

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Interim Financial Statements

For the nine months ended September 30, 2003 and September 30, 2002

(Unaudited)

MANAGEMENT DISCUSSION AND ANALYSIS

As expected, Royal Host's 2003 operating results continue to be negatively impacted by a number of external events including, SARS, mad cow disease, blackouts in Ontario and the forest fires in British Columbia. While these events have hurt demand levels in the Canadian hospitality sector in 2003, more recent trends suggest that the lodging industry will regain many of its prior losses beginning in 2004.

Royal Host's third quarter and year to date 2003 operating results were partially cushioned against the negative impacts of the above noted events by the newly acquired hotels in Belleville, Trenton and Calgary. The Calgary hotel was acquired in April of 2003. Belleville and Trenton were acquired in mid July 2002 and had partial results included in third quarter 2002 financials.

For purposes of this management discussion and analysis, the operating results of the three recent acquisitions (Belleville, Trenton and Calgary) and the Yellowknife property are excluded from the portfolio when referring to results on a same property comparative basis.

Royal Host completed the purchase of the 160 room Calgary Best Western Village Park Inn on April 1st, 2003. To help finance the purchase, the Belleville and Trenton hotels were mortgaged for gross proceeds of \$6.1 million.

In late September, Royal Host mortgaged the newly acquired Calgary property for \$8.7 million. The loan has a ten year term, bearing interest at a rate of 7.37%.

Royal Host's 2003 results have also been impacted by inclusion of the operating results of the Yellowknife hotel, which had been leased to a third party operator until November 2002.

Financial results for the three months ended September 30, 2003

HOSPITALITY REVENUES

Total hospitality revenues in the third quarter of 2003 decreased by \$1.1 million or 2.7% compared to the same quarter in 2002. On a same property comparative basis, total revenues were actually \$3.6 million lower in the third quarter of 2003, reflecting the negative impact of the previously identified external events.

ROOM REVENUES

Due to an increased number of rooms in the hotel portfolio resulting from the new acquisitions, room revenues in the third quarter of 2003 increased by \$105,000 compared to the third quarter of 2002. On a same property comparative basis, room revenues were \$1.9 million lower than the same quarter in 2002. For the portfolio as a whole, revenue per available room ("RevPAR") decreased year-over-year by \$4.28 (5.9%) to \$67.75 in the third quarter of 2003, as occupancies

declined by 2.4 percentage points (3.2%) to 73.1% and average daily rate (“ADR”) was \$2.78 (2.9%) lower at \$92.67.

FOOD AND BEVERAGE

Additional food and beverage operations at the Belleville, Trenton, Calgary and Yellowknife properties resulted in food and beverage revenues being \$61,000 higher in the third quarter of 2003 compared to the same quarter in 2002. Without the addition of these new operations, food and beverage revenues were actually \$657,000 lower on a same property comparative basis.

OTHER HOSPITALITY REVENUES

Other hospitality revenues decreased by \$1.3 million to \$4.8 million in the third quarter of 2003 from \$6.1 million in the same quarter of 2002. The decrease was largely due to reduced timeshare revenues and lower lease revenue associated with the expiration of the Yellowknife lease. For the third quarter of 2003, approximately 50% of these revenues are hotel or property related, with the remaining 50% split between third party management and franchise fees (approximately 36%) and vacation and other revenues (approximately 14%).

HOSPITALITY EXPENSES

For the third quarter of 2003, total hospitality expenses increased by \$1.6 million compared to the third quarter of 2002. All of this increase however, was attributable to the addition of the operating results of the three newly acquired hotels and the takeover of the Yellowknife operations. Adjusting for the new hotel additions for the three months ended September 30 2003, Royal Host’s expenses **decreased** by \$1.2 million compared to the same portfolio in the third quarter of 2002. These cost reductions were achieved despite continued cost increases in areas such as utilities, insurance and property taxes. These savings confirm that management has been successful in implementing a number of cost saving programs.

