certain hotel properties. As at June 30, 2003, Royal Host had received net advances of funds in the amount of \$4,226,000 related to the arranged financing.

On February 6, 2003, Royal Host completed financing in the amount of \$6.0 million, the proceeds to be used for general working capital purposes. This is a revolving operating loan, repayable on demand, available to the Trust at prime rate plus 2.0% payable monthly in arrears or as a First Bank Acceptance with a Stamping Fee of 3.0% per annum. The loan is secured by a certain hotel property. As at June 30, 2003, Royal Host had received advances of funds in the amount of \$4,500,000 related to the arranged financing.

ROYAL HOST REAL ESTATE INVESTMENT TRUST
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On February 5, 2003, Royal Host completed financing in the amount of \$6.2 million, the proceeds to be used for working capital and corporate purposes. This is an operating loan, repayable on demand, bearing interest at prime plus 1% per annum, with interest payable monthly. The loan is secured by a certain hotel property. As at June 30, 2003, Royal Host had received net advances of funds in the amount of \$3,640,000 related to the arranged financing.

On March 27, 2003, Royal Host completed two financings with one lender in the amounts of \$2.4 and \$3.7 million, the proceeds to be used for working capital and corporate purposes. These are 20 year term mortgage loans, secured by certain hotel properties. The interest is adjusted semi-annually and is the greater of:

- a) 3.2% over the yield on the Government of Canada mortgage benchmark bond; and
- b) A floor of 7.9% per annum.

All funds have been advanced by the lender.

Financing charges are deferred and amortized over the term of the related debt. In 2003, \$352,000 has been included in amortization (2002 - \$408,000).

7. OBLIGATIONS UNDER CAPITAL LEASES

Royal Host has entered into various capital lease obligations to acquire computers and hotel furniture, fixtures and equipment. The present values of minimum lease payments under capital lease as of June 30, 2003 are as follows:

	<u>June 30,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
Present value of future minimum lease payments	1,756	2,333
Less current portion	931	1,208
Long-term obligations	825	1,125
Years ending June 30 <i>(in 000's)</i>		
2004	1,057	
2005	564	
2006	238	
2007	97	
2008	11	
Future minimum lease payments	1,967	
Amounts representing interest	211	
Present value of future minimum lease payments	1,756	

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8. EQUITY

	<i>(in \$000's)</i>	
	June 30, 2003	December 31, 2002
Balance, beginning of period	113,234	130,988
Net (loss) earnings	(249)	8,136
Issuance of trust units		
Distribution reinvestment plan	422	720
Employee unit purchase program <i>(Note 8(g))</i>	-	2,320
Employee loans pursuant to		
employee unit purchase program <i>(Note 8(g))</i>	-	(2,320)
Employee loan payments pursuant to		
employee unit purchase program <i>(Note 8(g))</i>	74	95
Equity financing issue costs	-	(1,892)
Equity distributions		
Trust units	(8,859)	(17,611)
Redeemable partnership units	(1,135)	(2,269)
Interest paid on convertible debentures	(2,708)	(4,933)
	100,779	113,234
Convertible Equity		
Redeemable partnership units	27,500	27,500
Convertible debentures	62,000	62,000
	89,500	89,500
Balance, end of period	190,279	202,734

a) Unit Capital

	Number of units	<i>(in \$000's)</i>
Balance, December 31, 2001	24,115,846	219,868
Issuance of trust units		
Employee unit purchase program <i>(Note 8(g))</i>	400,000	2,320
Distribution reinvestment plan	119,130	720
Balance, December 31, 2002	24,634,976	222,908
Issuance of trust units		
Distribution reinvestment plan	78,831	422
Balance, June 30, 2003	24,713,807	223,330

As is common with REITs and other income trusts, Royal Host distributes cash in excess of the net earnings, and accordingly an accumulated deficit results, which at June 30, 2003 amounts to \$122,316,000 (December 31, 2002 - \$109,674,000).

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b) Distributions to Unitholders

For the six months ended June 30, 2003, distributions declared to Unitholders, excluding distributions on redeemable partnership units, aggregated \$8,859,000 (2002 - \$8,776,000) for the same period. The distributions to holders of redeemable partnership units for 2003 was \$1,135,000 (2002 - \$1,135,000) and interest on convertible debentures was \$2,708,000 (2002 - \$2,180,000).

On the consolidated statement of cash flows distributions paid are net of distribution reinvestment plan contributions of \$422,000 for the six months ended June 30, 2003 (2002 - \$321,000). Accordingly, gross distributions for the period were \$12,702,000 (2002 - \$12,091,000).

c) Distribution Reinvestment Plan

Royal Host has established a Distribution Reinvestment Plan ("DRIP") that is administered by its transfer agent and has reserved 500,000 units for issue under this Plan. For the period January 2001 to July 2001, the transfer agent purchased DRIP units on the open market. Subsequent to July 2001, Royal Host has issued new units for DRIP participants out of the previously authorized reserved units.

d) Unit Options

Royal Host has reserved 1,883,000 units under its unit option plan. As at June 30, 2003, Royal Host has unit options outstanding to certain directors, employees and consultants to purchase an aggregated total of 907,500 units (2002 - 907,500 units), ranging from \$10.00 to \$10.50 per unit. In 2003 and 2002, the weighted average exercise price is \$10.03. All unit options were issued prior to 1999 and were fully vested and exercisable at June 30, 2003 and December 31, 2002. These options expire on October 31, 2007 and on March 23, 2008. During 2003 and 2002, no options were issued or exercised and no options expired.

