



ROYAL HOST REAL ESTATE INVESTMENT TRUST

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

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS AND FINANCIAL CONDITION FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006

The following Management's Discussion and Analysis of Operations and Financial Condition ("MD&A") dated November 8, 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 and nine months ended September 30, 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 September 30, 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.

HIGHLIGHTS

The Trust realized record results in the third quarter of 2006. Net earnings from hospitality activities totalled \$5.2 million in the third quarter, a 44.4% increase over 2005. Net earnings for the nine months from hospitality activities were \$5.8 million, a 115.8% increase over 2005. In addition, during the third quarter of 2006, the Trust realized an \$8.7 million profit on the Royal Private Residence Club ("PRC"), bringing the Trust's total earnings from continuing operations for the nine months ended September 30, 2006 to \$14.7 million.

- Basic per unit Cash Available for Distribution for the three months increased by 126.7% to \$0.68 (2005 - \$0.30) and for the nine months increased by 93.5% to \$0.89 (2005 - \$0.46).
- Distributions to Unitholders for the three months increased by 20.0% to \$0.12 per unit (2005 - \$0.10 per unit) and for the nine months increased by 25.0% to \$0.35 (2005 - \$0.28).
- Revenue from hotel operations increased to \$42.7 million (2005 - \$41.2 million) for the three months and to \$113.7 million (\$109.3 million) for the nine months. Gross margin from hotel operations increased to 36.9% (2005 - 36.0%) for the three months and increased to 31.2% (2005 - 30.1%) for the nine months.
- Revenue per Available Room for the three months increased 2.8% to \$76.69 (2005 - \$74.63) and for the nine months increased 4.1% to \$66.53 (2005 - \$63.91).
- Construction of PRC was completed in the third quarter of 2006, and sales of 92% of the condominiums were closed. Revenue from the sale of condominiums and the corresponding gross margin recognized in the third quarter of 2006 were \$52.2 million and \$8.7 million, respectively. To date, 99.8% of the condominiums have been sold.
- In September 2006, the Trust issued \$60 million 6.25% convertible debentures that have a term of seven years. This, combined with the funds from PRC, leaves the Trust in a very strong financial position.
- The Trust actively repurchased its Trust Units pursuant to its Normal Course Issuer Bid, repurchasing 331,500 trust units with an aggregate cost of \$2.0 million in the quarter, bringing cumulative repurchases for the nine months ended September 30, 2006 to 557,200 trust units with an aggregate cost of \$3.4 million.
- The Trust announced a 25% increase in monthly distributions to unitholders to \$0.05 per month commencing with the November 2006 distribution.

SELECTED FINANCIAL INFORMATION

| (\$000's, except as otherwise noted) | Three months ended September 30 | | | Nine months ended September 30 | | |
|--|------------------------------------|---------------|---------------|-----------------------------------|----------------|---------------|
| | 2006 | 2005 | Change (%) | 2006 | 2005 | Change (%) |
| Hospitality Revenue (continuing operations) | | | | | | |
| Rooms | 31,131 | 30,317 | 2.7 | 80,654 | 77,478 | 4.1 |
| Food and Beverage | 6,290 | 6,110 | 2.9 | 19,266 | 18,937 | 1.7 |
| Other | 5,231 | 4,811 | 8.7 | 13,738 | 12,896 | 6.5 |
| | <u>42,652</u> | <u>41,238</u> | 3.4 | <u>113,658</u> | <u>109,311</u> | 4.0 |
| Hospitality Expenses | <u>26,899</u> | <u>26,393</u> | 1.9 | <u>78,156</u> | <u>76,438</u> | 2.2 |
| | <u>15,753</u> | <u>14,845</u> | 6.1 | <u>35,502</u> | <u>32,873</u> | 8.0 |
| Hospitality Gross Margin % | 36.9% | 36.0% | | 31.2% | 30.1% | |
| Royal Private Residence Club | | | | | | |
| Revenue | 52,245 | - | | 52,245 | - | |
| Cost of Sales | 43,518 | - | | 43,518 | - | |
| | <u>8,727</u> | <u>-</u> | | <u>8,727</u> | <u>-</u> | |
| Gross Margin | <u>24,480</u> | <u>14,845</u> | 64.9 | <u>44,229</u> | <u>32,873</u> | 34.5 |
| Net Earnings (Loss) | | | | | | |
| From Continuing Operations | 13,932 | 3,528 | 294.9 | 14,651 | 2,918 | 402.1 |
| From Discontinued Operations | 7 | 81 | | (149) | (242) | |
| | <u>13,939</u> | <u>3,609</u> | 286.2 | <u>14,502</u> | <u>2,676</u> | 441.9 |
| Basic Per Unit Net Earnings (Loss) (\$) | | | | | | |
| From Continuing Operations | 0.54 | 0.13 | | 0.56 | 0.10 | |
| From Discontinued Operations | - | - | | (0.01) | (0.01) | |
| | <u>0.54</u> | <u>0.13</u> | 315.4 | <u>0.55</u> | <u>0.09</u> | 511.1 |
| Diluted Per Unit Net Earnings (Loss) (\$) | | | | | | |
| From Continuing Operations | 0.32 | 0.13 | | 0.46 | 0.10 | |
| From Discontinued Operations | - | - | | - | (0.01) | |
| | <u>0.32</u> | <u>0.13</u> | 146.2 | <u>0.46</u> | <u>0.09</u> | 411.1 |
| Cash Available For Distribution | <u>17,417</u> | <u>8,105</u> | 114.9 | <u>23,186</u> | <u>11,925</u> | 94.4 |
| Distributions Declared on Trust Units | <u>3,083</u> | <u>2,717</u> | 13.5 | <u>9,004</u> | <u>7,292</u> | 23.5 |
| Basic Per Unit Cash Available For Distribution (\$) | <u>0.68</u> | <u>0.30</u> | 126.7 | <u>0.89</u> | <u>0.46</u> | 93.5 |
| Per Unit Distributions Declared (\$) | <u>0.12</u> | <u>0.10</u> | 20.0 | <u>0.35</u> | <u>0.28</u> | 25.0 |
| Weighted Average Number of Trust Units Outstanding (000's) | <u>25,755</u> | <u>27,240</u> | (5.5) | <u>25,958</u> | <u>25,925</u> | 0.1 |

OVERVIEW

Royal Host's core businesses are hotel ownership, management and franchising. As at September 30, 2006, Royal Host owned 37 hotels (comprising 4,500 rooms), managed an additional 89 properties (8 in Canada, 79 in the United States and 2 in Mexico) for third parties, and franchised 111 locations (including 16 owned by the Trust) under the Travelodge and Thriftlodge banners, for a total of 18,000 guestrooms in the economy, mid-market and upscale hospitality segment.

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 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 includes the following non-GAAP financial measures: Average Daily Rate ("ADR"), Occupancy, Revenue per Available Room ("RevPAR"), Cash Available for Distribution and Basic and Diluted Per Unit Cash Available for Distribution.

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 rented in a given time period by the number of rooms available in the same period;
- ADR, 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
- RevPAR, 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.

Cash Available for Distribution

Cash Available for Distribution is a non-GAAP financial measure commonly used by hotel real estate investment trusts and other Canadian income funds. As a "non-GAAP" measure, no standards exist for the calculation of Cash Available for Distribution and reporting practices vary widely.

Royal Host calculates Cash Available for Distribution as Cash from Operating Activities adjusted for changes in non-cash working capital balances; changes in its investment in PRC; distributions declared on its redeemable partnership units; and its provision for capital replacement. Royal Host considers this measure indicative of its cash available for distribution to Unitholders. This is a change from Royal Host's prior presentation in that the calculation's starting point previously was net earnings. The guidance issued by the Canadian Securities Administrators and the draft guidance issued by the Canadian Institute of Chartered Accountants consider distributable cash a cash flow measure and, as such, require that it be reconciled to Cash from Operating Activities. This change does not impact the Cash Available for Distribution as previously presented in prior periods.

