

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Interim Financial Statements
(unaudited)

For the nine months ended September 30, 2004 and September 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 third quarter and nine month financial statements dated September 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 nine months ended September 30, 2004. The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP).

OVERVIEW

On August 1, 2004 Royal Host successfully took over the management and operations of 69 US based hotels owned by Humphrey Hospitality, a U.S. based REIT. Under the terms of the management contract, Royal Host receives a management fee based on a percentage of the gross sales of the hotel properties. In 2004, the profit contribution from this contract is expected to be lower in the first five months of the contract due to a number of one time costs incurred in setting up the new management operation which have been expensed.

In addition, during the quarter the Trust continued to negotiate the potential sales of the four hotels it had previously designated as property held for sale. The total sale value of these assets is estimated to be \$8.5 million. One of the transactions requires mortgage lender approval and the second transaction is conditional on a rezoning application. Royal Host expects to conclude transactions on these properties in the next twelve months.

During the third quarter of 2004, Royal Host also entered into two separate loan commitments. The first loan is for a \$35 million mortgage secured by the Grand Okanagan Lakefront Resort and Conference Centre ("The Grand"), funding expected to be completed in the fourth quarter of 2004. The second is a \$25 million mortgage secured by the London Hilton and Ottawa Chimo hotels, funding was completed November 8, 2004. Proceeds from these financings will be used to retire an existing \$30 million portfolio loan, which had previously matured, and a \$25 million mortgage scheduled to mature in the third quarter of 2005. Both loans, totaling \$55 million, are classified as current liabilities on the balance sheet as at September 30, 2004.

The financing on The Grand is conditional on the completion of the subdivision of a segment of property related to the joint venture development at the hotel, which is almost complete as of the date of this document.

Royal Host has adopted the new CICA Handbook Section 3475, Disposal of Long-Lived Assets and Discontinued Operations. This section requires that proposed 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 properties 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 third quarter and year-to-date 2004 operating results from continuing and total operations showed significant improvement over the same periods in 2003. Most notably in 2004, sales have continued to improve, while operating costs have been reduced or remained relatively flat.

Year-to-date 2004 total revenues from continuing operations are up by \$4.6 million, an increase of 4.5% over the first nine months of 2003. For the third quarter of 2004, total revenues are \$1.7 million or 4.3% higher than the same period in 2003. Simultaneously, year-to-date operating costs were reduced slightly and showed a minor

increase on a quarterly basis. The net result has been that the third quarter of 2004 represents the fourth consecutive quarter of solid year-over-year improvement in operating margins.

Adjusted cash available for distribution for the three and nine months ended September 30, 2004 increased substantially by \$1.1 million and \$4.8 million respectively over the comparable periods of 2003. Adjusted cash available for distribution is a non-GAAP financial measure, and it may not be directly comparable to similar measures presented by other trusts.

SEASONALITY

The hospitality business is seasonal in nature and the third quarter accounts for almost 30% of Royal Host's total yearly sales and exceeds 50% of the REIT's annual cash available for distribution. Profitability in the third quarter is key since both the first and fourth quarters are traditionally very weak.

FINANCIAL RESULTS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004

Selected Quarterly Financial Data	September 30, 2004	September 30, 2003
	(\$000's)	(\$000's)
Total Hospitality Revenues	41,673	40,595
Less Discontinued Operations	(1,202)	(1,794)
Continuing Hospitality Revenues	40,471	38,801
Total Hospitality Expenses	27,275	27,709
Less Discontinued Operations	(773)	(1,345)
Continuing Hospitality Expenses	26,502	26,364
Total Gross Margin	14,398	12,886
Less Discontinued Operations	(429)	(449)
Continuing Operations Gross Margin	13,969	12,437
Total Operating Margin	34.6%	31.7%
Continuing Operations Operating Margin	34.5%	32.1%

The following third quarter analysis relates to continuing operations only, except where identified.

