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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**

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

**FOR THE THREE MONTHS ENDED MARCH 31, 2006**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS AND FINANCIAL CONDITION FOR THE THREE MONTHS ENDED MARCH 31, 2006**

The following Management's Discussion and Analysis of Operations and Financial Condition ("MD&A") dated May 11, 2006 is the responsibility of Management. The Board of Trustees carries out its responsibility for review of this MD&A principally through its Audit Committee.

This MD&A should be read in conjunction with the unaudited interim consolidated financial statements and notes of Royal Host Real Estate Investment Trust ("Royal Host" or the "Trust") for the three months ended March 31, 2006 and the annual consolidated financial statements and accompanying MD&A for the year ended December 31, 2005. The unaudited interim consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and were prepared using accounting policies and methods of their application consistent with those used in the preparation of the Trust's audited consolidated financial statements for the year ended December 31, 2005.

### **FORWARD-LOOKING STATEMENTS**

Certain statements in this MD&A, including those in the Outlook section, relate to periods commencing after March 31, 2006 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 Royal Host's 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 its 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](http://www.sedar.com).

### **SUMMARY**

The first quarter of 2006 continues the trend of improved results that Royal Host delivered in 2005. Increases in RevPAR and Occupancy translated into improved revenue and gross margin. Overall the first quarter of 2006 was significantly better than the same period in 2005.

### **HIGHLIGHTS**

- Revenue per Available Room increased 8.0% to \$56.08 (2005 - \$51.92), attributable to increases in both Average Daily Rate and Occupancy.
- Strong revenue translated into a 10.0% increase in gross margin to 23.1% in 2006 (2005 - 21.0%).
- Basic per unit cash available from continuing operations increased by \$0.05 to \$0.07 (2005 - \$0.02).
- Basic per unit cash available for distribution increased by \$0.05 to \$0.02 (2005 - (\$0.03)).
- Distributions to Unitholders increased to \$0.04 per unit in April from \$0.035 per unit.

## SELECTED FINANCIAL INFORMATION

Three months ended March 31 (\$000's, except as otherwise noted)	2006	2005	Change (%)
Hospitality Revenue (continuing operations)			
Rooms	22,557	20,758	8.7
Food and Beverage	5,769	5,503	4.8
Other	3,842	3,814	0.7
	<u>32,168</u>	<u>30,075</u>	7.0
Gross Margin	<u>7,435</u>	<u>6,310</u>	17.8
Gross Margin %	<u>23.1</u>	<u>21.0</u>	10.0
Net Loss			
From Continuing Operations	(1,953)	(2,962)	34.1
From Discontinued Operations	(73)	(109)	33.0
	<u>(2,026)</u>	<u>(3,071)</u>	34.0
Basic Per Unit Net Loss (\$)			
From Continuing Operations	(0.08)	(0.13)	38.5
From Discontinued Operations	-	(0.01)	100.0
	<u>(0.08)</u>	<u>(0.14)</u>	42.9
Diluted Per Unit Net Loss (\$)			
From Continuing Operations	(0.08)	(0.13)	38.5
From Discontinued Operations	-	(0.01)	100.0
	<u>(0.08)</u>	<u>(0.14)</u>	42.9
Cash Available From Operations	<u>1,680</u>	<u>279</u>	502.2
Cash Available For Distribution	<u>547</u>	<u>(771)</u>	
Basic and Diluted Per Unit Cash Available For Distribution (\$)	<u>0.02</u>	<u>(0.03)</u>	
Distributions Declared on Trust Units	<u>2,842</u>	<u>2,222</u>	
Per Unit Distributions Declared (\$)	<u>0.11</u>	<u>0.09</u>	
Weighted Average Number of Trust Units (000's)	<u>25,949</u>	<u>24,614</u>	

## OVERVIEW

Royal Host's core businesses are hotel ownership, management and franchising. As at March 31, 2006, Royal Host owned 37 hotels (comprising 4,500 rooms), managed an additional 88 properties (9 in Canada, 77 in the United States and 2 in Mexico) for third-parties, and franchised 114 locations (including 16 owned by the Trust) under the Travelodge and Thriftlodge banners, for a total of 18,000 guestrooms in the mid-market and upscale hospitality segments.

Royal Host's vision is to be considered by all stakeholders as one of the leading mid-market hotel companies in North America. This vision will be achieved focusing on a commitment to building a strong foundation and managing for results.

## 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 Royal Host's 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.

This MD&A incorporates the following non-GAAP financial measures: Average Daily Rate (“ADR”), Occupancy, Revenue per Available Room (“RevPAR”), Cash Available from Operations, Cash Available for Distribution, Basic and Diluted Per Unit Cash Available from Operations and Basic and Diluted Per Unit Cash Available for Distribution. The Trust’s definition of these financial measures and, where applicable, a reconciliation to earnings (loss) is set out below.