Room Statistics – Total

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|------------------------------|------------------------------------|----------------|---------------|-----------------------------------|----------------|---------------|
| | 2006 | 2005 | Change (%) | 2006 | 2005 | Change (%) |
| CONTINUING OPERATIONS | | | | | | |
| Occupancy | 73.5% | 75.0% | (2.0) | 67.5% | 67.8% | (0.4) |
| ADR | \$104.27 | \$99.50 | 4.8 | \$98.52 | \$94.32 | 4.5 |
| RevPAR | \$76.69 | \$74.63 | 2.8 | \$66.53 | \$63.91 | 4.1 |
| TOTAL OPERATIONS | | | | | | |
| Occupancy | 72.8% | 74.2% | (1.9) | 66.7% | 66.3% | 0.6 |
| ADR | \$103.95 | \$99.23 | 4.8 | \$98.33 | \$93.89 | 4.7 |
| RevPAR | \$75.71 | \$73.64 | 2.8 | \$65.55 | \$62.23 | 5.3 |

The third quarter of 2006 saw RevPAR from continuing operations increase by 2.8%. The increase resulted from a \$4.77, or 4.8%, increase in ADR offset by a 2.0% decrease in Occupancy which was attributable to four of the Trust's properties. Year-to-date RevPAR from continuing operations grew by 4.1% in 2006, attributable to a \$4.20 or 4.5% increase in ADR.

Room Statistics – By Region (Continuing Operations)

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|---------------------------------------|------------------------------------|----------------|---------------|-----------------------------------|----------------|---------------|
| | 2006 | 2005 | Change (%) | 2006 | 2005 | Change (%) |
| ONTARIO (53% of Rooms Revenue) | | | | | | |
| Occupancy | 72.6% | 72.2% | 0.6 | 67.4% | 66.3% | 1.7 |
| ADR | \$99.01 | \$96.80 | 2.3 | \$98.26 | \$95.62 | 2.8 |
| RevPAR | \$71.90 | \$69.87 | 2.9 | \$66.25 | \$63.38 | 4.5 |

The Trust's Ontario region produced healthy rooms revenue. RevPAR for the three and nine months increased 2.9% and 4.5% over 2005. The London Hilton, the Holiday Inn Oakville, the Chimo Hotel in Ottawa and Travelodge Ottawa West all produced particularly strong results in the quarter.

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|---------------------------------------|------------------------------------|----------------|---------------|-----------------------------------|----------------|---------------|
| | 2006 | 2005 | Change (%) | 2006 | 2005 | Change (%) |
| WESTERN (40% of Rooms Revenue) | | | | | | |
| Occupancy | 72.3% | 76.3% | (5.2) | 66.0% | 68.0% | (2.9) |
| ADR | \$114.34 | \$104.91 | 9.0 | \$101.59 | \$94.67 | 7.3 |
| RevPAR | \$82.67 | \$80.02 | 3.3 | \$67.05 | \$64.37 | 4.2 |

The Grand Okanagan Lakefront Resort and Conference Centre in Kelowna, the Best Western Village Park Inn in Calgary, the Holiday Inn (The Palace) in Edmonton and the Travelodge Fort Nelson all produced very strong results in the Trust's Western region. Three of the Trust's Southern Alberta limited service hotels and the Yellowknife Inn produce relatively weak rooms revenue.

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|---------------------------------------|------------------------------------|----------------|---------------|-----------------------------------|----------------|---------------|
| | 2006 | 2005 | Change (%) | 2006 | 2005 | Change (%) |
| ATLANTIC (7% of Rooms Revenue) | | | | | | |
| Occupancy | 83.4% | 85.7% | (2.7) | 72.3% | 73.7% | (1.9) |
| ADR | \$99.54 | \$98.40 | 1.2 | \$91.05 | \$89.33 | 1.9 |
| RevPAR | \$83.00 | \$84.37 | (1.6) | \$65.87 | \$65.80 | - |

Cash Available for Distribution

| (\$000's, except as otherwise noted) | Three months ended September 30 | | | Nine months ended September 30 | | |
|--|------------------------------------|--------------|---------------|-----------------------------------|----------------|---------------|
| | 2006 | 2005 | Change (%) | 2006 | 2005 | Change (%) |
| Cash from Operating Activities | 51,166 | 6,973 | | 48,593 | (1,038) | |
| Less: | | | | | | |
| Changes in Non-Cash Working Capital | 330 | (2,211) | | 3,640 | 3,372 | |
| Distributions on Redeemable Partnership Units | - | - | | - | (378) | |
| Changes in investment in PRC | (32,582) | 4,800 | | (25,050) | 13,826 | |
| Provision for Capital Replacement | (1,497) | (1,457) | | (3,997) | (3,857) | |
| Cash Available for Distribution | 17,417 | 8,105 | 114.9 | 23,186 | 11,925 | 94.4 |
| Distributions Declared | 3,083 | 2,717 | 13.5 | 9,004 | 7,292 | 23.5 |
| Basic Per Unit Cash Available For Distribution (\$) | 0.68 | 0.30 | 126.7 | 0.89 | 0.46 | 93.5 |
| Diluted Per Unit Cash Available For Distribution (\$) | 0.38 | 0.25 | 52.0 | 0.61 | 0.43 | 41.9 |
| Per Unit Distributions Declared (\$) | 0.12 | 0.10 | 20.0 | 0.35 | 0.28 | 25.0 |

Cash Available for Distribution for the three months ended September 30, 2006 increased by 114.9% to \$17.4 million (2005 - \$8.1 million), and for the nine months ended September 30, 2006 increased by 94.4% to \$23.2 million (2005 - \$11.9 million).

For purposes of calculating Cash Available for Distribution, Cash from Operating Activities have been adjusted to exclude changes in non-cash working capital requirements as the Trust's working capital requirements are not permanent and will reverse based on seasonal fluctuations in working capital. Cash flows from operating activities have also been adjusted to exclude the changes in the Trust's investment in PRC as this is the recovery of its investment and recognizes only the profit from the project as cash available for distribution. The Trust designates a portion of its capital expenditure budget for capital replacement to be funded from cash flows from operating activities. This provision is calculated as 4.0% of rooms and food and beverage revenue, or \$1.5 million for the three months ended September 30, 2006 (2005 - \$1.5 million) and \$4.0 million for the nine months ended September 30, 2006 (2005 - \$3.9 million). Royal Host considers the resulting measure, Cash Available for Distribution, as indicative of the Trust's Cash Available for Distribution to unitholders.

The Trust's revenue and profitability are typically higher in the second and third quarters, as compared to the first and fourth quarters. Therefore, cash flows from operating activities are not generated evenly throughout the year. Royal Host's Board of Trustees determines monthly distributions to unitholders based on, among other considerations, annual performance, projected cash flows, capital commitments and working capital requirements. The objective is to set the distributions at a level that will be sustainable over a longer period. Accordingly, cash distributions will not equal cash available for distribution in any one quarter. The PRC profit will be used to fund long-term initiatives and to support future distributions in meeting the Trust's stated objective of generating sustainable distributions. As a result of improving results, it was announced that the Trust will increase monthly distributions to \$0.05 per month beginning in November 2006.

During the third quarter of 2006, the Trust declared monthly distributions on trust units of \$0.04 per trust unit, or \$3.1 million, an increase of 13.5% over the \$2.7 million declared in 2005. During the nine months ended September 30, 2006, the Trust declared distributions on trust units of \$9.0 million, an increase of 23.3% (2005 - \$7.3 million). 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.

