



ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Interim Financial Statements
(unaudited)

For the six months ended June 30, 2004 and June 30, 2003

MANAGEMENT DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis (MD&A) of Operations and Financial Condition relating to Royal Host's second quarter and six month financial statements dated June 30, 2004 is the responsibility of management. The Board of Trustees carries out its responsibility for review of this discussion and analysis principally through its Audit Committee.

This MD&A should be read in conjunction with the consolidated financial statements and notes for the three months and six months ended June 30, 2004. The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP).

OVERVIEW

During the second quarter of 2004, Royal Host completed the sale of the assets and contracts of the marina and recreational vehicle facility in Oklahoma for approximately Cdn \$1.2 million. In addition, during the quarter the Trust decided to sell four hotel assets and has entered into two pending sales agreement with separate, unrelated buyers. The first agreement is for the pending sale of three Super 8 properties located in Lethbridge, Regina and North Battleford totaling 190 rooms. The second agreement involves the pending sale of the 95 room Orillia hotel. Both transactions are expected to close before year-end and together with the Oklahoma sale, have resulted in a net loss year to date from discontinued operations of \$296,000. This amount includes losses from discontinued operations, property impairment provisions and the net gain on sale of Oklahoma assets which has been booked in the second quarter of 2004.

Royal Host has adopted the new CICA Handbook Section 3475, Disposal of Long-Lived Assets and Discontinued Operations. This section requires that disposals of long-lived assets be classified as held for sale, and the results of operations and cash flows associated with the assets disposed and held for sale be reported separately as discontinued operations, net of applicable income taxes. Consequently, both current and historic figures have been adjusted to separate the financial results of these assets held for sale, from the results of the REIT's continuing operations. These adjusted numbers, excluding the operations of the hotels held for sale, have been used for all year-over-year, quarterly and year-to-date comparisons in the MD&A. Where appropriate, total results including those of the properties held for sale have been used and clearly identified.

In April 2004, Royal Host completed the placement of a \$35 million unsecured subordinated convertible debenture. Proceeds of the offering were used to retire an existing \$22 million convertible secured debenture, with the remaining funds being used for working capital and general corporate purposes.

Both second quarter and year-to-date operating results from continuing operations showed significant improvement in 2004 over the same periods in 2003. Most notably in 2004, sales have continued to improve, while management has stayed the course on reducing costs. Year-to-date 2004 total revenues are up by almost \$3 million, an increase of 4.7% over the first six months of 2003. For the second quarter of 2004, total revenues are \$1.5 million or 4.4% higher than the same period in 2003. Simultaneously, operating costs have been reduced both on a year-to-date and quarterly basis. The net result has been a solid improvement in 2004 operating margins. For the six months ended June 30, 2004, margins improved by 20.3% and by 18.7% for the second quarter alone.

SEASONALITY

The hospitality business is seasonal in nature and hotel operations in the first six months are slower than in the second half of the year. Both revenues and profits tend to be greater during the second and third quarters, which is the primary tourist season.

Financial results for the three months ended June 30, 2004

Selected Quarterly Financial Data	June 30, 2004	June 30, 2003
	(\$000's)	(\$000's)
Total Hospitality Revenues	37,068	36,085
Less Discontinued Operations	(929)	(1,462)
Continuing Hospitality Revenues	36,139	34,623
Total Hospitality Expenses	26,831	27,716
Less Discontinued Operations	(806)	(1,257)
Continuing Hospitality Expenses	26,025	26,459
Total Gross Margin	10,237	8,369
Less Discontinued Operations	(123)	(205)
Continuing Gross Margin	10,114	8,164
Continuing Operating Margin	27.99%	23.58%

HOSPITALITY REVENUES

Hospitality revenues in the second quarter of 2004 increased by \$1.5 million or 4.4% compared to the same quarter in 2003. The increase in hospitality revenues was primarily due to a 7.8% increase in revenue per available room (RevPAR) across the hotel portfolio.

ROOM REVENUES

Room revenues in the second quarter of 2004 increased by \$1.6 million or 6.5% to \$25.5 million compared to the same quarter of 2003. This increase is due to a \$4.52 or 7.8% increase in RevPAR for the continuing operations to \$62.87. The improvement in RevPAR is due to a 3.4 percentage point improvement in occupancies to 68.3% and a \$2.18 increase in average daily rate (ADR) to \$92.12.

FOOD AND BEVERAGE

For the second quarter of 2004, food and beverage revenues are almost \$100,000 lower than the second quarter of 2003. Part of the decrease in food and beverage revenues is due to leasing the Yellowknife restaurant facilities to a third party operator in November 2003.

OTHER HOSPITALITY REVENUES

During the second quarter, Royal Host recorded a one-time gain of approximately \$400,000 in other hospitality revenues, which offset on-going revenue reductions in the time-share business. As a result, other hospitality revenues increased marginally to almost \$3.7 million from \$3.6 million in the same quarter of 2003.

