

# ROYAL HOST REAL ESTATE INVESTMENT TRUST

## Management's Discussion and Analysis



# 2007

FOR THE THREE AND SIX MONTHS  
ENDED JUNE 30, 2007

## *Highlights*

Royal Host delivered strong results from continuing operations in the second quarter of 2007. Highlights for the three months ended June 30, 2007 include:

- Basic per unit Cash Available for Distribution increased by 47.1% to \$0.25 per unit (2006 - \$0.17 per unit).
- Increased Income from Continuing Operations for the three months by \$4.1 million to \$6.3 million (2006 - \$2.2 million).
- Gross Margin growth of 9.0% to \$12.7 million, or 33.1% of hospitality revenue (2006 - \$11.6 million, or 30.9% of hospitality revenue), attributable to revenue growth and a reduction in hospitality expenses.
- Repurchased 0.7 million trust units with an aggregate cost of \$5.3 million (\$7.42 per unit) and \$2.3 million of convertible debentures pursuant to Normal Course Issuer Bids.
- Completed an offering of \$60 million, 5.90%, 7-year convertible debentures in June 2007.
- Ended the quarter with \$108.7 million of cash and marketable securities (December 31, 2006 - \$94.1 million).

**ROYAL HOST**<sup>®</sup>  
HOTELS & RESORTS<sup>REIT</sup>

## *Forward-looking* STATEMENTS

Certain statements in this Management's Discussion and Analysis ("MD&A"), including those in the "Business Environment and Outlook" section, relate to periods commencing after June 30, 2007 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 and the risks to which its business is subject is contained in its Annual Information Form, which is available at [www.sedar.com](http://www.sedar.com).

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### *Overview*

Royal Host's core businesses are hotel ownership, management and franchising in Canada. As at June 30, 2007, the Trust owned a diversified portfolio of 37 properties, comprising more than 4,500 guest rooms in the mid-market to upscale hospitality segments. Royal Host properties operate under such brands as Best Western®, Country Inns & Suites®, Hilton®, Holiday Inn®, Ramada®, Super 8®, Thriftlodge® and Travelodge®, as well as a number of unbranded properties such as the Chimo Hotel in Ottawa and the Grand Okanagan Resort and Conference Centre in Kelowna. In addition to providing management services for its own portfolio, Royal Host manages a number of properties on behalf of third parties.

Royal Host owns the master franchise rights for Travelodge® and Thriftlodge® in Canada, of which there are over 100 franchise locations, including 15 owned by the Trust.

Royal Host Units and Convertible Debentures are traded on the Toronto Stock Exchange under the trading symbols "RYL.UN", "RYL.DB.A", "RYL.DB.B", "RYL.DB.C" and "RYL.DB.D", respectively.

## *Management's Discussion and Analysis* *for the three and six months ended June 30, 2007.*

This MD&A dated August 8, 2007 is the responsibility of Management. The Trustees carry out their responsibility for review of this MD&A principally through their 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 six months ended June 30, 2007 and the annual consolidated financial statements and accompanying Management's Discussion and Analysis for the year ended December 31, 2006. The unaudited interim Consolidated Financial Statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

## *Selected* **FINANCIAL INFORMATION**

(\$000's, except as otherwise noted)	Three months ended June 30			Six months ended June 30		
	2007	2006	Change (%)	2007	2006	Change (%)
Hospitality Revenue (Continuing Operations)						
Rooms	27,336	26,966	1.4	49,778	49,523	0.5
Food and Beverage	7,320	7,207	1.6	13,155	12,976	1.4
Franchising and Management	550	556	(1.1)	1,337	973	37.4
Other	3,037	2,928	3.7	5,695	5,355	6.4
Total	38,243	37,657	1.6	69,965	68,827	1.7
Hospitality Expenses	25,576	26,035	(1.8)	50,106	50,098	-
Hospitality Gross Margin	12,667	11,622	9.0	19,859	18,729	6.0
Hospitality Gross Margin %	33.1	30.9		28.4	27.2	
Income (Loss) From Continuing Operations	6,282	2,175		4,505	(45)	
Income From Discontinued Operations	36	415		4,161	609	
NET INCOME	6,318	2,590		8,666	564	
Basic Per Unit Net Earnings (\$)						
From Continuing Operations	0.24	0.08		0.18	-	
From Discontinued Operations	-	0.02		0.16	0.02	
	0.24	0.10		0.34	0.02	
Cash Available For Distribution	6,544	5,196	26.0	7,512	5,770	30.2
Distributions Declared on Trust Units	4,361	3,079	41.6	8,502	5,921	43.6
Basic Per Unit Cash Available For Distribution (\$)	0.25	0.17	47.1	0.30	0.22	36.4
Per Unit Distributions Declared (\$)	0.165	0.12	37.5	0.325	0.23	41.3
Weighted Average Number of Trust Units Outstanding (000's)	25,938	25,890		25,405	26,062	
Number of Trust Units Outstanding (June 30) (000's)	26,368	25,878				
Closing Trust Unit Trading Price (June 30) (\$)	7.35	6.03				

As at August 8, 2007 Royal Host had 26,056,461 trust units outstanding.

## 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 or cash flows from operations 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: Revenue per Available Room ("RevPAR"), Average Daily Rate ("ADR"), Occupancy, Cash Available for Distribution (and Basic and Diluted per Unit Cash Available for Distribution), Funds from Operations, Adjusted Funds from Operations and Gross Margin.

## 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 and operating performance:

- **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 period into the room revenue in the same period;
- **Occupancy**, which measures the level of hotel room utilization and is calculated by dividing the number of rooms rented in a given period by the number of rooms available in the same period; and
- **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 in a given period.

## CASH AVAILABLE FOR DISTRIBUTION, FUNDS FROM OPERATIONS AND ADJUSTED FUNDS FROM OPERATIONS

Cash Available for Distribution, Funds from Operations and Adjusted Funds from Operations are non-GAAP financial measures commonly used by hotel real estate investment trusts. As a "non-GAAP" measure, no standards exist for the calculation of Cash Available for Distribution and reporting practices vary widely.

The policies of the Canadian Securities Administrators and the July 6, 2007 Interpretive Release issued by the Canadian Institute of Chartered Accountants consider distributable cash (Cash Available for Distribution) a cash flow measure and, as such, require that it be reconciled to Cash Flows from Operating Activities. The Trust has conformed to this guidance and presented this calculation in this manner.

The Trust calculates Funds from Operations and Adjusted Funds from Operations, as defined by the Real Property Association of Canada.