The adoption of Handbook Section 3870 - Stock Based Compensation Plans has no financial impact on the stock options under the existing stock option plan, which were issued prior to the date of adoption.

e) Redeemable Partnership Units

Holders of redeemable partnership units ("Holders") are entitled to receive distributions indirectly from Royal Host equivalent to the distributions paid by Royal Host to its Unitholders, commencing on January 1, 1999. Each partnership unit is redeemable by the Holders after January 1, 2000 at a cash price equal to the market value of a Royal Host unit, or at the option of Royal Host and subject to regulatory approval, one Royal Host unit or a combination thereof.

Under certain circumstances, including a change of control ("Trigger Event"), the Holders have the right to redeem the partnership units for cash proceeds of \$27.5 million. If the Trigger Event occurs after the issuance of redeemable units but prior to January 1, 2004, then the Holders may redeem the then outstanding redeemable partnership units for cash, at the greater of \$9.00 per unit or the market price of the Royal Host units. Change in control is defined as ownership by any one entity or a group of related entities of more than 20% of the outstanding units of Royal Host.

For accounting purposes, the redeemable partnership units have equity characteristics and accordingly, they are classified as equity instruments.

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f) Convertible Debentures

i) 8.00% Convertible Secured Debentures

The convertible debentures of \$22,000,000 bear interest at 8% per annum and are payable monthly, at Royal Host's option, in either cash or Royal Host units of an equivalent value. In addition, upon maturity in 2003, Royal Host has the option to repay the debentures in either cash or in equivalent units of Royal Host on the basis that one unit has a value equal to the weighted average trading price of a unit on the Toronto Stock Exchange ("TSE") for the twenty (20) trading days immediately preceding the maturity date.

Based on certain conditions, the debentures are convertible, at the holders' discretion, at \$11.00 per trust unit for the period from October 1, 2001 to maturity at September 30, 2003.

ii) 9.25% Convertible Unsecured Subordinated Debentures

The convertible debentures of \$40,000,000 bear interest at 9.25% per annum and are payable semi-annually in arrears on March 1 and September 1 in each year commencing September 1, 2002.

On redemption or at maturity on March 1, 2007, Royal Host has the option to repay the debentures in either cash or in equivalent units of Royal Host. The number of units to be issued will be determined by dividing the principal amount of the debentures by 95% of the current market price of the units. The term "current market price" is defined in the Indenture to mean the weighted average trading price of the units on the TSE for the twenty (20) consecutive trading days ending on the fifth (5) trading day preceding the date of maturity.

The debentures will not be redeemable on or before March 1, 2005. Thereafter, the debentures will be redeemable, in whole at any time or in part from time to time, at the option of Royal Host on at least 30 days prior notice at a price equal to the principal amount thereof, plus accrued and unpaid interest, provided that the current market price preceding the date upon which notice of redemption is given is at least 125% of the conversion price of \$7.00 per unit.

Based on certain conditions, the debentures are convertible, at the holders' discretion, at \$7.00 per trust unit from date of issue to maturity at March 1, 2007.

For accounting purposes, the convertible debentures have equity characteristics and accordingly, they are classified as equity instruments.

g) Employee Unit Purchase Program

During 2000, the Trustees approved the issuance of up to 400,000 units from treasury for an employee unit purchase program. Under this program, certain approved Royal Host employees (excluding certain senior executives) were eligible to finance the purchase of units from treasury at \$5.80 per unit at that time.

On April 1, 2002, 400,000 units were issued under this plan. The employee unit purchase program represents a financing program for selected employees to purchase units of Royal Host. Royal Host has recorded employee loans receivable of \$2,320,000 in respect to this transaction, which bear interest at a fixed rate of 5.0%, a rate established based on consideration of existing institutional rates and Canadian Customs and Revenue Agency ("CCRA") guidelines for employee loan rates at that time. This plan structure does not meet the definition of stock based compensation plans, and therefore does not fall under the Handbook Section 3870 – Stock Based Compensation Plans.

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In accordance with EIC (“Emerging Issues Committee”) 44, for accounting purposes, these employee loans receivable have been offset against the corresponding trust units equity.

9. CONTINGENT LIABILITIES

Effective December 18, 2001, Royal Host management, acting in its capacity as manager of an unincorporated, independent vacation club society (“Society”) entered into a lease agreement with a party to secure, on behalf of the Society, the right to use a vacation property. The Society is not owned or controlled by Royal Host. The lease agreement temporarily obligates a Royal Host subsidiary to lease the particular vacation property for three successive 15-year terms followed by a final 5-year term. The renewal terms are automatic and substantially obligate the lessee to renew the lease for a full term of 50 years.

Management intends to fully transfer the entitlements and obligations associated with this lease agreement to the Society, and the Society has agreed to accept the entitlements and obligations associated with the lease agreement pending finalization of legal and contractual documentation pertaining to the transfer of the lease entitlements and obligations to the Society.

It is anticipated that the finalization of such transfer of lease entitlements and obligations will occur in the near future. Should matters arise that result, for whatever reason, in the entitlements and obligations of the lease agreement not transferring to the Society, Royal Host may record such entitlements and obligations in its consolidated financial statements at that time. The current estimated fair value of each of the future entitlements and of the obligations at June 30, 2003 is approximately \$3.285 million.

10. COMPARATIVE FIGURES

Certain prior year's figures have been reclassified to conform with the presentation adopted for 2003. Commencing December 31, 2002, Royal Host has adopted the practice of classifying restricted cash held by lenders (see Note 3) as a non-current item. This classification has been applied on a comparative basis.

11. SUBSEQUENT EVENTS

On July 21, 2003, Royal Host announced a decrease in the monthly distribution from \$0.06 per unit to \$0.02 per unit, effective for the July 2003 distribution payable August 29, 2003 to the unitholders of record as of August 15, 2003.