### Key Performance Drivers and Measures

The hospitality industry and hotel real estate investment trusts commonly use three non-GAAP financial measures as key indicators of financial performance:

- 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

The following table sets our Royal Host’s Occupancy, ADR and RevPAR for the periods indicated:

	Q1 2006	Q1 2005	Change (%)
<b>CONTINUING OPERATIONS</b>			
Occupancy	61.3%	59.2%	3.5%
ADR	\$91.41	\$87.68	4.3%
RevPAR	\$56.08	\$51.92	8.0%
<b>TOTAL OPERATIONS</b>			
Occupancy	60.4%	57.0%	6.0%
ADR	\$91.32	\$86.92	5.1%
RevPAR	\$55.16	\$49.57	11.3%

The first quarter of 2006 was strong. RevPAR from continuing operations grew by 8.0% in 2006, attributable to a \$3.73, or 4.3%, increase in ADR and a 3.5% increase in Occupancy.

The Trust delivered improved Occupancy and ADR figures in each of its regions, as illustrated below.

### Room Statistics – By Region (Continuing Operations)

	Q1 2006	Q1 2005	Change (%)
<b>ONTARIO</b>			
Occupancy	61.6%	58.6%	5.1%
ADR	\$97.42	\$94.09	3.5%
RevPAR	\$60.01	\$55.16	8.8%
<b>WESTERN</b>			
Occupancy	60.4%	59.2%	2.0%
ADR	\$85.01	\$81.01	4.9%
RevPAR	\$51.34	\$48.00	7.0%
<b>ATLANTIC</b>			
Occupancy	60.5%	58.4%	3.6%
ADR	\$82.46	\$80.19	2.8%
RevPAR	\$49.86	\$46.87	6.4%

## Cash Available from Operations and Cash Available for Distribution

Three months ended March 31 (\$000's, except as otherwise noted)	2006	2005	Change (%)
Loss From Continuing Operations	(1,953)	(2,962)	34.1
Add (Deduct):			
Depreciation and Amortization	3,813	3,623	
Property Impairment Provision	-	390	
Future Income Taxes (Recovery)	(66)	(345)	
Cash Available From Continuing Operations	1,794	706	154.1
Cash Available From Discontinued Operations	(114)	(143)	20.3
	1,680	563	198.4
Less: Distributions on Redeemable Partnership Units	-	(284)	
<b>Cash Available From Operations</b>	<b>1,680</b>	<b>279</b>	<b>502.2</b>
Less: Estimated Capital Maintenance	(1,133)	(1,050)	
<b>Cash Available For Distribution</b>	<b>547</b>	<b>(771)</b>	
<b>Distributions Declared</b>	<b>2,842</b>	<b>2,222</b>	<b>27.9</b>
Basic Per Unit Cash Available From Continuing Operations (\$)	0.07	0.02	
Diluted Per Unit Cash Available From Continuing Operations (\$)	0.07	0.01	
<b>Basic and Diluted Per Unit Cash Available For Distribution (\$)</b>	<b>0.02</b>	<b>(0.03)</b>	
<b>Per Unit Distributions Declared (\$)</b>	<b>0.11</b>	<b>0.09</b>	

Cash available for distribution for the period ended March 31, 2006 increased to \$0.5 million (2005 – (\$0.8 million)). 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 4.0% of rooms and food and beverage revenue, was estimated to be \$1.1 million in the first quarter of 2006, unchanged from 2005.

Royal Host's Board of Trustees approves distributions based on, among other things, projected cash flows, capital requirements and working capital requirements. Royal Host pays monthly cash distributions 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 April 2006, as a direct result of improved results, the Trust increased monthly distributions per unit to \$0.040 from \$0.035.

As monthly distributions are based on annual performance, cash distributions will not equal cash available for distribution in any one quarter. During the first quarter of 2006, the Trust declared distributions on trust units of \$2.8 million, an increase of 27.9% over the \$2.2 million declared in 2005. The actual amount paid during the three months ended March 31, 2006 was \$2.7 million, which compares to \$2.1 million paid in 2005.

In addition to distributions, the Trust used cash from operations to fund principal repayments of \$0.8 million. The total amount of funds used for capital investment was \$1.3 million, including the portion funded from restricted cash.

## THREE MONTHS ENDED MARCH 31, 2006 (Continuing Operations)

### Seasonality

The hospitality industry business is seasonal in nature. The Trust's revenue and profitability are typically stronger in the second and third quarter, as compared to the first and fourth quarters.

### Hospitality Revenue

Hospitality revenue from continuing operations in the first quarter of 2006 increased by \$2.1 million to \$32.2 million (2005 - \$30.1 million).

Three months ended March 31 (\$000's, except as otherwise noted)	2006	2005	Change	Change (%)
Hospitality Revenue (continuing operations)				
Rooms	22,557	20,758	1,799	8.7
Food and Beverage	5,769	5,503	266	4.8
Other	3,842	3,814	28	0.1
	<u>32,168</u>	<u>30,075</u>	<u>2,093</u>	<u>7.0</u>

Rooms revenue increased \$1.8 million, or 8.7%, to \$22.6 million (2005 - \$20.8 million), a result of the 4.3% increase in ADR to \$91.41 (2005 - \$87.68), and the 3.5% increase in Occupancy to 61.3% (2005 - 59.2%). The increase in ADR is a result of Management's continued focus on managing room rate yield and improving overall industry rates. Properties in each of the Trust's regions realized significant increases in RevPAR. The London Hilton in London, Ontario and the Holiday Inn (The Palace) in Edmonton, Alberta produced particularly strong results.