HOSPITALITY EXPENSES

For the second quarter of 2004, hospitality expenses decreased by \$434,000 compared to the second quarter of 2003. This marks the third consecutive quarter of year-over-year decreases in operating expenses. These cost reductions were achieved despite continued upward cost pressures and confirms management's continued focus on controlling costs and improving margins.

GROSS MARGIN

Gross margin increased by 23.9% or almost \$2.0 million in the second quarter of 2004, compared to the same quarter of 2003. This increase was facilitated by a general improvement in hotel revenues and a simultaneous reduction in costs. Operating margins improved significantly to 28.0% in 2004 compared to 23.6% in the second quarter of 2003. Removing the operations of the four properties held for sale did not materially impact margins, although the operating margins of those properties were lower than that of the continuing portfolio. This is the third successive quarter of improving operating margins.

OTHER (INCOME) AND EXPENSES

Total other expenses increased by \$721,000 in the second quarter of 2004. Almost all of the increase relates to non-cash items which do not impact cash available for distribution. Actual cash expenses were reduced by \$367,000 as a \$15,000 increase in interest expense was offset by a \$216,000 reduction in Trust administration expenses and a \$166,000 reduction in capital and other taxes. Decreases in non-cash items were noted in

amortization, unrealized foreign exchange losses, and future income taxes recoveries from the second quarter of 2003.

NET EARNINGS (LOSS)

For the Three Months Ended June 30, 2004.

Selected Quarterly Data	June 30, 2004	June 30, 2003
Net Earning (Loss) (\$000's)		
- Total Operations	1,461	636
- Continuing Operations	1,768	539
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Net Earnings (Loss) Per Unit		
Continuing Operations (1)		
- Basic	\$0.00	(\$0.06)
- Fully Diluted	\$0.00	(\$0.06)

(1) Adjusted for interest payments on convertible debentures and distributions on redeemable partnership units.

For the three months ended June 30, 2004, Royal Host recorded net earnings of \$1.8 million, an increase of \$1.2 million over the same period in 2003.

CASH AVAILABLE FOR DISTRIBUTION

For the Three Months Ended June 30, 2004

	June 30, 2004	June 30, 2003
Cash available for distribution before interest on convertible debentures and distributions on redeemable partnership units - Continuing Operations	5,995	3,813
Cash Available For Distribution (\$000's) (1)		
- Total Operations	4,553	2,087
- Continuing Operations	4,246	1,885
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Cash Available For Distribution Per Unit - Continuing Operations (1)		
- Basic	\$0.17	\$0.08
- Fully Diluted	\$0.16	\$0.08

(1) Adjusted for interest payments on convertible debentures and distributions on redeemable partnership units.

For the second quarter of 2004, cash available for distribution before interest on convertible debentures and distributions to redeemable partnership units is \$6.0 million versus \$3.8 million in 2003, and increase of 57.2%.

After deducting interest payments on convertible debentures and distributions on redeemable partnership units for the three months ended June 30, 2004, cash available for distribution increased by \$2.4 million from the same quarter of 2003.

FINANCIAL RESULTS FOR THE SIX MONTHS ENDED JUNE 30, 2004

HOSPITALITY REVENUES

	Six Months Ended	
	June 30, 2004	June 30, 2003
Total Hospitality Revenues (\$000's)	68,053	65,882
Less Discontinued Operations	(1,776)	(2,576)
Hospitality Revenues from continuing operations (\$000's)	<u>66,277</u>	<u>63,306</u>

Hospitality revenues in the first six months of 2004 increased by \$3.0 million or 4.7% compared to the same period in 2003. The increase is largely due to improved year-over-year hotel operating conditions. Higher revenues were also recorded due to the inclusion of six months of operations in 2004 for the Calgary Best Western hotel, versus only three months beginning April 1, in 2003.

ROOM REVENUES

For the first six month of 2004, room revenues increased by \$3.2 million due to a 6.4% increase in revenue per available room to \$57.74 from \$54.25 in the same period of 2003. Occupancy increased by 2.9 percentage points and average daily rate increased by \$1.46 to \$89.21 compared to 2003.

FOOD AND BEVERAGE REVENUES

Six month food and beverage revenues increased by \$359,000 year-over-year compared to the first six months of 2003. Part of the increase is due to the additional food and beverage operations at the Calgary Best Western hotel as well as improved revenues at the Ottawa West hotel.

OTHER HOSPITALITY REVENUES

Year-to-date, other hospitality revenues are \$619,000 lower in 2004. This reduction is primarily due to the continuing restructuring of the timeshare operations.

HOSPITALITY EXPENSES

	Six Months Ended	
	June 30, 2004	June 30, 2003
	(\$000's)	(\$000's)
Total Hospitality Expenses	51,558	52,584
Less Discontinued Operations	(1,747)	(2,345)
Hospitality Expenses from continuing operations (\$000's)	<u>49,811</u>	<u>50,239</u>

Hospitality expenses were \$428,000 lower in the first six months of 2004, compared to 2003. This reduction is even more impressive because the 2004 results include six months of operating expenses at the Calgary Best Western hotel, compared to only three months in 2003.