## Room Statistics – Total

CONTINUING OPERATIONS (4,423 rooms)	Three months ended June 30			Six months ended June 30		
	2007	2006	Change %	2007	2006	Change (%)
<b>RevPAR</b>	<b>\$68.45</b>	<b>\$66.81</b>	<b>2.5</b>	<b>\$62.29</b>	<b>\$61.45</b>	<b>1.4</b>
Occupancy	66.7%	67.7%	(1.5)	62.6%	64.5%	(2.9)
ADR	\$102.65	\$98.71	4.0	\$99.53	\$95.24	4.5

RevPAR from continuing operations improved by 2.5% to \$68.45 in the second quarter of 2007 (2006 - \$66.81). The increase resulted from a \$3.94, or 4.0%, increase in ADR, offset by a 1.5% decrease in Occupancy. RevPAR from continuing operations improved by 1.4% to \$62.29 during the first half of 2007 (2006 - \$61.45). ADR increased by \$4.29, or 4.5%, offset by a 2.9% decrease in Occupancy. Growth was attributable in the majority of markets to increased ADR, as opposed to Occupancy. The improvement in ADR reflects the success of the Trust's yield management strategies.

## Room Statistics – By Region (Continuing Operations)

ONTARIO (57.2% of rooms revenue/2,554 rooms)	Three months ended June 30			Six months ended June 30		
	2007	2006	Change (%)	2007	2006	Change (%)
<b>RevPAR</b>	<b>\$66.04</b>	<b>\$66.84</b>	<b>(1.2)</b>	<b>\$62.52</b>	<b>\$63.44</b>	<b>(1.5)</b>
Occupancy	66.1%	68.0%	(3.0)	62.6%	64.8%	(3.4)
ADR	\$99.87	\$98.25	1.6	\$99.85	\$97.87	2.0

RevPAR decreased by 1.2% to \$66.04 in the second quarter of 2007 (2006 - \$66.84). ADR improved by 1.6% to \$99.87 from \$98.25 in 2006. Occupancy decreased by 3.0% to 66.1% from 68.0% in 2006. Ontario's hospitality industry experienced a relatively weak first half due, in part, to a downturn among key economic drivers in Central Canada, reduced US leisure travel and the introduction of new competition in some markets. In spite of this, a number of properties including the Travelodge Ottawa West, Travelodge Burlington on the Lake, and Super 8 Sudbury produced particularly strong results.

RevPAR decreased by 1.5% to \$62.52 in the first half of 2007 (2006 - \$63.44). ADR increased by \$1.98, or 2.0%, offset by a 3.4% decrease in Occupancy.

WESTERN (36.8% of rooms revenue / 1,593 rooms)	Three months ended June 30			Six months ended June 30		
	2007	2006	Change (%)	2007	2006	Change (%)
<b>RevPAR</b>	<b>\$72.45</b>	<b>\$67.13</b>	<b>7.9</b>	<b>\$62.45</b>	<b>\$59.24</b>	<b>5.4</b>
Occupancy	65.7%	65.3%	0.6	61.0%	62.8%	(2.9)
ADR	\$110.24	\$102.82	7.2	\$102.39	\$94.26	8.6

RevPAR increased by 7.9% to \$72.45 in the second quarter of 2007 (2006 - \$67.13). ADR improved by 7.2% to \$110.24 from \$102.82 in 2006. Occupancy increased by 0.6% to 65.7% from 65.3% in 2006. The Holiday Inn (The Palace) in Edmonton, and the Best Western Village Park Inn in Calgary continued to produce record results and the Grand Okanagan Resort and Conference Centre, the Yellowknife Inn and the Trust's properties in Winnipeg, Regina, and Saskatoon each delivered very strong performances. The Travelodge Fort Nelson and the Trust's Southern Alberta limited service hotels experienced lower Occupancy.

RevPAR increased by 5.4% to \$62.45 in the first half of 2007 (2006 - \$59.24). ADR increased by \$8.13, or 8.6%, offset by a 2.9% decrease in Occupancy.

ATLANTIC (6.0% of rooms revenue / 276 rooms)	Three months ended June 30			Six months ended June 30		
	2007	2006	Change (%)	2007	2006	Change (%)
<b>RevPAR</b>	<b>\$66.17</b>	<b>\$64.76</b>	<b>2.2</b>	<b>\$59.24</b>	<b>\$57.31</b>	<b>3.4</b>
Occupancy	72.6%	73.2%	0.8	66.8%	66.8%	-
ADR	\$91.14	\$88.47	3.0	\$88.62	\$85.76	3.3

The Trust's Atlantic region generated positive results in each of the first and second quarters of 2007. In particular, the Country Inns & Suites in New Glasgow and Dartmouth produced notable increases in both Occupancy and ADR.

# Cash Available FOR DISTRIBUTION

(\$000's, except as otherwise noted)	Three months ended June 30			Six months ended June 30		
	2007	2006	Change (%)	2007	2006	Change (%)
<b>Cash Flows from Operating Activities</b>	<b>4,951</b>	<b>483</b>		<b>6,767</b>	<b>(2,566)</b>	
Changes in Non-Cash Working Capital	3,030	1,676		4,813	3,312	
Changes in Investment in PRC	(51)	4,392		(1,551)	7,532	
Changes in Minority Interest	-	12		-	(8)	
<b>Cash Flows from Total Operations</b>	<b>7,930</b>	<b>6,563</b>	<b>20.8</b>	<b>10,029</b>	<b>8,270</b>	<b>21.3</b>
Provision for Capital Replacement	(1,386)	(1,367)		(2,517)	(2,500)	
<b>Cash Available for Distribution</b>	<b>6,544</b>	<b>5,196</b>	<b>26.0</b>	<b>7,512</b>	<b>5,770</b>	<b>30.2</b>
<b>Distributions Declared</b>	<b>4,361</b>	<b>3,079</b>	<b>41.6</b>	<b>8,502</b>	<b>5,921</b>	<b>43.6</b>
<b>Basic Per Unit Cash Available For Distribution (\$)</b>	<b>0.25</b>	<b>0.17</b>	<b>47.1</b>	<b>0.30</b>	<b>0.22</b>	<b>36.4</b>
<b>Diluted Per Unit Cash Available For Distribution (\$)</b>	<b>0.20</b>	<b>0.16</b>	<b>25.0</b>	<b>0.30</b>	<b>0.22</b>	<b>36.4</b>
<b>Per Unit Distributions Declared (\$)</b>	<b>0.165</b>	<b>0.12</b>	<b>37.5</b>	<b>0.325</b>	<b>0.23</b>	<b>41.3</b>

Cash Available for Distribution is calculated by deducting a provision for capital replacement from cash flows from total operations. 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 \$1.4 million (2006 - \$1.4 million), and \$2.5 million (2006 - \$2.5 million) for the three and six months ended June 30, 2007 respectively. Cash Available for Distribution for the three months ended June 30, 2007 increased to \$6.5 million, or \$0.25 per unit (2006 - \$5.2 million, or \$0.17 per unit). Cash Available for Distribution for the six months ended June 30, 2007 increased to \$7.5 million, or \$0.30 per unit (2006 - \$5.8 million, or \$0.22 per unit).