HOSPITALITY REVENUES

Hospitality revenues in the third quarter of 2004 increased by \$1.7 million or 4.3% compared to the same quarter in 2003. The increase in hospitality revenues was primarily due to a 4.2% improvement in revenue per available room (RevPAR) across the hotel portfolio as well as increases in food and beverage revenues and additional management fee revenue due to the new management contract.

ROOM REVENUES

In the third quarter of 2004, room revenues from continuing operations increased by \$1 million compared to the same quarter of 2003. This improvement was due to a 2.1% increase in occupancies to 74.7% and a \$1.98 increase in average daily rate (ADR) to \$96.37, which resulted in a 4.2% increase in RevPAR.

RevPAR, Occupancy, ADR	September 30, 2004 3 months	September 30, 2003 3 months
ADR - Continuing Operations	\$96.37	\$94.39
Total Operations	\$94.66	\$92.67
Occupancy - Continuing Operations	74.7%	73.2%
Total Operations	74.2%	73.1%
RevPAR - Continuing Operations	\$71.98	\$69.07
Total Operations	\$70.23	\$67.75

FOOD AND BEVERAGE REVENUES

Improved meeting room and conference business in the third quarter of 2004, resulted in a \$266,000 increase in food and beverage revenues for the continuing portfolio compared to the third quarter of 2003. Closing the food and beverage operations at the Orillia hotel earlier this year resulted in reduced food and beverage revenues in the total hotel portfolio. These food services have been replaced by Travelodge's standard complimentary continental breakfast program.

OTHER HOSPITALITY REVENUES

During the third quarter of 2004 other hospitality revenues increased by \$388,000 to \$5.0 million compared to the same period of 2003. This increase is primarily due to additional management revenues generated from the new U.S. hotel management contract, which began on August 1, 2004.

HOSPITALITY EXPENSES

Hospitality expenses in 2004 showed only a marginal increase of \$138,000 over the third quarter of 2003. Management feels it has successfully maintained its focus on cost controls despite continued upward pressures in numerous areas such as energy and wages.

GROSS MARGIN

With revenues increasing and costs staying relatively constant, gross margin increased by \$1.5 million or 12.3% in the third quarter of 2004, compared to the same quarter of 2003. Operating margins also improved significantly to 34.5% in the third quarter of 2004 from 32.1% in 2003, an increase of 7.7%. For total operations, which include the operations of the four properties held for sale, margins also rose in the third quarter of 2004 to 34.6% from 31.7% in 2003, an improvement of 8.9%. Royal Host's management has now been successful in improving the year-over-year operating margins for four successive quarters.

OTHER (INCOME) AND EXPENSES

A \$2.2 million reduction in a future income tax expense (a non-cash item) resulted in other expenses being reduced by \$1.7 million in the third quarter of 2004 compared to the same period of 2003. Actual cash expenses increased marginally by \$127,000 year-over-year in 2004, due to an increase in interest charges on mortgages and other debt.

NET EARNINGS (LOSS)

For the Three Months Ended September 30, 2004.

Selected Quarterly Data **September 30, 2004** **September 30, 2003**

Net Earning (Loss) (\$000's)		
- Total Operations	5,044	1,634
- Continuing Operations	4,593	1,387

(Note 6 to financial statements)

Adjusted Net Earnings (Loss) Per Unit

Continuing Operations

- Basic	\$0.11	(\$0.01)
- Fully Diluted	\$0.11	(\$0.01)

Primarily due to the substantial improvement in hotel operations, Royal Host's net earnings increased by \$3.2 million in the third quarter of 2004, over the same period in 2003.

CASH AVAILABLE FOR DISTRIBUTION**For the Three Months Ended September 30, 2004****Adjusted Cash Available for Distribution for the three months:**

	September 30, 2004 Continuing Operations	September 30, 2004 Total Operations	September 30, 2003 Continuing Operations	September 30, 2003 Total Operations
	000's	000's	000's	000's
Basic earnings (Note 6 financial statements)	2,789	3,240	(179)	68
Add non-cash items (1)	5,353	5,330	7,154	7,353
Deduct draw down of tax allowance	(30)	(30)	-	-
Adjusted cash available for distribution from operations (2)	8,112	8,540	6,975	7,421

Basic per unit cash available for distribution:	\$0.33	\$0.35	\$0.28	\$0.30
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Fully diluted per unit cash available for distribution:	\$0.25	\$0.26	\$0.24	\$0.25
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Note (1) Includes amortization of capital assets, amortization for deferred finance charges, unrealized gain/loss on translation of foreign subsidiaries and future income taxes.