Food and beverage revenue increased \$0.3 million, or 4.8%, to \$5.8 million (2005 - \$5.5 million). Improvements were realized in all regions.

Other hospitality revenue was unchanged at \$3.8 million. Management fees earned from the Supertel Hospitality contract replaced the fees generated from a management contract which was terminated effective March 31, 2005. Travelodge franchise fees also continue to be strong, in line with 2005.

### Hospitality Expenses

Three months ended March 31 (\$000's, except as otherwise noted)	2006	2005	Change	Change (%)
Hospitality Expenses	24,733	23,765	968	4.1

Total hospitality expenses increased \$1.0 million, or 4.1%, to \$24.7 million (2005 - \$23.8 million). Hospitality expenses decreased as a percentage of hospitality revenue to 76.5% (2005 - 79.0%), reflecting Management's continuing focus on operations and the success of the operations managers in managing costs. Utility costs for the quarter were unchanged from 2005.

### Gross Margin

Three months ended March 31 (\$000's, except as otherwise noted)	2006	2005	Change	Change (%)
Gross Margin	7,435	6,310	1,125	17.8

Gross margin increased \$1.1 million, or 17.8%, to \$7.4 million in 2006, which compares to \$6.3 million in 2005, as a result of the higher overall revenue and lower incremental hospitality expenses. Gross margin as a percentage of hospitality revenue, improved by 10.0% to 23.1% (2005 - 21.0%).

## **Other Expenses**

Other expenses remained steady in 2006 at \$9.4 million (2005 - \$9.3 million). Mortgage repayments in 2005 resulted in a \$0.8 million decrease in interest on mortgages and capital leases. This was offset by an increase in convertible debenture interest of \$0.9 million, a result of the \$60 million debenture issued in the fourth quarter of 2005. Trust administration was unchanged at \$0.5 million. 2006 included a modest \$0.1 million future income tax recovery (2005 - \$0.4 million) and excluded a property impairment provision, whereas 2005 included a \$0.4 million provision for the Lethbridge, Alberta property.

## **Net Loss**

Strong revenue growth produced an improved gross margin, which, combined with an overall decrease in other expenses, resulted in a \$2.0 million loss from continuing operations, a \$1.0 million improvement over 2005's loss of \$3.0 million. 2006's net loss from total operations decreased to \$2.0 million, compared to a net loss from total operations of \$3.1 million in 2005.

## **DISCONTINUED OPERATIONS**

Discontinued operations consist primarily of two properties. On February 23, 2005, Royal Host sold the Travelodge North York hotel, and Royal Host continues to actively seek a buyer for its 95-room Travelodge Orillia. Revenue from discontinued operations in 2006 was \$0.1 million, attributable entirely to the Travelodge Orillia (2005 - \$0.6 million). 2006's loss from discontinued operations was \$0.1 million (2005 - \$0.1 million).

## **LIQUIDITY AND CAPITAL RESOURCES**

As at March 31, 2006, cash and short-term investments were \$21.5 million and undrawn credit facilities were \$12.0 million. Restricted cash as at March 31, 2006 was \$6.5 million (December 31, 2005 - \$6.0 million). Restricted cash consists primarily of funds held by lenders pursuant to financing arrangements for future planned capital expenditures. During the three months ended March 31, 2006, no restricted cash was drawn down in connection with capital expenditures. These liquid resources, together with Royal Host's future cash flows, are expected to be sufficient to fund anticipated cash requirements over the next year.

The 9.25% convertible debenture matures in March 2007 and, accordingly, has been classified as a current liability as at March 31, 2006. The Trust has the financial capacity to repay or refinance this obligation when it matures.

## **Financing Activities**

As at March 31, 2006, the Trust's mortgages totalled \$144.5 million (December 31, 2005 - \$145.2 million). The current portion of mortgages consists of an \$8.0 million mezzanine loan and a \$7.4 million construction loan, both related to the Royal Host Private Residence Club ("PRC"), and \$2.9 million related to other mortgages. Subsequent to March 31, 2006, the \$8.0 million mezzanine loan was repaid. Additionally, the construction loan commitment was reduced from \$20.0 million to \$10.0 million.

The following tables identify Royal Host's mortgages, obligations under capital leases and convertible debentures and the amounts due during the periods indicated:

### Mortgages and Leases

As at March 31, 2006 (\$000's)	Total	2007	2008	2009	2010	2011	Thereafter
Mortgages	144,487	18,322	3,160	3,383	59,848	36,136	23,638
Obligations Under Capital Leases	983	421	385	177	-	-	-

### Convertible Debentures

(\$000's)	March 31, 2006	December 31, 2005	Maturity Date	Conversion Price
9.25% Convertible Unsecured Subordinated	38,912	39,712	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	58,370	58,340	October 2015	\$6.85
	<u>132,282</u>	<u>133,052</u>		

As at March 31, 2006, the average maturity of mortgages was 4.6 years, the average maturity of convertible debentures was 5.3 years, and the average maturity of mortgages and convertible debentures was 5.0 years. As at March 31, 2006, Royal Host's overall debt had an average interest rate of 7.82% (December 31, 2005 - 7.83%).