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 Trustees determine 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 necessarily equal cash available for distribution in any interim financial period.

During the three months ended June 30, 2007, the Trust declared distributions on trust units of \$4.4 million, an increase of 41.6% (2006 - \$3.1 million). During the six months ended June 30, 2007, the Trust declared distributions on trust units of \$8.5 million, an increase of 43.6% (2006 - \$5.9 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.

The Trust increased monthly distributions from \$0.05 per unit to \$0.055 per unit, or \$0.66 per unit annually, effective for the February 2007 distribution.

Royal Host made various cash outlays in addition to distributions. During the three months ended June 30, 2007, the Trust made total debt principal repayments of \$0.9 million and spent \$1.8 million on capital investment, which it funded from cash from operations and restricted cash. The Trust also spent \$5.3 million repurchasing trust units and \$2.8 million repurchasing convertible debentures pursuant to its Normal Course Issuer Bids ("NCIBs").

During the six months ended June 30, 2007, the Trust deployed \$32.5 million in cash in connection with the maturity of its 9.25% convertible debentures in March 2007. The Trust also made total debt principal repayments of \$1.8 million, spent \$4.9 million on capital investment, and spent \$8.3 million repurchasing trust units and \$3.1 million repurchasing convertible debentures.

# *Funds* FROM OPERATIONS AND *Adjusted Funds* FROM OPERATIONS

(\$000's, except as otherwise noted)	Three months ended June 30			Six months ended June 30		
	2007	2006	Change (%)	2007	2006	Change (%)
<b>Cash Flows provided by Total Operations</b>	<b>7,930</b>	<b>6,563</b>	<b>20.8</b>	<b>10,029</b>	<b>8,270</b>	<b>21.3</b>
Accretion on mortgages and convertible debentures	(445)	(369)		(1,027)	(738)	
<b>Funds From Operations</b>	<b>7,485</b>	<b>6,194</b>	<b>20.9</b>	<b>9,002</b>	<b>7,532</b>	<b>19.5</b>
Provision for Capital Replacement	(1,386)	(1,367)		(2,517)	(2,500)	
<b>Adjusted Funds From Operations</b>	<b>6,099</b>	<b>4,827</b>	<b>26.4</b>	<b>6,485</b>	<b>5,032</b>	<b>28.9</b>

During the three and six months ended June 30, 2007, the Trust generated Funds from Operations of \$7.5 million, or \$0.29 per unit (2006 - \$6.2 million, or \$0.24 per unit) and \$9.0 million, or \$0.35 per unit (2006 - \$7.5 million or \$0.29 per unit), respectively. Funds from Operations reflects the adjustment for the deduction of accretion of convertible debentures and mortgages, of \$0.4 million (2006 - \$0.4 million), and \$1.0 million (2006 \$0.7 million) for the three and six months ended June 30, 2007. Debt issuance costs are accreted over the term of the related debt. Adjusted Funds from Operations is calculated by deducting the Trust's provision for capital replacement from Funds from Operations. Adjusted Funds from Operations was \$6.1 million, or \$0.24 per unit (2006 - \$4.8 million, or \$0.19 per unit) and \$6.5 million, or \$0.26 per unit (2006 - \$5.0 million, or \$0.19 per unit) for the three and six months ended June 30, 2007, respectively.

## *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 JUNE 30, 2007 (Continuing Operations)

(\$000's, except as otherwise noted)	For the three months ended June 30			
	2007	2006	Change	Change (%)
Hospitality Revenue	38,243	37,657	586	1.6
Hospitality Expenses	25,576	26,035	(459)	(1.8)
Gross Margin	12,667	11,622	1,045	9.0
Other Expenses	6,385	9,447	(3,062)	(32.4)
Income from Continuing Operations	6,282	2,175	4,107	188.8

## *Hospitality* REVENUE

Hospitality revenue from continuing operations for the three months ended June 30, 2007 increased by \$0.6 million to \$38.2 million (2006 - \$37.7 million).

<i>(\$000's, except as otherwise noted)</i>	For the three months ended June 30			
	2007	2006	Change	Change (%)
<b>Revenue</b> (continuing operations)				
Rooms	27,336	26,966	370	1.4
Food and Beverage	7,320	7,207	113	1.6
Franchising and Management	550	556	(6)	-
Other	3,037	2,928	109	3.7
	<b>38,243</b>	<b>37,657</b>	<b>586</b>	<b>1.6</b>

Rooms revenue increased by \$0.4 million, or 1.4%, to \$27.3 million (2006 - \$27.0 million). The Travelodge Ottawa West, the Holiday Inn (The Palace), the Best Western Village Park Inn, and in particular, the Super 8 Regina, the Yellowknife Inn, and the Grand Okanagan Resort and Conference Centre, produced particularly strong results. The Trust's yield management strategies contributed to producing a 4.0% increase in ADR during the quarter.

Food and beverage revenue increased modestly to \$7.3 million (2006 - \$7.2 million), and franchising and management revenue was unchanged at \$0.6 million (2006 - \$0.6 million).

Other revenue increased 3.7% to \$3.0 million (2006 - \$2.9 million), and includes revenue from telephone, retail sales, tenant lease, parking, and other minor operated departments.

## *Hospitality* EXPENSES

<i>(\$000's, except as otherwise noted)</i>	For the three months ended June 30			
	2007	2006	Change	Change (%)
<b>Hospitality Expenses</b>	25,576	26,035	(459)	(1.8)

Total hospitality expenses decreased by \$0.5 million, or 1.8%, to \$25.6 million (2006 - \$26.0 million). Operating expenses decreased as a percentage of revenue to 66.9% (2006 - 69.1%). As described above, revenue growth was attributable to ADR. Payroll, the largest component of hospitality expenses, is proportionate to Occupancy, and continued to be well controlled. The Trust employs proactive energy cost management strategies, which resulted in utility costs being unchanged from 2006.

## *Hospitality* GROSS MARGIN

<i>(\$000's, except as otherwise noted)</i>	For the three months ended June 30			
	2007	2006	Change	Change (%)
<b>Hospitality Gross Margin</b>	12,667	11,622	1,045	9.0

Hospitality gross margin increased by \$1.0 million, or 9.0%, to \$12.7 million in 2007 (2006 - \$11.6 million). Gross margin as a percentage of revenue improved to 33.1% (2006 - 30.9%) due, in part, to room rate yield despite lower Occupancy.