Note (2) Adjusted cash available for distribution is calculated after interest payments on convertible debentures and distributions on redeemable partnership units.

For the third quarter of 2004, adjusted cash available for distribution from total operations was \$8.5 million, an increase of \$1.1 million or 15.1% over the same quarter of 2003. Adjusted cash available for distribution from continuing operations was \$8.1 million or \$1.1 million (16.3%) greater than the comparable quarter of 2003. This is the fourth consecutive quarter of year-over-year improvement in adjusted cash available for distribution.

FINANCIAL RESULTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004

HOSPITALITY REVENUES

	Nine Months Ended	
	September 30, 2004	September 30, 2003
	000's	000's
Total Hospitality Revenues	109,726	106,477
Less Discontinued Operations	(2,978)	(4,370)
Hospitality Revenues from Continuing Operations	106,748	102,107

Hospitality revenues in the first nine months of 2004 increased by \$4.6 million or 4.6% 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 nine months of operations in 2004 for the Calgary Best Western hotel, versus only six months beginning April 1, in 2003, and the new management contract, which began on August 1, 2004.

ROOM REVENUES

For the first nine months of 2004, room revenues increased by \$4.2 million due to a 5.5% improvement in RevPAR, to \$62.49 from \$59.25 in the same period of 2003. Occupancy increased by 2.3 percentage points and the average daily rate increased by \$1.58 to \$91.83 compared to 2003.

FOOD AND BEVERAGE REVENUES

Nine-month food and beverage revenues in 2004 increased by \$625,000 year-over-year compared to 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 Travelodge Ottawa West, The Grand and London Hilton hotels.

OTHER HOSPITALITY REVENUES

Year-to-date, other hospitality revenues were \$231,000 lower in 2004 compared to 2003. This reduction is primarily due to the continuing restructuring of the timeshare operations, especially in the first two quarters of 2004. The reduction in timeshare revenues was partially offset by an increase in management fees from the new management contract.

HOSPITALITY EXPENSES

	Nine Months Ended	
	September 30, 2004	September 30, 2003
	(\$000's)	(\$000's)
Total Hospitality Expenses	78,833	80,293
Hospitality Expenses from Continuing Operations	76,313	76,603

During the first nine months of 2004, hospitality expenses were \$290,000 lower than in 2003. On a comparative basis, the reduction in costs is actually greater than it looks since the 2004 results include nine months of operating expenses from the Calgary Best Western Hotel compared to only six months in 2003.

GROSS MARGIN

	Nine Months Ended	
	September 30, 2004	September 30, 2003
	(\$000's)	(\$000's)
Total Gross Margins	30,893	26,184
Gross Margin from Continuing Operations	30,435	25,504
<u>Operating Margin</u>		
Total Operations	28.2%	24.6%
Continuing Operations	28.5%	25.0%

For the first nine months of 2004, gross margin from continuing operations increased by 19.3% or \$4.9 million compared to the same period in 2003. Operating margins for continuing operations also improved to 28.5% from 25.0% in 2003, an improvement of 14.1%.

OTHER (INCOME) AND EXPENSES

Other (income) expenses increased by \$407,000 during the first nine months of 2004. Interest on debt increased by \$494,000 from 2003, reflecting a greater amount of debt in 2004. This increase was partially offset by lower Trust administration expenses and capital and other taxes.

NET EARNINGS (LOSS)

	Nine Months Ended	
	September 30, 2004	September 30, 2003
	(\$000's)	(\$000's)
<u>Net Earnings (Loss)</u>		
Total Operations	5,742	1,385
Continuing Operations	5,587	1,063
<u>Basic Per Unit Earnings:</u>		
Total Operations	\$0.03	(\$0.16)
Continuing Operations	\$0.02	(\$0.17)
<u>Fully Diluted Per Unit Earnings:</u>		
Total Operations	\$0.03	(\$0.17)
Continuing Operations	\$0.02	(\$0.18)

Net earnings from continuing and total operations improved by \$4.5 million and \$4.4 million respectively, during the first nine months of 2004, compared to the same period in 2003.