GROSS MARGIN

Gross margin decreased to 31.7% in the third quarter of 2003, from 37.4% in the same quarter of 2002. The largest impact on the decrease in margin in the third quarter of 2003 was the previously noted, expiration of the Yellowknife lease, which was in place for almost all of fiscal 2002. In 2002, the Yellowknife hotel was leased to a third party operator for approximately \$500,000 per quarter and there were virtually no costs associated with the lease payment. In

2003, Royal Host has recognized revenue and expenses from the Yellowknife hotel on an actual operating basis. A reduction in average daily rate and additional food and beverage revenues associated with the newly acquired hotels' cost increases and one time items also contributed to the reduction in Royal Host's operating margins in the third quarter of 2003 compared to the third quarter of 2002. It is encouraging to note that the rate of decline in the margin has slowed considerably from the second quarter, suggesting that management is responding to the downturn by reducing costs.

OTHER EXPENSES

Total other expenses increased by \$1.8 million in third quarter 2003 compared to third quarter 2002. Major variances include: reduced interest income; higher interest expense; increased trust administration; reduced capital and other taxes; and an increase in future income taxes and an unrealized foreign currency gain (both non-cash items). Increased trust administration expenses are impacted in part by regulatory and corporate governance changes.

NET EARNINGS

Earnings in the third quarter of 2003 were \$1.6 million compared to \$6.1 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 September 30, 2003, cash available for distribution was \$7.4 million compared to \$10.1 million in the same period of 2002. Distributions declared to unitholders, in the third quarter of 2003, excluding distributions on redeemable partnership units, totaled \$1.5 million (\$4.4 million in 2002). The difference between cash available and actual distributions of approximately \$5.9 million improved Royal Host's working capital position.

	For the three months ended	
	September 30, 2003 (\$000's)	September 30, 2002 (\$000's)
Cash available for distribution		
Net earnings	1,634	6,134
Add (deduct):		
Amortization of capital assets	4,020	4,431
Amortization of deferred financing fees	152	99
Unrealized gain on translation of foreign subsidiaries	(107)	-
Future income tax expense	3,288	1,387
Cash available for distribution	8,987	12,051
Distributions on redeemable partnership units	(189)	(567)
Interest on 8% convertible debentures	(444)	(444)
Interest on 9.25% convertible debentures	(933)	(933)
Basic adjusted cash available for distribution	7,421	10,107
Per unit	\$ 0.30	\$ 0.41
Weighted average units outstanding	24,727,269	24,575,810

Financial results for the nine months ended September 30th 2003

HOSPITALITY REVENUES

Total hospitality revenues in the first nine months of 2003 increased by \$3.9 million or 3.8% 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 nine months of 2003 and the Calgary Best Western beginning April 1, 2003. On a same property comparative basis, total revenues actually decreased by \$5.4 million.

ROOM REVENUES

For the first nine months of 2003, a \$3.8 million increase in room revenues is entirely attributable to the addition of rooms to the hotel portfolio (the new hotels). On a same property comparative basis, room revenues decreased by \$2.9 million year-to-date 2003, compared to the same period in 2002. RevPAR decreased for the first nine months of 2003 by \$1.63 (2.7%) to \$57.88 compared to \$59.51 in the same period in 2002, as ADR decreased by \$2.79 (3.1%) to \$88.67 and occupancy increased by 0.2% to 65.3%.

FOOD AND BEVERAGE

In the first nine months of 2003, food and beverage revenues increased by approximately \$2.3 million, all of which is directly attributable to the addition of food and beverage operations at the Belleville, Trenton, Calgary and Yellowknife hotels. Without the additions from these operations, food and beverage revenues decreased by \$1.1 million in the same hotel portfolio during the first three quarters of 2003 compared to 2002.

OTHER HOSPITALITY REVENUES

Other hospitality revenues were \$2.2 million lower at \$12.8 million in the first nine months of 2003 compared to \$15.0 million in the same period of 2002. A large portion of this decrease is due to the change at the Yellowknife hotel. During the first nine months of 2002, Royal Host recognized \$1.5 million in lease revenue associated with the Yellowknife hotel, which was not recognized in the first nine months of 2003 due to the lease expiration on October 31, 2002. For the first nine months of 2003, the Yellowknife hotel's actual operations were included in Royal Host's consolidated financial results. Reduced timeshare and other miscellaneous revenues also contributed to the reduction.