## ROYAL PRIVATE PRESIDENCE CLUB

During the three months ended June 30, 2007, sales of the final 0.2% of the condominiums were closed, bringing cumulative sales to 100%. During the three months ended June 30, 2007, the Trust recognized revenue from the sale of condominiums of \$0.2 million and cost of sales of \$0.2 million.

## OTHER EXPENSES

As described under “Changes in Accounting Policies”, commencing on January 1, 2007, interest on convertible debentures, mortgages and capital leases includes accretion of debt issuance costs. Interest on mortgages and capital leases for the three months ended June 30, 2007 decreased by \$0.1 million to \$2.6 million despite the recognition of \$0.1 million of accretion of debt issuance costs (2006 - \$nil) related to mortgages. Interest on convertible debentures for the three months ended June 30, 2007 increased by \$0.8 million as a result of: incremental indebtedness from the issuance of \$60 million of convertible debentures in September 2006; the maturity of the 9.25% convertible debentures in March 2007; the recognition of \$0.1 million (2006 - \$nil) of accretion of convertible debentures conversion options and debt issuance costs of \$0.3 million (2006 - \$nil); and the recognition of \$0.3 million (2006 - \$nil) of premiums on repurchases of convertible debentures.

Interest and investment income increased to \$0.8 million (2006 - \$0.1 million), as a result of higher levels of cash on hand and an increase in overall investment rates. The Trust also generated realized gains on the sales of marketable securities of \$0.7 million (2006 - \$nil) and unrealized gains on marketable securities of \$1.1 million (2006 - \$nil).

Trust administration expenses decreased by \$0.1 million to \$0.4 million (2006 - \$0.5 million).

Depreciation and amortization was unchanged at \$3.8 million. In 2006, depreciation and amortization included \$0.4 million of amortization of deferred debt issuance costs related to mortgages and convertible debentures. In 2007, due to the aforementioned change in accounting policy, accretion of debt issuance costs is included in interest on convertible debentures, mortgages and capital leases.

## NET INCOME, OTHER COMPREHENSIVE LOSS AND COMPREHENSIVE INCOME

The Trust’s income from continuing operations for the three months ended June 30, 2007 was \$6.3 million (2006 - \$2.2 million). Income from discontinued operations was \$nil (2006 - \$0.4 million) and included the Trust’s timeshare and US hotel management businesses, in addition to the Sundial Inn, as described in “Discontinued Operations and Property Held For Sale”.

Net income was \$6.3 million (2006 - \$2.6 million). The Trust’s other comprehensive loss is attributable to unrealized gains on marketable securities classified as available-for-sale. Comprehensive income, the combination of net income and other comprehensive loss, was \$6.3 million (2006 - \$2.6 million) for the three months ended June 30, 2007.

## SIX MONTHS ENDED JUNE 30, 2007 (Continuing Operations)

(\$000’s, except as otherwise noted)	For the six months ended June 30			
	2007	2006	Change	Change (%)
Hospitality Revenue	69,965	68,827	1,138	1.7
Hospitality Expenses	50,106	50,098	8	-
Gross Margin	19,859	18,729	1,130	6.0
Other Expenses	15,354	18,774	(3,420)	(18.2)
Income from Continuing Operations	4,505	(45)	4,550	

## *Hospitality* REVENUE

Hospitality revenue from continuing operations for the six months ended June 30, 2007 increased by \$1.1 million to \$70.0 million (2006 - \$68.9 million).

<i>(\$000's, except as otherwise noted)</i>	For the six months ended June 30			
	2007	2006	Change	Change (%)
<b>Revenue</b> (continuing operations)				
Rooms	49,778	49,523	255	0.5
Food and Beverage	13,155	12,976	179	1.4
Franchising and Management	1,337	973	364	37.4
Other	5,695	5,355	340	6.4
	<u>69,965</u>	<u>68,827</u>	<u>1,138</u>	<u>1.7</u>

Rooms revenue increased by \$0.3 million, or 0.5%, to \$49.8 million (2006 - \$49.5 million). The Grand Okanagan Resort and Conference Centre, the Travelodge Ottawa West, the Yellowknife Inn, the Chimo Hotel, the Holiday Inn (The Palace) and the Best Western Village Park Inn produced particularly strong results, offset by lower rooms revenue at certain of the Trust's hotels as noted previously in "Rooms Statistics".

Food and beverage revenue increased by \$0.2 million to \$13.2 million (2006 - \$13.0 million).

Franchising and management revenue increased by \$0.4 million to \$1.3 million (2006 - \$1.0 million). Travelodge franchise fees increased relative to 2006 due largely to the receipt of termination fees in the first quarter of 2007.

Other revenue increased by \$0.3 million to \$5.7 million (2006 - \$5.4 million).

## *Hospitality* EXPENSES

<i>(\$000's, except as otherwise noted)</i>	For the six months ended June 30			
	2007	2006	Change	Change (%)
<b>Hospitality Expenses</b>	50,106	50,098	8	-

Total hospitality expenses was unchanged at \$50.1 million (2006 - \$50.1 million). Operating expenses decreased as a percentage of revenue to 71.6% (2006 - 72.8%) due, in part, to a decrease in payroll costs as a percentage of revenue.

## *Hospitality* GROSS MARGIN

<i>(\$000's, except as otherwise noted)</i>	For the six months ended June 30			
	2007	2006	Change	Change (%)
<b>Hospitality Gross Margin</b>	19,859	18,827	1,032	5.5

Hospitality gross margin increased by \$1.0 million, or 5.5%, to \$19.9 million in 2007 (2006 - \$18.8 million). Gross margin as a percentage of revenue improved to 28.4% (2006 - 27.2%).

## ROYAL PRIVATE PRESIDENCE CLUB

During the six months ended June 30, 2007, sales of 3.2% of the condominiums were closed and the Trust recognized revenue from the sale of condominiums of \$1.7 million and cost of sales of \$1.7 million.

## OTHER EXPENSES

As described under "Changes in Accounting Policies", commencing on January 1, 2007, interest on convertible debentures, mortgages and capital leases includes accretion of debt issuance costs. Interest on mortgages and

capital leases for the six months ended June 30, 2007 increased by \$0.1 million to \$5.5 million due to the recognition of \$0.2 million of accretion of debt issuance costs (2006 - \$nil) related to mortgages. Interest on convertible debenture for the months ended June 30, 2007 increased by \$1.5 million as a result of incremental indebtedness from the issuance of \$60 million of convertible debentures in September 2006; the recognition of accretion of convertible debentures' conversion options of \$0.2 million (2006 - \$nil) and debt issuance costs of \$0.6 million (2006 - \$nil); and the recognition of \$0.3 million (2006 - \$nil) of premiums on repurchases of convertible debentures; offset by the maturity of the 9.25% convertible debentures in March 2007.