### Investing Activities

During the three months ended March 31, 2006, the Trust spent \$1.3 million on capital expenditures (2005 - \$1.4 million). Significant capital expenditures include improvements at several hotels including the Holiday Inn (The Palace) in Edmonton, Alberta, the Chimo Hotel in Ottawa, Ontario and the London Hilton in London, Ontario.

Restricted cash, described above, is available for funding certain hotel capital expenditures. An estimated \$3.0 million of 2006 capital expenditures will be funded out of restricted cash. The overall capital budget for 2006 is currently planned to be \$11.0 million, of which \$9.7 million has yet to be spent. 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 Lakefront Resort and Conference Centre. During 2006, construction proceeded at a brisk pace, with the Trust investing \$3.5 million to bring the total property under development as at March 31, 2006 to \$41.0 million. Construction of the residence units, which commenced in May 2005, is expected to be completed in the second quarter of 2006. As at March 31, 2006, 78% of the development's residence units have been sold.

### Equity

During the three months ended March 31, 2006 equity decreased \$6.2 million to \$88.7 million. Reductions to equity included the \$2.0 million net loss, \$2.8 million for declared distributions and \$1.3 million related to the repurchase of 225,700 Trust Units under the Trust's Normal Course Issuer Bid (described below).

As at March 31, 2006, a total of 26,153,897 trust units were issued and outstanding.

## Normal Course Issuer Bids

Commencing on December 29, 2005, Royal Host initiated a Normal Course Issuer Bid ("NCIB") to repurchase a maximum of 1.8 million of its issued and outstanding trust units. During the three months ended March 31, 2006, and cumulatively to March 31, 2006, 225,700 trust units were repurchased at an aggregate cost of \$1.3 million.

Commencing on 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 three months ended March 31, 2006, Royal Host repurchased \$800,000 of Convertible Debentures at an average cost of \$104.00 per debenture. Cumulative repurchases to March 31, 2006 total \$1.1 million.

## SUMMARY OF QUARTERLY FINANCIAL RESULTS

(\$000's, except as otherwise noted)	2006		2005		2004			
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Revenue	32,168	34,988	41,238	37,998	30,075	33,330	40,087	35,621
Net Earnings (Loss)								
From Continuing Operations	(1,953)	(336)	3,528	2,528	(3,138)	(6,246)	2,774	339
From Discontinued Operations	(73)	6	81	(214)	(109)	205	532	(587)
	(2,026)	(330)	3,609	2,314	(3,247)	(6,041)	3,306	(248)
Cash Available from Operations								
From (Used In) Continuing Operations	1,794	2,597	9,535	6,140	422	(1,685)	8,164	4,508
From (Used In) Discontinued Operations	(114)	(82)	27	(202)	(140)	37	394	(16)
	1,680	2,515	9,562	5,938	282	(1,648)	8,558	4,492
Per Unit Results								
Earnings (Loss) from Continuing Operations								
Basic	(0.08)	(0.01)	0.13	0.09	(0.14)	(0.26)	0.11	0.01
Diluted	(0.08)	(0.01)	0.13	0.09	(0.14)	(0.26)	0.10	0.01
Earnings (Loss) from Total Operations								
Basic	(0.08)	(0.01)	0.13	0.08	(0.14)	(0.25)	0.13	(0.01)
Diluted	(0.08)	(0.01)	0.13	0.08	(0.14)	(0.25)	0.12	(0.01)
Cash Available from (Used In) Continuing Operations								
Basic	0.07	0.10	0.35	0.24	0.02	(0.07)	0.33	0.18
Diluted	0.07	0.10	0.29	0.20	0.01	(0.07)	0.25	0.18
Cash Available from (Used In) Total Operations								
Basic	0.06	0.10	0.35	0.23	0.01	(0.07)	0.35	0.18
Diluted	0.06	0.10	0.29	0.20	0.01	(0.07)	0.26	0.18

## KEY ACCOUNTING POLICIES AND ESTIMATES

Note 2 to the audited consolidated financial statements for the year ended December 31, 2005 includes a summary of the Trust's 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.

## **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. These risks include general economic risks, operating risks, competitive risks, environmental risks, and development risks amongst others.

The risks and uncertainties facing the Trust's operations are described in the Trust's MD&A and Annual Information Form for the year ended December 31, 2005, which may be viewed on SEDAR at [www.sedar.com](http://www.sedar.com).

## **BUSINESS ENVIRONMENT AND OUTLOOK**

The hospitality industry experienced a steady recovery in 2005 and it is anticipated that continued growth will occur in 2006. Growth in demand is anticipated to exceed that of supply, resulting in anticipated improvements in Occupancy and ADR. Pannell Kerr Forster ("PKF"), a recognized industry consultant, has projected national RevPAR growth of 3.9% and growth in industry-wide profitability of 5.3% in 2006.