During the third quarter of 2006, the Trust used cash on hand to make debt principal repayments of \$8.2 million. The total amount of funds used for capital investment was \$3.4 million, funded from cash from operations and restricted cash. During the nine month period, the Trust made total debt principal repayments of \$18.0 million, as described further under "Liquidity and Capital Resources", spent \$6.0 million on capital investment, and repurchased \$3.4 million of Trust Units pursuant to its NCIB.

SEASONALITY

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

THREE MONTHS ENDED SEPTEMBER 30, 2006 (Continuing Operations)

Hospitality Revenue

Hospitality revenue from continuing operations in the third quarter of 2006 increased by \$1.4 million to \$42.7 million (2005 - \$41.2 million).

| Three months ended September 30 (\$000's, except as otherwise noted) | 2006 | 2005 | Change | (%) |
|---|---------------|---------------|--------------|------------|
| Hospitality Revenue (continuing operations) | | | | |
| Rooms | 31,131 | 30,317 | 814 | 2.7 |
| Food and Beverage | 6,290 | 6,110 | 180 | 2.9 |
| Other | 5,231 | 4,811 | 420 | 8.7 |
| | <u>42,652</u> | <u>41,238</u> | <u>1,414</u> | <u>3.4</u> |

Rooms revenue increased \$0.8 million, or 2.7%, to \$31.1 million (2005 - \$30.3 million), a product of the 4.8% increase in ADR to \$104.27 (2005 - \$99.50), and the 2.0% decrease in Occupancy to 73.5% (2005 - 75.0%). The increase in ADR is a result of management's continued focus on managing room rate yield and improvement in overall industry rates. The Trust's Ontario region produced generally healthy rooms revenue, including strong results from the London Hilton. The Grand Okanagan Lakefront Resort and Conference Centre, the Best Western Village Park, the Holiday Inn (The Palace) and the Travelodge Fort Nelson produced strong results in the Trust's Western region, more than offsetting decreased rooms revenue in 2006 at certain of the Trust's Southern Alberta limited service hotels and the Yellowknife Inn.

Food and beverage revenue increased 2.9% to \$6.3 million (2005 - \$6.1 million).

Other hospitality revenue increased \$0.4 million, or 8.7%, to \$5.2 million (2005 - \$4.8 million), attributable in part to the increase in third party management fees. Travelodge franchise fees were relatively constant from 2005.

Hospitality Expenses

| Three months ended September 30 (\$000's, except as otherwise noted) | 2006 | 2005 | Change | (%) |
|---|--------|--------|--------|-----|
| Hospitality Expenses | 26,899 | 26,393 | 506 | 1.9 |

Total hospitality expenses increased \$0.5 million to \$26.9 million (2005 - \$26.4 million). Hospitality expenses decreased as a percentage of hospitality revenue to 63.1% (2005 - 64.0%), reflecting the increase in ADR and the success of the operations team in managing costs.

Hospitality Gross Margin

| Three months ended September 30 (\$000's, except as otherwise noted) | 2006 | 2005 | Change | (%) |
|---|--------|--------|--------|-----|
| Gross Margin | 15,753 | 14,845 | 908 | 6.1 |

Hospitality gross margin increased \$0.9 million, or 6.1%, to \$15.8 million in 2006 (2005 - \$14.8 million), as a result of the higher overall revenue and lower incremental hospitality expenses. Gross margin as a percentage of hospitality revenue improved to 36.9% (2005 - 36.0%). These results are particularly noteworthy given the Trust's strong performance in the third quarter of 2005.

Royal Private Residence Club

During the third quarter of 2006, the Trust completed construction and closed the sales of 92% of the condominiums. Revenue and cost of sales are recorded at the time each condominium is closed and title and possession have been transferred to the buyer. The Trust recognized revenue from the sale of condominiums of \$52.2 million, cost of sales of \$43.5 million and gross margin of \$8.7 million. Currently, 99.8% of the condominiums have been sold.

Other Expenses

Other expenses decreased \$0.8 million to \$10.5 million (2005 - \$11.3 million). Mortgage repayments in 2005 resulted in a \$0.7 million decrease in interest on mortgages and capital leases. This was offset by an increase in convertible debenture interest of \$1.1 million, a result of the \$60 million debenture issued in the fourth quarter of 2005. Trust administration was in line with 2005. In the third quarter, the Trust also recorded a future income tax expense of \$1.1 million (2005 - \$1.6 million). In the third quarter of 2005, the Trust recorded a \$0.6 million property impairment provision.

Net Earnings

Earnings from continuing operations, excluding the \$8.7 million contribution from PRC, totaled \$5.2 million, a 47.5% increase over 2005. Earnings from continuing operations, including the contribution from PRC, increased \$10.4 million to \$13.9 million (2005 - \$3.5 million). Net earnings from total operations in 2006 also increased to \$13.9 million, compared to net earnings from total operations of \$3.6 million in 2005.

NINE MONTHS ENDED SEPTEMBER 30, 2006 (Continuing Operations)

Hospitality Revenue

Hospitality revenue from continuing operations for the nine months of 2006 increased by \$4.3 million to \$113.7 million (2005 - \$109.3 million).

| Nine months ended September 30 (\$000's, except as otherwise noted) | 2006 | 2005 | Change | Change (%) |
|--|----------------|----------------|--------------|------------|
| Hospitality Revenue (continuing operations) | | | | |
| Rooms | 80,654 | 77,478 | 3,176 | 4.1 |
| Food and Beverage | 19,266 | 18,937 | 329 | 1.7 |
| Other | 13,738 | 12,896 | 842 | 6.5 |
| | <u>113,658</u> | <u>109,311</u> | <u>4,347</u> | <u>4.0</u> |

Rooms revenue increased \$3.2 million, or 4.1%, to \$80.7 million (2005 - \$77.5 million), a result of the 4.5% increase in ADR to \$98.52 (2005 - \$94.32). The increase in ADR is a result of management's continued focus on managing room rate yield and the improvement in overall industry rates. The Grand Okanagan Resort and Conference Centre, the London Hilton, the Best Western Village Park Inn and the Holiday Inn (The Palace) produced particularly strong results, more than offsetting lower rooms revenue at the Yellowknife Inn and certain of the Trust's Southern Alberta limited service hotels.

Food and beverage revenue increased \$0.3 million, or 1.7%, to \$19.3 million (2005 - \$18.9 million).

Other hospitality revenue increased \$0.8 million, or 6.5%, to \$13.7 million (2005 - \$12.9 million), attributable to an increase in third-party management fees. Travelodge franchise fees were consistent with 2005.

Hospitality Expenses

| Nine months ended September 30 (\$000's, except as otherwise noted) | 2006 | 2005 | Change | Change (%) |
|--|--------|--------|--------|------------|
| Hospitality Expenses | 78,156 | 76,438 | 1,718 | 2.2 |

Total hospitality expenses increased \$1.7 million, or 2.2%, to \$78.2 million (2005 - \$76.4 million). Hospitality expenses decreased as a percentage of hospitality revenue to 68.8% (2005 - 69.9%). Utility costs for the period decreased modestly from 2005.

Hospitality Gross Margin

| Nine months ended September 30 (\$000's, except as otherwise noted) | 2006 | 2005 | Change | Change (%) |
|--|--------|--------|--------|------------|
| Hospitality Gross Margin | 35,502 | 32,873 | 2,629 | 8.0 |

Hospitality gross margin increased \$2.6 million, or 8.0%, to \$35.5 million in 2006, which compares to \$32.9 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 to 31.2% (2005 - 30.1%).

Royal Private Residence Club

As described above, the Trust recognized revenue from the sale of condominiums of \$52.2 million, cost of sales of \$43.5 million and gross margin of \$8.7 million in 2006.