Interest and investment income increased to \$1.8 million (2006 - \$0.3 million), attributable to higher levels of cash on hand and an increase in overall investment rates. The Trust also generated realized gains on marketable securities of \$0.7 million (2006 - \$nil) and unrealized gains on marketable securities of \$1.4 million (2006 - \$nil).

Trust administration expenses decreased by \$0.2 million to \$0.8 million (2006 - \$1.0 million).

Depreciation and amortization was unchanged at \$7.6 million. In 2006, depreciation and amortization included \$0.7 million of amortization of deferred debt issuance costs related to mortgages and convertible debentures. In 2007, due to the aforementioned change in accounting policy, accretion of debt issuance costs is included in interest on convertible debentures, mortgages and capital leases.

## **NET INCOME, OTHER COMPREHENSIVE LOSS AND COMPREHENSIVE INCOME**

The Trust's income from continuing operations for the six months ended June 30, 2007 was \$4.5 million (2006 - \$nil). Income from discontinued operations was \$4.2 million (2006 - \$0.6 million) and included the Trust's timeshare and US hotel management businesses, in addition to the Sundial Inn, as described further below.

Net income was \$8.7 million (2006 - \$0.6 million). The Trust's other comprehensive loss of \$0.1 million is attributable to unrealized gains on marketable securities classified as available-for-sale. Comprehensive income for the six months ended June 30, 2007 was \$8.6 million (2006 - \$0.6 million).

## ***Discontinued* OPERATIONS AND PROPERTY HELD FOR SALE**

The operations of properties and businesses that were disposed of during the six months ended June 30, 2007 or that are held for sale as at June 30, 2007 have been included in discontinued operations on the consolidated statements of net income and comprehensive income and reflected as assets and liabilities of discontinued operations and property held for sale on the consolidated balance sheets beginning in the year they are determined to be discontinued. Discontinued operations are comprised of: Royal Host's former US hotel management business sold effective January 1, 2007; Royal Host's former timeshare business sold effective December 31, 2006; and the 75-room Sundial Inn in Orillia, Ontario, for which Royal Host is seeking a buyer.

Royal Host periodically evaluates potential disposition of certain properties in the interest of maximizing Unitholder value. In June 2007, three properties were identified and a broker was engaged to conduct a competitive bidding process for each. Royal Host has not reached agreement on the price or terms of any potential disposition. The three properties are included in continuing operations on the consolidated statements of net earnings and reflected as assets and liabilities of continuing operations on the consolidated balance sheets.

## *Income* FROM DISCONTINUED OPERATIONS

(\$000's, except as otherwise noted)	Three months ended June 30		Six months ended June 30	
	2007	2006	2007	2006
Revenue	119	1,339	264	2,450
Operating expenses	176	753	356	1,641
Gross margin	(57)	586	(92)	809
Other expenses	(115)	171	(38)	200
Income (loss) before gain on disposition	58	415	(54)	609
Gain (loss) on disposition	(22)	-	4,215	-
<b>Income from discontinued operations</b>	<b>36</b>	<b>415</b>	<b>4,161</b>	<b>609</b>

Revenue from discontinued operations for the three and six months ended June 30, 2007 decreased to \$0.1 million (2006 - \$1.3 million) and \$0.3 million (2006 - \$2.5 million), respectively. The decreases were due primarily to the sale of the Trust's US hotel management business in the first quarter of 2007. Income from discontinued operations decreased to \$nil (2006 - \$0.4 million) for the three months and increased to \$4.2 million (2006 - \$0.6 million) for the six months due to the gain realized on the sale of the Trust's US hotel management business.

## *Liquidity* AND CAPITAL RESOURCES

As at June 30, 2007, the Trust had cash and cash equivalents of \$86.4 million (December 31, 2006 - \$92.1 million) and liquid marketable securities of \$22.4 million (December 31, 2006 - \$2.0 million). Marketable securities are comprised of publicly-traded debt and equity instruments.

As at June 30, 2007, the Trust also had restricted cash of \$3.8 million (December 31, 2006 - \$5.3 million) and undrawn credit facilities of \$12.0 million (December 31, 2006 - \$12.0 million). Restricted cash consists primarily of funds held by lenders pursuant to financing arrangements for future planned capital expenditures.

The Trust's 9.25% convertible debentures matured on March 1, 2007. Prior to maturity, \$5.6 million of convertible debentures were converted into 0.8 million trust units. The Trust repaid the remaining \$32.5 million principal balance of the debentures upon maturity.

On June 26, 2007, the Trust closed an offering of \$60 million aggregate principal amount of 5.90% convertible unsecured subordinated debentures due June 30, 2014. The offering provides Royal Host with capital at attractive terms to reduce outstanding indebtedness including its convertible debentures, to upgrade and reposition its hotels, for future acquisitions of hotels, and general trust purposes. The Trust is within its "safe harbour" growth limits described under "Taxation Changes to Income Trusts".

As Royal Host evaluates opportunities, it invests excess cash not required for operations in liquid income-earning marketable securities, currently including convertible debentures and trust units. As a result of the higher levels of cash invested in 2007 and improved investment yields, the Trust realized interest and investment income of \$0.8 million (2006 - \$0.1 million) and \$1.8 million (2006 - \$0.3 million), respectively, during the three and six months ended June 30, 2007.

As at June 30, 2007, Royal Host's debt (excluding convertible debentures) to gross book value was 21.9% (December 31, 2006 - 22.4%). Royal Host's debt (excluding convertible debentures) is limited by its Declaration of Trust to 45% of gross book value. As at June 30, 2007 Royal Host's debt (including convertible debentures) to gross book value was 56.6% (December 31, 2006 - 56.4%).

Royal Host's cash and marketable securities, together with its future cash flows, are expected to be sufficient to fund all anticipated cash requirements over the next year, including distributions, required debt repayments, planned capital investment and operating expenses.

## Contractual Obligations

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 June 30, 2007, the carrying value of the Trust's mortgages was \$124.0 million (December 31, 2006 - \$126.9). The carrying value reflects total outstanding principal of \$125.4 million (December 31, 2006 - \$126.9 million) less \$1.4 million of debt issuance costs. The \$2.9 million decrease is attributable to the classification of debt issuance costs effective January 1, 2007, and \$1.5 million of mortgage principal repayments made during the six months ended June 30, 2007.