CASH AVAILABLE FOR DISTRIBUTION

After adjusting for interest payments on convertible debentures and distributions on redeemable partnership units for the nine months ended September 30, 2004, cash available for distribution improved by \$4.8 million from continuing operations and by \$4.7 million from total operations, compared to the same period of 2003. Included in the nine months ended September 30, 2004, adjusted cash available for distribution, is a cash gain on disposition of \$196,000.

CASH AVAILABLE FOR DISTRIBUTION

Cash Available for Distribution for the Nine Months ended:	September 30,	September 30,	September 30,	September 30,
	2004 Continuing Operations	2004 Total Operations	2003 Continuing Operations	2003 Total Operations
	000's	000's	000's	000's
Basic earnings (Note 6 - Financial Statement)	487	642	(4,345)	(4,023)
Add non-cash items (1) deducted from earnings	12,782	13,268	12,630	12,980
Deduct drawdown of tax allowance	(221)	(221)	-	-
Adjusted cash available for distribution from operations: (2)	13,048	13,689	8,285	8,957
Basic per unit cash available for distribution:	\$0.53	\$0.56	\$0.34	\$0.36
Fully diluted per unit cash available for distribution:	\$0.48	\$0.50	\$0.34	\$0.36

Note (1) Includes amortization of capital assets, amortization for deferred finance charges, unrealized gain/loss on translation of foreign subsidiaries and future income taxes.

Note (2) Adjusted cash available for distribution is calculated after interest payments on convertible debentures and distributions on redeemable partnership units.

BALANCE SHEET

ASSETS

Current Assets

Cash and short-term investments as at September 30, 2004 were \$9.3 million compared to \$5.2 million at December 31, 2003, an improvement of \$4.1 million. The increase is partially due to seasonality as well as the impact of the \$35 million convertible debenture completed in April.

At September 30, 2004, total current assets increased by \$19.7 million from December 31, 2003, consisting of the aforementioned increase in total cash, as well as increases in accounts and notes receivable, 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 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 September 30, 2004, restricted cash was \$5.6 million and represents a substantial portion of the year's capital expenditure requirements for certain hotels and will be drawn down on an ongoing basis as part of a planned capital program.

Capital Assets

Throughout the first nine months of 2004, Royal Host continued to invest in its existing hotel properties. Spending on capital expenditures and property under development totaled \$4.4 million and \$3.3 million respectively. The current capital expenditure program is expected to total approximately \$8.5 million in 2004, some of which will not be completed until 2005.

LIABILITIES AND EQUITY

Current Liabilities

Current liabilities of \$85 million at September 30, 2004, increased from \$61.2 million at December 31, 2003. The main reason for the increase is the reclassification of the \$25 million mortgage on The Grand from long-term to current debt. The mortgage is scheduled to mature in September of 2005. Royal Host has already received a commitment from the existing lender, effectively increasing the principal amount to \$35 million and extending the maturity date to 2009. This loan is expected to be funded in the fourth quarter of 2004.

Also during the third quarter of 2004, Royal Host entered into a \$25 million first mortgage loan commitment to be secured by the London Hilton and Ottawa Chimo hotels. This financing was completed and funded on November 8, 2004.

Both these financings would effectively retire \$55 million in debt presently classified as current liabilities. Any additional proceeds, net of expenses, will be used as working capital for the REIT.

Changes to other current liabilities reflect normal seasonal adjustments from the hotel business.

Mortgages and Other Debt

During the first nine months of 2004, Royal Host's long-term portion of debt decreased by \$27.3 million to \$94.4 million from \$121.7 million at December 31, 2003. The main reason for this large decrease was the reclassification of the \$25 million mortgage on The Grand, as noted above. Total mortgages and other debt, including the current portion, decreased by \$5.9 million to \$155.3 million at September 30, 2004 compared to \$161.2 million at December 31, 2003 reflecting stronger operating results and a stronger balance sheet.