GROSS MARGIN

	Six Months Ended	
	June 30, 2004	June 30, 2003
	(\$000's)	(\$000's)
Total Gross Margins	16,495	13,298
Less Discontinued Operations	(29)	(231)
Gross Margin	<u>16,466</u>	<u>13,067</u>
Operating Margin (continuing operations)	<u>24.84%</u>	<u>20.64%</u>

For the six months of 2004, gross margin, increased by 26.0% or \$3.4 million compared to the same period in 2003. Operating margins improved to 24.8% in 2004 from 20.6% in 2003.

OTHER (INCOME) AND EXPENSES

Other expenses increased by \$2.1 million during the first half of 2004. Almost all of the increase relates to changes to non-cash items, which do not affect the cash available for distribution calculation. With respect to cash expenses, a \$374,000 increase in interest expense was almost completely offset by a combined reduction of \$331,000 in trust administration and capital and other taxes.

NET EARNINGS (LOSS)

	Six Months Ended	
	June 30, 2004	June 30, 2003
	(\$000's)	(\$000's)
Net Earnings (Loss)		
- Total Operations	698	(249)
- Continuing Operations	994	(324)

Net earnings are \$994,000 in the six months ended June 30, 2004 compared to a loss of \$324,000 in 2003, an improvement of \$1.3 million.

CASH AVAILABLE FOR DISTRIBUTION

	June 30, 2004	June 30, 2003
	(\$000's)	(\$000's)
Cash Available For Distribution (1)		
- Total Operations	5,149	1,536
- Continuing Operations	4,936	1,310
Cash Available For Distribution Per (1)		
Unit - Continuing Operations		
- Basic	\$0.20	\$0.05
- Fully Diluted	\$0.19	\$0.05

(1) Adjusted for interest payments on convertible debentures and distributions on redeemable partnership units.

After adjusting for interest payments on convertible debentures and distributions on redeemable partnership units for the six months ended June 30, 2004, cash available for distribution from continuing operations, increased to almost \$4.9 million from \$1.3 million in the same period of 2003.

BALANCE SHEET

ASSETS

Current Assets

Cash and short-term investments are \$10.9 million at June 30, 2004 compared to \$5.2 million at December 31, 2003, an increase of \$5.7 million. The increase is partially due to seasonality as well as the impact of the \$35 million convertible debenture completed in April.

At June 30, 2004, total current assets increased by \$18.3 million from December 31, 2003, consisting of the aforementioned increase in total cash, as well as increases in deposits and prepaid expenses, property under development, future income taxes and the reclassification of the four properties held for sale. The increase in property under development relates to the Royal Private Residence Club ("PRC") project at the Grand Okanagan Lakefront Resort and Conference Center in Kelowna, which is planned to be sold to third party purchasers as privately owned, luxury condominiums. The increased future income taxes asset represents operating losses available to reduce future taxable income.

Restricted Cash

Royal Host classifies restricted cash held by lenders as a non-current item. At June 30, 2004, restricted cash has a balance of \$4.9 million and represents a substantial portion of the year's capital expenditure requirements for certain hotels and will be drawn down as part of a planned capital program.

Capital Assets

Throughout the first six months of 2004, Royal Host continued to invest in its existing hotel properties. Spending on capital expenditures and property under development totaled almost \$3.6 million in the first six months of 2004 versus approximately a combined \$22.5 million in the same period of 2003. The current capital expenditure program is expected to total approximately \$8.5 million in 2004, some of which may not be completed until 2005.

LIABILITIES AND EQUITY

Current Liabilities

Current liabilities of \$61.1 million at June 30, 2004, declined slightly from \$61.2 million at December 31, 2003. Changes to current liabilities reflect normal seasonal adjustments from the hotel business.

Subsequent to the end of the second quarter, Royal Host entered into \$60 million of first mortgage loan commitments which would effectively retire a \$30 million mortgage classified as a current liability; extend the term of another mortgage by four years, which is due to mature in September 2005 and raise an additional \$5 million of working capital for the REIT. The two loans will have 5 year terms; be secured by first mortgages on the Grand

Okanagan, London Hilton and Ottawa Chimo hotels; and are expected to be priced in the range of 8% per annum. These financings are expected to be completed during the third quarter of 2004.

Mortgages and Other Debt

During the first six months of 2004, Royal Host's long-term portion of debt decreased by \$1.5 million to \$120.2 million from \$121.7 million at December 31, 2003. Total mortgages and other debt including the current portion, decreased by \$2.1 million to \$159.1 million at June 30, 2004 compared to \$161.2 million at December 31, 2003.

Equity

During the first six months, Royal Host's equity increased by \$6.0 million to \$188.8 million at June 30, 2004 from \$182.8 million at December 31, 2003. Equity increased primarily due to the issuance of convertible debentures in the second quarter of 2004.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2004, Royal Host has \$10.9 million cash and short term investments and \$7.2 million in undrawn working capital bank lines. The REIT also has additional borrowing capacity as the debt to gross book value stood at 33.5% at the end of the second quarter 2004 compared to a maximum allowable of 45%.

