

ROYAL HOST REAL ESTATE INVESTMENT TRUST

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF OPERATIONS AND FINANCIAL CONDITION**

FOR THE YEAR ENDED DECEMBER 31, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS AND FINANCIAL CONDITION FOR THE YEAR ENDED DECEMBER 31, 2005

The following Management's Discussion and Analysis of Operations and Financial Condition ("MD&A") dated March 16, 2006, 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 audited Consolidated Financial Statements and notes of Royal Host Real Estate Investment Trust ("Royal Host", the "Trust") for the year ended December 31, 2005. The Consolidated Financial Statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The results are reported in Canadian dollars with foreign operations measured in US dollars and translated into Canadian dollars using the temporal method.

FORWARD-LOOKING STATEMENTS

Certain statements in this MD&A, including those in the Outlook section, relate to periods commencing after December 31, 2005 and contain estimates or assumptions about the outcome of future events. These forward-looking statements are subject to risks, uncertainties, and other factors that could result in the outcome of these events being materially different from those anticipated in this MD&A. These factors include, but are not limited to: general economic conditions, levels of travel in our key market areas, political conditions and events, competitive pressures, changes in government policy or regulations and other risk factors including risks and uncertainties described below. Royal Host does not undertake to update such forward-looking statements should our estimates or assumptions change, except as required by law. Additional information relating to Royal Host, including its Annual Information Form, is available at www.sedar.com.

Summary

Royal Host had a very good year and delivered improved results in all areas of its business. Royal Host's focus on its core business has enabled the Trust to take advantage of the improving economy and realize increases in revenue, gross margin, net income, cash available for distribution, and distributions to Unitholders.

The single largest factor in the improved overall results for 2005 was a revenue increase of \$5.5 million. This, combined with a continued focus on costs, resulted in strong overall growth in gross margin, earnings, and cash flows.

Royal Host has also strengthened its balance sheet through its successful refinancing efforts in 2005 including the completion in October of a \$60 million, 10-year, 6.0% Convertible Debenture. A portion of these proceeds was used to repay \$25.6 million in long-term debt. This puts the Trust in a very strong financial position moving forward into 2006.

Highlights for 2005

- Strong cash flow was driven by stronger revenue, which translated into an increase in gross margin to 28.7% in 2005 up 9% from 26.3% in 2004.
- The Trust increased distributions twice in 2005: distributions increased to \$0.03 per unit in January and to \$0.035 per unit in August. This brought total declared distributions for the year to \$0.385 per unit an increase of 60% from \$0.24 per unit in 2004.
- Of the amount distributed in 2005, 65% was income in nature, whereas 100% of distributions were income in nature in 2004.
- Cash available from operations per basic unit increased by \$0.21 to \$0.70 per unit, a 43% increase over the \$0.49 per unit realized in 2004. On a diluted per unit basis, the change was \$0.18 to \$0.64 per unit, a 39% increase over the \$0.46 per unit achieved in 2004.
- Cash available for distribution per basic unit increased to \$0.51 per unit, up 76% over the \$0.29 per unit realized in 2004. Distributions as a percentage of cash available for distribution were 76% vs. 82% in 2004.

- Royal Host strengthened its balance sheet: Management refinanced the Grand Okanagan Resort's debt with a 5-year mortgage, increasing the face amount to \$35 million from \$25 million in January; completed a \$28 million construction financing for the Royal Private Residence Club ("PRC") in April; completed a \$60 million, 10-year, 6.0% Convertible Debenture in October; and repaid \$25.6 million in debt that had an average interest rate of 8.62%. The result is a strong cash position with no significant mortgage debt repayments until 2009, and funds available to repay the 9.25% Convertible Debenture due in March 2007. In addition, the Trust now has seven properties unlevered and undrawn credit lines of \$12 million.
- There was a strong contribution from Royal Host's first full year of the successful management contract with Supertel Hospitality.
- A \$7.0 million Capital Program which, as well as funding required maintenance, enabled a number of improvements at certain properties and included the replacement of 2,200 beds and almost 1,000 televisions in 19 of the Trust's properties. The capital program expenditures are equal to 4.9% of total revenue.
- There was significant progress on the construction of the PRC, which is expected to be completed in April 2006. The PRC is 78% sold and the Trust expects to profitably exit this project in 2006.
- The Trust repurchased 1.2 million units under a Normal Course Issuer Bid at an average price of \$5.90, and repurchased \$288,000 of Convertible Debentures at an average price of \$104.00 also under a Normal Course Issuer Bid.

SELECTED FINANCIAL AND OPERATING HIGHLIGHTS

(\$000's, except as otherwise noted)	For the Year Ended December 31		
	2005	2004 (Restated)	Change %
Hospitality Revenue (continuing operations)			
Room	99,984	97,208	2.9
Food and Beverage	26,460	24,698	7.1
Other	17,855	16,879	5.8
	<u>144,299</u>	<u>138,785</u>	4.0
Gross Margin	<u>41,385</u>	<u>36,537</u>	13.3
Gross Margin %	<u>28.7</u>	<u>26.3</u>	9.1
Net Earnings (Loss)			
From Continuing Operations	2,582	(5,281)	148.9
From Discontinued Operations	(236)	84	(381.0)
	<u>2,346</u>	<u>(5,197)</u>	145.1
Basic Per Unit Net Earnings (Loss) (\$)			
From Continuing Operations	0.08	(0.24)	133.3
From Discontinued Operations	(0.01)	-	-
	<u>0.07</u>	<u>(0.24)</u>	129.2
Diluted Per Unit Net Earnings (Loss) (\$)			
From Continuing Operations	0.08	(0.24)	133.3
From Discontinued Operations	(0.01)	-	-
	<u>0.07</u>	<u>(0.24)</u>	129.2
Cash Available From Operations	<u>18,297</u>	<u>12,074</u>	51.5
Cash Available For Distribution	<u>13,239</u>	<u>7,198</u>	83.9
Basic Per Unit Cash Available For Distribution (\$)	<u>0.51</u>	<u>0.29</u>	75.9
Diluted Per Unit Cash Available For Distribution (\$)	<u>0.51</u>	<u>0.29</u>	75.9
Distributions Declared	<u>10,044</u>	<u>5,872</u>	71.0
Per Unit Distributions Declared (\$)	<u>0.385</u>	<u>0.24</u>	60.4

OUR VISION

Our vision is to be considered by all stakeholders as one of the best mid-market hotel companies in North America.

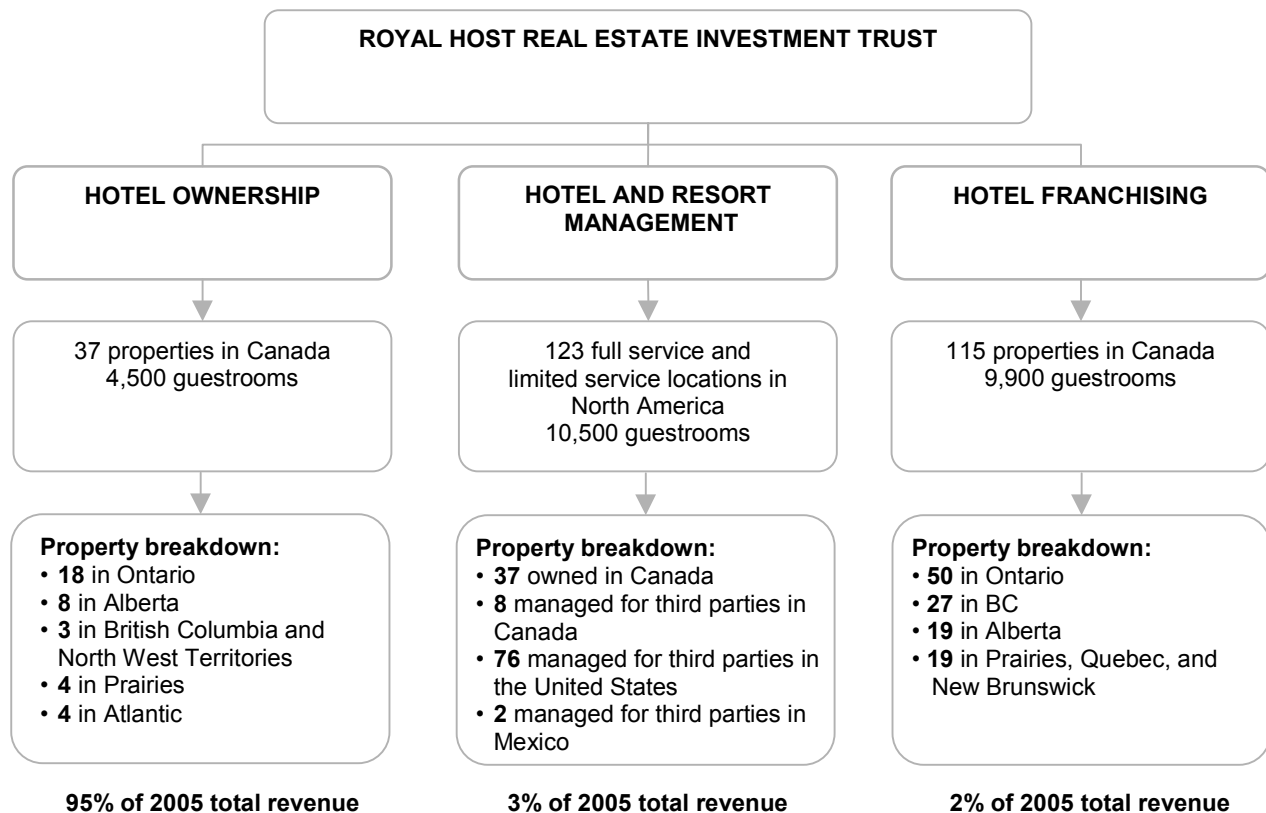
The Trust will achieve this vision with a focus on a commitment to building a strong foundation and managing for results by:

- conducting business with simplicity, integrity and trust;
- communicating with our stakeholders, conveying a message of confidence and professionalism to external customers, and promoting an atmosphere of clear and open communication with all internal team members;
- building a team of talented, highly skilled employees, who are empowered to achieve, and who are recognized and rewarded for their performance; and
- striving for excellence, driven and motivated by results.

OUR CORE BUSINESS

At its core, Royal Host is in the hospitality business and manages hotels through ownership, third party contracts, and franchising services.

At December 31, 2005, Royal Host owned 37 hotels, (comprising 4,500 rooms), managed 86 additional properties (8 in Canada, 76 in the United States and 2 in Mexico), and franchised 115 locations under the Travelodge and Thriftlodge banners (including 16 which the Trust owns). In total this comprises 18,000 guestrooms in mid-market to upscale hospitality segments.