Other Expenses

Other expenses decreased \$0.4 million. Interest on mortgages and capital leases decreased by \$2.2 million and convertible debenture interest increased by \$2.8 million. Trust administration was unchanged at \$1.6 million (2005 - \$1.6 million). The Trust recorded a future income tax expense of \$1.1 million in 2006 (2005 - \$1.3 million). The nine months ended September 30, 2005 includes a \$1.0 million property impairment provision.

Net Earnings

The Trust's earnings from continuing operations for the nine months ended September 30, 2006 of \$14.7 million was a significant improvement over the \$2.9 million for the nine months ended September 30, 2005, primarily due to the recognition of profit on PRC in 2006. Net earnings from total operations in 2006 increased to \$14.5 million, compared to net earnings from total operations of \$2.7 million in 2005. Earnings excluding the PRC profit were \$5.8 million, a healthy 115.8% increase over 2005.

PROPERTY HELD FOR SALE AND 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. Property held for sale on the Trust's Consolidated Balance Sheets represents the Travelodge Orillia.

Revenue from discontinued operations for the three months ended September 30, 2006 was \$0.3 million, attributable entirely to the Travelodge Orillia (2005 - \$0.2 million). Earnings from discontinued operations for the three months ended September 30, 2006 totalled \$Nil (2005 - \$0.1 million), and the loss from discontinued operations for the nine months ended September 30, 2006 was \$0.2 million (2005 - \$0.2 million).

ROYAL PRIVATE RESIDENCE CLUB

In the third quarter of 2006, the Trust completed construction of PRC, a 71-unit luxury condominium development being developed adjacent to the Grand Okanagan Lakefront Resort and Conference Centre, and commenced closing of sales of the condominiums. As at September 30, 2006, sales of 92% of the condominiums were closed. Currently, 99.8% of the condominiums have been sold.

In the third quarter of 2006, the Trust recognized revenue from the sale of condominiums of \$52.2 million and cost of sales of \$43.5 million, producing a gross margin of \$8.7 million.

During the three months ended September 30, 2006, the Trust also repaid the \$7.4 million PRC construction loan, which retired all of the debt associated with the project.

LIQUIDITY AND CAPITAL RESOURCES

As at September 30, 2006, the Trust had cash and short-term investments of \$92.2 million, cash held in escrow of \$8.2 million and undrawn credit facilities of \$12.0 million. Subsequent to September 30, 2005, \$5.8 million of the cash held in escrow was received by the Trust.

The 9.25% convertible debentures (RYL.DB) mature in March 2007 and, accordingly, have been classified as a current liability as at September 30, 2006. With funds on hand, the Trust has the financial capacity to repay this obligation when it matures. In addition to planning for the retirement of this obligation, the Trust is currently reviewing various options for the deployment of funds including the repayment of debt and investment and acquisition opportunities with the goal of continuing to maximize Unitholder value over the longer term.

In addition, the Trust had restricted cash as at September 30, 2006 of \$5.9 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.

Royal Host's cash and short-term investments, together with its future cash flows, are expected to be sufficient to fund all anticipated cash requirements over the next year.

Financing Activities

As at September 30, 2006, the Trust's mortgages totalled \$127.6 million (December 31, 2005 - \$145.2 million). During the nine months ended September 30, 2006, the \$7.4 million PRC construction loan and the \$8.0 million PRC mezzanine loan were repaid in full, and \$2.6 of additional mortgage principal repayments were made.

In September 2006, the Trust issued \$60.0 million of convertible debentures (RYL.DB.C). The convertible debentures bear interest at 6.25% per annum and have a term of seven years.

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 September 30, 2006 (\$000's) | Total | 2007 | 2008 | 2009 | 2010 | 2011 | Thereafter |
|---------------------------------------|---------|-------|-------|-------|--------|--------|------------|
| Mortgages | 127,647 | 3,036 | 3,269 | 3,502 | 82,640 | 11,994 | 23,206 |
| Capital Leases | 707 | 375 | 332 | - | - | - | - |

Convertible Debentures

| (\$000's) | September 30, 2006 | December 31, 2005 | Maturity Date | Conversion Price |
|--|-----------------------|----------------------|----------------|---------------------|
| 9.25% Convertible Unsecured Subordinated | 38,493 | 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 | 58,432 | 58,340 | October 2015 | \$6.85 |
| 6.25% Convertible Unsecured Subordinated, Series C | 58,200 | - | September 2013 | \$7.00 |
| | <u>190,125</u> | <u>133,052</u> | | |

As at September 30, 2006, the average maturity of mortgages was 4.0 years, the average maturity of convertible debentures was 5.5 years, and the average maturity of mortgages and convertible debentures combined was 4.9 years. As at September 30, 2006, Royal Host's overall debt had an average interest rate of 7.52% (December 31, 2005 - 7.83%).

Investing Activities

During the three and nine months ended September 30, 2006, the Trust spent \$2.9 million and \$6.2 million, respectively, on capital expenditures (2005 - \$2.3 million and \$5.1 million, respectively), including guest room and exterior upgrades at several of the Trust's hotels. In addition, capital assets increased by \$1.2 million as a result of the parkade addition at the Grand Okanagan Resort in connection with the completion of PRC.

As at September 30, 2006, the Trust has invested \$6.2 million and made project commitments of an additional \$4.5 million. In addition to its anticipated 2006 provision for capital replacement of \$5.4 million, the Trust is investing funds in certain properties to improve their overall market position. Restricted cash, described above, is available for funding certain hotel capital expenditures.

Equity

During the three months ended September 30, 2006, equity increased \$10.6 million to \$98.9 million. The increase is attributable to net earnings of \$13.9 million and the recognition of a \$1.8 million equity element related to the conversion option of the \$60.0 million convertible debenture issued in the third quarter of 2006. These items were offset by \$3.1 million of declared distributions and \$2.0 million related to the repurchase of 331,500 Trust Units under the Trust's Normal Course Issuer Bid (described below).

During the nine months ended September 30, 2006, equity increased \$4.0 million to \$98.9 million. The increase is attributable to net earnings of \$14.5 million and the recognition of the aforementioned \$1.8 million equity element, offset by \$9.0 million of declared distributions and \$3.4 million related to the repurchase of 557,200 Trust Units.

As at September 30, 2006, 25,547,581 trust units were issued and outstanding, and as at November 8, 2006, 25,220,795 trust units were issued and outstanding.

Normal Course Issuer Bid – Trust Units

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 September 30, 2006, 331,500 trust units were repurchased at an aggregate cost of \$2.0 million (average cost of \$6.07 per unit). During the nine months ended September 30, 2006, and cumulatively to September 30, 2006, 557,200 trust units have been repurchased at an aggregate cost of \$3.4 million (average cost of \$6.01 per unit). Subsequent to September 30, 2006, Royal Host repurchased 542,200 trust units at an aggregate cost of \$3.3 million (average cost of \$6.10 per unit). As at November 8, 2006 2,299,400 trust units have been repurchased at an aggregate cost of \$13.7 million (average cost of \$5.98 per unit), including 1,200,000 trust units repurchased at an aggregate cost of \$7.1 million (average cost of \$5.90 per unit) in 2005 pursuant to the preceding NCIB commencing December 21, 2004.

Normal Course Issuer Bids – 9.25% Convertible Debentures

Commencing on July 17, 2006, Royal Host initiated a NCIB to repurchase up to \$3.9 million principal amount of its issued and outstanding 9.25% Convertible Debentures. During the three and nine months ended September 30, 2006, Royal Host repurchased \$0.4 million of Convertible Debentures at an average cost of \$101.95 per debenture. Subsequent to September 30, 2006, Royal Host repurchased \$0.5 million of Convertible Debentures at an average cost of \$101.82 per debenture.