These resources are sufficient to meet our working capital and other liquidity requirements for 2004.

INTERPRETATION OF OUR FINANCIAL RESULTS

Significant Accounting Policies

The critical accounting policies utilized in the interim financial statements remain consistent with those disclosed in the December 31, 2003 financial statements of Royal Host, with the exception of the adoption of CICA Handbook Section 3475, Disposal of Long-Lived Assets, as previously discussed.

Significant Estimates and Assumptions

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenue and expenses for the reported periods. Areas of significant estimates and assumptions by management include the carrying values of capital assets and property under construction, deferred charges and intangibles, accounts receivable and notes receivable, future tax balances, amortization, allocation of the joint venture costs and fair values of financial instruments. Actual results could differ from those estimates.

Off Balance Sheet Arrangements

As at June 30, 2004, Royal Host had no undisclosed off balance sheet arrangements.

OUTLOOK

The overall outlook indicates that the cash available will safely support projected distributions and working capital requirements. Management will continue to focus on reducing costs and improving operating margins, with the objective of maintaining a strong position of liquidity, maintaining the quality of its hotel portfolio through renovations, and looking for accretive hotel acquisitions. Management expects revenues and operating margins to continue to improve throughout the rest of 2004, albeit at a slower pace than the year-over-year growth rates experienced in the first half of the year. On August 1, 2004, Royal Host successfully took over management of 71 U.S. hotel properties pursuant to a newly acquired management contract. Management believes that this contract will contribute to Royal Host's future profitability.

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

	As At	
	June 30, 2004	December 31, 2003
ASSETS		
Current Assets		
Cash and short-term investments	10,878	5,183
Accounts and notes receivable	8,286	8,609
Deposits and prepaid expenses	5,507	3,453
Inventories	3,584	3,739
Property held for sale <i>(Notes 2 and 4)</i>	8,533	-
Property under development <i>(Note 3)</i>	3,310	2,068
Future income taxes	1,867	583
	41,965	23,635
Restricted Cash <i>(Note 5)</i>	4,938	4,247
Capital Assets <i>(Note 7)</i>	323,778	338,336
Long-term Notes Receivable and Other Assets	2,842	3,297
	373,523	369,515
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	18,906	18,330
Current portion of mortgages and other debt <i>(Note 8)</i>	38,895	39,515
Current portion of capital leases <i>(Note 9)</i>	694	864
Distributions payable	559	558
Other current liabilities	2,092	1,929
	61,146	61,196
Mortgages and Other Debt <i>(Note 8)</i>	120,155	121,650
Capital Leases <i>(Note 9)</i>	1,215	1,490
Future Income Taxes	1,479	1,350
Deferred Revenue	695	963
Equity <i>(Note 10)</i>	188,833	182,866
	373,523	369,515

See accompanying Notes to Consolidated Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Consolidated Interim Statements of Net Earnings (Loss)
For the six months ended June 30, 2004 and June 30, 2003
\$000's
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2004	2003	2004	2003
Hospitality Revenues				
Rooms	25,517	23,965	46,849	43,618
Food and beverage	6,941	7,033	12,353	11,994
Other hospitality revenues	3,681	3,625	7,075	7,694
	36,139	34,623	66,277	63,306
Hospitality Expenses				
	26,025	26,459	49,811	50,239
Gross Margin				
	10,114	8,164	16,466	13,067
Other (Income) and Expenses				
Interest income	(25)	(30)	(28)	(113)
Interest on mortgages and other debt	3,527	3,512	7,027	6,653
Trust administration	469	685	955	1,145
Capital and other taxes	16	182	88	229
Future income taxes (recovery)	206	(1,215)	(936)	(3,550)
Amortization	4,197	4,318	8,420	8,854
Gain on foreign currency translation	(44)	173	(54)	173
	8,346	7,625	15,472	13,391
Earnings (loss) from continuing operations (Note 6)				
	1,768	539	994	(324)
(Loss) earnings from discontinued operations, net of tax (Notes 4 and 6)				
	(307)	97	(296)	75
Net earnings (loss)				
	1,461	636	698	(249)
Basic per unit net loss				
- from continuing operations	-	(0.06)	(0.10)	(0.17)
- from discontinued operations	(0.01)	0.01	(0.01)	-
Basic per unit net loss (Note 6)	(0.01)	(0.05)	(0.11)	(0.17)
Diluted per unit net loss				
- from continuing operations	-	(0.06)	(0.10)	(0.17)
- from discontinued operations	(0.01)	0.01	(0.01)	-
Diluted per unit net loss (Note 6)	(0.01)	(0.05)	(0.11)	(0.17)