Royal Host's main revenue stream is through the Hotel Ownership business segment, which includes hotel room rentals, food and beverage services and other hotel services. Hotel Ownership represents approximately 95% of total revenue. The Trust also leverages the existing hotel infrastructure to provide third-party hotel management service and this segment contributes approximately 3% of total revenue. The Hotel Franchising is a steady part of our business that is self-sufficient and contributes an additional 2% of total revenue representing a dependable source of income. In addition to seeking acquisition opportunities, the Trust is continually striving to grow our management business and add franchises to our portfolio.

Royal Host has two primary types of hotel operations:

- Full and focused service operations, concentrating on the broad range of needs of business travelers, client groups, conferences, and meetings. In our portfolio, 14 hotels fit in this category and this contributes approximately 68% of total hotel revenue. Our largest property in this group is the Grand Okanagan Resort.
- Limited service operations with limited amenities are aimed at recreational travelers, vacations, group tours, sports teams, and weekend get-aways. Royal Host has 23 Economy and Mid-market limited service hotels, which contribute the balance of hotel revenue.

RESOURCES

The key resources that the Trust utilizes for the implementation of its strategy and the ongoing management of its business include human, financial, capital infrastructure, and systems process resources.

Human Resources

Royal Host employs approximately 3,600 people throughout its organization, and recognizes that they are critical to the success of its business. In order to retain a highly skilled team of managers and staff, Royal Host maintains competitive compensation programs, makes an extensive commitment to training and development, and encourages empowerment within specific areas of responsibility. Royal Host also recognizes and rewards the successes of its employees.

Royal Host is only one of two Canadian hotel real estate investment trusts that manages its own hotels and where management is internalized. The hotel business is highly management intensive and success or failure of a hotel property is highly dependent on good management.

Financial Resources

The financial and liquid resources are discussed under Liquidity and Capital Resources on page 14 of this MD&A. In general, under the terms of our Trust Indenture, our total debt is limited to 45% of total assets before accumulated amortization. This limit does not include instruments that may be repaid with Trust units and therefore does not include the Trust's Convertible Debentures. As at December 31, 2005, this would be 26.8%. At present, Management believes that its balance sheet is very strong and that the Trust has sufficient capacity to finance all future operations and will provide capacity for expansion opportunities.

Capital Infrastructure Resources

It is important to maintain the quality and appearance of its hotels in order to ensure guest retention. Accordingly, the Trust budgets for regular maintenance and upgrading programs to ensure all hotels remain competitive. In 2005, the Trust spent \$7.0 million on maintaining and improving its assets. Over the last five years the Trust has invested over \$43.4 million in its properties.

System and Process Resources

The Trust uses established systems and processes to maintain a competitive operating advantage. These systems include comprehensive "Standard Operating Procedure" manuals, modern, innovative information and data communication systems, sound internal controls, and an innovative guest reward program that is unique to major hotel chains in the industry.

NON-GAAP FINANCIAL MEASURES

This MD&A includes certain non-GAAP financial measures (measures that are not calculated or presented in accordance with GAAP). These measures are not recognized under GAAP and our method of calculation may not be comparable to measures presented by other entities. These measures should not be used as an alternative to net earnings (loss) determined in accordance with GAAP when assessing Royal Host's financial performance. However, the Trust believes these measures are useful in supplementing the reader's understanding of the Trust's performance.

We have included the following non-GAAP financial measures in this MD&A: Average Daily Rate ("ADR"), Occupancy, Revenue per Available Room ("RevPAR"), Cash Available from Operations, and Cash Available for Distribution.

Key Performance Drivers and Measures

The hospitality industry and REITs commonly use three non-GAAP financial measures as key indicators of the financial performance of operators:

- Occupancy, which measures the level of hotel room utilization and is calculated by dividing the number of rooms available in a given time period into the number of rooms actually rented in the same period;
- Average Daily Rate, which measures the average room price for all guest rooms and is calculated by dividing total room revenue by the number of rooms rented; and
- Revenue per Available Room, which combines information about both pricing levels and occupancy. This measure of efficiency is based on all available rooms regardless of whether they are occupied or not. RevPAR is calculated by dividing the number of rooms available in a given time period into the room revenue in the same period.

Room Statistics – Total

	YTD 2005	YTD 2004	% Change	Q4 2005	Q4 2004	% Change
CANADA (Total Operations)						
Occupancy	65.0%	65.2%	(0.3%)	61.2%	59.3%	3.2%
ADR	\$92.95	\$89.50	3.9%	\$89.84	\$86.18	4.2%
RevPAR	\$60.44	\$58.32	3.6%	\$54.97	\$51.07	7.6%
CANADA (Continuing Operations)						
Occupancy	66.4%	66.5%	(0.2%)	62.1%	60.5%	2.6%
ADR	\$93.29	\$90.29	3.3%	\$89.94	\$86.85	3.6%
RevPAR	\$61.90	\$60.01	3.1%	\$55.89	\$52.51	6.4%

For continuing operations, RevPAR grew by 3.1% in 2005, attributable to a 3.3% increase in overall ADR of \$3.00 year-over-year. The fourth quarter of 2005 was very strong. For continuing operations, ADR grew 3.6% and Occupancy gained 2.6% for a RevPAR gain of \$3.38 or 6.4%.

Room Statistics – By Region

	YTD 2005	YTD 2004	% Change	Q4 2005	Q4 2004	% Change
WESTERN (Total Operations)						
Occupancy	66.2%	64.6%	2.5%	61.0%	58.0%	5.2%
ADR	\$93.00	\$88.87	4.6%	\$87.41	\$81.71	7.0%
RevPAR	\$61.61	\$57.39	7.4%	\$53.32	\$47.40	12.5%
WESTERN (Continuing Operations)						
Occupancy	66.2%	64.7%	2.3%	61.0%	58.0%	5.2%
ADR	\$93.00	\$89.41	4.0%	\$87.41	\$82.01	6.6%
RevPAR	\$61.61	\$57.81	6.6%	\$53.32	\$47.60	12.0%
ONTARIO (Total Operations)						
Occupancy	62.8%	64.0%	(1.9%)	59.8%	58.8%	1.7%
ADR	\$94.56	\$91.20	3.7%	\$93.56	\$90.42	3.5%
RevPAR	\$59.38	\$58.36	1.7%	\$55.92	\$53.16	5.2%
ONTARIO (Continuing Operations)						
Occupancy	65.1%	66.2%	(1.7%)	61.4%	60.9%	0.8%
ADR	\$95.18	\$92.32	3.1%	\$93.76	\$91.60	2.4%
RevPAR	\$61.93	\$61.09	1.4%	\$57.60	\$55.81	3.2%
ATLANTIC (Total Operations)						
Occupancy	72.8%	74.2%	(1.9%)	70.2%	66.2%	6.0%
ADR	\$87.11	\$85.92	1.4%	\$80.13	\$79.99	0.2%
RevPAR	\$63.41	\$63.76	(0.5%)	\$56.23	\$52.94	6.2%

The strongest gains were in western Canada, which accounts for 40% of our portfolio. For continuing operations, increases in both Occupancy, and ADR contributed to a 6.6% gain in RevPAR. In the fourth quarter of 2005, RevPAR increased a solid 12.0% or \$5.72. Ontario, which makes up 54% of our portfolio, saw strong gains in the fourth quarter of 2005, which resulted in a modest annual gain of 1.4% in ADR from continuing operations. Atlantic Canada, which makes up 6% of our portfolio, was steady year over year, with gains in the fourth quarter.

Cash Available from Operations and Cash Available for Distribution

(\$000's, except as otherwise noted)	For the Year Ended December 31		%
	2005	2004 (restated)	
Earnings From Continuing Operations	2,582	(5,281)	148.9
Add:			
Depreciation and Amortization	15,488	16,769	
Property Impairment Provision	980	734	
Future Income Taxes (Recovery)	(2,001)	442	
Mortgage Retirement Costs	2,023	-	
Cash Available From Continuing Operations	19,072	12,664	50.6
Cash Available From Discontinued Operations	(397)	166	(339.2)
	18,675	12,830	45.6
Less: Distributions on Redeemable Partnership Units	(378)	(756)	50.0
Cash Available From Operations	18,297	12,074	51.5
Less: Estimated Capital Maintenance (1)	5,058	4,876	3.7
Cash Available For Distribution	13,239	7,198	83.9
Distributions Declared	10,044	5,872	71.0
Basic Per Unit Cash Available From Operations (\$)	0.70	0.49	42.9
Diluted Per Unit Cash Available From Operations (\$)	0.64	0.46	39.1
Basic Per Unit Cash Available For Distribution	0.51	0.29	75.9
Diluted Per Unit Cash Available For Distribution	0.51	0.29	75.9
Per Unit Distributions Declared (\$)	0.385	0.24	60.4
% of Cash Available For Distribution Distributed	76%	82%	(7.3)

(1) Capital maintenance is calculated as 4% of the total hotel revenue

Cash available for distribution for the year ended December 31, 2005 increased by 83.9% to \$13.2 million (2004 - \$7.2 million). On a basic per unit basis, the cash available for distribution increased by 75.9% to \$0.51 per unit from \$0.29 per unit in 2004. Cash available for distribution is calculated as cash available from operations less estimated capital maintenance. The Trust identifies a certain amount of its capital expenditure budget as maintenance capital, which is to be funded from cash available from operations. Maintenance capital, which is calculated as 4% of rooms and food and beverage revenue, was estimated to be \$5.1 million in 2005, which compares with \$4.9 million in 2004.

Royal Host's Trustees approve distributions based on, among other things, projected cash flows, capital requirements, and working capital needs. Royal Host pays cash distributions on a monthly basis to Unitholders of record on or about the 15th day of each month. Distributions are payable on or about the last business day of the month. In January 2005, as a direct result of improved results, the Trust increased distributions per unit to \$0.03 per month from \$0.02. Later in the year, the Trustees increased distributions per unit to \$0.035 per month commencing with the August 2005 distribution.

During 2005, the Trust declared distributions of \$10.0 million, an increase of 71% over the \$5.9 million declared in 2004. The actual amount paid during the year was \$9.8 million, which compares to \$6.3 million paid in 2004.

In addition to the distributions, the Trust used cash from operations to fund principal repayments of \$3.1 million. The total amount of funds used for capital investment was \$7.0 million including the maintenance capital estimate of \$5.1 million. Of this amount a certain portion was funded from restricted cash.

The Trust was successful in completing a \$60 million, 6.0% Convertible Debenture offering in October. Of the net proceeds of \$57.5 million, \$27.8 million was used to repay \$25.6 million of debt, \$2.0 million in early repayment costs and \$0.2 million in interest related to the debt repaid. The early repayment costs have been expensed for the year, but have been added back in calculating cash available for distribution as they were funded by the proceeds raised in the 6.0% Convertible Debenture issue.