Commencing on July 15, 2005, Royal Host initiated a NCIB to repurchase up to \$2.0 million principal amount of its issued and outstanding 9.25% Convertible Debentures. During the three months ended September 30, 2006, no Convertible Debentures were repurchased pursuant to this NCIB. During the nine months ended September 30, 2006, Royal Host repurchased \$0.8 million of Convertible Debentures at an average cost of \$104.00 per debenture. From commencement of the NCIB to expiration on July 15, 2006, Royal Host repurchased \$1.1 million of Convertible Debentures.

As at November 8, 2006, a total of \$2.0 million of Convertible Debentures have been repurchased pursuant to the NCIBs.

SUMMARY OF QUARTERLY FINANCIAL RESULTS

| (\$000's, except as otherwise noted) | 2006 | | | | 2005 | | 2004 | |
|--|---------------|--------------|----------------|--------------|--------------|--------------|----------------|----------------|
| | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 |
| Revenue | 94,897 | 38,839 | 32,168 | 34,988 | 41,238 | 37,998 | 30,075 | 33,330 |
| Net Earnings (Loss) | | | | | | | | |
| From Continuing Operations | 13,932 | 2,673 | (1,953) | (336) | 3,528 | 2,528 | (3,138) | (6,246) |
| From Discontinued Operations | 7 | (83) | (73) | 6 | 81 | (214) | (109) | 205 |
| | <u>13,939</u> | <u>2,590</u> | <u>(2,026)</u> | <u>(330)</u> | <u>3,609</u> | <u>2,314</u> | <u>(3,247)</u> | <u>(6,041)</u> |
| Per Unit Results (\$) | | | | | | | | |
| Earnings (Loss) from Continuing Operations | | | | | | | | |
| Basic | 0.54 | 0.10 | (0.08) | (0.01) | 0.13 | 0.09 | (0.14) | (0.26) |
| Diluted | 0.32 | 0.10 | (0.08) | (0.01) | 0.13 | 0.09 | (0.14) | (0.26) |
| Earnings (Loss) from Total Operations | | | | | | | | |
| Basic | 0.54 | 0.10 | (0.08) | (0.01) | 0.13 | 0.08 | (0.14) | (0.25) |
| Diluted | 0.32 | 0.10 | (0.08) | (0.01) | 0.13 | 0.08 | (0.14) | (0.25) |

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.

RESTATEMENT

Royal Host's financial statements for the periods ended December 31, 2002 through June 30, 2006 included changes in property under development in cash from investing activities on its Consolidated Statements of Cash Flows. Changes in property under development have been retroactively restated to be included in cash from operating activities. The effects of the restatement are as follows: cash from operating activities for the three and nine months ended September 30, 2005 decreased by \$4,800,000 to \$6,973,000 and decreased by \$13,826,000

to (\$1,038,000), respectively; and cash from investment activities for the three and nine months ended September 30, 2005 increased by \$4,800,000 to (\$2,305,000) and increased by \$13,826,000 to \$1,366,000, respectively.

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.

BUSINESS ENVIRONMENT AND OUTLOOK

The hospitality industry experienced a steady recovery in 2005 and the first nine months of 2006, and it is anticipated that growth will continue through the remainder of 2006 and 2007. Growth in demand is anticipated to exceed that of supply, resulting in anticipated improvements in Occupancy and ADR. Pannell Kerr Forster, a recognized industry consultant, has projected national RevPAR growth of 4.8% and growth in industry-wide profitability of 5.8% in 2007.

The Trust has achieved several significant accomplishments in the first nine months of 2006. It delivered strong operating results, successfully completed PRC and closed a \$60 million convertible debenture offering, leaving the Trust in an even stronger financial position. The Trust intends to use its funds to repay debt and reinvest in its properties. The Trust also has substantial resources and capacity, allowing it to target and complete accretive opportunities it identifies.

On October 31, 2006 the Department of Finance (Canada) introduced modifications to the income tax rules that will result in the taxation of distributions made by publicly traded income trusts and limited partnerships beginning in the year 2011. These measures result in the application of a tax to income trusts similar to that applied to corporations and apply a tax to taxable distributions similar to that applied to dividends on shares of a corporation. Management is reviewing the potential impact of these proposed changes. Management is, however, confident that the inherent value of the Trust's hotel properties is not impacted by the proposed changes and will continue to work to maximize its cash available for distribution.

Overall, Canada's general economic environment is strong and the hospitality industry's fundamentals remain sound. Royal Host views the remainder of 2006 and 2007 with optimism, and with its solid foundation, is well positioned to continue to deliver increased value to its unitholders.



ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Financial Statements
(unaudited)

For the nine months ended September 30, 2006

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Balance Sheets

in \$000's

(unaudited)

| | As at | |
|--|-------------------------------------|------------------------------------|
| | <u>September 30,</u> <u>2006</u> | <u>December 31,</u> <u>2005</u> |
| ASSETS | | |
| Current assets: | | |
| Cash and short-term investments | 92,169 | 31,483 |
| Cash held in escrow (Note 3) | 8,197 | - |
| Accounts and notes receivable | 13,996 | 12,291 |
| Prepaid expenses | 4,259 | 3,484 |
| Inventories | 3,156 | 3,150 |
| Assets of discontinued operations (Note 4) | 232 | 188 |
| Property under development (Note 3) | 3,471 | 37,908 |
| Future income taxes | 824 | 3,100 |
| | <u>126,304</u> | <u>91,604</u> |
| Restricted cash | 5,935 | 6,033 |
| Long-term notes receivable | 62 | 190 |
| Capital assets (Note 5) | 310,387 | 314,102 |
| Property held for sale (Notes 4 and 13) | 2,704 | 2,704 |
| Deferred debt issuance costs | 7,806 | 6,371 |
| | <u>453,198</u> | <u>421,004</u> |
| LIABILITIES AND UNITHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | 21,973 | 22,905 |
| Equity distributions payable | 1,030 | 924 |
| Interest accrued on convertible debentures | 3,063 | 2,429 |
| Mortgages (Note 6) | 3,036 | 18,304 |
| Convertible debentures (Notes 7 and 9) | 38,493 | - |
| Obligations under capital leases (Note 8) | 375 | 443 |
| Other liabilities | 1,677 | 2,086 |
| Liabilities of discontinued operations (Note 4) | 35 | 58 |
| | <u>69,682</u> | <u>47,149</u> |
| Mortgages (Note 6) | 124,611 | 126,922 |
| Convertible debentures (Notes 7 and 9) | 151,632 | 133,052 |
| Obligations under capital leases (Note 8) | 332 | 660 |
| Deferred revenue | 318 | 639 |
| Future income taxes | 7,706 | 9,041 |
| | <u>354,281</u> | <u>317,463</u> |
| Minority interest (Note 3) | - | 8,591 |
| Unitholders' equity (Notes 9 and 11) | 98,917 | 94,950 |
| | <u>453,198</u> | <u>421,004</u> |

See accompanying Notes to the Interim Consolidated Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Net Earnings