Equity

During the first nine months, Royal Host's equity increased by \$7.8 million to \$190.7 million at September 30, 2004 from \$182.9 million at December 31, 2003. Equity increased primarily due to the issuance of convertible debentures in the second quarter of 2004, as well as a significant turn around in earnings.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2004, Royal Host has \$9.3 million in cash and short term investments and \$12.3 million in undrawn working capital bank lines. The REIT also has additional borrowing capacity as the debt to gross book value stood at 32.4% at the end of the third quarter 2004 compared to a maximum allowable of 45%.

Based on operating results to date, Royal Host can easily support the current level of cash distributions to unitholders, as well as meet its capital expenditure and working capital requirements. Assuming no significant deterioration in operating results from the current level, Royal Host has sufficient resources to meet its liquidity requirements for the next 12 months.

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 September 30, 2004, Royal Host had no undisclosed off balance sheet arrangements.

OUTLOOK

Management will continue to focus on improving revenues, 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. On August 1, 2004, Royal Host successfully took over management of 69 U.S. hotel properties pursuant to a newly acquired management contract. Management believes that this contract will contribute positively to Royal Host's future profitability. Assuming no significant deterioration in operating results from the current level, Royal Host has sufficient resources to meet its liquidity requirements for the next 12 months. We should be well positioned to continue to improve our balance sheet as well as pursue accretive acquisition opportunities.

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

	As At	
	September 30, 2004	December 31, 2003
ASSETS		
Current Assets		
Cash and short-term investments	9,312	5,183
Accounts and notes receivable	10,124	8,609
Deposits and prepaid expenses	5,582	3,453
Inventories	3,700	3,739
Property held for sale <i>(Notes 2 and 4)</i>	8,533	-
Property under development <i>(Note 3)</i>	5,362	2,068
Future income taxes	726	583
	43,339	23,635
Restricted Cash <i>(Note 5)</i>	5,626	4,247
Capital Assets <i>(Note 7)</i>	321,638	338,336
Long-term Notes Receivable and Other Assets	2,704	3,297
	373,307	369,515
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	21,004	18,330
Current portion of mortgages and other debt <i>(Note 8)</i>	60,903	39,515
Current portion of capital leases <i>(Note 9)</i>	635	864
Distributions payable	559	558
Other current liabilities	1,796	1,929
	84,897	61,196
Mortgages and Other Debt <i>(Note 8)</i>	94,371	121,650
Capital Leases <i>(Note 9)</i>	1,079	1,490
Future Income Taxes	1,460	1,350
Deferred Revenue	797	963
Equity <i>(Note 10)</i>	190,703	182,866
	373,307	369,515

See accompanying Notes to Consolidated Financial Statements

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

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2004	2003	2004	2003
Hospitality Revenues				
Rooms	29,388	28,372	76,237	71,990
Food and beverage	6,131	5,865	18,484	17,859
Other hospitality revenues	4,952	4,564	12,027	12,258
	40,471	38,801	106,748	102,107
Hospitality Expenses				
	26,502	26,364	76,313	76,603
Gross Margin				
	13,969	12,437	30,435	25,504
Other (Income) and Expenses				
Interest income	(22)	(21)	(50)	(134)
Interest on mortgages and other debt	3,529	3,409	10,556	10,062
Trust administration	465	459	1,420	1,604
Capital and other taxes	52	50	140	279
Future income taxes (recovery)	1,065	3,229	129	(321)
Amortization	4,143	4,039	12,563	12,893
Gain on foreign currency translation	144	(115)	90	58
	9,376	11,050	24,848	24,441
Earnings from continuing operations (Note 6)				
	4,593	1,387	5,587	1,063
Earnings from discontinued operations, net of tax (Notes 4 and 6)				
	451	247	155	322
Net earnings				
	5,044	1,634	5,742	1,385
Basic per unit net earnings				
- from continuing operations	0.11	(0.01)	0.02	(0.17)
- from discontinued operations	0.02	0.01	0.01	0.01
Basic per unit net earnings (Note 6)	0.13	-	0.03	(0.16)
Diluted per unit net earnings				
- from continuing operations	0.11	(0.01)	0.02	(0.18)
- from discontinued operations	0.02	0.01	0.01	0.01
Diluted per unit net earnings (Note 6)	0.13	-	0.03	(0.17)