Disclosure Controls and Procedures

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by Royal Host is accumulated and communicated to Royal Host's Management as appropriate to allow timely decisions regarding required disclosure. Royal Host's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the 2005 annual filings, that Royal Host's disclosure controls and procedures are effective to provide reasonable assurance that material information related to Royal Host, including its consolidated subsidiaries, is made known to them by others within those entities. It should be noted that while Royal Host's Chief Executive Officer and Chief Financial Officer believe that Royal Host's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal controls over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Key Accounting Policies and Estimates

Note 2 to the Consolidated Financial Statements includes a complete summary of all of the significant accounting policies.

The application of some of these policies requires the Trust to make estimates of future events that may have a material effect on current or future financial results. These estimates require experience and judgement and are subject to the inherent risk of inaccuracy, particularly where they relate to events that are expected to take place well into the future.

Revenue Recognition

The Trust recognizes revenue from its hospitality operations when the service has been provided and collection is reasonably assured. In certain cases, such as period end accruals, application of this policy may require estimates to be made of final charges, discounts and allowances, cost of the product or service delivered and creditworthiness of the customer. The Trust makes these estimates based on the most recent information available and considers consistency with historical trends.

Capital Assets

Hotel properties are recorded at the lower of cost less accumulated amortization or net recoverable value. The net recoverable value represents the estimated undiscounted projected future net cash flow to be generated from the property throughout its useful life, including its residual value, and is intended to determine the recoverability of an investment and is not an expression of a property's fair market value.

Hotel properties are amortized using the straight-line method over their estimated useful lives. Each property is evaluated quarterly and its useful life is estimated based on certain factors including construction materials used, location, condition of the property and the capital maintenance program and requirements of the property.

Estimates of future cash flows and the useful lives of hotel properties require substantial judgement, and are subject to ongoing review and adjustment as conditions change.

CHANGES IN ACCOUNTING POLICIES

Consolidation of Variable Interest Entities

In November 2003, the CICA issued Accounting Guideline 15 "Consolidation of Variable Interest Entities" ("AcG-15"), effective for fiscal years beginning after November 1, 2004. AcG-15 requires an enterprise to consolidate a variable interest entity when the enterprise is the primary beneficiary of the entity, the enterprise absorbs the majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity.

Prior to the issuance of AcG-15, an enterprise generally consolidated an entity when the enterprise had a controlling financial interest in the entity through ownership of a majority voting interest. Prior to the adoption of AcG-15, the Trust proportionately consolidated the Royal Private Residence Club Joint Venture. However, the Joint Venture is a variable interest entity as Royal Host will absorb a majority of the Joint Venture's expected losses and will receive the majority of the Joint Venture's expected returns. Accordingly, effective January 1, 2005, Royal Host is now consolidating the Joint Venture. The fiscal 2004 results were also restated to appropriately reflect this change.

Liabilities and Equity

In November 2003, the CICA amended Section 3860 "Financial Instruments – Disclosure and Presentation" requiring that certain obligations that may be settled at the issuer's option in cash or the equivalent value by a variable number of the issuer's own equity instruments to be presented as liabilities. The amendments to Section 3860 are effective for fiscal years beginning on or after November 1, 2004. The Trust has applied the provisions of Section 3860 retroactively, and has restated prior years' Consolidated Financial Statements. The amendments result in the Convertible Debentures, which were previously classified as equity, being classified as a liability on the Consolidated Balance Sheets and the associated interest expense correspondingly being classified as Interest on Convertible Debentures on the Consolidated Statements of Net Earnings (Loss).

As a result of the reclassification, interest on Convertible Debentures and amortization of related issuance costs were recorded in other expenses for the year ended December 31, 2004 of \$6.8 million, and deferred debt issuance costs as at December 31, 2004 increased by \$2.3 million.

Selected Annual Information For Three Years

(\$000's, except as otherwise noted)	2005	2004 (restated)	2003 (restated)
Total Revenue	144,299	138,785	138,021
Net Earnings (Loss)			
From Continuing Operations	2,582	(5,281)	138
From Total Operations	2,346	(5,197)	19
Net Earnings (Loss) Per Unit (\$)	0.07	(0.24)	(0.28)
Total Assets	421,004	387,705	375,880
Total Long-term Liabilities	270,314	202,874	193,818
Distributions Declared Per Unit (\$)	0.385	0.24	0.48

SUMMARY OF QUARTERLY FINANCIAL RESULTS

(\$000's, except as otherwise noted)	2005				2004			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	34,988	41,238	37,998	30,075	33,330	40,087	35,621	29,747
Net Earnings (Loss)								
From Continuing Operations	(336)	3,528	2,528	(3,138)	(6,246)	2,774	339	(2,148)
From Discontinued Operations	6	81	(214)	(109)	205	532	(587)	(66)
	(330)	3,609	2,314	(3,247)	(6,041)	3,306	(248)	(2,214)
Cash Available for Distribution								
From (used in) Continuing Operations	2,597	9,535	6,140	422	(1,685)	8,164	4,508	921
From (used in) Discontinued Operations	(82)	27	(202)	(140)	37	394	(16)	(249)
	2,515	9,562	5,938	282	(1,648)	8,558	4,492	672
Per Unit Results								
Earnings (Loss) from Continuing Operations								
Basic	(0.01)	0.13	0.09	(0.14)	(0.26)	0.11	0.01	(0.10)
Diluted	(0.01)	0.13	0.09	(0.14)	(0.26)	0.10	0.01	(0.10)
Earnings (Loss) from Total Operations								
Basic	(0.01)	0.13	0.08	(0.14)	(0.25)	0.13	(0.01)	(0.10)
Diluted	(0.01)	0.13	0.08	(0.14)	(0.25)	0.12	(0.01)	(0.10)
Cash Available from (used in) Continuing Operations								
Basic	0.10	0.35	0.24	0.02	(0.07)	0.33	0.18	0.04
Diluted	0.10	0.29	0.20	0.01	(0.07)	0.25	0.18	0.03
Cash Available from (used in) Total Operations								
Basic	0.10	0.35	0.23	0.01	(0.07)	0.35	0.18	0.03
Diluted	0.10	0.29	0.20	0.01	(0.07)	0.26	0.18	0.02

Seasonality

The hospitality business is seasonal in nature. The Trust's revenue and profitability are typically stronger in the second and third quarters, as compared to the first and fourth quarters. The Board of Trustees sets cash distributions based on annual performance; as a result, actual distributions will not equal cash available for distribution in any one quarter.

YEAR ENDED DECEMBER 31, 2005 (Continuing Operations)

Hospitality Revenue

For the Year Ended December 31 (\$000's)	2005	2004	Change	%
Hospitality Revenue (continuing operations)				
Rooms	99,984	97,208	2,776	2.9
Food and Beverage	26,460	24,698	1,762	7.1
Other	17,855	16,879	976	5.8
	144,299	138,785	5,514	4.0

Hospitality revenue increased \$5.5 million or 4.0% to \$144.3 million (2004 - \$138.8 million). Increases were realized in all areas with improving rooms revenue being supplemented by very strong food and beverage and other hospitality revenue.

Rooms Revenue

Rooms revenue from same-store sales increased \$2.8 million, or 2.9%, to \$100.0 million (2004 - \$97.2 million), a result of the 3.3% increase in ADR to \$93.29 (2004 - \$90.29), while Occupancy was steady at 66.4% (2004 - 66.5%). The increase in ADR is a result of Management's focus on managing room rate yield and the improving overall industry rates. In particular, the Western region realized the highest increase with the Holiday Inn in Edmonton, Alberta showing an 11% improvement, the Village Park Inn in Calgary, Alberta showing an 8% improvement, and the Grand Okanagan Resort in Kelowna B.C., our largest property, experiencing a 6% increase.

Food and Beverage Revenue

Food and beverage revenue increased \$1.8 million, or 7.1%, to \$26.5 million (2004 - \$24.7 million), based on same store-sales. Improvements were realized in all areas. The primary reason for the increase was the addition for the first full year of two restaurants added late in 2004.

Other Hospitality Revenue

Other hospitality revenue was very solid, increasing \$1.0 million, or 5.8% in 2005, to \$17.9 million (2004 - \$16.9 million). The increase is primarily the result of the success of Royal Host's management of Supertel Hospitality's hotel properties, which commenced on August 1, 2004, and the management contract for the Wingate Inn Edmonton West, which commenced on January 1, 2005. The revenue from the new contracts more than offset the reduction resulting from Management's decision to terminate an unprofitable management contract effective March 31, 2005 and the continuing managed decrease in timeshare activities. Travelodge franchise fees also continue to be strong in line with the prior year.

Hospitality Expenses

<u>For the Year Ended December 31 (\$000's)</u>	<u>2005</u>	<u>2004</u>	<u>Change</u>	<u>%</u>
Hospitality Expenses	102,914	102,248	666	0.7

Royal Host has focused particular attention on managing its costs. The success of this objective combined with increased revenue resulted in overall hospitality expenses decreasing as a percentage of hospitality revenue to 71.3% (2004 - 73.7%).

Total hospitality expenses were steady, increasing by \$0.7 million or 0.7% to \$102.9 million (2004 - \$102.2 million). This reflects Management's continuing focus on operations and the success of the operations managers in controlling overall payroll costs. In addition to the controlling of costs, 2004 results included \$1.8 million in one-time costs, including inventory writedowns, which are not in the 2005 amounts. The Trust did include a one-time cost in 2005 for severance costs of \$0.6 million. Overall utility costs were also higher by \$0.6 million.

Gross Margin

<u>For the Year Ended December 31 (\$000's)</u>	<u>2005</u>	<u>2004</u>	<u>Change</u>	<u>%</u>
Gross Margin	41,385	36,537	4,848	13.3

Gross margin increased \$4.9 million, or 13.3%, to \$41.4 million in 2005, which compares to \$36.5 million in 2004. This is a direct result of the higher overall revenue and consistent hospitality costs. Gross margin as a percentage of hospitality revenue, improved by 9.1% to 28.7% (2004 - 26.3%).

Other Expenses

Other expenses decreased 7.2% in 2005 to \$38.8 million, compared to \$41.8 million in 2004. The Trust was able to reduce net interest expense by \$1.5 million from lower overall interest rates and higher interest income received on notes receivable and short-term investments. The company recorded a \$2.0 million mortgage retirement expense related to repayments made in October. This was funded out of proceeds of the 6.0% Convertible Debenture and was offset by a future income tax recovery of \$2.0 million, which is a non-cash item. Also included in 2005 is \$1.0 million in property impairment provisions (2004 - \$0.7 million) for a timeshare property and the Lethbridge property, which are also non-cash items. Trust administration costs are lower by \$1.4 million in 2005 as severance costs of \$1.6 million were incurred in 2004.