See accompanying Notes to Consolidated Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Consolidated Interim Statements of Cash Flows
For the six months ended June 30, 2004 and June 30, 2003
\$000's
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
CASH PROVIDED BY (USED IN)				
Operating Activities				
Net earnings (loss)	1,461	636	698	(249)
Net loss (earnings) on discontinued operations (Note 4)	307	(97)	296	(75)
Items not affecting cash:				
Amortization of capital assets	4,056	4,150	8,115	8,502
Future income tax (recovery) expense	206	(1,215)	(936)	(3,550)
	<u>6,030</u>	<u>3,474</u>	<u>8,173</u>	<u>4,628</u>
Change in non-cash working capital:				
Decrease (increase) in accounts and notes receivable	(288)	(289)	323	581
Increase in deposits and prepaid expenses	(1,134)	(743)	(1,965)	(982)
Decrease (increase) in inventories	25	(264)	155	(191)
Increase in accounts payable and accrued liabilities	1,955	2,933	576	3,115
(Decrease) increase in other current liabilities and deferred revenue	114	(159)	(105)	(625)
Amortization of deferred finance costs	141	168	305	352
Cash flows from continuing operations	<u>6,843</u>	<u>5,120</u>	<u>7,462</u>	<u>6,878</u>
Funds from discontinued operations	<u>70</u>	<u>163</u>	<u>(18)</u>	<u>187</u>
Net change in property for sale	<u>(692)</u>	<u>-</u>	<u>(692)</u>	<u>-</u>
Cash flows from operating activities	<u>6,221</u>	<u>5,283</u>	<u>6,752</u>	<u>7,065</u>
Financing Activities				
Additions to mortgages and other debt	100	7,560	5,750	18,963
Principal repayments on mortgages, other debt and capital leases	(6,909)	(2,294)	(8,600)	(3,417)
Issuance of trust units under employee unit purchase plan	4	37	8	74
Issuance of convertible debentures, net of retirements (Note 10(d)(ii))	13,000	-	13,000	-
Equity financing issue costs	(1,619)	-	(1,664)	-
Equity distributions (Note 10(b))	(3,139)	(6,164)	(6,074)	(12,275)
	<u>1,437</u>	<u>(861)</u>	<u>2,420</u>	<u>3,345</u>
Investing Activities				
Restricted cash (Note 5)	(325)	120	(691)	(69)
Capital expenditures	(896)	(5,225)	(2,349)	(20,969)
Property under development	(548)	(773)	(1,242)	(1,540)
Net cash from sale of properties	654	-	654	-
Increase in long-term notes receivable and other assets	261	206	151	(54)
	<u>(854)</u>	<u>(5,672)</u>	<u>(3,477)</u>	<u>(22,632)</u>
Net Change in Cash and Short-term Investments	<u>6,804</u>	<u>(1,250)</u>	<u>5,695</u>	<u>(12,222)</u>
Cash and Short-term Investments, beginning of period	<u>4,074</u>	<u>5,134</u>	<u>5,183</u>	<u>16,106</u>
Cash and Short-term Investments, end of period	<u>10,878</u>	<u>3,884</u>	<u>10,878</u>	<u>3,884</u>

See accompanying Notes to Consolidated Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Notes to Consolidated Interim Financial Statements
As at June 30, 2004 and June 30, 2003
(unaudited)

1. GENERAL INFORMATION

Royal Host Real Estate Investment Trust ("Royal Host" or the "Trust") was created pursuant to the Declaration of Trust dated August 27, 1997. Royal Host is an unincorporated open-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, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004 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, 2003.

2. CHANGE IN ACCOUNTING POLICY - DISPOSAL OF LONG LIVED ASSETS

Effective January 1, 2004, the Trust adopted the new CICA Handbook Section 3475, Disposal of Long-Lived Assets and Discontinued Operations. The recommendations of this section requires that disposals of long-lived assets be classified as held for sale, and the results of operations and cash flows associated with the assets disposed and held for sale be reported separately as discontinued operations, net of applicable income taxes. A long-lived asset is classified by the Trust as an asset held for sale at the point in time when it is available for immediate sale, management has committed to a plan to sell the asset and is actively locating a buyer for the asset at a sales price that is reasonable in relation to the current fair value of the asset, and the sale is probable and expected to be completed within a one-year period. For unsolicited interest in a long-lived asset, the asset is classified as held for sale if all the conditions of the purchase and sale agreement have been met, a sufficient purchaser deposit has been received and the sale is probable and expected to be completed shortly after the end of the current period. The impact of adopting the new recommendations for disposals of long-lived assets is disclosed in Note 4.

3. PROPERTY UNDER DEVELOPMENT

In accordance with Royal Host's Declaration of Trust, which permits the development of new facilities on property adjacent to existing REIT properties, a subsidiary of Royal Host is participating in a joint venture to develop a portion of the property at the Grand Okanagan Resort and Conference Center in Kelowna, British Columbia for resale. Property under development reflects Royal Host's proportionate share of the costs incurred to date to develop the property. Construction of the first phase of the project, a parkade, commenced January 2004. Revenue from the sale of land or property is recorded on closing or, where sold by way of an agreement of purchase and sale, when the agreement is duly executed and delivered. Profit from the sale of land or property is recorded on closing or, where sold by way of an agreement of purchase and sale, when the collection of the sale proceeds is reasonably assured and all other material conditions are met.