In the first nine months of 2003, approximately 54% of other hospitality revenues are related to the ownership and operation of hotel properties; approximately 27% are from third party management and franchise fees; with the remaining approximate 19% related to the vacation and other revenues.

HOSPITALITY EXPENSES

Consolidating the operations of the four above-mentioned hotels into Royal Host's operating results was the primary reason for the \$9.7 million increase in hospitality expenses during the first nine months of 2003. On a same property comparative basis year-over-year costs were \$206,000 higher for first three quarters of 2003 compared to the same period in 2002.

GROSS MARGIN

Gross margin decreased to 24.6% in the first nine months of 2003 from 31.2% in the same period of 2002. Expiration of the Yellowknife hotel lease, a reduction in ADR in the portfolio, cost increases and one time expenses were primarily responsible for reduced margins in the first nine months of 2003 compared to the same period in 2002. In addition, year-over-year cost increases occurred in utilities, property taxes and insurance.

OTHER EXPENSES

On a year to date basis total other expenses decreased by \$1.1 million in 2003 compared to 2002. Increases in mortgage interest, trust administration, capital and other taxes, an unrealized foreign currency loss and reduced interest income were offset by a \$442,000 recovery in future income taxes. Future income taxes, which are a non-cash item and an estimate, had a recovery in 2003 compared to 2002.

NET EARNINGS

For the first nine months of 2003, after deducting non-cash expenses of \$13.0 million (2002 - \$15.1 million) Royal Host recorded net earnings of \$1.4 million compared to \$6.1 million for the same period in 2002.

CASH AVAILABLE FOR DISTRIBUTION

For the first nine month of 2003, after adjusting for interest payments on convertible debentures and distributions on redeemable partnership units, cash available for distribution was \$9.0 million compared to \$16.0 million in 2002, a decrease of \$7.0 million. Distributions to unitholders, excluding distributions on redeemable partnership units, totaled \$10.3 million (\$13.2 million in 2002) for the same period. The shortfall of \$1.3 million between cash available and actual distributions was financed out of borrowing and working capital. This has been done to accommodate level monthly distributions to unitholders and is a common practice with REIT'S and other income trusts. Traditionally, 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.

	For the nine months ended	
	September 30, 2003	September 30, 2002
	(\$000's)	(\$000's)
Cash available for distribution		
Net Earnings	1,385	6,126
Add (deduct):		
Amortization of capital assets	12,813	13,017
Amortization of deferred financing fees	504	507
Unrealized loss on translation of foreign subsidiaries	105	-
Future income tax (recovery) expense	(442)	1,622
Cash available for distribution	14,365	21,272
Distributions on redeemable partnership units	(1,324)	(1,702)
Interest on 8% convertible debentures	(1,316)	(1,316)
Interest on 9.25% convertible debentures	(2,767)	(2,240)
Basic adjusted cash available for distribution	8,958	16,014
Per Unit	\$ 0.36	\$ 0.66
Weighted Average Units Outstanding	24,688,649	24,401,073

BALANCE SHEET

Assets

Current Assets

Cash and short-term investments were \$8.8 million at September 30, 2003 compared to \$16.1 million at December 31, 2002, a reduction of \$7.3 million. A portion of this reduction relates to the \$12.9 million purchase of the Calgary Best Western Village Park Inn which was completed on April 1st, 2003. Also, Royal Host has spent \$10.7 million on capital expenditures during the first nine months of 2003.

At September 30, 2003, total current assets decreased by \$2.8 million from December 31, 2002, consisting of the aforementioned decrease in total cash, which was partially offset by increases in property under development, deposits and prepaids, accounts and notes receivable and future income taxes. These variances are due to normal business activities and the cyclical nature of the hospitality industry. 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, which is planned to be sold to third party purchasers as private luxury condominiums.

Restricted Cash

For 2003, Royal Host adopted the practice of classifying restricted cash held by lenders as a non-current item. At September 30, 2003 restricted cash of \$4.3 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, ("VPI") adding 160 guestrooms, for a purchase price of \$12.9 million. The operating results for this hotel were included in Royal Host's financial statements in the second and third quarters of 2003.