Net Earnings

As a result of the strong revenue growth, improved gross margins, and an overall decrease in other expenses, net earnings from continuing operations improved to \$2.6 million and net earnings from total operations increased to \$2.3 million. This compares to a net loss from continuing operations of \$5.3 million and a net loss of \$5.2 million from total operations in 2004.

DISCONTINUED OPERATIONS

Revenue and gross margin from discontinued operations in 2005 were \$1.2 million (2004 - \$5.5 million) and (\$0.4 million) (2004 - \$0.2 million).

On February 23, 2005, the Travelodge North York hotel was sold to a condominium developer. Under the agreement of purchase and sale, the Trust received \$10.8 million for its 50% interest in the property. Payment was made by way of \$7.0 million in cash and a \$3.8 million vendor take-back mortgage, which was collected in the third quarter. In addition, Royal Host received a subordinated vendor take-back mortgage for a maximum of \$2.0 million to recover certain costs associated with closing the hotel. As at December 31, 2005, \$1.9 million of the subordinated vendor take-back mortgage was recognized and included in Accounts and Notes Receivable. Cash proceeds received from the transaction were used to repay a \$5.5 million mortgage on the property and for general corporate purposes.

Royal Host continues to actively seek a buyer for its 95-room hotel in Orillia, Ontario.

SELECTED FOURTH QUARTER DATA

For the three months ended December 31 (\$000's, except as otherwise noted)	2005	2004 (restated)	Change	%
Hospitality Revenue (continuing operations)				
Rooms	22,506	21,506	1,000	4.6
Food and Beverage	7,523	6,920	603	8.7
Other	4,959	4,904	55	1.1
	<u>34,988</u>	<u>33,330</u>	<u>1,658</u>	<u>5.0</u>
Hospitality Expenses	<u>26,476</u>	<u>27,579</u>	<u>(1,103)</u>	<u>(4.0)</u>
Gross Margin	8,512	5,751	2,761	48.0
Other Expenses	<u>8,848</u>	<u>11,997</u>	<u>(3,149)</u>	<u>(26.2)</u>
Loss From Continuing Operations	(336)	(6,246)	5,910	94.6
Earnings From Discontinued Operations	6	205	(199)	(97.1)
Add: Non-cash Items Deducted From Earnings	2,845	4,393	(1,548)	(35.2)
Basic Cash Available For Distribution (used in operations)	<u>2,515</u>	<u>(1,648)</u>	<u>4,163</u>	<u>252.6</u>
Basic Per Unit Cash Available For Distribution (used in operations)	<u>0.10</u>	<u>(0.07)</u>	<u>0.17</u>	<u>242.9</u>

Hospitality revenue from continuing operations in the fourth quarter of 2005 increased by \$1.7 million, compared to the same quarter of 2004. Hospitality revenue was higher in all areas with Rooms revenue contributing \$1.0 million and Food and Beverage operations contributing \$0.6 million of the increase.

Gross margin of \$8.5 million in the fourth quarter of 2005 was \$2.8 million higher than the fourth quarter of 2004. Adjusted cash available for distribution from total operations in the fourth quarter of 2005 was \$4.2 million higher than the fourth quarter of 2004. In addition to the higher revenue recorded in the quarter, overall hospitality expenses were lower in 2005 by \$1.1 million as a result of one-time expenses recorded in 2004. Included in the 2005 amount are severance expenses of \$0.6 million. In the fourth quarter of 2004, there were a number of one-time expenses recorded totaling \$1.8 million, including asset write-downs due to impairment or obsolescence, and accounts receivable allowances. In comparing 2005 other expenses to 2004 they are lower as a result. However this is offset by a severance expense of \$1.6 million recorded in the fourth quarter of 2004.

LIQUIDITY AND CAPITAL RESOURCES

As at December 31, 2005, cash and short-term investments were \$31.5 million and undrawn credit facilities were \$12.0 million. Restricted cash as at December 31, 2005 was \$6.0 million (December 31, 2004 - \$6.4 million). Restricted cash consists primarily of funds held by lenders pursuant to financing arrangements for future planned capital expenditures. It is anticipated a net amount of that approximately \$2.8 million of the restricted cash will be drawn down in 2006 for planned expenditures to be made in 2006.

These liquid resources, together with Royal Host's future cash flows, and undrawn lines of credit are anticipated to be sufficient to fund anticipated cash requirements over the next year.

Financing Activities

On January 13, 2005, the Trust replaced the \$25 million mortgage on the Grand Okanagan Resort, increasing it to \$35 million for a five-year term at a 7.5% fixed interest rate. Royal Host used the additional proceeds from the financing, net of expenses, for working capital and general corporate purposes. The mortgage was originally scheduled to mature in August 2005 and was included in the current portion of mortgages as at December 31, 2004.

In April 2005, Royal Host, along with its joint venture partner in the Royal Private Residence Club, entered into a non-revolving \$28.0 million financing arrangement consisting of a \$20.0 million construction loan and an \$8.0 million mezzanine loan. During 2005, \$7.4 million was drawn on the construction loan. The full amount of \$8.0 million was drawn on the mezzanine loan in April 2005. It is anticipated that all future development will be funded from cash on hand. The Trust currently also has access to \$12.6 million from its undrawn project credit facilities to fund the project if required. The Trust has also arranged a takeout commitment of up to \$13 million, should it be required, from a US lender who specializes in resort funding.

As at December 31, 2005, the Trust's mortgages had decreased to \$145.2 million (December 31, 2004 - \$157.0 million). The current portion of mortgages and other debt has decreased to \$18.3 million and includes \$15.4 million related to the PRC as described above. This compares with \$39.1 million at December 31, 2004, which included the Grand Okanagan Resort mortgage of \$25 million that was refinanced as described above.

The following table identifies Royal Host's future mortgage and lease obligations:

Mortgages and Leases

As at December 31, 2005 (\$000's)	Total	2006	2007	2008	2009	2010	Thereafter
Mortgages	145,226	18,304	3,108	3,325	24,973	71,670	23,846
Obligations Under Capital Leases	1,103	443	390	269	1	-	-
Obligations Under Operating Leases	739	321	205	95	47	23	48
	<u>147,068</u>	<u>19,068</u>	<u>3,703</u>	<u>3,689</u>	<u>25,021</u>	<u>71,693</u>	<u>23,894</u>

Convertible Debentures

As at December 31 (in \$000's)	2005	2004	Maturity Date	Conversion Price
9.25% Convertible Unsecured Subordinated	39,712	40,000	March 2007	\$7.00
7.90% Convertible Unsecured Subordinated, Series A	35,000	35,000	April 2009	\$6.00
6.00% Convertible Unsecured Subordinated, Series B	58,340	-	October 2015	\$6.85
	<u>133,052</u>	<u>75,000</u>		

On October 20, 2005, the Trust completed a \$60 million offering of 6.0% Convertible Debentures. Net proceeds to the Trust were \$57.5 million. The Trust used \$27.8 million of the proceeds to repay debt. Of this amount, \$25.6 million was applied to principal repayments, \$0.2 million to interest, with the balance of \$2.0 million being prepayment penalties. The 6.0% Convertible Debentures have a conversion feature whereby the Trust can elect to repay in Trust units at maturity. Accordingly, this equity feature has a value, which, the Trust has calculated to be \$1.7 million and recorded this amount as equity and the balance of \$58.3 million being recorded as long-term debt. In 2005, the Trust initiated a Normal Course Issuer Bid for up to \$2 million of the 9.25% Convertible Debenture and repurchased \$288,000 in debentures.

Average Maturity and Weighted Average Interest Rate

As at December 31, 2005, the average maturity of the mortgages is 4.8 years. Including Convertible Debentures, the average maturity is 5.2 years. This compares to 4.6 years and 5.3 years respectively in 2004. The weighted average interest rate on mortgages outstanding at December 31, 2005 is 8.19%, which compares to the December 31, 2004 rate of 8.46%. Including Convertible Debentures, the weighted-average interest rate at December 31, 2005 is 7.83% per annum, which is 8% lower than the December 31, 2004 weighted-average interest rate of 8.50% per annum.

Investing Activities

During 2005, the Trust spent \$7.0 million on capital expenditures (2004 - \$6.3 million). A key focus has been on its customer retention program by improving existing facilities. The Trust has an ongoing capital program whereby it has replaced over 2,200 beds and almost 1,000 televisions in 19 of its hotels in 2005. High-speed Internet access has also been added in 25 of the Trust's owned properties.

Restricted cash, described above, is available for funding certain hotel capital expenditures. A portion of the capital expenditures planned for 2006 will be funded out of restricted cash. At \$7.0 million, capital expenditures in 2005 were lower than the \$8 million originally forecast. The Trust has included the unused portion of the 2005 capital expenditures in its 2006 budget. The overall capital budget for 2006 is currently planned to be \$10 million. In addition to its regular maintenance capital, the Trust will be investing funds in certain properties to improve their overall market position.

Property Under Development

Property under development relates to the PRC, a 70-unit luxury condominium development, which is being developed adjacent to the Grand Okanagan Resort. During 2005, the construction progressed well with the Trust investing \$20.2 million to bring the total property under development as at December 31, 2005 to \$37.9 million. Construction of the development's first phase, the parkade, was completed in 2004. Construction of the residence units, which commenced in May 2004, is expected to be completed in the second quarter of 2006. As at December 31, 2005, 78% of the development's residence units have been sold.

Equity

As described under "Changes in Accounting Policies", the Convertible Debentures have been reclassified from equity to liabilities. Equity as at December 31, 2004, originally reported at \$183.4 million has been restated to \$110.6 million to reflect the reclassification of Convertible Debentures and related debt issuance costs. Equity has decreased to \$95 million as at December 31, 2005. Additions to equity included the net earnings of \$2.3 million and \$1.7 million related to the equity value of the conversion option of the 6.0% Convertible Debenture. Overall, equity was reduced by \$20.0 million including \$10.0 million for declared distributions, \$7.1 million for the repurchase of 1.2 million Trust Units under its Normal Course Issuer Bid (described below), and \$2.4 million pursuant to the redemption of the redeemable partnership units (described below).

Normal Course Issuer Bids

Royal Host initiated a Normal Course Issuer Bid ("NCIB"), commencing December 21, 2004, to repurchase a maximum of 1.2 million of the Trust's issued and outstanding trust units. The Trust believes that the repurchase of units at current levels is accretive to Unitholders. During 2005, 1.2 million trust units were repurchased at an average cost of \$5.90 per unit. Of these, the Trust cancelled 983,600 during 2005, and the balance of 216,400 in January 2006. This bid expired on December 21, 2005.