See accompanying Notes to Consolidated Financial Statements

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

	Three Months Ended		Nine Months Ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
CASH PROVIDED BY (USED IN)				
Operating Activities				
Net earnings	5,044	1,634	5,742	1,385
Net (earnings) on discontinued operations (Note 4)	(451)	(247)	(155)	(322)
Items not affecting cash:				
Amortization of capital assets	3,986	3,887	12,101	12,389
Future income tax expense(recovery)	1,065	3,229	129	(321)
	<u>9,644</u>	<u>8,503</u>	<u>17,817</u>	<u>13,131</u>
Change in non-cash working capital:				
Increase in accounts and notes receivable	(1,838)	(1,252)	(1,515)	(671)
Increase in deposits and prepaid expenses	(75)	(57)	(2,040)	(1,039)
(Increase) decrease in inventories	(116)	221	39	30
Increase (decrease) in accounts payable and accrued liabilities	2,098	(2,293)	2,674	822
Decrease in other current liabilities and deferred revenue	(192)	(135)	(296)	(760)
Amortization of deferred finance costs	157	152	462	504
Cash flows from continuing operations	<u>9,678</u>	<u>5,139</u>	<u>17,141</u>	<u>12,017</u>
Funds from discontinued operations	<u>507</u>	<u>438</u>	<u>489</u>	<u>625</u>
Net change in property for sale	<u>-</u>	<u>-</u>	<u>(498)</u>	<u>-</u>
Cash flows from operating activities	<u>10,185</u>	<u>5,577</u>	<u>17,132</u>	<u>12,642</u>
Financing Activities				
Additions to mortgages and other debt	-	12,877	5,750	31,840
Principal repayments on mortgages, other debt and capital leases	(3,971)	(7,067)	(12,571)	(10,484)
Issuance of trust units under employee unit purchase plan	4	12	12	86
Issuance of convertible debentures, net of retirements (Note 10(d)(ii))	-	-	13,000	-
Equity financing issue costs	16	-	(1,648)	-
Equity distributions (Note 10(b))	(3,194)	(4,033)	(9,268)	(16,308)
	<u>(7,145)</u>	<u>1,789</u>	<u>(4,725)</u>	<u>5,134</u>
Investing Activities				
Restricted cash (Note 5)	(688)	(70)	(1,379)	(139)
Capital expenditures	(1,847)	(2,668)	(4,391)	(23,637)
Property under development	(2,052)	460	(3,294)	(1,080)
Net cash from sale of properties	-	-	654	-
(Increase) decrease in long-term notes receivable and other assets	(19)	(202)	132	(256)
	<u>(4,606)</u>	<u>(2,480)</u>	<u>(8,278)</u>	<u>(25,112)</u>
Net Change in Cash and Short-term Investments	<u>(1,566)</u>	<u>4,886</u>	<u>4,129</u>	<u>(7,336)</u>
Cash and Short-term Investments, beginning of period	<u>10,878</u>	<u>3,884</u>	<u>5,183</u>	<u>16,106</u>
Cash and Short-term Investments, end of period	<u>9,312</u>	<u>8,770</u>	<u>9,312</u>	<u>8,770</u>

See accompanying Notes to Consolidated Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST
Notes to Consolidated Interim Financial Statements
As at September 30, 2004 and September 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 nine months ended September 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 Lakefront 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.