Royal Host accounts for its subsidiary's interest in the above joint venture on a proportionate consolidation basis. Accordingly, these financial statements reflect Royal Host's undivided interest in the assets, liabilities, revenues and expenses in the joint venture. As a joint venture participant, Royal Host is subject to the normal development risks associated with property development activity.

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Notes to Consolidated Interim Financial Statements
As at June 30, 2004 and June 30, 2003
(unaudited)

4. PROPERTY HELD FOR SALE, DISPOSAL OF LONG-LIVED ASSETS, AND DISCONTINUED OPERATIONS

During the second quarter of 2004, the Trust decided to sell certain properties and has pending sales to two separate, unrelated buyers. The first pending sale involves an offer to purchase of \$5.8 million in net consideration for three properties in Western Canada with a total of 190 rooms. The second pending sale involves an offer to purchase of \$2.7 million in net consideration for one property in Ontario with 95 rooms. The expected completion dates of these transactions is prior to June 30, 2005. Revenue will be recognized within the next year in accordance with provisions as specified in accordance with Canadian generally accepted accounting principles (GAAP).

On May 28, 2004 the Trust completed the sale of a marina and recreational vehicle facility in Oklahoma, USA for \$1.2 million.

The following table sets forth the results of operations associated with the above noted long-lived assets, separately reported as discontinued operations for the current and prior periods.

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2004	2003	2004	2003
Hospitality Revenues				
Rooms	772	911	1,409	1,630
Food and beverage	73	343	202	616
Other hospitality revenues	84	208	165	330
	929	1,462	1,776	2,576
Hospitality Expenses	806	1,257	1,747	2,345
Gross Margin	123	205	29	231
Other (Income) and Expenses				
Interest on mortgages and other debt	4	1	5	3
Capital and other taxes	7	1	7	3
Amortization	91	131	196	291
Loss on foreign currency translation	41	39	35	39
	143	172	243	336
Operating loss from discontinued operations before income taxes	(20)	33	(214)	(105)
Future income taxes	(33)	(64)	(238)	(180)
Operating income from discontinued operations	13	97	24	75
Property impairment provision	(498)	-	(498)	-
Gain on disposition	196	-	196	-
Future income taxes	(18)	-	(18)	-
Net (Loss) Income from discontinued operations	(307)	97	(296)	75

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5. RESTRICTED CASH

Restricted cash is \$4,938,000 (December 31, 2003 - \$4,247,000) representing funds on deposit with lenders for future planned capital expenditures within the next 12 months.

6. PER UNIT COMPUTATIONS

There were 24,793,785 trust units outstanding as at June 30, 2004 (2003 – 24,713,807). 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 \$2,918,000 (2003 - \$2,708,000) and payments on the redeemable partnership units of \$378,000 (2003 - \$1,135,000).

For the six months ended:

	June 30, 2004			June 30, 2003		
	(\$000's)	Weighted Average Units (000's)	Per Unit	(\$000's)	Weighted Average Units (000's)	Per Unit
Earnings						
Net earnings (loss) - continuing operations	994			(324)		
Less:						
Distributions on redeemable partnership units	(378)			(1,135)		
Interest on 8% convertible debentures	(534)			(872)		
Interest on 9.25% convertible debentures	(1,840)			(1,836)		
Interest on 7.90% convertible debentures	(544)			-		
Basic loss - continuing operations	(2,302)	24,558	(0.10)	(4,167)	24,669	(0.17)
Basic (loss) earnings						
- discontinued operations	(296)		(0.01)	75		0.00
Basic loss - total operations	(2,598)	24,558	(0.11)	(4,092)	24,669	(0.17)
Unit options		138			907	
Unit option repurchase		(271)			(1,721)	
Diluted loss - total operations	(2,598)	24,425	(0.11)	(4,092)	23,855	(0.17)
Diluted (loss) earnings						
- discontinued operations	(296)	24,425	(0.01)	75	23,855	0.00
Diluted loss - continuing operations	(2,302)	24,425	(0.10)	(4,167)	23,855	(0.17)

In computing the per unit diluted earnings from total operations for the six months ended June 30, 2004 and 2003, the convertible debentures and redeemable partnership units had an anti-dilutive impact on earnings from total operations and therefore did not impact this calculation.

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For the three months ended:

	June 30, 2004			June 30, 2003		
	(\$000's)	Weighted Average Units (000's)	Per Unit	(\$000's)	Weighted Average Units (000's)	Per Unit
Earnings						
Net earnings - continuing operations	1,768			539		
Less:						
Distributions on redeemable partnership units	(189)			(567)		
Interest on 8% convertible debentures	(96)			(439)		
Interest on 9.25% convertible debentures	(920)			(923)		
Interest on 7.90% convertible debentures	(544)			-		
Basic loss - continuing operations	19	24,566	0.00	(1,390)	24,690	(0.06)
Basic (loss) earnings						
- discontinued operations	(307)		(0.01)	97		0.01
Basic loss - total operations	(288)	24,566	(0.01)	(1,293)	24,690	(0.05)
Unit options		-		907		
Unit option repurchase		-		(1,788)		
Diluted loss - total operations	(288)	24,566	(0.01)	(1,293)	23,809	(0.05)
Diluted (loss) earnings						
- discontinued operations	(307)	24,566	(0.01)	97	23,809	0.01
Diluted loss - continuing operations	19	24,566	0.00	(1,390)	23,809	(0.06)

In computing the per unit diluted earnings from total operations for the three months ended June 30, 2004 and 2003, the convertible debentures and redeemable partnership units had an anti-dilutive impact on earnings from total operations and therefore did not impact this calculation.