On December 29, 2005 the Trust filed another NCIB for a total of 1.8 million units. Subsequent to December 31, 2005, the Trust repurchased an additional 255,700 units at an average price of \$5.93 bringing the total units repurchased and cancelled to date under both bids to 1.46 million.

Royal Host initiated a NCIB, commencing July 15, 2005, to repurchase a maximum of \$2.0 million of its 9.25% subordinated unsecured Convertible Debentures. In 2005 the Trust repurchased \$288,000 of debentures at an average price of \$104.00. Subsequent to December 31, 2005 the Trust repurchased \$800,000 of debentures at an average price of \$104.00, thereby bringing the Trust's total repurchases and cancellations to date to \$1,088,000.

Redeemable Partnership Units

During 2005, the Trust redeemed 3,151,433 redeemable partnership units by way of a combination of issuance of 2,706,682 Royal Host trust units and a cash payment of \$2.4 million. The partnership units were held by entities controlled by certain current and former officers and trustees of Royal Host. As such, the redemption was a related party transaction and the partnership units were recorded at the historical amount of \$27.5 million in the Consolidated Financial Statements.

As at December 31, 2005 a total of 10 (2004 - 3,151,443) redeemable partnership units remained outstanding.

There were no other material Related Party Transactions in 2005.

OFF BALANCE SHEET ARRANGEMENTS

Royal Host had no undisclosed off balance sheet arrangements as at December 31, 2005.

RISKS AND UNCERTAINTIES

Royal Host's business is subject to various risks and uncertainties, which occur in the normal course of business that could adversely affect its earnings and cash flow, as well as its ability to make distributions to Unitholders. The following is a discussion of the key risks and uncertainties facing its business on a day-to-day basis, and the strategies adopted to mitigate these risks. However, it should not be assumed that this discussion is exhaustive or that the strategies adopted to mitigate these risks will be effective.

Additional information with respect to the risks and uncertainties to which Royal Host is subjected is contained in our Annual Information Form, which may be viewed on SEDAR at www.sedar.com.

General Economic Risks

Hotel performance is affected by the following factors:

- general economic conditions and consumer confidence which determine discretionary spending;
- the state of the airline and other transportation industries;
- demographic shifts impacting nature of travel;
- geopolitical events affecting consumer and business confidence;
- fiscal and taxation policies;
- changes in legislation; and
- fluctuations in interest rates.

While these factors are mainly external and uncontrollable, the Trust adopts several strategies in an effort to minimize their impact:

- diversification of its existing hotel portfolio both geographically and across market segments in order to lower the exposure to regional economic fluctuations;
- acquisition of properties in desirable locations with a history of stable cash flows that are at or above our minimum expected rate of return;
- maintaining a corporate legal structure to limit risks;
- maintaining a strong balance sheet and conservative fiscal strategies; and
- using debt instruments with fixed interest rates where such financing can be obtained on favourable terms.

Operating Risk

The Trust also faces normal operating risks associated with the hotel business. These risks include:

- operating cost increases due to inflation and other factors;
- dependence on business travelers and tourism;
- increases in energy costs and other expenses; and
- reliance on key personnel.

In order to mitigate these risks, the Trust has developed strategies focusing on:

- ensuring consumer satisfaction through proactive measures such as staff training;
- maintaining a high quality product by ensuring that the hotel portfolio is constantly renovated and managed at or above industry standards;
- developing specific sales and marketing programs targeting a wide variety of customer segments, using innovative electronic marketing techniques;
- employing sophisticated operating systems to manage and control cost;
- managing the capital structures with a focus on a constructive and prudent use of leverage; and
- providing incentive based compensation programs to attract and maintain a high quality management team.

Competitive Risks

Substantially all of Royal Host's hotels are located in developed areas that include other hotel properties. The number of competitive hotel properties in a particular area could have a material effect on occupancy and ADR of its hotels or at hotel properties acquired in the future. New, competing hotels may be opened in the Trust's markets, which could adversely affect the profitability of hotel operations.

Environmental Risk

The Trust is subject to numerous federal, provincial, and local laws and regulations governing the environment. Under these laws and regulations, Royal Host may be liable for the costs of removal or remediation of certain hazardous or toxic substances on our properties.

In recent years environmental legislation in Canada has undergone significant change in response to greater public awareness. As a result, environmental management and remediation standards have increased. The nature of the business does not subject it to a high level of environmental risk, but Royal Host takes this risk seriously. Under current investment guidelines, all potential acquisition properties must have minimum phase one environmental assessments conducted by an independent consultant. Royal Host also maintains environmental impairment insurance on all properties.

Development Risk

The development of the Royal Private Residence Club is a complex and non-standard project for Royal Host. Additionally, development projects are subject to different risks than the regular hotel business. These risks include:

- cost increases and/or cost overruns;
- sales/marketing risks;
- reliance on external experts/advisors;
- financing risks;
- timing risks related to holding assets in inventory pending sale; and
- closing risk, as some purchasers may not complete the purchase.

The Trust has attempted to mitigate these risks by:

- entering into fixed price contracts for the construction of the project;
- establishing relationships and entering into service contracts with reputable experts and advisors that have experience with this type of project;
- requiring non-refundable deposits from potential purchasers;
- engaging experienced sales professionals to reduce the sales/timing risk; and
- ensuring the balance sheet can support any obligations Royal Host undertakes and use of reasonable construction financing sufficient to support the project.

OUTLOOK

Royal Host has made significant progress in 2005 toward its goal of simplification by focusing on its core competencies of hotel ownership, management and franchising. The Trust intends to continue to focus on expansion within its areas of expertise, which may include acquiring limited, full and focused service hotels in Canada. The funding of the Royal Private Residence Club has been finalized, construction is on budget, and the Trust anticipates exiting this non-core business profitably in 2006. The management contract with Supertel Hospitality is performing very well as the Trust is delivering on its management promises and the contract is contributing to overall profitability. The Trust will continue to focus on its customer retention programs with more beds and televisions being replaced and other improvements being completed.

National demand in the hospitality industry is growing and Pannell Kerr Forster Consulting Inc., a recognized industry consultant, is forecasting solid growth in ADR and steady Occupancy. The Trust anticipates that the growth in ADR will continue and is optimistic about 2006. The Trust exited 2005 with a strong focused team, a diversified portfolio, and a solid capital base. The Trust is well positioned to take advantage of this positive environment to continue its growth and realize on opportunities to add value and deliver on its goal of providing increasing distributions from a stable base of well-managed assets.



ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Financial Statements

For the year ended December 31, 2005

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The preparation and presentation of the consolidated financial statements and the overall quality of financial reporting are the responsibility of Management of Royal Host Real Estate Investment Trust (the "Trust"). The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and necessarily include certain amounts based on management's best estimates and careful judgement. Financial information contained throughout the annual report is consistent with that contained in the consolidated financial statements.

Management is responsible for installing and maintaining a system of internal controls to provide reasonable assurance that assets are safeguarded and that transactions are properly authorized recorded and reported. The Trust augments the internal control system with a program of internal reviews covering significant aspects of the operations. Management believes that the system of internal controls operated effectively in 2005.

The Board of Trustees is responsible for overseeing Management's performance of its responsibilities for financial reporting and internal control. The Board exercises this responsibility with the assistance of its Audit Committee. The Committee reviews the consolidated financial statements with management and the independent auditors prior to submission to the Board for approval, considers the appropriateness of accounting policies and assesses the overall quality of the financial reporting. In addition, the Committee reviews and makes recommendations to the Board regarding financial matters and oversees the process Management has in place to identify business risks. Finally, the Committee reviews the recommendations of the independent auditors for improvements to internal controls as well as the actions of management to implement such recommendations.

The Committee reviews and approves the terms of engagement of the auditors, the scope and plan for the audit and reviews with the auditors the results of the audit and the Auditors' Report. The auditors report to the Audit Committee. The Committee also discusses with the auditors their independence from Management and the Trust and receives written confirmation of their independence.

Management and auditors attend various Committee meetings and each is provided with the opportunity to meet privately with the Committee.

As signed by

Greg Royer
President & Chief Executive Officer
March 3, 2006

As signed by

Wayne King
Chief Financial Officer
March 3, 2006



Deloitte & Touche LLP
3000 Scotia Centre
700 Second Street S.W.
Calgary AB T2P 0S7
Canada

Tel: (403) 267-1700
Fax: (403) 264-2871
www.deloitte.ca

AUDITORS' REPORT

To the Unitholders of
Royal Host Real Estate Investment Trust

We have audited the consolidated balance sheets of Royal Host Real Estate Investment Trust (the "Trust") as at December 31, 2005 and 2004 and the consolidated statements of net earnings (loss) and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2005 and 2004 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is written in a cursive, flowing style.

Chartered Accountants
Calgary, Alberta
March 3, 2006

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Balance Sheets

in \$000's

	As at	
	December 31, 2005	December 31, 2004
		(restated - Notes 3 and 4)
ASSETS		
Current assets:		
Cash and short-term investments	31,483	8,707
Accounts and notes receivable	12,291	8,259
Prepaid expenses	3,484	3,686
Inventories	3,150	2,993
Assets of discontinued operations (Note 4)	188	306
Property held for sale (Note 4)	2,704	2,704
Property under development (Note 5)	37,908	17,684
Future income taxes (Note 12)	3,100	1,004
	<u>94,308</u>	<u>45,343</u>
Restricted cash (Note 6)	6,033	6,380
Long-term notes receivable (Note 8)	190	466
Assets of discontinued operations (Note 4)	-	10,456
Capital assets (Note 7)	314,102	319,999
Deferred debt issuance costs	6,371	5,061
	<u>421,004</u>	<u>387,705</u>
LIABILITIES AND UNITHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	22,905	20,795
Equity distributions payable	924	561
Interest accrued on convertible debentures	2,429	1,686
Current portion of mortgages (Note 9)	18,304	39,083
Current portion of obligations under capital leases (Note 11)	443	563
Other liabilities	2,086	2,249
Liabilities of discontinued operations (Note 4)	58	546
	<u>47,149</u>	<u>65,483</u>
Mortgages (Note 9)	126,922	117,896
Convertible debentures (Note 10)	133,052	75,000
Obligations under capital leases (Note 11)	660	961
Deferred revenue	639	688
Future income taxes (Note 12)	9,041	8,329
	<u>317,463</u>	<u>268,357</u>
Minority interest (Note 5)	8,591	8,741
Unitholders' equity (Note 13)	94,950	110,607
	<u>421,004</u>	<u>387,705</u>

See accompanying Notes to the Consolidated Financial Statements

Approved on behalf of the Board of Trustees:

As signed by

Alvin G. Poettcker
Chairman of the Board

As signed by

Stan Spavold
Chairman of the Audit Committee

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Net Earnings (Loss)

in \$000's (except per unit amounts)