In the first quarter of 2006, Royal Host delivered favourable results and second quarter results to date are encouraging. Canada's general economic environment is strong and the hospitality industry's fundamentals remain sound. Royal Host views the remainder of 2006 with optimism and with its solid foundation is well-positioned to continue to deliver value to its Unitholders.

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**

## Consolidated Balance Sheets

in \$000's

	As at	
	March 31, 2006	December 31, 2005
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and short-term investments	21,523	31,483
Accounts and notes receivable	12,690	12,291
Prepaid expenses	3,901	3,484
Inventories	3,134	3,150
Assets of discontinued operations (Note 3)	184	188
Property held for sale (Note 3)	2,704	2,704
Property under development (Note 4)	41,048	37,908
Future income taxes	3,234	3,100
	<u>88,418</u>	<u>94,308</u>
<b>Restricted cash</b>	6,484	6,033
<b>Long-term notes receivable</b>	100	190
<b>Capital assets (Note 5)</b>	311,485	314,102
<b>Deferred debt issuance costs</b>	6,004	6,371
	<u>412,491</u>	<u>421,004</u>
<b>LIABILITIES AND UNITHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued liabilities	21,763	22,905
Equity distributions payable	1,047	924
Interest accrued on convertible debentures	3,049	2,429
Current portion of mortgages (Note 6)	18,322	18,304
Current portion of convertible debentures (Note 7 and 10)	38,912	-
Current portion of obligations under capital leases (Note 8)	421	443
Other liabilities	1,984	2,086
Liabilities of discontinued operations (Note 3)	52	58
	<u>85,550</u>	<u>47,149</u>
<b>Mortgages (Note 6)</b>	126,165	126,922
<b>Convertible debentures (Note 7 and 10)</b>	93,370	133,052
<b>Obligations under capital leases (Note 8)</b>	562	660
<b>Deferred revenue</b>	547	639
<b>Future income taxes</b>	8,946	9,041
	<u>315,140</u>	<u>317,463</u>
<b>Minority interest (Note 4)</b>	8,611	8,591
<b>Unitholders' equity (Note 9 and 10)</b>	88,740	94,950
	<u>412,491</u>	<u>421,004</u>

*See accompanying Notes to the Interim Consolidated Financial Statements*

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**

## Consolidated Statements of Net Loss

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

	Three Months Ended	
	March 31, 2006	March 31, 2005
<b>Hospitality revenue</b>		
Rooms	22,557	20,758
Food and beverage	5,769	5,503
Other	3,842	3,814
	<u>32,168</u>	<u>30,075</u>
<b>Hospitality expenses</b>	<u>24,733</u>	<u>23,765</u>
<b>Gross margin</b>	<u>7,435</u>	<u>6,310</u>
<b>Other expenses</b>		
Trust administration	517	544
Interest on mortgages and capital leases	2,505	3,329
Interest on convertible debentures	2,479	1,590
Depreciation and amortization	3,813	3,623
Property impairment provision (Note 11)	-	390
Future income taxes (recovery)	(66)	(345)
Capital and other taxes	138	87
Loss on foreign currency translation	2	54
	<u>9,388</u>	<u>9,272</u>
<b>Loss from continuing operations</b>	<u>(1,953)</u>	<u>(2,962)</u>
<b>Loss from discontinued operations</b> (Note 3)	<u>(73)</u>	<u>(109)</u>
<b>Net loss</b>	<u>(2,026)</u>	<u>(3,071)</u>
<b>Basic per unit net loss</b> (Note 12)		
- from continuing operations	(0.08)	(0.13)
- from discontinued operations	-	(0.01)
	<u>(0.08)</u>	<u>(0.14)</u>
<b>Diluted per unit net loss</b> (Note 12)		
- from continuing operations	(0.08)	(0.13)
- from discontinued operations	-	(0.01)
	<u>(0.08)</u>	<u>(0.14)</u>

*See accompanying Notes to the Interim Consolidated Financial Statements*

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## ROYAL HOST REAL ESTATE INVESTMENT TRUST