(\$000's)	As at June 30, 2007						
	Total	2008	2009	2010	2011	2012	Thereafter
Mortgages	125,392	3,214	3,441	59,725	25,156	13,063	20,793
Capital Leases	842	475	131	81	81	74	-

### Convertible Debentures

(\$000's)	June 30, 2007	December 31, 2006	Maturity Date	Conversion Price
Current:				
9.25% Convertible Unsecured Subordinated	-	38,021	March 2007	\$7.00
Long-term:				
7.90% Convertible Unsecured Subordinated, Series A	23,297	35,000	April 2009	\$6.00
6.00% Convertible Unsecured Subordinated, Series B	52,940	58,464	October 2015	\$6.85
6.25% Convertible Unsecured Subordinated, Series C	55,416	58,225	September 2013	\$7.00
5.90% Convertible Unsecured Subordinated, Series D	57,338		June 2014	\$8.90
	188,991	151,689		

As described above, during the second quarter of 2007, the Trust closed an offering of \$60 million of 5.90% convertible unsecured subordinated debentures due June 30, 2014.

Royal Host's convertible debentures have a total outstanding balance at June 30, 2007 of \$199.7 million (December 31, 2006 - \$189.7 million). The carrying value of the convertible debentures as at June 30, 2007 is \$189.0 million, reflecting \$10.7 million of debt issuance costs and conversion options.

As at June 30, 2007, the average maturity of mortgages was 3.3 years, the average maturity of convertible debentures was 6.5 years, and the average maturity of mortgages and convertible debentures combined was 5.3 years. As at June 30, 2007, Royal Host's debt had an average overall interest rate of 7.02% (December 31, 2006 - 7.52%).

During the two months prior to maturity on March 1, 2007, \$5.6 million of the 9.25% convertible debentures were converted into 0.8 million trust units, and on March 1, 2007, the remaining \$32.5 million of the debentures were repaid and cancelled.

During the three months ended June 30, 2007, holders of the Trust's convertible debentures benefited from the strength in Royal Host's unit price performance and converted \$8.0 million of the 7.90% convertible debentures into 1.3 million trust units, and \$1.7 million of the 6.00% convertible debentures were converted into 0.2 million trust units.

During the six months ended June 30, 2007, \$10.2 million of the 7.90% convertible debentures were converted into 1.7 million trust units and \$2.2 million of the 6.00% convertible debentures were converted into 0.3 million trust units.

Subsequent to June 30, 2007, \$40,000 of the 7.90% convertible debentures were converted into 7,000 trust units and \$0.2 million of the 6.00% convertible debentures were converted into 29,342 trust units.

## **Distributions**

Distributions to Unitholders for the three months ended June 30, 2007 increased by \$1.3 million, or 41.6%, to \$4.4 million, and for the six months ended June 30, 2007 increased by \$2.6 million, or 43.6%, to \$8.5 million. Distributions were increased from \$0.035 to \$0.04 per unit effective April 2006 to \$0.05 per unit effective November 2006, and to \$0.055 per unit effective February 2007.

## **Investing Activities**

During the three months ended June 30, 2007, the Trust's capital expenditures totalled \$1.8 million (2006 - \$2.1 million) and included guest room renovations at the Ramada Hotel on the Bay in Belleville, Holiday Inn Oakville, Grand Okanagan Resort and Conference Centre and improvements at several other hotels. Capital expenditures utilized cash of \$1.8 million (2006 - \$1.5 million) in the quarter.

During the six months ended June 30, 2007, the Trust's capital expenditures totalled \$4.1 million (2006 - \$3.4 million) and utilized cash of \$4.9 million (2006 - \$2.8 million).

\$0.3 million and \$2.7 million were released from restricted cash during the three and six months ended June 30, 2007, respectively, for reimbursement of previous capital investment. Restricted cash, described above, is available for funding certain hotel capital expenditures.

## **Unitholders' Equity**

During the three months ended June 30, 2007, equity increased by \$6.4 million to \$98.4 million. The overall increase is attributable to comprehensive income of \$6.3 million, the conversion of \$9.5 million of convertible debentures into trust units, less \$4.4 million of declared distributions and \$5.3 million related to the repurchase of trust units under the Trust's Normal Course Issuer Bid (described below).

During the six months ended June 30, 2007, equity increased by \$11.2 million to \$98.4 million. The overall increase is attributable to comprehensive income of \$8.6 million, the conversion of \$17.8 million of convertible debentures into trust units, less \$8.5 million of declared distributions and \$7.3 million related to the repurchase of trust units under the Trust's Normal Course Issuer Bid.

As at June 30, 2007, 26,368,006 trust units were issued and outstanding, and as at August 8, 2007, 26,056,461 trust units were issued and outstanding.

## ***Normal* COURSE ISSUER BIDS**

Management believes that, from time to time, the market price of the Trust's securities may not fully reflect the underlying value of the securities and that at such times the purchase of the securities would be in the best interest of Royal Host.

### **Normal Course Issuer Bid – Trust Units**

Commencing on December 29, 2006, Royal Host initiated a Normal Course Issuer Bid ("NCIB") to repurchase a maximum of 2.0 million of its issued and outstanding trust units. During the three months ended June 30, 2007, 0.7 million trust units with an aggregate cost of \$5.3 million (average cost of \$7.42 per unit) were repurchased

pursuant to this NCIB. During the six months ended June 30, 2007, 1.0 million trust units with an aggregate cost of \$7.2 million (average cost of \$7.30 per unit) were repurchased. Subsequent to June 30, 2007, 0.5 million trust units with an aggregate cost of \$3.5 million (average cost of \$7.23 per unit) were repurchased pursuant to this NCIB.

Cumulatively to August 8, 2007, Royal Host has repurchased 3.3 million trust units pursuant to its NCIBs.

### Normal Course Issuer Bid – 7.90% Convertible Debenture

Commencing on November 23, 2006, Royal Host initiated an NCIB to repurchase up to \$3.5 million principal amount of its issued and outstanding 7.90% convertible debentures. During the three months ended June 30, 2007, Royal Host repurchased \$0.7 million in principal balance with an aggregate cost of \$0.8 million (average cost of \$122.97) of 7.90% debentures pursuant to this NCIB. During the six months ended June 30, 2007, Royal Host repurchased \$1.0 million in principal balance with an aggregate cost of \$1.2 million (average cost of \$121.13) of 7.9% debentures.

### Normal Course Issuer Bid – 6.00% Convertible Debenture

Commencing on March 30, 2007, Royal Host initiated an NCIB to repurchase up to \$5.9 million principal amount of its issued and outstanding 6.00% convertible debentures. During the three and six months ended June 30, 2007, Royal Host repurchased \$1.2 million in principal balance with an aggregate cost of \$1.3 million (average cost of \$108.22) of 6.00% debentures pursuant to this NCIB. Subsequent to June 30, 2007, \$0.4 million of debentures (average cost of \$105.94) were repurchased pursuant to this NCIB.