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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 with a total of 190 rooms in Western Canada, two of which are conditional on mortgage lender approval. The second pending sale involves an offer to purchase of \$2.7 million in net consideration for one property with 95 rooms in Ontario, which is conditional on a rezoning application. 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		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2004	2003	2004	2003
Hospitality Revenues				
Rooms	1,098	1,213	2,507	2,843
Food and beverage	81	391	283	1,007
Other hospitality revenues	23	190	188	520
	1,202	1,794	2,978	4,370
Hospitality Expenses	773	1,345	2,520	3,690
Gross Margin	429	449	458	680
Other Expenses				
Interest on mortgages and other debt	-	-	5	3
Capital and other taxes	1	2	8	5
Amortization	-	133	196	424
(Gain) loss on foreign currency translation	(79)	8	(44)	47
	(78)	143	165	479
Operating earnings from discontinued operations before income taxes	507	306	293	201
Future income taxes (recovery) expense	56	59	(182)	(121)
Operating earnings from discontinued operations	451	247	475	322
Property impairment provision	-	-	(498)	-
Gain on disposition	-	-	196	-
Future income taxes (recovery)	-	-	(18)	-
Net earnings from discontinued operations	451	247	155	322

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5. RESTRICTED CASH

Restricted cash is \$5,626,000 (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 24,809,250 trust units outstanding as at September 30, 2004 (2003 – 24,743,660). 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 \$4,533,000 (2003 - \$4,084,000) and payments on the redeemable partnership units of \$567,000 (2003 - \$1,324,000).

For the nine months ended:

	September 30, 2004			September 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	5,587			1,063		
Less:						
Distributions on redeemable partnership units	(567)			(1,324)		
Interest on 8% convertible debentures	(524)			(1,316)		
Interest on 9.25% convertible debentures	(2,770)			(2,768)		
Interest on 7.90% convertible debentures	(1,239)			-		
Basic earnings (loss) - continuing operations	487	24,566	0.02	(4,345)	24,689	(0.17)
Basic earnings						
- discontinued operations	155		0.01	322		0.01
Basic earnings (loss) - total operations	642	24,566	0.03	(4,023)	24,689	(0.16)
Unit options		-			907	
Unit option repurchase		-			(1,842)	
Diluted earnings (loss) - total operations	642	24,566	0.03	(4,023)	23,754	(0.17)
Diluted earnings						
- discontinued operations	155	24,566	0.01	322	23,754	0.01
Diluted earnings (loss) - continuing operations	487	24,566	0.02	(4,345)	23,754	(0.18)

In computing the per unit diluted earnings from total operations for the nine months ended September 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:

	September 30, 2004			September 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	4,593			1,387		
Less:						
Distributions on redeemable partnership units	(189)			(189)		
Interest on 8% convertible debentures	10			(444)		
Interest on 9.25% convertible debentures	(930)			(933)		
Interest on 7.90% convertible debentures	(695)			-		
Basic earnings (loss) - continuing operations	2,789	24,581	0.11	(179)	24,727	(0.01)
Basic earnings - discontinued operations	451		0.02	247		0.01
Basic earnings - total operations	3,240	24,581	0.13	68	24,727	0.00
Distributions on redeemable partnership units	189	3,151		-	-	
Unit conversion		-			907	
Unit option repurchase		-			(2,018)	
Diluted earnings - total operations	3,429	27,732	0.12	68	23,616	0.00
Diluted earnings - discontinued operations	451	27,732	0.02	247	23,616	0.01
Diluted earnings (loss) - continuing operations	2,978	27,732	0.11	(179)	23,616	(0.01)

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

In computing the per unit diluted earnings from total operations for the three months ended September 30, 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
September 30, 2004			
Land	39,112	-	39,112
Buildings	307,795	54,648	253,147
Furniture, fixtures and equipment	36,705	31,402	5,303
Furniture, fixtures and equipment under capital leases	7,446	3,780	3,666
Paving and other	1,319	449	870
	392,377	90,279	302,098
Capital assets under development	5,570	-	5,570
Intangible assets			
Franchise rights and management contracts	27,414	14,419	12,995
Customer lists and intellectual and human capital	7,270	6,295	975
	432,631	110,993	321,638

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	<i>(in \$000's)</i>		
	Gross Book Value	Accumulated Amortization	Net Book Value
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
	404,945	83,906	321,039
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
	440,991	102,655	338,336

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 nine months ended September 30, 2004 would have been \$3,136,000 (2003 - \$3,010,000). As Royal Host has spent \$4,391,000 (2003 - \$10,678,000) 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 nine months ended September 30, 2004 and 2003.