	Year Ended	
	December 31, 2005	December 31, 2004
		(restated - Notes 3 and 4)
Hospitality revenue		
Rooms	99,984	97,208
Food and beverage	26,460	24,698
Other	17,855	16,879
	<u>144,299</u>	<u>138,785</u>
Hospitality expenses	<u>102,914</u>	<u>102,248</u>
Gross margin	<u>41,385</u>	<u>36,537</u>
Other expenses		
Trust administration	2,195	3,600
Interest on mortgages and capital leases	12,291	13,749
Interest on convertible debentures	7,236	6,167
Mortgage retirement costs (Note 9)	2,023	-
Depreciation and amortization	15,488	16,769
Property impairment provision (Note 14)	980	734
Future income taxes (recovery)	(2,001)	442
Capital and other taxes	509	226
Loss on foreign currency translation	82	131
	<u>38,803</u>	<u>41,818</u>
Earnings (loss) from continuing operations	2,582	(5,281)
Earnings (loss) from discontinued operations (Note 4)	<u>(236)</u>	<u>84</u>
Net earnings (loss)	<u>2,346</u>	<u>(5,197)</u>
Basic per unit net earnings (loss) (Note 15)		
- from continuing operations	0.08	(0.24)
- from discontinued operations	<u>(0.01)</u>	<u>0.00</u>
	<u>0.07</u>	<u>(0.24)</u>
Diluted per unit net earnings (loss) (Note 15)		
- from continuing operations	0.08	(0.24)
- from discontinued operations	<u>(0.01)</u>	<u>0.00</u>
	<u>0.07</u>	<u>(0.24)</u>

See accompanying Notes to the Consolidated Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Cash Flows

in \$000's

	Years Ended	
	December 31, 2005	December 31, 2004 (restated - Notes 3 and 4)
Operating activities		
Net earnings (loss) from continuing operations	2,582	(5,281)
Items not affecting cash:		
Depreciation and amortization	15,488	16,769
Future income taxes (recovery)	(2,001)	442
Property impairment provision (Note 14)	980	734
Accretion of convertible debentures (Note 10(c))	20	-
Funds from continuing operations	17,069	12,664
Funds from discontinued operations	(397)	(238)
Changes in non-cash working capital (Note 16)	(2,124)	5,388
	14,548	17,814
Financing activities		
Proceeds from the acquisition of mortgages	26,426	32,750
Principal repayments on mortgages and capital leases	(38,874)	(38,055)
Issuance of convertible debentures, net of retirements	60,000	13,000
Financing issuance costs	(3,003)	(1,607)
Repurchase of trust units pursuant to normal course issuer bid	(7,110)	-
Repurchase of convertible debentures pursuant to normal course issuer bid	(288)	-
Redemption of redeemable partnership units	(2,415)	-
Equity distributions	(9,780)	(6,291)
	24,956	(203)
Investing activities		
Acquisition of capital assets	(7,025)	(6,285)
Net cash from sale of properties	10,048	1,779
Increase in property under development	(20,224)	(15,616)
(Increase) decrease in restricted cash	347	(2,133)
(Increase) decrease in long-term notes receivable	276	(573)
Increase (decrease) in minority interest	(150)	8,741
	(16,728)	(14,087)
Increase in cash and short-term investments	22,776	3,524
Cash and short-term investments, beginning of year	8,707	5,183
Cash and short-term investments, end of year	31,483	8,707
Cash interest paid		
Mortgages and capital leases	12,232	13,220
Convertible debentures	6,464	5,082
	18,696	18,302

See accompanying Notes to the Consolidated Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

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. Royal Host's Declaration of Trust permits the development of new facilities on property adjacent to its existing properties.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Accounting

The Royal Host accounting policies and standards of financial disclosure are in accordance with Canadian generally accepted accounting principles ("GAAP") as prescribed by the Canadian Institute of Chartered Accountants ("CICA").

(b) Use of Estimates

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. Actual results could differ from those estimates.

(c) Principles of Consolidation

These consolidated financial statements include the accounts of Royal Host and its wholly-owned subsidiaries, and the accounts of all partnerships, joint ventures and co-tenancies to the extent of Royal Host's interest in their respective assets, liabilities, revenues, expenses and cash flows. All intercompany transactions and balances have been eliminated.

(d) Revenue Recognition

Revenue, consisting of rooms, food and beverage and other revenue, is recognized when services are provided and collection is reasonably assured. Other revenue includes management fees, franchise royalties, parking, tenant leases, health club and spa, timeshare maintenance fees and sales and other. Ongoing credit evaluations are performed and an allowance for potential credit losses is provided against the portion of accounts receivable which is estimated to be uncollectible.

(e) Capital Assets

Hotel properties are recorded at the lower of cost less accumulated amortization or net recoverable value. The net recoverable value represents the estimated undiscounted projected future net cash flow generated from the property throughout its useful life, including its residual value, and is intended to determine the recovery of an investment and is not an expression of a property's fair market value.

Hotel properties are amortized using the straight-line method over their estimated useful lives ranging between 25 and 40 years. Each individual property is evaluated quarterly and a useful life is estimated based on certain factors including construction materials used, location, condition of the property and the particular capital maintenance program and requirements of the property.

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(e) Capital Assets (continued)

Maintenance and repair costs are expensed against operations as incurred, while significant improvements, replacements and major renovations are capitalized to hotel properties. Furniture, equipment and certain improvements are amortized on a straight-line basis over periods of up to ten years.

Franchise rights and management contracts are amortized using the straight-line method based on their estimated useful lives.

Property under development consists of properties under construction and are recorded at the lower of cost, including pre-development expenditures, and their net recoverable value.

(f) Impairment of Long-Lived Assets

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying value may not be recoverable. An impairment loss is recognized when the carrying value of the asset exceeds the total undiscounted cash flows expected from its use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value.

(g) Capitalized Costs

Costs associated with the acquisition of hotel properties are capitalized to the respective hotel property. These costs typically include realty agent commissions, property transfer taxes, legal fees, environmental studies, engineering and other direct expenses.

The cost of hotel properties under development includes all expenditures incurred in connection with the activities of acquiring, developing and constructing these properties. These expenditures consist of all direct costs including interest on debt and an appropriate allocation of general and administrative costs incurred.

(h) Inventory

Inventory consists of food, beverages, china, silverware, glassware and linen. These items are recorded at the lower of cost or net replacement value and are determined on a first-in, first-out basis.

(i) Financing Costs

Debt financing costs are deferred and amortized on a straight-line basis over the terms of the related loans.

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(j) Income Taxes

Royal Host is taxed as a "mutual fund trust" for income tax purposes. Pursuant to the Declaration of Trust, the Trustees intend to distribute all taxable income directly earned by Royal Host to its Unitholders and to deduct such distributions and designations for income tax purposes.

Royal Host utilizes the future tax asset and liability method of accounting for future income taxes. This method requires recording a future income tax amount for the Trust's subsidiaries based on differences between the carrying amounts of balance sheet items and their corresponding tax basis. In addition, the future tax benefits of income tax assets, including unused tax losses, are recognized to the extent that it is more likely than not that such losses will be ultimately utilized by the Trust's subsidiaries. Future income tax assets and liabilities are measured using the enacted tax rates and laws that are expected to apply when the tax assets or liabilities are to be either realized or settled.

(k) Unit Option Plan

Royal Host has a unit option plan as described in Note 13(c). No compensation expense has been recognized for options issued under this plan when granted. Consideration received on exercise of options is credited to Unitholders' equity.

(l) Cash and Short-Term Investments

Cash and short-term investments include all cash and highly liquid investments with an original maturity of less than three months and exclude restricted cash.

(m) Foreign Currency Translation

The Trust's foreign operations are conducted through integrated subsidiaries and financial statements are translated using the temporal method. Accordingly, monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the consolidated financial statements. Non-monetary assets, liabilities and other items recorded in the net earnings arising from transactions denominated in foreign currencies are translated at rates of exchange in effect at the date of the transaction. The Trust discloses exchange gains and losses as part of net earnings.

3. CHANGES IN ACCOUNTING POLICIES

(a) Variable Interest Entities

In November 2003, the CICA issued Accounting Guideline 15, "*Consolidation of Variable Interest Entities*" ("AcG-15"), effective for fiscal years beginning after November 1, 2004. AcG-15 requires an enterprise to consolidate a variable interest entity when the enterprise is the primary beneficiary of the entity, meaning that the enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, whether that is contractually or by other financial interests in the entity.

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

3. CHANGES IN ACCOUNTING POLICIES (CONTINUED)

(a) Variable Interest Entities (continued)

Prior to the adoption of AcG-15, Royal Host proportionately consolidated the Royal Private Residence Club Joint Venture (the "Joint Venture"). However, the Joint Venture is a variable interest entity as Royal Host absorbs a majority of the Joint Venture's expected losses and receives a majority of the Joint Venture's expected residual returns. Therefore, effective January 1, 2005, Royal Host consolidates the Joint Venture. The consolidated balance sheet as at December 31, 2004 has been restated to include all of the Joint Venture's assets and liabilities. In particular, property under development has been restated from \$6.9 million to \$17.7 million, current assets have been restated from \$36.9 million to \$45.3 million, current liabilities have been restated from \$65.2 million to \$65.5 million and minority interest in joint venture has been restated from \$Nil to \$8.7 million. Previously reported earnings and Unitholders' equity did not change as a result of this restatement.

(b) Liabilities and Equity

In November 2003, the CICA amended Section 3860 (replaced in April 2005 by Section 3861), "*Financial Instruments - Disclosure and Presentation*", to require that certain obligations that may be settled at the issuer's option in cash or the equivalent value by a variable number of the issuer's own equity instruments be presented as a liability. The amendments to Section 3860 are effective for fiscal years beginning on or after November 1, 2004. The Trust has applied the provisions of Section 3860 retroactively, with restatement of prior years presented. The amendments result in the Trust's convertible debentures being classified as a liability on the consolidated balance sheets and the associated interest expense correspondingly being classified as "interest on convertible debentures" on the consolidated statements of net earnings (loss).

As a result of the reclassification, other expenses for the year ended December 31, 2004 increased by \$6.8 million and deferred debt issuance costs as at December 31, 2004 increased by \$2.3 million.

As the associated interest expense was already included in the December 31, 2004 per unit net earnings (loss) calculations, this reclassification does not impact per unit earnings for the year ended December 31, 2004.