Capital Assets

Throughout the first nine months of 2003, Royal Host continued to make substantial investments to its existing properties. Total spending on capital expenditures, excluding purchase of VPI, was approximately \$10.7 million in the first nine months of 2003 versus \$2.9 million in the same period of 2002. The current capital expenditure program is expected to be completed in 2003 and will continue in 2004 at substantially reduced levels.

Liabilities and Equity

Current Liabilities

The current liabilities increased to \$63.7 million at September 30, 2003 from \$60.0 million at December 31, 2002. Almost all of the increase is the result of increases in the current portion of mortgages and other debt.

Mortgages and Other Debt

During the first nine months of 2003, Royal Host's long-term portion of debt increased by \$17.6 million to \$122.6 million from \$104.9 million at December 31, 2002. Total mortgages and other debt increased by \$22.6 million to \$163.8 million at September 30, 2003 compared to \$141.2 million at December 31, 2002. During 2003, Royal Host obtained debt financing totaling \$27.0 million, with funds advanced of \$20.5 million as at September 30, 2003.

Equity

During 2003, Royal Host's equity decreased by \$13.7 million to \$189.0 million at September 30, 2003 from \$202.7 million at December 31, 2002. This decrease was mainly due to equity distributions to unitholders and interest paid on convertible debentures.

LIQUIDITY AND CAPITAL RESOURCES

Royal Host continues to maintain a reasonable level of liquidity, with an \$8.8 million cash balance and \$6.5 million in undrawn bank lines at the end of September 2003. The REIT also has additional borrowing capacity as the debt to gross book value stood at 34.7% at the end of the third quarter 2003 compared to a maximum allowable of 45%.

OUTLOOK

While 2003 operating results have clearly been hurt by a number of external events, Royal Host's RevPAR has compared favorably against the industry as a whole in the first three quarters of 2003. Industry forecasters are now suggesting that the worst is behind us and that a recovery will take hold in 2004. Royal Host's October operating results are encouraging because they suggest that a recovery has begun. In the near term, 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. As the expected recovery unfolds, Royal Host is well positioned to take advantage of reduced costs which will result in superior operating margins.

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

	As At	
	September 30, 2003	December 31, 2002
	<u> </u>	<u> </u>
ASSETS		
Current Assets		
Cash and short-term investments	8,770	16,106
Accounts and notes receivable	9,843	9,430
Deposits and prepaid expenses	4,822	3,783
Inventories	3,855	3,885
Property under development	1,420	340
Future income taxes	2,269	195
	<u>30,979</u>	<u>33,739</u>
Restricted Cash (Note 3)	4,298	4,159
Capital Assets (Note 5)	340,112	327,818
Long-term Notes Receivable and Other Assets	5,169	5,012
	<u>380,558</u>	<u>370,728</u>
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	19,335	18,366
Current portion of mortgages and other debt (Note 6)	41,268	36,307
Current portion of capital leases (Note 7)	961	1,208
Distributions payable	558	1,667
Other current liabilities	1,596	2,118
	<u>63,718</u>	<u>59,666</u>
Mortgages and Other Debt (Note 6)	122,529	104,933
Capital Leases (Note 7)	1,641	1,125
Future Income Taxes	2,424	792
Deferred Revenue	1,240	1,478
Equity (Note 8)	189,006	202,734
	<u>380,558</u>	<u>370,728</u>