### Normal Course Issuer Bid – 6.25% Convertible Debenture

Commencing on March 30, 2007, Royal Host initiated an NCIB to repurchase up to \$6.0 million principal amount of its issued and outstanding 6.25% convertible debentures. During the three and six months ended June 30, 2007, Royal Host repurchased \$0.4 million in principal balance with an aggregate cost of \$0.5 million (average cost of \$106.29) of 6.25% debenture pursuant to this NCIB. Subsequent to June 30, 2007, \$25,000 of debentures (average cost of \$104.50) were repurchased pursuant to this NCIB.

## Summary OF QUARTERLY FINANCIAL RESULTS

	2007		2006				2005	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenue	38,420*	31,717*	37,468	93,653*	37,658	31,170	33,834	40,049
Net Income (Loss)								
From Continuing Operations	6,282	(1,782)	226	13,296	2,174	(2,220)	(14)	3,032
From Discontinued Operations	36	4,125	(470)	643	415	194	(316)	577
	6,318	2,343	(244)	13,939	2,589	(2,026)	(330)	3,609
Per Unit Results (\$)								
Income (Loss) from Continuing Operations								
Basic	0.24	(0.07)	0.01	0.52	0.08	(0.09)	-	0.11
Diluted	0.18	(0.07)	0.01	0.31	0.08	(0.09)	-	0.11
Income (Loss) from Total Operations								
Basic	0.24	0.10	(0.01)	0.54	0.10	(0.08)	(0.01)	0.13
Diluted	0.18	0.10	(0.01)	0.32	0.10	(0.08)	(0.01)	0.13

\* Includes Royal Private Residence Club Revenue.

Quarterly financial results as presented reflect the changes to discontinued operations.

## *Disclosure* **CONTROLS AND PROCEDURES**

The President & Chief Operating Officer (acting as Chief Executive Officer for this purpose) and the Chief Financial Officer evaluated the effectiveness of Royal Host's disclosure controls and procedures as at June 30, 2007. Based on that evaluation, the President & Chief Operating Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective as at June 30, 2007 to provide reasonable assurance that material information relating to Royal Host, including its consolidated subsidiaries, would be made known to them.

## *Internal* **CONTROL OVER FINANCIAL REPORTING**

There have been no changes in Royal Host's internal control over financial reporting that occurred during the most recent interim period ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, Royal Host's internal control over financial reporting.

Upon the adoption of new accounting standards described in "Changes in Accounting Policies", Royal Host is required to record certain financial instruments at fair market value, instead of the previously used amortized cost basis. Controls and procedures have been implemented by Royal Host to ensure the accuracy of recording these financial instruments using the fair market value basis of accounting.

## *Key* **ACCOUNTING POLICIES AND ESTIMATES**

Note 2 to the audited consolidated financial statements for the year ended December 31, 2006 includes a summary of the Trust's significant accounting policies. Effective January 1, 2007, Royal Host adopted new accounting policies related to financial instruments, as described further herein under "Changes in 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.

## *Changes* **IN ACCOUNTING POLICIES**

### **Financial Instruments and Comprehensive Income**

The Canadian Institute of Chartered Accountants ("CICA") issued new guidance related to financial instruments that are effective for the Trust commencing January 1, 2007.

CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement" provides guidance on when a financial instrument must be recognized on the balance sheet and how it is to be measured. It also provides guidance on the presentation of gains and losses on financial instruments. The Trust has elected to apply the following treatment to each of its significant categories of financial instruments:

Cash equivalents	Held-to-maturity
Marketable securities	Held for trading or available-for-sale
Mortgages	Amortized cost
Convertible debentures	Amortized cost

CICA Handbook Section 1530, "Comprehensive Income" requires an entity to recognize certain unrealized gains and losses on financial instruments that are classified as available-for-sale in "other comprehensive income", an

account included in unitholders' equity. When such gains and losses are realized, they are recognized in net income.

Unrealized gains and losses on financial instruments classified as held for trading are recognized in net income based on the change in the fair market value of the financial instruments in the period.

For periods prior to January 1, 2007, Royal Host deferred and amortized debt issuance costs on a straight-line basis over the term of the loan. Commencing on January 1, 2007, debt issuance costs are no longer classified as assets on the balance sheet or amortized over the term of the debt. CICA Handbook Section 3855 "Financial Instruments – Recognition and Measurement" prescribes that under the effective interest method, debt issuance costs must be applied against the debt to which they relate. Over the term of the debt the long-term liability will increase to the face value of the debt, with the accretion being included in interest on mortgages or interest on convertible debentures on the Consolidated Statement of Net Income and Comprehensive Income.

The adoption of these new accounting standards on January 1, 2007 has resulted in an adjustment to certain opening financial statement accounts. Prior periods' statements have not been restated for adoption of these new accounting standards. The adoption of the new accounting policies is done on a prospective basis. As a result of adopting these standards as at January 1, 2007 deferred debt issuance costs decreased from \$7.4 million to \$nil. Mortgages decreased from \$126.9 million to \$125.3 million, convertible debentures decreased from \$189.7 million to \$183.9 million and accumulated income increased by \$0.1 million. The balances of cash and cash equivalents, and marketable securities were not impacted by the adoption of these new accounting policies.

## *Restatement*

Royal Host's financial statements for the periods ended December 31, 2002 through June 30, 2006 included changes in property under development and minority interest in cash from investing activities on its Consolidated Statements of Cash Flows. Changes in property under development and minority interest have been retroactively restated to be reclassified and included in cash from operating activities. The effects of the reclassification are as follows: for the three months ended June 30, 2006, cash provided by (used in) operating activities decreased by \$4.4 million to \$0.4 million; cash used in investing activities for the three months ended June 30, 2006 increased by \$4.4 million to (\$0.1 million); for the six months ended June 30, 2006, cash provided by (used in) operating activities decreased by \$7.5 million to (\$2.5 million); and cash used in investing activities increased by \$7.5 million to (\$1.3 million).

## *Off* BALANCE SHEET ARRANGEMENT

Royal Host had no undisclosed off balance sheet arrangements as at June 30, 2007.

## *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 and environmental risks amongst others.

Additional information with respect to the risks and uncertainties to which Royal Host is subject is contained in its MD&A and Annual Information Form for the year ended December 31, 2006, which may be viewed on SEDAR at [www.sedar.com](http://www.sedar.com).