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

On February 23, 2005, Royal Host completed the sale of its 50% interest in a hotel property located in Toronto, Ontario to a condominium developer. The property was sold for proceeds of \$10.8 million, consisting of \$7.0 million cash and a \$3.8 million vendor take-back ("VTB") mortgage which was received in August 2005. Royal Host operated the property as a hotel for the period subsequent to the closing date in order to wind-up the hotel operations. Royal Host was entitled to all operating revenues and funded all operating and closing costs during the wind-up period. The net cost of winding up the business, to a maximum of \$2.0 million, is to be reimbursed to Royal Host in the form of a non-interest bearing, 18-month VTB mortgage (included in accounts receivable). The December 31, 2004 consolidated balance sheet and consolidated statement of net earnings (loss) have been restated to reflect these discontinued operations.

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

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

The Trust is actively pursuing a buyer for a hotel property in Ontario. Accordingly, this property has been reflected as "property held for sale" and "assets and liabilities of discontinued operations" on the consolidated balance sheets and the property's operations have been included in discontinued operations on the consolidated statements of net earnings (loss).

In 2004, the Trust completed the sale of a hotel property located in North Battleford, Saskatchewan and a marina and recreational vehicle facility in Oklahoma, USA for proceeds aggregating \$2.4 million.

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

	Year Ended (in \$000's)	
	December 31, 2005	December 31, 2004
Hospitality revenue		
Rooms	943	3,849
Food and beverage	169	1,332
Other	52	276
	<u>1,164</u>	<u>5,457</u>
Hospitality expenses	<u>1,555</u>	<u>5,304</u>
Gross margin	<u>(391)</u>	<u>153</u>
Other expenses		
Interest on capital leases	2	16
Depreciation and amortization	87	485
Property impairment provision (recovery)	(21)	406
Future income taxes (recovery)	(475)	(250)
Capital and other taxes	6	10
Gain on foreign currency translation	(2)	(39)
(Gain) loss on disposition	248	(559)
	<u>(155)</u>	<u>69</u>
Earnings (loss) from discontinued operations	<u>(236)</u>	<u>84</u>

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

5. PROPERTY UNDER DEVELOPMENT

A subsidiary of Royal Host is participating in a joint venture to develop the Royal Private Residence Club on a portion of the property at the Grand Okanagan Lakefront Resort and Conference Centre in Kelowna, British Columbia for resale. Construction of the first phase of the project, a parkade, commenced in January 2004 and was completed in October 2004. Construction of the residence units commenced in May 2004. As the project is still in the development phase, no revenue has been recognized. All costs incurred have been capitalized to "property under development".

As stated in Note 3(a), Royal Host consolidates the joint venture. The \$8.6 million (December 31, 2004 - \$8.7 million) minority interest in joint venture on the consolidated balance sheets as at December 31, 2005 represents the portion of net assets of the joint venture not owned by Royal Host.

In April 2005, Royal Host, along with its joint venture partner, entered into a non-revolving \$28.0 million financing arrangement consisting of a \$20.0 million construction loan and an \$8.0 million mezzanine loan. The loan proceeds are to be used to complete the project. As at December 31, 2005, \$7.4 million was drawn on the construction loan and \$8.0 million was drawn on the mezzanine loan.

Royal Host has provided a completion, cost overrun and debt service deficiency guarantee on the \$20.0 million construction loan, a specific guarantee of the payment of notes receivable from certain limited partners and a guarantee on an \$8.0 million mezzanine loan.

Property under development includes \$1.3 million of capitalized interest as at December 31, 2005 (December 31, 2004 - \$Nil).

6. RESTRICTED CASH

Restricted cash represents funds on deposit with lenders pursuant to financing arrangements for future planned capital expenditures.

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

7. CAPITAL ASSETS

	<i>(in \$000's)</i>		
	<u>Gross Book Value</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
December 31, 2005			
Buildings	313,421	62,872	250,549
Land	38,815	-	38,815
Furniture, fixtures, and equipment	46,451	36,999	9,452
Other	1,152	343	809
	<u>399,839</u>	<u>100,214</u>	<u>299,625</u>
Capital assets under development	4,214	-	4,214
Intangible assets:			
Franchise rights and management contracts	27,414	17,151	10,263
Customer lists and intellectual capital	7,270	7,270	-
	<u>438,737</u>	<u>124,635</u>	<u>314,102</u>
	<i>(in \$000's)</i>		
	<u>Gross Book Value</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
December 31, 2004			
Buildings	309,113	53,966	255,147
Land	38,644	-	38,644
Furniture, fixtures, and equipment	44,660	34,248	10,412
Other	1,320	460	860
	<u>393,737</u>	<u>88,674</u>	<u>305,063</u>
Capital assets under development	2,500	-	2,500
Intangible assets:			
Franchise rights and management contracts	27,414	15,278	12,136
Customer lists and intellectual capital	7,270	6,970	300
	<u>430,921</u>	<u>110,922</u>	<u>319,999</u>

During the year, Royal Host spent \$7.0 million (2004 - \$6.3 million) to maintain and renovate its hotel properties, excluding capital lease additions totaling \$0.3 million (2004 - \$0.2 million).

As at December 31, 2005, Royal Host has committed \$0.6 million (2004 - \$0.5 million) to complete capital assets under development for 2006.

8. LONG-TERM NOTES RECEIVABLE

The notes receivable mature between January 2007 and May 2009, require monthly payments of principal and interest based on individual customer amortization schedules, and bear interest at rates between 10.00% and 14.75%. The carrying value of the notes receivable approximate fair value.

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

9. MORTGAGES

	<i>(in \$000's)</i>	
	<u>December 31, 2005</u>	<u>December 31, 2004</u>
Mortgages secured by hotel properties	129,800	156,979
Mortgages secured by property under development	15,426	-
	<u>145,226</u>	<u>156,979</u>
Less: current portion	18,304	39,083
	<u>126,922</u>	<u>117,896</u>

Principal repayments required for the years ending December 31:

	<u><i>(in \$000's)</i></u>
2006	18,304
2007	3,108
2008	3,325
2009	24,973
2010	71,670
Thereafter	23,846
	<u>145,226</u>

On January 13, 2005, Royal Host completed the early replacement of mortgage debt on the Grand Okanagan Lakefront Resort and Conference Centre. The existing \$25.0 million mortgage, which was originally scheduled to mature in August 2005, was increased to \$35.0 million for a five-year term with a 7.50% fixed interest rate. The additional proceeds have been used for working capital and general corporate purposes.

In April 2005, Royal Host entered into financing arrangements for property under development totaling \$28.0 million as described in Note 5.

During the fourth quarter of 2005, Royal Host repaid \$25.6 million in mortgages. Retirement costs of \$2.0 million were incurred as a result of these repayments.

Mortgages bear interest at rates ranging from 5.75% to 10.00% per annum (2004 - 5.13% to 9.47%) with a weighted average year-end rate of 8.19% per annum (2004 - 8.46%) and mature between 2006 and 2013. The mortgages are secured by fixed charges over specified hotel properties and property under development. Monthly principal and interest payments pursuant to the indebtedness at December 31, 2005 total \$0.9 million (2004 - \$1.4 million).

As at December 31, 2005, Royal Host has drawn \$0.1 million (December 31, 2004 - \$0.1 million) on credit facilities totaling \$12.0 million, secured by first charges over two hotels. Interest is payable on a floating rate basis. The effective annual rate at December 31, 2005 was 6.00% (December 31, 2004 - 5.25%).

Debt issuance costs are deferred and amortized over the term of the related debt. For the year ended December 31, 2005, \$1.7 million was included in depreciation and amortization expense (2004 - \$1.2 million).

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

10. CONVERTIBLE DEBENTURES

	<i>(in \$000's)</i>	
	<u>December 31, 2005</u>	<u>December 31, 2004</u>
9.25% Convertible Unsecured Subordinated Debentures	39,712	40,000
7.90% Convertible Unsecured Subordinated Debentures, Series A	35,000	35,000
6.00% Convertible Unsecured Subordinated Debentures, Series B	58,340	-
	<u>133,052</u>	<u>75,000</u>

(a) 9.25% Convertible Unsecured Subordinated Debentures

The convertible debentures of \$40.0 million 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 redemption or maturity.

After March 1, 2005, the debentures are 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.

Commencing July 15, 2005, Royal Host initiated a normal course issuer bid to repurchase up to \$2.0 million in principal of its issued and outstanding 9.25% convertible debentures. During the year, Royal Host repurchased \$0.3 million of debentures, which were subsequently cancelled.

(b) 7.90% Convertible Unsecured Subordinated Debentures, Series A

The convertible debentures of \$35.0 million 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 REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

10. CONVERTIBLE DEBENTURES (CONTINUED)

(c) 6.00% Convertible Unsecured Subordinated Debentures, Series B

In October 2005, \$60.0 million of convertible unsecured subordinated debentures were issued with a term of ten years. These debentures bear interest at 6.00% per annum and are payable semi-annually in arrears on April 30 and October 31 in each year commencing April 30, 2006.

The Series B debentures may not be redeemed by Royal Host prior to October 31, 2009. On or after October 31, 2009, but prior to October 31, 2011, the debentures are 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 \$6.85 per unit. After October 31, 2011, but prior to the maturity date of October 31, 2015, the debentures are redeemable without stipulation. 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 redemption or maturity.

On redemption or at maturity on October 31, 2015, 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.

Based on certain conditions, the debentures are convertible, at the holders' discretion, at \$6.85 per trust unit at any time from the date of issue to close of business on the day prior to the maturity date, October 31, 2015.

In accordance with EIC ("Emerging Issues Committee") 158, "*Accounting for Convertible Debt Instruments*", the principal amount of the debenture has been allocated between its liability and equity elements and classified separately on the balance sheet. As a result, \$58.3 million was recorded as a long-term liability with the balance of \$1.7 million recorded as Conversion Option in equity. The long-term liability will increase to the \$60.0 million face value of the debenture over its ten year term, with the accretion being included in interest on convertible debentures on the consolidated statements of net earnings (loss).

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

11. OBLIGATIONS UNDER CAPITAL LEASES

Royal Host has entered into various capital lease obligations to acquire computers and furniture, fixtures, and equipment. The present values of future minimum lease payments under capital leases as at December 31, 2005 are as follows:

	<i>(in \$000's)</i>	
	<u>December 31, 2005</u>	<u>December 31, 2004</u>
Present value of future minimum lease payments	1,103	1,524
Less: current portion of principal payments	443	563
	<u>660</u>	<u>961</u>

Total repayments required for the years ending December 31:

	<i>(in \$000's)</i>	
		<u></u>
2006	513	
2007	428	
2008	276	
Future minimum lease payments		<u>1,217</u>
Less: amounts representing interest		<u>114</u>
Present value of future minimum lease payments		<u><u>1,103</u></u>

The leases outstanding at December 31, 2005 bear interest at a weighted average annual rate of 8.75% per annum (2004 - 8.25%).