See accompanying Notes to Consolidated Interim Financial Statements

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

	Three Months Ended		Nine Months Ended	
	September, 30 2003	September, 30 2002	September, 30 2003	September, 30 2002
Hospitality Revenues				
Rooms	29,585	29,480	74,833	71,080
Food and beverage	6,256	6,195	18,866	16,563
Other hospitality revenues	4,754	6,045	12,778	14,937
	40,595	41,720	106,477	102,580
Hospitality Expenses	27,709	26,135	80,293	70,605
Gross Margin	12,886	15,585	26,184	31,975
Other (Income) and Expenses				
Interest income	(21)	(125)	(134)	(344)
Interest on mortgages and other debt	3,409	3,153	10,065	9,575
Trust administration	459	414	1,604	1,255
Capital and other taxes	52	92	284	217
Future income taxes (recovery)	3,288	1,387	(442)	1,622
Amortization	4,172	4,530	13,317	13,524
Loss (gain) on translation of foreign subsidiaries	(107)	-	105	-
	11,252	9,451	24,799	25,849
Net Earnings (Note 4)	1,634	6,134	1,385	6,126
Per unit net (loss) earnings				
- basic (Note 4)	0.00	0.17	(0.16)	0.04
- diluted (Note 4)	0.00	0.17	(0.17)	0.04

See accompanying Notes to Consolidated Interim Financial Statements

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

	Three Months Ended		Nine Months Ended	
	September 30, 2003	September 30, 2002	September 30, 2003	September 30, 2002
CASH PROVIDED BY (USED IN)				
Operating Activities				
Net earnings	1,634	6,134	1,385	6,126
Items not affecting cash:				
Amortization of capital assets	4,020	4,431	12,813	13,017
Future income tax (recovery) expense	3,288	1,387	(442)	1,622
Funds from operations (Note 2)	<u>8,942</u>	<u>11,952</u>	<u>13,756</u>	<u>20,765</u>
Change in non-cash working capital:				
Increase in accounts and notes receivable	(1,252)	(1,099)	(413)	(979)
Increase in deposits and prepaid expenses	(57)	(1,009)	(1,039)	(1,485)
Decrease (increase) in inventories	221	(84)	30	(112)
Increase (decrease) in accounts payable and accrued liabilities	(2,294)	(689)	969	1,988
Decrease in other current liabilities and deferred revenue	(135)	(206)	(760)	(349)
Amortization of deferred finance costs	152	99	504	507
	<u>5,577</u>	<u>8,964</u>	<u>13,047</u>	<u>20,335</u>
Financing Activities				
Additions to mortgages and other debt	12,877	10,940	31,840	10,940
Principal repayments on mortgages and other debt and capital leases	(7,067)	(1,225)	(10,484)	(22,113)
Payments on trust units under employee unit purchase plan	12	37	86	59
Issuance of convertible debentures	-	-	-	40,000
Equity financing issue costs	-	(9)	-	(1,888)
Equity distributions (Note 8(b))	(4,033)	(6,169)	(16,308)	(17,912)
	<u>1,789</u>	<u>3,574</u>	<u>5,134</u>	<u>9,086</u>
Investing Activities				
Increase restricted cash (Note 3)	(70)	(1,156)	(139)	(503)
Capital expenditures	(2,668)	(12,361)	(23,637)	(14,585)
Property under development	460	-	(1,080)	-
Increase in long-term notes receivable and other assets	(202)	(662)	(661)	(1,724)
	<u>(2,480)</u>	<u>(14,179)</u>	<u>(25,517)</u>	<u>(16,812)</u>
Net Change in Cash and Short-term Investments	4,886	(1,641)	(7,336)	12,609
Cash and Short-term Investments, beginning of period	3,884	23,257	16,106	9,007
Cash and Short-term Investments, end of period	8,770	21,616	8,770	21,616

See accompanying Notes to Consolidated Interim Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Notes to Consolidated Interim Financial Statements
As at September 30, 2003 and September 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 nine months ended September 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 \$4,298,000 (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 September 30, 2003 and September 30, 2002
(Unaudited)

4. PER UNIT COMPUTATIONS

There were 24,743,660 trust units outstanding as at September 30, 2003 (2002 – 24,597,160). Per unit computations are based on the weighted average number of trust units outstanding for the period, after adjusting the net earnings for payments on the convertible debentures of \$4,084,000 (2002 - \$3,557,000) and payments on the redeemable partnership units of \$1,324,000 (2002 - \$1,702,000).