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

(unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2006 | September 30, 2005 | September 30, 2006 | September 30, 2005 |
| Hospitality revenue | | | | |
| Rooms | 31,131 | 30,317 | 80,654 | 77,478 |
| Food and beverage | 6,290 | 6,110 | 19,266 | 18,937 |
| Other | 5,231 | 4,811 | 13,738 | 12,896 |
| | <u>42,652</u> | <u>41,238</u> | <u>113,658</u> | <u>109,311</u> |
| Hospitality expenses | <u>26,899</u> | <u>26,393</u> | <u>78,156</u> | <u>76,438</u> |
| | <u>15,753</u> | <u>14,845</u> | <u>35,502</u> | <u>32,873</u> |
| Royal Private Residence Club (Note 3) | | | | |
| Revenue | 52,245 | - | 52,245 | - |
| Cost of sales | 43,518 | - | 43,518 | - |
| | <u>8,727</u> | <u>-</u> | <u>8,727</u> | <u>-</u> |
| Gross margin | <u>24,480</u> | <u>14,845</u> | <u>44,229</u> | <u>32,873</u> |
| Other expenses | | | | |
| Trust administration | 451 | 433 | 1,563 | 1,615 |
| Interest on mortgages and capital leases | 2,398 | 3,092 | 7,445 | 9,661 |
| Interest on convertible debentures | 2,672 | 1,605 | 7,630 | 4,853 |
| Depreciation and amortization | 3,889 | 3,790 | 11,534 | 11,306 |
| Property impairment provision (Note 10) | - | 590 | - | 980 |
| Future income taxes | 1,055 | 1,627 | 1,055 | 1,271 |
| Capital and other taxes | 80 | 49 | 268 | 155 |
| Loss on foreign currency translation | 3 | 131 | 83 | 114 |
| | <u>10,548</u> | <u>11,317</u> | <u>29,578</u> | <u>29,955</u> |
| Earnings from continuing operations | <u>13,932</u> | <u>3,528</u> | <u>14,651</u> | <u>2,918</u> |
| Earnings (loss) from discontinued operations (Note 4) | <u>7</u> | <u>81</u> | <u>(149)</u> | <u>(242)</u> |
| Net earnings | <u>13,939</u> | <u>3,609</u> | <u>14,502</u> | <u>2,676</u> |
| Basic per unit net earnings (loss) (Note 11) | | | | |
| - from continuing operations | 0.54 | 0.13 | 0.56 | 0.10 |
| - from discontinued operations | - | - | (0.01) | (0.01) |
| | <u>0.54</u> | <u>0.13</u> | <u>0.55</u> | <u>0.09</u> |
| Diluted per unit net earnings (loss) (Note 11) | | | | |
| - from continuing operations | 0.32 | 0.13 | 0.46 | 0.10 |
| - from discontinued operations | - | - | - | (0.01) |
| | <u>0.32</u> | <u>0.13</u> | <u>0.46</u> | <u>0.09</u> |

See accompanying Notes to the Interim Consolidated Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Unitholders' Equity

in \$000's

(unaudited)

| | Trust Units | Convertible Equity | Contributed Surplus | Accumulated Earnings | Distributions | Total |
|---|----------------|-----------------------|------------------------|-------------------------|------------------|----------------|
| Balance, December 31, 2004 | 202,037 | 27,500 | 89 | 8,072 | (127,091) | 110,607 |
| Net earnings | - | - | - | 2,676 | - | 2,676 |
| Equity distributions | | | | | | |
| Trust units | - | - | - | - | (7,292) | (7,292) |
| Redeemable partnership units | - | - | - | - | (378) | (378) |
| 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 | 255 | - | - | - | - | 255 |
| Employee loans pursuant to employee unit purchase program | - | - | 13 | - | - | 13 |
| Trust units cancelled pursuant to normal course issuer bid | (901) | - | 360 | - | - | (541) |
| Trust units repurchased pursuant to normal course issuer bid | (2,242) | - | - | - | - | (2,242) |
| Balance, September 30, 2005 | 224,234 | - | 462 | 10,748 | (134,761) | 100,683 |
| Net earnings | - | - | - | (330) | - | (330) |
| Equity distributions | | | | | | |
| Trust units | - | - | - | - | (2,752) | (2,752) |
| Issuance of trust units pursuant to distribution reinvestment plan | 2 | - | - | - | - | 2 |
| Trust units cancelled pursuant to normal course issuer bid (Note 9) | (5,410) | - | 2,353 | - | - | (3,057) |
| Trust units repurchased pursuant to normal course issuer bid (Note 9) | (1,270) | - | - | - | - | (1,270) |
| Employee loans pursuant to employee unit purchase program | - | - | 9 | - | - | 9 |
| Restatement of convertible debenture issuance costs | (15) | - | - | - | - | (15) |
| Conversion option related to issued convertible debentures | - | 1,680 | - | - | - | 1,680 |
| Balance, December 31, 2005 | 217,541 | 1,680 | 2,824 | 10,418 | (137,513) | 94,950 |
| Net earnings | - | - | - | 14,502 | - | 14,502 |
| Equity distributions | | | | | | |
| Trust units | - | - | - | - | (9,004) | (9,004) |
| Issuance of trust units pursuant to distribution reinvestment plan | 9 | - | - | - | - | 9 |
| Trust units cancelled pursuant to normal course issuer bid (Note 9) | (5,441) | - | 2,076 | - | - | (3,365) |
| Employee loans pursuant to employee unit purchase program | 22 | - | 3 | - | - | 25 |
| Conversion option related to issued convertible debentures | - | 1,800 | - | - | - | 1,800 |
| Balance, September 30, 2006 | 212,131 | 3,480 | 4,903 | 24,920 | (146,517) | 98,917 |

See accompanying Notes to the Interim Consolidated Financial Statements

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Cash Flows

in \$000's

(unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|--|-----------------------|--|
| | September 30, 2006 | September 30, 2005 (Restated - Note 13) | September 30, 2006 | September 30, 2005 (Restated - Note 13) |
| Operating activities | | | | |
| Net earnings from continuing operations | 13,932 | 3,528 | 14,651 | 2,918 |
| Items not affecting cash: | | | | |
| Depreciation and amortization | 3,889 | 3,790 | 11,534 | 11,306 |
| Future income taxes | 1,055 | 1,627 | 1,055 | 1,271 |
| Property impairment provision | - | 590 | - | 980 |
| Accretion of convertible debentures | 31 | - | 92 | - |
| Funds from continuing operations | 18,907 | 9,535 | 27,332 | 16,475 |
| Funds from discontinued operations | 7 | 27 | (149) | (315) |
| Changes in non-cash working capital (Note 12) | (330) | 2,211 | (3,640) | (3,372) |
| Decrease (increase) in property under development | 40,779 | (4,800) | 33,247 | (13,826) |
| Increase in cash held in escrow | (8,197) | - | (8,197) | - |
| | 51,166 | 6,973 | 48,593 | (1,038) |
| Financing activities | | | | |
| Principal repayments on mortgages and capital leases | (8,247) | (1,444) | (17,976) | (12,342) |
| Equity distributions | (3,074) | (2,480) | (8,864) | (6,968) |
| Repurchase of trust units pursuant to normal course issuer bid | (2,021) | (2,242) | (3,365) | (2,783) |
| Repurchase of convertible debentures pursuant to normal course issuer bid | (419) | - | (1,219) | - |
| Issuance of convertible debentures | 60,000 | - | 60,000 | - |
| Debt issuance costs | (2,542) | - | (2,544) | (428) |
| Proceeds from the acquisition of mortgages | - | 4,023 | - | 26,426 |
| Redemption of redeemable partnership units | - | - | - | (2,415) |
| | 43,697 | (2,143) | 26,032 | 1,490 |
| Investing activities | | | | |
| Acquisition of capital assets | (3,370) | (2,286) | (6,025) | (5,350) |
| (Increase) decrease in restricted cash | (674) | (461) | 98 | (2,165) |
| Net cash from sale of capital assets | - | - | 451 | 10,048 |
| Decrease (increase) in long-term notes receivable | 27 | 96 | 128 | (1,777) |
| (Decrease) increase in minority interest | (8,599) | 346 | (8,591) | 610 |
| | (12,616) | (2,305) | (13,939) | 1,366 |
| Increase in cash and short-term investments | 82,247 | 2,525 | 60,686 | 1,818 |
| Cash and short-term investments, beginning of period | 9,922 | 8,000 | 31,483 | 8,707 |
| Cash and short-term investments, end of period | 92,169 | 10,525 | 92,169 | 10,525 |
| Cash interest paid | | | | |
| Mortgages and capital leases | 2,318 | 3,301 | 7,769 | 9,818 |
| Convertible debentures | 1,791 | 1,850 | 6,864 | 5,083 |
| | 4,109 | 5,151 | 14,633 | 14,901 |

See accompanying Notes to the Interim Consolidated Financial Statements

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.