### Consolidated Statements of Unitholders' Equity

in \$000's

	Trust Units	Convertible Equity	Contributed Surplus	Accumulated Earnings	Distributions	Total
<b>Balance, December 31, 2005</b>	<b>217,541</b>	<b>1,680</b>	<b>2,824</b>	<b>10,418</b>	<b>(137,513)</b>	<b>94,950</b>
Net loss	-	-	-	(2,026)	-	(2,026)
Issuance of trust units pursuant to distribution reinvestment plan	3	-	-	-	-	3
Trust units repurchased pursuant to normal course issuer bid (Note 10)	(2,559)	-	1,216	-	-	(1,343)
Employee loans pursuant to employee unit purchase program	(5)	-	3	-	-	(2)
Equity distributions Trust units	-	-	-	-	(2,842)	(2,842)
<b>Balance, March 31, 2006</b>	<b>214,980</b>	<b>1,680</b>	<b>4,043</b>	<b>8,392</b>	<b>(140,355)</b>	<b>88,740</b>
	Trust Units	Convertible Equity	Contributed Surplus	Accumulated Earnings	Distributions	Total
<b>Balance, December 31, 2004</b>	<b>202,037</b>	<b>27,500</b>	<b>89</b>	<b>8,072</b>	<b>(127,091)</b>	<b>110,607</b>
Net loss	-	-	-	(3,071)	-	(3,071)
Issuance of trust units pursuant to distribution reinvestment plan	100	-	-	-	-	100
Employee loans pursuant to employee unit purchase program	-	-	3	-	-	3
Equity distributions Trust units	-	-	-	-	(2,222)	(2,222)
Redeemable partnership units	-	-	-	-	(284)	(284)
<b>Balance, March 31, 2005</b>	<b>202,137</b>	<b>27,500</b>	<b>92</b>	<b>5,001</b>	<b>(129,597)</b>	<b>105,133</b>
Net earnings	-	-	-	5,417	-	5,417
Issuance of trust units pursuant to redemption of redeemable partnership units	25,085	(27,500)	-	-	-	(2,415)
Issuance of trust units pursuant to distribution reinvestment plan	157	-	-	-	-	157
Trust units repurchased pursuant to normal course issuer bid	(9,823)	-	2,713	-	-	(7,110)
Employee loans pursuant to employee unit purchase program	-	-	19	-	-	19
Restatement of convertible debenture issuance costs	(15)	-	-	-	-	(15)
Conversion option related to issued convertible debentures	-	1,680	-	-	-	1,680
Equity distributions Trust units	-	-	-	-	(7,822)	(7,822)
Redeemable partnership units	-	-	-	-	(94)	(94)
<b>Balance, December 31, 2005</b>	<b>217,541</b>	<b>1,680</b>	<b>2,824</b>	<b>10,418</b>	<b>(137,513)</b>	<b>94,950</b>

See accompanying Notes to the Interim Consolidated Financial Statements

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**

## Consolidated Statements of Cash Flows

in \$000's

	Three Months Ended	
	March 31, 2006	March 31, 2005
<b>Operating activities</b>		
Net loss from continuing operations	(1,953)	(2,962)
Items not affecting cash:		
Depreciation and amortization	3,813	3,623
Future income taxes (recovery)	(66)	(345)
Property impairment provision (Note 11)	-	390
Accretion of convertible debentures	30	-
<b>Funds from continuing operations</b>	<b>1,824</b>	<b>706</b>
<b>Funds from discontinued operations</b>	<b>(117)</b>	<b>(143)</b>
Changes in non-cash working capital (Note 13)	(1,636)	(964)
	<b>71</b>	<b>(401)</b>
<b>Financing activities</b>		
Equity distributions	(2,719)	(2,124)
Repurchase of trust units pursuant to normal course issuer bid	(1,343)	-
Principal repayments on mortgages and capital leases	(859)	(7,705)
Repurchase of convertible debentures pursuant to normal course issuer bid	(800)	-
Proceeds from the acquisition of mortgages	-	10,000
	<b>(5,721)</b>	<b>171</b>
<b>Investing activities</b>		
Increase in property under development	(3,140)	(3,621)
Acquisition of capital assets	(1,278)	(1,393)
Increase in restricted cash	(451)	(2,086)
Net cash from sale of properties	451	6,248
(Increase) decrease in long-term notes receivable	90	(1,188)
Increase in minority interest	20	-
Deferred debt issuance costs	(2)	(344)
	<b>(4,310)</b>	<b>(2,384)</b>
<b>Decrease in cash and short-term investments</b>	<b>(9,960)</b>	<b>(2,614)</b>
<b>Cash and short-term investments, beginning of year</b>	<b>31,483</b>	<b>8,707</b>
<b>Cash and short-term investments, end of year</b>	<b>21,523</b>	<b>6,093</b>
<b>Cash interest paid</b>		
Mortgages and capital leases	12,232	13,220
Convertible debentures	6,464	5,082
	<b>18,696</b>	<b>18,302</b>

*See accompanying Notes to the Interim Consolidated Financial Statements*

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## **ROYAL HOST REAL ESTATE INVESTMENT TRUST**

### Notes to the Consolidated Financial Statements

*(unaudited)*

#### **1. GENERAL INFORMATION**

Royal Host Real Estate Investment Trust ("Royal Host" or the "Trust") was created pursuant to the Declaration of Trust dated August 27, 1997. Royal Host is an unincorporated open-end mutual fund trust established for the purpose of investing in hotel properties and hospitality businesses, under specified guidelines as defined under the Declaration of Trust. Royal Host's Declaration of Trust permits the development of new facilities on property adjacent to its existing properties.

#### **2. BASIS OF PRESENTATION**

These unaudited interim consolidated financial statements and notes have been prepared using the accounting policies that are consistent with the policies used in preparing the Trust's 2005 annual consolidated financial statements. They do not include all disclosures required under Generally Accepted Accounting Principles for annual financial statements and should be read in conjunction with the annual consolidated financial statements.