For the nine months ended:

	September 30, 2003			September 30, 2002		
	(\$000's)	Weighted Average Units (000's)	Per Unit	(\$000's)	Weighted Average Units (000's)	Per Unit
(Loss) Earnings						
Net Earnings	1,385			6,126		
Less:						
Distributions on redeemable partnership units	(1,324)			(1,702)		
Interest on 8% convertible debentures	(1,316)			(1,316)		
Interest on 9.25% convertible debentures	(2,768)			(2,241)		
Basic (loss) earnings	(4,023)	24,689	(0.16)	867	24,401	0.04
Unit options		907			-	
Unit option repurchase		(1,842)			-	
Diluted (loss) earnings	(4,023)	23,754	(0.17)	867	24,401	0.04

For the three months ended:

	September 30, 2003			September 30, 2002		
	(\$000's)	Weighted Average Units (000's)	Per Unit	(\$000's)	Weighted Average Units (000's)	Per Unit
Earnings						
Net Earnings	1,634			6,134		
Less:						
Distributions on redeemable partnership units	(189)			(567)		
Interest on 8% convertible debentures	(444)			(444)		
Interest on 9.25% convertible debentures	(933)			(933)		
Basic earnings	68	24,727	0.00	4,190	24,576	0.17
Adjust for impact of:						
Interest on 9.25% convertible debentures	-	-		933	5,714	
Diluted earnings	68	24,727	0.00	5,123	30,290	0.17

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

In computing the diluted earnings per unit for the three months ended September 30, 2003, the unit options, 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 September 30, 2002, the unit options, 8.00% convertible debentures and redeemable partnership units were anti-dilutive and excluded from that calculation.

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

5. CAPITAL ASSETS

	<i>(in \$000's)</i>		
	<u>Gross Book Value</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
September 30, 2003			
Land	41,365	-	41,365
Buildings	304,660	48,056	256,604
Furniture, fixtures and equipment	36,150	29,481	6,669
Furniture, fixtures and equipment under capital leases	7,241	2,854	4,387
Paving and other	1,283	384	899
	<u>390,699</u>	<u>80,775</u>	<u>309,924</u>
Properties under development	13,360	-	13,360
Intangible assets			
Franchise rights and management contracts	27,612	12,059	15,553
Customer lists and intellectual and human capital	7,270	5,995	1,275
	<u>438,941</u>	<u>98,829</u>	<u>340,112</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 \$12.9 million. This transaction closed on April 1, 2003.

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Notes to Consolidated Interim Financial Statements
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(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 nine months ended September 30, 2003 would have been \$3,010,000 (2002 - \$2,815,000). Royal Host has spent \$10,678,000, excluding the purchase price for the Best Western Village Park Inn and capital leases to September 30, 2003 (2002 - \$2,925,000, excluding the purchase price for two hotel properties and capital leases) to renovate and reposition the hotel properties. The Trustees have determined that no reserve would be provided for the nine months ended September 30, 2003 and 2002.

6. MORTGAGES AND OTHER DEBT

	<i>(in \$000's)</i>	
	September 30, 2003	December 31, 2002
Mortgages and other debt secured by hotel properties	163,797	141,240
Less current portion	41,268	36,307
Long-term obligations	122,529	104,933
Years ending September 30 <i>(in \$000's)</i>		
2004	41,268	
2005	28,098	
2006	3,399	
2007	20,324	
2008	3,474	
Subsequent	67,234	
	163,797	
Supplementary Information:		
	September 30, 2003	September 30, 2002
Cash interest paid in the periods ended	\$ 10,262	\$ 9,487

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 September 30, 2003, Royal Host had received net advances of funds in the amount of \$4,903,000 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 September 30, 2003, Royal Host had no outstanding balance owing from net advances of funds related to the arranged financing.

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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 September 30, 2003, Royal Host had received net advances of funds in the amount of \$5,690,000 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.

On September 29, 2003, Royal Host completed financing in the amount of \$8.7 million, the proceeds were used to pay down short-term debt and for working capital and general corporate purposes. This is a 10 year term mortgage, secured by a certain hotel property. The interest is 7.37% compounded semi-annually, and all funds have been advanced by the lender.

Financing charges are deferred and amortized over the term of the related debt. In 2003, \$504,000 has been included in amortization (2002 - \$507,000).