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. ROYAL PRIVATE RESIDENCE CLUB

A subsidiary of Royal Host is participating in a joint venture to develop the Royal Private Residence Club, a residential condominium development, on a portion of the property at the Grand Okanagan Lakefront Resort and Conference Centre in Kelowna, British Columbia for resale. Royal Host proportionately consolidates its interest in the joint venture.

During the three months ended September 30, 2006, Royal Host completed construction and commenced closings of sales of condominiums. Revenue and cost of sales (including commissions and other selling costs) are recorded at the time each condominium is closed, and title and possession have been transferred to the buyer. Revenue and cost of sales were recognized on 92% of the condominiums during the three months ended September 30, 2006. Subsequent to September 30, 2006, sales of an additional 7.8% of the condominiums were closed.

The cash held in escrow on the consolidated balance sheet represents proceeds from the sales of condominiums held in trust by legal counsel. Subsequent to September 30, 2006, \$5.8 million of the cash held in escrow was received by Royal Host.

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 minority interest on the consolidated balance sheet 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. Royal Host provided a completion, cost overrun and debt service deficiency guarantee on the construction loan and a specific guarantee of payment of notes receivable from the limited partners. During the six months ended June 30, 2006, the \$8.0 million mezzanine loan was repaid in full. During the three months ended September 30, 2006, the amount drawn on the construction loan of \$7.4 million was repaid in full.

Property under development includes \$0.2 million of capitalized interest as at September 30, 2006 (December 31, 2005 - \$1.3 million).

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

*(unaudited)***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, and as a result, this property's operations have been included in discontinued operations on the consolidated statements of net earnings.

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.

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.

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | <i>(in \$000's)</i> | | <i>(in \$000's)</i> | |
| | September 30, 2006 | September 30, 2005 | September 30, 2006 | September 30, 2005 |
| Hospitality revenue | | | | |
| Rooms | 256 | 233 | 507 | 840 |
| Food and beverage | - | - | - | 169 |
| Other | 9 | 7 | 29 | 44 |
| | <u>265</u> | <u>240</u> | <u>536</u> | <u>1,053</u> |
| Hospitality expenses | <u>255</u> | <u>213</u> | <u>671</u> | <u>1,365</u> |
| Gross margin | <u>10</u> | <u>27</u> | <u>(135)</u> | <u>(312)</u> |
| Other expenses | | | | |
| (Gain) loss on foreign currency translation | - | - | 11 | (4) |
| Future income taxes (recovery) | - | (83) | - | (382) |
| Depreciation and amortization | - | 3 | - | 83 |
| Property impairment provision (recovery) | - | - | - | (21) |
| Capital and other taxes | 3 | - | 2 | 5 |
| Interest on capital leases | - | - | 1 | 2 |
| (Gain) loss on disposition | - | 26 | - | 247 |
| | <u>3</u> | <u>(54)</u> | <u>14</u> | <u>(70)</u> |
| Earnings (loss) from discontinued operations | <u>7</u> | <u>81</u> | <u>(149)</u> | <u>(242)</u> |

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

*(unaudited)***5. CAPITAL ASSETS**

| | <i>(in \$000's)</i> | | |
|---|-----------------------------|-------------------------------------|---------------------------|
| | <u>Gross Book Value</u> | <u>Accumulated Amortization</u> | <u>Net Book Value</u> |
| September 30, 2006 | | | |
| Buildings | 317,727 | 69,047 | 248,680 |
| Land | 37,799 | - | 37,799 |
| Furniture, fixtures, and equipment | 48,865 | 39,542 | 9,323 |
| Other | 2,914 | 377 | 2,537 |
| | <u>407,305</u> | <u>108,966</u> | <u>298,339</u> |
| Capital assets under development | 3,270 | - | 3,270 |
| Intangible assets: | | | |
| Franchise rights and management contracts | 27,414 | 18,636 | 8,778 |
| | <u>437,989</u> | <u>127,602</u> | <u>310,387</u> |
| | | | |
| | <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 |
| | <u>431,467</u> | <u>117,365</u> | <u>314,102</u> |

During the three and nine months ending September 30, 2006, respectively, capital additions to Royal Host's hotel properties totalled \$3.9 million (2005 - \$2.3 million) and \$7.2 million (2005 - \$5.1 million).

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

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

| | <i>(in \$000's)</i> | |
|---|-------------------------------|------------------------------|
| | <u>September 30, 2006</u> | <u>December 31, 2005</u> |
| Mortgages secured by hotel properties | 127,647 | 129,800 |
| Mortgages secured by property under development | - | 15,426 |
| | 127,647 | 145,226 |
| Less: current portion | 3,036 | 18,304 |
| | 124,611 | 126,922 |

Principal repayments required for the years ending September 30:

| | <u><i>(in \$000's)</i></u> |
|------------|----------------------------|
| 2007 | 3,036 |
| 2008 | 3,269 |
| 2009 | 3,502 |
| 2010 | 82,640 |
| 2011 | 11,994 |
| Thereafter | 23,206 |
| | <u>127,647</u> |

Debt issuance costs are deferred and amortized over the term of the related debt. During the three and nine months ended September 30, 2006, respectively, \$0.4 million (2005 - \$0.4 million) and \$1.1 million (2005 - \$1.1 million) was included in depreciation and amortization expense.

During the nine months ended September 30, 2006, an \$8.0 million mezzanine loan and a \$7.4 million construction loan secured by property under development were repaid.

7. CONVERTIBLE DEBENTURES

| | <i>(in \$000's)</i> | |
|---|-------------------------------|------------------------------|
| | <u>September 30, 2006</u> | <u>December 31, 2005</u> |
| 9.25% Convertible Unsecured Subordinated Debentures | 38,493 | 39,712 |
| 7.90% Convertible Unsecured Subordinated Debentures, Series A | 35,000 | 35,000 |
| 6.00% Convertible Unsecured Subordinated Debentures, Series B | 58,432 | 58,340 |
| 6.25% Convertible Unsecured Subordinated Debentures, Series C | 58,200 | - |
| | 190,125 | 133,052 |
| Less: current portion | 38,493 | - |
| | 151,632 | 133,052 |

The convertible debentures' maturity dates are as follows: the 9.25% debentures - March 1, 2007; the 7.90% debentures - April 30, 2009; the 6.00% debentures - October 31, 2015 and the 6.25% debentures - September 30, 2013.

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

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7. CONVERTIBLE DEBENTURES (continued)

In September 2006, \$60.0 million of convertible unsecured subordinated debentures were issued with a term of seven years. These debentures bear interest at 6.25% per annum and are payable semi-annually in arrears on March 31 and September 30 in each year commencing March 31, 2007.

The Series C debentures may not be redeemed by Royal Host prior to September 30, 2009. On or after September 30, 2009, but prior to September 30, 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 \$7.00 per unit. After September 30, 2011, but prior to the maturity date of September 30, 2013, 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 September 30, 2013, 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 \$7.00 per trust unit at any time from the date of issue to close of business on the day prior to the maturity date, September 30, 2013.

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, \$58.2 million was recorded as a long-term liability with the balance of \$1.8 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 seven year term, with the accretion being included in interest on convertible debentures on the consolidated statements of net earnings.