7. CAPITAL ASSETS

	<i>(in \$000's)</i>		
	Gross Book Value	Accumulated Amortization	Net Book Value
June 30, 2004			
Land	39,112	-	39,112
Buildings	307,795	52,671	255,124
Furniture, fixtures and equipment	36,676	30,329	6,347
Furniture, fixtures and equipment under capital leases	7,350	3,551	3,799
Paving and other	1,319	433	886
	392,252	86,984	305,268
Capital assets under development	3,851	-	3,851
Intangible assets			
Franchise rights and management contracts	27,414	13,805	13,609
Customer lists and intellectual and human capital	7,270	6,220	1,050
	430,787	107,009	323,778

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	<i>(in \$000's)</i>		
	<u>Gross Book Value</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
December 31, 2003			
Land	41,433	-	41,433
Buildings	315,680	50,201	265,479
Furniture, fixtures and equipment	39,221	30,179	9,042
Furniture, fixtures and equipment under capital leases	7,292	3,126	4,166
Paving and other	1,319	400	919
	<u>404,945</u>	<u>83,906</u>	<u>321,039</u>
Capital assets under development	1,164	-	1,164
Intangible assets			
Franchise rights and management contracts	27,612	12,679	14,933
Customer lists and intellectual and human capital	7,270	6,070	1,200
	<u>440,991</u>	<u>102,655</u>	<u>338,336</u>

Under the Royal Host capital replacement reserve policy, 3% of total hotel revenue is reserved 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 six months ended June 30, 2004 would have been \$1,967,000 (2003 - \$1,877,000). As Royal Host has spent \$2,349,000 (2003 - \$8,172,000) to renovate and reposition the hotel properties, excluding capital lease additions totaling \$200,000 (2003 - \$130,000), the Trustees have determined that no reserve would be provided for in six months ended June 30, 2004 and 2003.

8. MORTGAGES AND OTHER DEBT

	<i>(in \$000's)</i>	
	<u>June 30, 2004</u>	<u>December 31, 2003</u>
Mortgages and other debt secured by hotel properties	159,050	161,165
Less current portion	38,895	39,515
Long-term obligations	<u>120,155</u>	<u>121,650</u>
Principal repayments required for the years ending June 30:		
2005	38,895	
2006	28,245	
2007	3,516	
2008	20,398	
2009	3,008	
Subsequent	64,988	
	<u>159,050</u>	
Supplementary Information:	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Cash interest paid in the periods ended	6,520	6,397

The current portion of the long-term debt includes a \$30.0 million portfolio loan, which became due March 31, 2004 (see Note 12).

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Financing charges are deferred and amortized over the term of the related debt. For the six months ended June 30, 2004, \$305,000 was included in amortization (2003 - \$352,000).

9. 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, 2004 are as follows:

	<i>(in \$000's)</i>	
	<u>June 30, 2004</u>	<u>December 31, 2003</u>
Present value of future minimum lease payments	1,909	2,354
Less current portion	694	864
Long-term obligations	<u>1,215</u>	<u>1,490</u>
Years ending June 30		
2005	831	
2006	561	
2007	400	
2008	333	
2009	<u>68</u>	
Future minimum lease payments	2,193	
Amounts representing interest	<u>284</u>	
Present value of future minimum lease payments	<u>1,909</u>	

10. EQUITY

	<i>(in \$000's)</i>	
	<u>June 30, 2004</u>	<u>December 31, 2003</u>
Balance, beginning of period	93,366	111,261
Net earnings	698	19
Issuance of trust units		
Distribution reinvestment plan	155	629
Employee loans pursuant to employee unit purchase program	8	8
Equity financing issue costs	(1,664)	-
Contributed surplus	-	89
Equity distributions		
Trust units	(2,934)	(11,667)
Redeemable partnership units	(378)	(1,513)
Interest on convertible debentures	<u>(2,918)</u>	<u>(5,460)</u>
	<u>86,333</u>	<u>93,366</u>
Convertible Equity		
Redeemable partnership units	27,500	27,500
Convertible debentures	75,000	62,000
	<u>102,500</u>	<u>89,500</u>
Balance, end of period	<u>188,833</u>	<u>182,866</u>

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a) Unit Capital

	Number of units	(in \$000's)
Balance, December 31, 2002	24,634,976	222,908
Issuance of trust units		
Distribution reinvestment plan	127,368	629
Balance, December 31, 2003	24,762,344	223,537
Issuance of trust units		
Distribution reinvestment plan	31,441	155
Balance, June 30, 2004	24,793,785	223,692

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, 2004 amounts to \$137,359,000 (at December 31, 2003 - \$130,171,000).

b) Distributions to Unitholders

For the six months ended June 30, 2004, distributions declared to Unitholders, excluding distributions on redeemable partnership units, aggregated \$2,934,000 (2003 - \$8,859,000). The distributions to holders of redeemable partnership units for the six months ended June 30, 2004 were \$378,000 (2003 - \$1,135,000) and interest on convertible debentures was \$2,918,000 (2003 - \$2,708,000).