#### **3. 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, and as a result, this property's operations have been included in discontinued operations on the consolidated statements of net loss.

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 loss.

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.

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## ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

(unaudited)

### 3. PROPERTY HELD FOR SALE, DISPOSAL OF LONG-LIVED ASSETS AND DISCONTINUED OPERATIONS (Continued)

	Three Months Ended	
	<i>(in \$000's)</i>	
	<u>March 31,</u>	<u>March 31,</u>
	<u>2006</u>	<u>2005</u>
<b>Hospitality revenue</b>		
Rooms	104	455
Food and beverage	-	167
Other	9	27
	<u>113</u>	<u>649</u>
<b>Hospitality expenses</b>	<u>220</u>	<u>783</u>
<b>Gross margin</b>	<u>(107)</u>	<u>(134)</u>
<b>Other expenses</b>		
Future income taxes (recovery)	(44)	(278)
Gain on foreign currency translation	10	1
(Gain) loss on disposition	-	189
Depreciation and amortization	-	73
Property impairment provision (recovery)	-	(18)
Capital and other taxes	-	5
Interest on capital leases	-	3
	<u>(34)</u>	<u>(25)</u>
<b>Loss from discontinued operations</b>	<u>(73)</u>	<u>(109)</u>

### 4. 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 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". Royal Host proportionately consolidates its interest in the joint venture.

Another subsidiary of Royal Host is the General Partner of the Limited Partnership which is the other party to the joint venture agreement. This Limited Partnership is a variable interest entity for which Royal Host is the primary beneficiary. As a result, Royal Host consolidates the Limited Partnership as required by the CICA issued Accounting Guideline 15 "Consolidation of Variable Interest Entities", effective for fiscal years beginning after November 1, 2004. The \$8.6 million (December 31, 2005 -\$8.6 million) minority interest on the consolidated balance sheets as at March 31, 2006 represents the proportion of net assets of the Limited Partnership 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 March 31, 2006, \$7.4 million was drawn on the construction loan and \$8.0 million was drawn on the mezzanine loan. Subsequent to March 31, 2006, the mezzanine loan was repaid in full and the construction loan commitment was reduced from \$20.0 million to \$10.0 million.

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**

## Notes to the Consolidated Financial Statements

*(unaudited)***4. PROPERTY UNDER DEVELOPMENT** (Continued)

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

Property under development includes \$1.6 million of capitalized interest as at March 31, 2006 (December 31, 2005 - \$1.3 million).

**5. CAPITAL ASSETS**

	<i>(in \$000's)</i>		
	<u>Gross Book Value</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
<b>March 31, 2006</b>			
Buildings	313,680	64,840	248,840
Land	38,372	-	38,372
Furniture, fixtures, and equipment	46,934	37,845	9,089
Other	1,151	355	796
	<u>400,137</u>	<u>103,040</u>	<u>297,097</u>
Capital assets under development	4,620	-	4,620
Intangible assets:			
Franchise rights and management contracts	27,414	17,646	9,768
	<u>432,171</u>	<u>120,686</u>	<u>311,485</u>
		<i>(in \$000's)</i>	
	<u>Gross Book Value</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
<b>December 31, 2005</b>			
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
	<u>431,467</u>	<u>117,365</u>	<u>314,102</u>

During the three months ending March 31, 2006 Royal Host spent \$1.3 million (2005 - \$1.4 million) with respect to capital costs incurred to maintain and renovate its hotel properties.

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**

## Notes to the Consolidated Financial Statements

*(unaudited)***6. MORTGAGES**

	<i>(in \$000's)</i>	
	<u>March 31, 2006</u>	<u>December 31, 2005</u>
Mortgages secured by hotel properties	<b>129,061</b>	129,800
Mortgages secured by property under development	<b>15,426</b>	15,426
	<b>144,487</b>	145,226
Less: current portion	<b>18,322</b>	18,304
	<b>126,165</b>	126,922

Principal repayments required for the years ending March 31:

	<u><i>(in \$000's)</i></u>
2006	18,322
2007	3,160
2008	3,383
2009	59,848
2010	36,136
Thereafter	23,638
	<u>144,487</u>

Debt issuance costs are deferred and amortized over the term of the related debt. For the three months ended March 31, 2006, \$0.4 million was included in depreciation and amortization expense (2005 - \$0.3 million).

Subsequent to March 31, 2006, an \$8.0 million mortgage secured by property under development was repaid. This mortgage is included in "Current portion of mortgages".

**7. CONVERTIBLE DEBENTURES**

	<i>(in \$000's)</i>	
	<u>March 31, 2006</u>	<u>December 31, 2005</u>
9.25% Convertible Unsecured Subordinated Debentures	<b>38,912</b>	39,712
7.90% Convertible Unsecured Subordinated Debentures, Series A	<b>35,000</b>	35,000
6.00% Convertible Unsecured Subordinated Debentures, Series B	<b>58,370</b>	58,340
	<b>132,282</b>	133,052
Less: current portion	<b>38,912</b>	-
	<b>93,370</b>	133,052

The convertible debentures' maturity dates are as follows: the 9.25% debentures - March 1, 2007; the 7.90% debentures - April 30, 2009; and the 6.00% debentures - October 31, 2015.