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 September 30, 2006 are as follows:

| | <i>(in \$000's)</i> | |
|--|-------------------------------|----------------------|
| | September 30, 2006 | December 31, 2005 |
| Present value of future minimum lease payments | 707 | 1,103 |
| Less: current portion of principal payments | 375 | 443 |
| | 332 | 660 |

Total repayments required for the years ending September 30:

| | <i>(in \$000's)</i> |
|--|---------------------|
| 2007 | 421 |
| 2008 | 341 |
| 2009 | 4 |
| Future minimum lease payments | 766 |
| Less: amounts representing interest | 59 |
| Present value of future minimum lease payments | 707 |

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

(unaudited)

9. NORMAL COURSE ISSUER BIDS

(a) Trust Units

Commencing on December 29, 2005, Royal Host initiated a normal course issuer bid to repurchase a maximum of 1.8 million of its issued and outstanding trust units. During the three months ended September 30, 2006, 331,500 trust units with an aggregate cost of \$2.0 million (average cost of \$6.07 per unit) were repurchased and cancelled. During the nine months ended September 30, 2006, 557,200 trust units with an aggregate cost of \$3.4 million (average cost of \$6.01 per unit) were repurchased and cancelled. Subsequent to September 30, 2006, 542,200 trust units with an aggregate cost of \$3.3 million (average cost of \$6.10 per unit) were repurchased.

(b) 9.25% Convertible Unsecured Subordinated Debentures

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 nine months ended September 30, 2006, Royal Host repurchased \$0.8 million of debentures (average cost of \$104.00 per debenture). As of June 30, 2006, Royal Host repurchased and cancelled \$1.1 million of debentures pursuant to this bid. The normal course issuer bid expired on July 15, 2006.

Commencing on July 17, 2006, Royal Host initiated a normal course issuer bid to repurchase up to \$3.9 million in principal of its issued and outstanding 9.25% convertible debentures. During the three and nine months ended September 30, 2006, Royal Host repurchased \$0.4 million of debentures (average cost of \$101.95). Subsequent to September 30, 2006, Royal Host repurchased \$0.5 million of debentures (average cost of \$101.82).

10. PROPERTY IMPAIRMENT PROVISION

During the third quarter of 2005, the Trust recorded a property impairment provision of \$0.6 million relating to a 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

*(unaudited)***11. PER UNIT CALCULATIONS**

As at September 30, 2006, a total of 25,547,581 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 (September 30, 2005 - \$378,000).

| For the three months ended September 30, 2006: | <u>Weighted Average Units (in 000's)</u> | <u>Per Unit (\$)</u> |
|---|--|--------------------------|
| <i>(in \$000's)</i> | | |
| Basic earnings - continuing operations | 13,932 | 0.54 |
| Basic earnings - discontinued operations | 7 | - |
| Basic earnings - total operations | <u>13,939</u> | <u>0.54</u> |
| Net earnings - continuing operations | 13,932 | |
| Add: interest on convertible debentures | 3,447 | |
| Diluted earnings - continuing operations | 17,379 | 0.32 |
| Diluted earnings - discontinued operations | 7 | - |
| Diluted earnings - total operations | <u>17,386</u> | <u>0.32</u> |
| | | |
| For the three months ended September 30, 2005: | <u>Weighted Average Units (in 000's)</u> | <u>Per Unit (\$)</u> |
| <i>(in \$000's)</i> | | |
| Basic earnings - continuing operations | 3,528 | 0.13 |
| Basic earnings - discontinued operations | 81 | - |
| Basic earnings - total operations | <u>3,609</u> | <u>0.13</u> |
| Net earnings - continuing operations | 3,528 | |
| Add: interest on convertible debentures | 697 | |
| Diluted earnings - continuing operations | 4,225 | 0.13 |
| Diluted earnings - discontinued operations | 81 | - |
| Diluted earnings - total operations | <u>4,306</u> | <u>0.13</u> |
| | | |
| For the nine months ended September 30, 2006: | <u>Weighted Average Units (in 000's)</u> | <u>Per Unit (\$)</u> |
| <i>(in \$000's)</i> | | |
| Basic earnings - continuing operations | 14,651 | 0.56 |
| Basic loss - discontinued operations | (149) | (0.01) |
| Basic earnings - total operations | <u>14,502</u> | <u>0.55</u> |
| Net earnings - continuing operations | 14,651 | |
| Add: interest on convertible debentures | 10,229 | |
| Diluted earnings - continuing operations | 24,880 | 0.46 |
| Diluted loss - discontinued operations | (149) | - |
| Diluted earnings - total operations | <u>24,731</u> | <u>0.46</u> |

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

*(unaudited)***11. PER UNIT CALCULATIONS** (continued)**For the nine months ended September 30, 2005:**

| | <i>(in \$000's)</i> | Weighted Average Units <i>(in 000's)</i> | Per Unit (\$) |
|--|---------------------|--|------------------|
| Net earnings - continuing operations | 2,918 | | |
| Less: distributions on redeemable partnership units | (378) | | |
| Basic and diluted earnings - continuing operations | 2,540 | | 0.10 |
| Basic and diluted loss - discontinued operations | (242) | | (0.01) |
| Basic and diluted earnings - total operations | 2,298 | 25,925 | 0.09 |
| Net earnings - continuing operations | 2,918 | | |
| Add: interest on convertible debentures | - | | |
| Diluted earnings - continuing operations | 2,918 | | 0.10 |
| Diluted loss - discontinued operations | (242) | | (0.01) |
| Diluted earnings - total operations | 2,676 | 25,925 | 0.09 |

12. CHANGES IN NON-CASH WORKING CAPITAL

| | Three Months Ended <i>(in \$000's)</i> | | Nine Months Ended <i>(in \$000's)</i> | |
|--|---|-----------------------|--|-----------------------|
| | September 30, 2006 | September 30, 2005 | September 30, 2006 | September 30, 2005 |
| (Increase) decrease in: | | | | |
| Accounts and notes receivable | (1,089) | (277) | (1,705) | (3,308) |
| Mortgage receivable | - | 3,800 | - | - |
| Prepaid expenses | 506 | 205 | (775) | (875) |
| Inventories | 34 | (13) | (6) | (79) |
| Assets of discontinued operations | 16 | 121 | (44) | (19) |
| | (533) | 3,836 | (2,530) | (4,281) |
| Increase (decrease) in: | | | | |
| Accounts payable and accrued liabilities | (239) | (856) | (877) | 2,427 |
| Interest accrued on convertible debentures | 842 | (246) | 634 | (230) |
| Other liabilities | (176) | (331) | (409) | (769) |
| Deferred revenue | (261) | 7 | (321) | 25 |
| Future income taxes | 57 | (190) | (114) | (190) |
| Liabilities of discontinued operations | (20) | (9) | (23) | (354) |
| | 203 | (1,625) | (1,110) | 909 |
| | (330) | 2,211 | (3,640) | (3,372) |

ROYAL HOST REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

(unaudited)

13. COMPARATIVE FIGURES AND RESTATEMENT

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

Royal Host's financial statements for the periods ended December 31, 2002 through June 30, 2006 included changes in property under development in cash from investing activities on Royal Host's Consolidated Statements of Cash Flows. Changes in property under development have been retroactively restated to be included in cash from operating activities. The effects of the restatement are as follows: cash from operating activities for the three and nine months ended September 30, 2005 decreased by \$4,800,000 to \$6,973,000 and decreased by \$13,826,000 to (\$1,038,000), respectively; and cash from investing activities for the three and nine months ended September 30, 2005 increased by \$4,800,000 to (\$2,305,000) and increased by \$13,826,000 to \$1,366,000, respectively.

Royal Host's financial statements for the periods ended June 30, 2004 through June 30, 2006 included property held for sale in current assets on its Consolidated Balance Sheets. Property held for sale has been retroactively restated to be included in long-term assets.