On the consolidated statements of cash flows, distributions paid are net of distribution reinvestment plan contributions of \$155,000 for the six months ended June 30, 2004 (2003 - \$422,000). Accordingly, gross distributions for the six months ended June 30, 2004 were \$6,230,000 (2003 - \$12,702,000).

c) Unit Options

Royal Host has reserved 1,883,000 units under its unit option plan. As at June 30, 2004, Royal Host has unit options outstanding to certain board members, employees and consultants to purchase an aggregate total of 137,500 units (December 31, 2003 - 852,500 units), at an exercise price of \$10.00 per unit (December 31, 2003 - weighted average exercise price of \$10.03). All unit options were issued prior to 1999 and were fully vested and exercisable at the end of June 30, 2004 and December 31, 2003. The options currently outstanding expire on October 31, 2007. Of the options outstanding December 31, 2003, 797,500 options were to expire as of October 31, 2007 and 55,000 options as of March 23, 2008. During 2004 and 2003, no options were issued or exercised and no options expired in the six months ended June 30, 2004 (December 31, 2003 - 55,000). As per agreements signed April 21, 2004, 715,000 options held by board members and executives of Royal Host were cancelled and terminated by agreement of the Board of Trustees. Of these cancelled unit options, 660,000 options were to expire October 31, 2007 and 55,000 options were to expire on March 23, 2008.

d) Convertible Debentures

i) 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

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TSX 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.

ii) 7.90% Convertible Unsecured Subordinated Debentures, Series A

During the quarter, \$35,000,000 convertible unsecured subordinated debentures were issued. These debentures bear interest at 7.90% per annum and are payable semi-annually in arrears on April 30 and October 31 in each year commencing October 31, 2004.

The Series A debentures may not be redeemed by Royal Host prior to the maturity date. At maturity on April 30, 2009, 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 TSX for the twenty (20) consecutive trading days ending on the fifth (5) trading day preceding the date of maturity.

Based on certain conditions, the debentures are convertible, at the holders' discretion, at \$6.00 per trust unit at any time from the date of issue to close of business on the day prior to the maturity date, April 30, 2009.

Royal Host used approximately \$22.0 million of the net proceeds of the Debentures to retire its 8.00% Convertible Secured Debentures and the balance will be used for working capital and general trust purposes, including acquisitions.

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

11. 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 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.

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 July 1, 2004 to December 31, 2006 is approximately \$553,000. The estimated fair value of this obligation is \$500,000. As at June 30, 2004, the Society has not defaulted on any lease payments.

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12. SUBSEQUENT EVENTS

a) \$35 Million Mortgage Loan

On July 5, 2004, Royal Host committed to extend the term of an existing first mortgage to August 31, 2009, which has a current principal balance outstanding of \$25 million and to provide a loan increase up to \$10 million for a maximum loan amount of \$35 million. This mortgage is secured by the Grand Okanagan Lakefront Resort and Conference Centre property in Kelowna, British Columbia.

The interest for the refinanced loan will be compounded monthly at a rate equal to the lender's benchmark 5-year Government of Canada Bond yield plus 3.75% per annum with a minimum aggregate rate of 8.00%. The difference between the existing loan rate of 8.50% and the refinanced loan rate will be prepaid to the lender calculated from the closing date of the refinanced loan to August 31, 2005. Providing there has been no demand for payment by the lender and subsequent to August 31, 2009, a rate of 12.0% per annum will be applied to the outstanding principal up to and including February 28, 2010. The financing arrangements are expected to be closed prior to August 31, 2004, at this time the final interest rate will be fixed.

b) \$25 Million Portfolio Mortgage Loan

On July 5, 2004, Royal Host committed to a financing arrangement for a \$25 million, 5-year term mortgage, which will be secured by The Hilton, London, Ontario and The Chimo Hotel, Ottawa properties. The proceeds will be used to retire the principal balance outstanding on an existing \$30 million portfolio mortgage which matured March 31, 2004.

The interest for the refinanced loan will be compounded quarterly at a rate equal to the lender's 5-year SWAP rate plus 3.50% per annum. The financing arrangements are expected to be closed prior to August 14, 2004, at this time the final interest rate will be fixed.

13. COMPARATIVE FIGURES

Certain prior year's figures have been reclassified to conform to the presentation adopted for 2004.