12. FUTURE INCOME TAXES

The Trust has tax losses of approximately \$8.6 million (2004 - \$2.7 million) available to reduce future taxable income. The losses will begin to expire in 2008, but the majority of the losses will expire between 2010 and 2012. The adjustment for the change in effective tax rates reflects the benefit from the reduction of the currently substantially enacted federal rate resulting in combined federal and provincial rates of between 33.6% and 39.1%, depending on the province.

The net future income tax liability is calculated as follows:

	<i>(in \$000's)</i>	
	<u>December 31, 2005</u>	<u>December 31, 2004</u>
Tax assets relating to operating losses	3,100	1,004
Tax liabilities relating to differences in tax and book basis and other items	(9,041)	(8,329)
Net future tax liability	<u>(5,941)</u>	<u>(7,325)</u>

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

13. UNITHOLDERS' EQUITY

(a) Trust units

As at December 31, 2005, a total of 26,595,545 (December 31, 2004 - 24,824,942) trust units were issued and outstanding.

Commencing on December 21, 2004, Royal Host initiated a normal course issuer bid to repurchase a maximum of 1,200,000 of its issued and outstanding trust units. During the year, Royal Host repurchased 1,200,000 trust units at an aggregate cost of \$7.1 million (average cost of \$5.90 per unit). As at December 31, 2005, 983,600 of these units were cancelled with the remaining 216,400 units being cancelled in January 2006.

Commencing on December 29, 2005, Royal Host initiated a normal course issuer bid to repurchase a maximum of 1,800,000 of its issued and outstanding trust units. As at December 31, 2005, no units had been repurchased under this bid.

(b) Redeemable Partnership Units

In May 2005, 3,151,433 redeemable partnership units were redeemed by way of a combination of the issuance of 2,706,682 Royal Host trust units and \$2.4 million in cash. The redeemable partnership units were held by entities controlled by certain current and former officers and trustees of Royal Host. As such, the redemption of the redeemable partnership units was a related party transaction and was recorded at the historical amount of the redeemable partnership units in the financial statements. The net carrying value of the redeemable partnership units of \$25.1 million, being \$27.5 million net of cash of \$2.4 million, has been recorded to unit capital.

As at December 31, 2005, a total of 10 (2004 - 3,151,443) redeemable partnership units were outstanding.

(c) Unit Options

Royal Host has reserved 1,883,000 units under its unit option plan. As at December 31, 2005, Royal Host has unit options outstanding to certain consultants to purchase an aggregate of 137,500 units (December 31, 2004 - 137,500 units) at an exercise price of \$10.00 per unit (December 31, 2004 - \$10.00). All unit options were issued prior to 1999 and were fully vested and exercisable at December 31, 2005 and December 31, 2004. The options currently outstanding expire on October 31, 2007.

During the years ended December 31, 2005 and 2004, no options were issued or exercised and no options expired.

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

13. UNITHOLDERS' EQUITY (CONTINUED)

(d) Employee Unit Purchase Program

During 2000, the Trustees approved the issuance of up to 400,000 units from treasury for an employee unit purchase program. Under this program, certain approved Royal Host employees (excluding certain senior executives) were eligible to finance the purchase of units from treasury at a prescribed per unit rate based on current market values.

As at December 31, 2005, 122,500 units (2004 - 182,500 units) were allocated under this plan. The employee unit purchase program represents a financing program for selected employees to purchase units of Royal Host. Royal Host has outstanding employee loans receivable, net of additions and terminations, of \$0.6 million (2004 - \$0.9 million) with respect to the program. These loans bear interest at a fixed rate of 3.0% per annum (2004 - 3.0%), a rate established based on consideration of existing institutional rates and Canada Revenue Agency ("CRA") guidelines for employee loan rates. This plan structure does not meet the definition of stock based compensation plans, and therefore does not fall under CICA Handbook Section 3870, "*Stock Based Compensation Plans*".

In accordance with EIC-132, "*Share Purchase Financing*", for accounting purposes, these employee loans receivable have been offset against the corresponding unit capital.

14. PROPERTY IMPAIRMENT PROVISION

During the third quarter of 2005, the Trust recorded a property impairment provision of \$0.6 million relating to its timeshare resort property in Cabo San Lucas, Mexico.

During the first quarter of 2005, the Trust recorded a property impairment provision of \$0.4 million relating to a hotel property in Lethbridge, Alberta.

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

15. PER UNIT CALCULATIONS

There were 26,595,545 trust units outstanding as at December 31, 2005 (December 31, 2004 - 24,824,942). Per unit computations are based on the weighted average number of trust units outstanding for the period, after adjusting the net earnings (loss) for distributions on the redeemable partnership units of \$378,000 (December 31, 2004 - \$756,000).

For the year ended December 31, 2005:		Weighted Average Units	Per Unit
	<i>(in \$000's)</i>	<i>(in 000's)</i>	<i>(\$)</i>
Net earnings - continuing operations	2,582		
Less: distributions on redeemable partnership units	(378)		
Basic earnings - continuing operations	2,204		0.08
Basic loss - discontinued operations	(236)		(0.01)
Basic earnings - total operations	1,968	26,115	0.07

The diluted earnings (loss) per unit for the year ended December 31, 2005 is the same as the basic amounts presented as all items that can result in units being issued are anti-dilutive.

For the year ended December 31, 2004: (restated - Notes 3 and 4)		Weighted Average Units	Per Unit
	<i>(in \$000's)</i>	<i>(in 000's)</i>	<i>(\$)</i>
Net loss - continuing operations	(5,281)		
Less: distributions on redeemable partnership units	(756)		
Basic loss - continuing operations	(6,037)		(0.24)
Basic earnings - discontinued operations	84		0.00
Basic loss - total operations	(5,953)	24,574	(0.24)
Net loss - continuing operations	(5,281)		
Less: distributions on redeemable partnership units	(756)		
Unit options		138	
Unit option repurchase		(271)	
Diluted loss - continuing operations	(6,037)		(0.24)
Diluted earnings - discontinued operations	84		0.00
Diluted loss - total operations	(5,953)	24,441	(0.24)

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

16. CHANGES IN NON-CASH WORKING CAPITAL

	<i>(in \$000's)</i>	
	<u>December 31,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
(Increase) decrease in:		
Accounts and notes receivable	(4,032)	215
Prepaid expenses	202	(177)
Inventories	(157)	608
Assets of discontinued operations	118	-
	<u>(3,869)</u>	<u>646</u>
Increase (decrease) in:		
Accounts payable and accrued liabilities	2,110	4,183
Interest accrued on convertible debentures	743	459
Other liabilities	(163)	375
Deferred revenue	(49)	(275)
Future income taxes	(408)	-
Liabilities of discontinued operations	(488)	-
	<u>1,745</u>	<u>4,742</u>
	<u>(2,124)</u>	<u>5,388</u>

17. COMMITMENTS AND GUARANTEES

In the normal course of business, the Trust may provide indemnification to counterparties in transactions such as credit facilities, leasing transactions, service arrangements, director and officer indemnification agreements and sales of assets. These indemnification agreements may require the Trust to compensate the counterparties for costs incurred as a result of changes in laws and regulations (including tax legislation) or as a result of litigation claims or statutory sanctions that may be suffered by counterparties as a consequence of the transaction. The terms of these indemnification agreements may vary based on the contract and do not provide any limit on the maximum potential liability. To date, the Trust has not made any significant payments under such indemnifications and no amount has been accrued in the financial statements with respect to these indemnification agreements.

In the normal course of business, the Trust may enter into various agreements that may meet the AcG-14 definition of a guarantee. AcG-14 defines a guarantee to be a contract (including an indemnity) that contingently requires the Trust to make payments to the guaranteed party based on (i) changes in an underlying interest rate, foreign exchange rate, equity or commodity instrument, index or other variable, that is related to an asset, a liability or an equity security of the counterparty, (ii) failure of another party to perform under an obligating agreement or, (iii) failure of a third party to pay its indebtedness when due.

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18. FRANCHISE AND MEMBERSHIP AGREEMENTS

Under the terms of the hotel franchise agreements expiring at various dates commencing October 31, 2007 through to December 12, 2021, annual payments for franchise expenses (including fees, reservation and advertising services) are due to external parties for 34 of the 37 hotels owned by Royal Host (2004 - 35 of the 38 hotels).

The franchise royalties and membership fees paid to external parties are calculated based upon percentages of defined revenues and amounted to \$2.2 million for the year (2004 - \$2.2 million).

19. OPERATING LEASES

Certain property and equipment is leased under operating lease agreements expiring at varying intervals. Total future minimum rental payments required under these leases are as follows:

Years ending December 31:	<i>(in \$000's)</i>
	<u> </u>
2006	321
2007	205
2008	95
2009	47
2010	23
Thereafter	48
	<u> </u>
	<u>739</u>

20. FINANCIAL INSTRUMENTS

(a) Fair values

Current assets and liabilities approximate their carrying values at December 31, 2005, due to their short-term nature. The fair values of the non-current portion of mortgages and other debt and convertible equity instruments are as follows:

	December 31, 2005		December 31, 2004	
	<i>(in \$000's)</i>		<i>(in \$000's)</i>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Mortgages	126,922	137,474	117,896	125,414
Convertible debentures and redeemable partnership units	133,052	138,400	102,500	107,341
Capital leases	660	664	961	1,035

Fair value estimates are made at a specific point in time based on relevant market information. These are estimates and involve uncertainties and matters of significant judgment and cannot be determined with precision. Changes in assumptions and estimates could significantly affect fair values.

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Notes to the Consolidated Financial Statements

20. FINANCIAL INSTRUMENTS (CONTINUED)

(b) Interest Rate Risk Management

Interest rate risk is continually monitored and managed through limiting the amount of variable rate debt as well as the total amount of debt. The amount of variable rate debt aggregated \$7.4 million or 2.7% of the Royal Host total debt portfolio as at December 31, 2005 (December 31, 2004 - \$7.0 million or 3.0%). The variable rate on this debt is prime plus 3/4% (2004 - prime plus 3/4% to prime plus 2.0%).

(c) Credit Risk Management

Credit risks arising from receivables from corporate accounts and amounts owed by purchases of timeshares are minimized, as amounts due from any one debtor are not significant and routine credit assessments are carried out prior to credit being granted. The accounts receivable from timeshare owners are secured by the timeshares purchased.

(d) Commodity Price Risk Management

Commodity price risk on utilities is managed through the use of fixed price contracts, where available, for the stable supply of natural gas and electricity in the jurisdictions where such commodities have been de-regulated.

21. SUBSEQUENT EVENTS

Subsequent to December 31, 2005, Royal Host repurchased 225,700 trust units at an aggregate cost of \$1.3 million and \$0.8 million of convertible debentures pursuant to normal course issuer bids.

22. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the presentation adopted for 2005.