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 September 30, 2003 are as follows:

	<i>(in \$000's)</i>	
	September 30, 2003	December 31, 2002
Present value of future minimum lease payments	2,602	2,333
Less current portion	961	1,208
Long-term obligations	1,641	1,125
Years ending September 30 <i>(in \$000's)</i>		
2004	1,147	
2005	764	
2006	481	
2007	332	
2008	282	
Future minimum lease payments	3,006	
Amounts representing interest	404	
Present value of future minimum lease payments	2,602	

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8. EQUITY

	<i>(in \$000's)</i>	
	September 30, 2003	December 31, 2002
Balance, beginning of period	113,234	130,988
Net earnings	1,385	8,136
Issuance of trust units		
Distribution reinvestment plan	548	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>	86	95
Equity financing issue costs	-	(1,892)
Equity distributions		
Trust units	(10,339)	(17,611)
Redeemable partnership units	(1,324)	(2,269)
Interest paid on convertible debentures	(4,084)	(4,933)
	99,506	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	189,006	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	108,684	548
Balance, September 30, 2003	24,743,660	223,456

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 September 30, 2003 amounts to \$123,950,000 (December 31, 2002 - \$109,674,000).

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b) Distributions to Unitholders

For the nine months ended September 30, 2003, distributions declared to Unitholders, excluding distributions on redeemable partnership units, aggregated \$10,339,000 (2002 - \$13,191,000) for the same period. The distributions to holders of redeemable partnership units for 2003 was \$1,324,000 (2002 - \$1,702,000) and interest on convertible debentures was \$4,084,000 (2002 - \$3,557,000).

On the consolidated statements of cash flows, distributions paid are net of distribution reinvestment plan contributions of \$548,000 for the nine months ended September 30, 2003 (2002 - \$509,000).

Accordingly, gross distributions for the period were \$16,856,000 (2002 - \$18,421,000).

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 September 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), at amounts 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 September 30, 2003 and December 31, 2002. These options expire on October 31, 2007 (852,500 options) or March 23, 2008 (55,000 options). 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 (Note 11(a)).

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 with respect to this program, 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. CONTRACTUAL GUARANTEE

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 obligated 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.

Effective July 8, 2003, Royal Host management fully transferred the entitlements and obligations associated with the aforementioned lease agreement to the Society. The Society has agreed to accept the entitlements and obligations associated with the lease.

Royal Host has agreed to guarantee the lease obligations of the Society for a period of five years, effective from the lease commencement date of January 1, 2002, should the Society default on any obligations. Royal Host has avenues to pursue recourse with the Society for the full extent of any default on the lease payments. The maximum potential amount of future payments for the period from October 1, 2003 to December 31, 2006 is approximately \$720,000. The fair market value of this obligation is \$631,320. As at September 30, 2003, the Society has not defaulted on any lease payments.

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

a) 8.00% Convertible Secured Debentures

With respect to the \$22,000,000 of 8% convertible secured debentures which matured September 30, 2003, a letter of intent has been obtained that anticipates an extension to the maturity date until September 30, 2005, with no changes to the interest rate, settlement options or any other condition of the initial debentures. Completion of this extension agreement is pending finalization of a development agreement at the Yorkdale Travelodge hotel. Accordingly, the convertible debentures have continued to be recorded as an equity instrument based on the aforementioned intended terms of extension.

b) Debt Maturing on September 30, 2003

Pursuant to a revision of the original loan agreement for the \$30,000,000 mortgage, the maturity date is defined as the earlier of March 30, 2004, and anytime after September 30, 2003, the date of demand. The lender has agreed to an extension to March 30, 2004, presently with no change in the interest rate for the ensuing period. Royal Host is currently in negotiations with the lender on the terms of this mortgage and for an extension beyond March 2004. This balance has been classified in the current portion of long-term debt as at September 30, 2003.

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c) Debt maturing on September 1, 2003

On October 22, 2003, Royal Host completed the renewal of a mortgage for \$2.41 million. The renewal is for a one year term, bearing interest at 5.73%, with all other terms and conditions of the original loan agreement remaining in full force and effect.