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8. MORTGAGES AND OTHER DEBT

	<u>September 30,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>
Mortgages and other debt secured by hotel properties	155,274	161,165
Less current portion	60,903	39,515
Long-term obligations	<u>94,371</u>	<u>121,650</u>
Principal repayments required for the years ending September 30:		
2005	60,903	
2006	3,311	
2007	20,324	
2008	3,474	
2009	3,081	
Subsequent	64,181	
	<u>155,274</u>	
Supplementary Information:	<u>September 30,</u>	<u>September 30,</u>
	<u>2004</u>	<u>2003</u>
Cash interest paid in the periods ended	10,318	10,262

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

Financing charges are deferred and amortized over the term of the related debt. For the nine months ended September 30, 2004, \$462,000 was included in amortization (2003 - \$504,000).

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 September 30, 2004 are as follows:

	<u>September 30,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>
Present value of future minimum lease payments	1,714	2,354
Less current portion	635	864
Long-term obligations	<u>1,079</u>	<u>1,490</u>
Years ending September 30		
2005	757	
2006	516	
2007	367	
2008	315	
2009	3	
Future minimum lease payments	1,958	
Amounts representing interest	244	
Present value of future minimum lease payments	<u>1,714</u>	

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10. EQUITY

	<i>(in \$000's)</i>	
	September 30, 2004	December 31, 2003
Balance, beginning of period	93,366	111,261
Net earnings	5,742	19
Issuance of trust units		
Distribution reinvestment plan	233	629
Employee loans pursuant to employee unit purchase program	12	8
Equity financing issue costs	(1,648)	-
Contributed surplus	-	89
Equity distributions		
Trust units	(4,402)	(11,667)
Redeemable partnership units	(567)	(1,513)
Interest on convertible debentures	(4,533)	(5,460)
	88,203	93,366
Convertible Equity		
Redeemable partnership units	27,500	27,500
Convertible debentures	75,000	62,000
	102,500	89,500
Balance, end of period	190,703	182,866

a) Unit Capital

	Number of units	<i>(in \$000's)</i>
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	46,906	233
Balance, September 30, 2004	24,809,250	223,770

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, 2004 amounts to \$135,567,000 (at December 31, 2003 - \$130,171,000).

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b) Distributions to Unitholders

For the nine months ended September 30, 2004, distributions declared to Unitholders, excluding distributions on redeemable partnership units, aggregated \$4,402,000 (2003 - \$10,339,000). The distributions to holders of redeemable partnership units for the nine months ended September 30, 2004 were \$567,000 (2003 - \$1,324,000) and interest on convertible debentures was \$4,533,000 (2003 - \$4,084,000).

On the consolidated statements of cash flows, distributions paid are net of distribution reinvestment plan contributions of \$233,000 for the nine months ended September 30, 2004 (2003 - \$548,000). Accordingly, gross distributions for the nine months ended September 30, 2004 were \$9,502,000 (2003 - \$15,747,000).

c) Unit Options

Royal Host has reserved 1,883,000 units under its unit option plan. As at September 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 September 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 nine months ended September 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 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.

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ii) 7.90% Convertible Unsecured Subordinated Debentures, Series A

During the quarter ended June 30, 2004, \$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 October 1, 2004 to December 31, 2006 is approximately \$498,000. The estimated fair value of this obligation is \$454,000. As at September 30, 2004, the Society has not defaulted on any lease payments.

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 ("The Grand") property in Kelowna, British Columbia.

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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. The financing arrangements are continuing and are conditional upon completion of the subdivision of a segment of the property related to the joint venture development at The Grand (see Note 3). The arrangements are expected to close in the fourth quarter of 2004, at that 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 paid quarterly at a rate equal to 7.35% per annum. The financing was completed and funded on November 8, 2004.

13. COMPARATIVE FIGURES

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