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## ROYAL HOST REAL ESTATE INVESTMENT TRUST

### Notes to the Consolidated Financial Statements

(unaudited)

#### 8. 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 March 31, 2006 are as follows:

	<i>(in \$000's)</i>	
	<u>March 31, 2006</u>	<u>December 31, 2005</u>
Present value of future minimum lease payments	983	1,103
Less: current portion of principal payments	421	443
	<u>562</u>	<u>660</u>

Total repayments required for the years ending March 31:

	<u><i>(in \$000's)</i></u>
2007	483
2008	413
2009	179
Future minimum lease payments	<u>1,075</u>
Less: amounts representing interest	<u>92</u>
Present value of future minimum lease payments	<u>983</u>

#### 9. UNITHOLDERS' EQUITY

##### Trust Units

As at March 31, 2006, a total of 26,153,897 (December 31, 2005 - 26,595,545) trust units were issued and outstanding.

#### 10. NORMAL COURSE ISSUER BIDS

##### (a) 9.25% Convertible Unsecured Subordinated Debentures

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 three months ended March 31, 2006, Royal Host repurchased \$0.8 million of debentures (average cost of \$104.00 per debenture). As of March 31, 2006, Royal Host repurchased and cancelled \$1.1 million of debentures.

##### (b) Trust Units

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 of March 31, 2006, 225,700 of these units with an aggregate cost of \$1.3 million (average cost of \$5.93 per unit) were repurchased and cancelled.

#### 11. PROPERTY IMPAIRMENT PROVISION

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.

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**

Notes to the Consolidated Financial Statements

*(unaudited)***12. PER UNIT CALCULATIONS**

As at March 31, 2006, a total of 26,153,897 trust units (December 31, 2005 - 26,595,545) were issued and outstanding. Per unit computations are based on the weighted average number of trust units outstanding for the period, after adjusting the net loss for distributions on the redeemable partnership units of \$Nil (March 31, 2005 - \$284,000).

<b>For the three months ending March 31, 2006:</b>	<u>(in \$000's)</u>	<u>Weighted Average Units (in 000's)</u>	<u>Per Unit (\$)</u>
Net loss - continuing operations	(1,953)		
Less: distributions on redeemable partnership units	-		
Basic loss - continuing operations	(1,953)		(0.08)
Basic loss - discontinued operations	(73)		-
<b>Basic loss - total operations</b>	<b>(2,026)</b>	<b>25,949</b>	<b>(0.08)</b>
Net loss - continuing operations	(1,953)		
Less: distributions on redeemable partnership units	-		
Unit options		138	
Unit option repurchase		(225)	
Diluted loss - continuing operations	(1,953)		(0.08)
Diluted loss - discontinued operations	(73)		-
<b>Diluted loss - total operations</b>	<b>(2,026)</b>	<b>25,862</b>	<b>(0.08)</b>
<b>For the three months ending March 31, 2005:</b>	<u>(in \$000's)</u>	<u>Weighted Average Units (in 000's)</u>	<u>Per Unit (\$)</u>
Net loss - continuing operations	(2,962)		
Less: distributions on redeemable partnership units	(284)		
Basic loss - continuing operations	(3,246)		(0.13)
Basic loss - discontinued operations	(109)		(0.01)
<b>Basic loss - total operations</b>	<b>(3,355)</b>	<b>24,614</b>	<b>(0.14)</b>
Net loss - continuing operations	(2,962)		
Less: distributions on redeemable partnership units	(284)		
Unit options		138	
Unit option repurchase		(259)	
Diluted loss - continuing operations	(3,246)		(0.13)
Diluted loss - discontinued operations	(109)		(0.01)
<b>Diluted loss - total operations</b>	<b>(3,355)</b>	<b>24,493</b>	<b>(0.14)</b>

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**

Notes to the Consolidated Financial Statements

*(unaudited)***13. CHANGES IN NON-CASH WORKING CAPITAL**

	Three Months Ended	
	<i>(in \$000's)</i>	
	<u>March 31,</u>	<u>March 31,</u>
	<u>2006</u>	<u>2005</u>
<b>(Increase) decrease in:</b>		
Accounts and notes receivable	(399)	(2,289)
Prepaid expenses	(417)	(13)
Inventories	16	2
Assets of discontinued operations	4	85
	<u>(796)</u>	<u>(2,215)</u>
<b>Increase (decrease) in:</b>		
Accounts payable and accrued liabilities	(1,141)	571
Interest accrued on convertible debentures	620	(261)
Other liabilities	(102)	(487)
Deferred revenue	(92)	107
Future income taxes	(119)	-
Liabilities of discontinued operations	(6)	1,321
	<u>(840)</u>	<u>1,251</u>
	<u>(1,636)</u>	<u>(964)</u>

**14. COMPARATIVE FIGURES**

Certain comparative figures have been reclassified to conform to the presentation adopted for 2006.