## Taxation Changes to Income Trusts

On October 31, 2006, the Minister of Finance announced proposed changes to the manner in which certain flow-through entities and the distributions from such entities are taxed. On December 15, 2006, The Minister of Finance released guidelines on normal growth for income trusts and other flow-through entities (the "Guidelines"). On June 22, 2007, Bill C-52 *An Act to implement certain provisions of the budget tabled in Parliament on March 19, 2007* ("Bill C-52") which includes legislative provisions to implement the proposals originally announced on October 31, 2006, received Royal Assent. These provisions will apply a tax, which we refer to as the "SIFT tax", on certain income earned by a "specified investment flow-through" ("SIFT") trust as well as taxing the taxable distributions received by investors from such entities as dividends.

Royal Host constitutes a SIFT trust and, as a result, Royal Host and its Unitholders will be subject to the SIFT tax.

Subject to the normal growth limit discussed below for income trusts the units of which were publicly-traded as of October 31, 2006, such as Royal Host, there will be a four year transition period and the SIFT tax will not apply until 2011. The Guidelines indicate that the 2011 date will continue to apply in respect of any SIFT whose equity capital grows as a result of issuances of new equity (which includes trust units, debt that is convertible into trust units, and potentially other substitutes for such equity), before 2011, by an amount that does not exceed the greater of \$50 million and an objective "safe harbour" amount. This amount is based on a percentage of the SIFT's market capitalization as of the end of trading on October 31, 2006 (measured in terms of the value of a SIFT's issued and outstanding publicly-traded units, not including debt, options or other interests that were convertible into units of the SIFT). For the period from November 1, 2006 to the end of 2007, the Guidelines provide that a SIFT's safe harbour will be 40% of the October 31, 2006 benchmark. As at August 8, 2007, the Trust is within its "safe harbour" growth limits described herein, however, there can be no assurance that Royal Host will not undertake actions in the future that could cause the SIFT tax to apply to it before 2011.

## *Business* ENVIRONMENT AND OUTLOOK

Pannell Kerr Forster, a recognized industry consultant, anticipates that the Canadian hospitality industry will experience continued growth through the latter half of 2007. Growth in demand is anticipated to exceed that of supply, resulting in anticipated improvements in RevPAR. Overall, Canada's general economic environment is strong and the hospitality industry's fundamentals remain sound.

Ontario's hospitality industry has been soft due, in part, to a downturn among key economic drivers and reduced US leisure travel.

Western Canada's hospitality industry has experienced strong growth and is anticipated to benefit from a robust economy through the remainder of 2007, and market conditions in Atlantic Canada are anticipated to improve modestly compared to 2006.

Royal Host is favourably positioned in its markets to benefit from the hospitality industry's expected growth and to deliver an excellent hospitality experience to its guests and value to its Unitholders.

The Trust's performance during the first half of 2007 reflects its belief in the fundamentals of well-maintained product, a focus on its core business activities and a strong financial position, ending the quarter with \$108.7 million of cash and marketable securities.

# ROYAL HOST REAL ESTATE INVESTMENT TRUST

## Consolidated Interim Financial Statements

*(unaudited)*



# 2007

**FOR THE SIX MONTHS  
ENDED JUNE 30, 2007**

**ROYAL HOST**<sup>®</sup>  
HOTELS & RESORTS<sup>REIT</sup>

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**

## Consolidated Balance Sheets

in \$000's

*(unaudited)*

	As at	
	June 30, 2007	December 31, 2006
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	86,353	92,144
Marketable securities	22,367	2,000
Accounts and notes receivable	9,174	9,529
Prepaid expenses	4,900	3,237
Inventories	3,213	3,174
Property under development	-	1,551
Assets of discontinued operations (Note 4)	139	4,285
Future income taxes (Note 12)	1,490	931
	<u>127,636</u>	<u>116,851</u>
<b>Long-term notes receivable</b>	36	47
<b>Capital assets (Note 5)</b>	304,872	308,396
<b>Property held for sale (Note 4)</b>	2,025	2,056
<b>Restricted cash</b>	3,787	5,261
<b>Deferred debt issuance costs (Note 2)</b>	-	7,422
	<u>438,356</u>	<u>440,033</u>
<b>LIABILITIES AND UNITHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued liabilities	13,482	16,421
Equity distributions payable	1,445	1,232
Interest accrued on convertible debentures	1,960	3,390
Mortgages (Note 6)	3,214	3,108
Convertible debentures (Notes 7 and 9)	-	38,021
Obligations under capital leases (Note 8)	432	375
Other liabilities	2,331	2,288
Liabilities of discontinued operations (Note 4)	45	4,351
	<u>22,909</u>	<u>69,186</u>
<b>Mortgages (Note 6)</b>	120,765	123,820
<b>Convertible debentures (Notes 7 and 9)</b>	188,991	151,689
<b>Obligations under capital leases (Note 8)</b>	323	242
<b>Deferred revenue</b>	214	417
<b>Future income taxes (Note 12)</b>	6,769	7,479
	<u>339,971</u>	<u>352,833</u>
<b>Unitholders' equity (Note 10)</b>	98,385	87,200
	<u>438,356</u>	<u>440,033</u>

See accompanying Notes to the Interim Consolidated Financial Statements

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## ROYAL HOST REAL ESTATE INVESTMENT TRUST

### Consolidated Statements of Net Income and Comprehensive Income

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

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
<b>Hospitality revenue</b>				
Rooms	27,336	26,966	49,778	49,523
Food and beverage	7,320	7,207	13,155	12,976
Franchising and management	550	556	1,337	973
Other	3,037	2,928	5,695	5,355
	<u>38,243</u>	<u>37,657</u>	<u>69,965</u>	<u>68,827</u>
<b>Hospitality expenses</b>				
	<u>25,576</u>	<u>26,035</u>	<u>50,106</u>	<u>50,098</u>
	<u>12,667</u>	<u>11,622</u>	<u>19,859</u>	<u>18,729</u>
<b>Royal Private Residence Club (Note 3)</b>				
Revenue	177	-	1,675	-
Cost of sales	177	-	1,675	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Gross margin</b>	<u>12,667</u>	<u>11,622</u>	<u>19,859</u>	<u>18,729</u>
<b>Other expenses</b>				
Trust administration	350	503	761	1,020
Interest on mortgages and capital leases	2,583	2,678	5,503	5,389
Interest on convertible debentures	3,255	2,479	6,465	4,958
Interest and investment income	(758)	(109)	(1,799)	(313)
Unrealized gain on marketable securities (Note 2)	(1,071)	-	(1,433)	-
Realized gain on marketable securities (Note 2)	(722)	-	(722)	-
Depreciation and amortization	3,756	3,819	7,572	7,621
Future income taxes (recovery) expense (Note 12)	(1,070)	66	(1,089)	-
Capital and other taxes	31	(1)	61	88
Loss on foreign currency translation	31	12	35	11
	<u>6,385</u>	<u>9,447</u>	<u>15,354</u>	<u>18,774</u>
<b>Income (loss) from continuing operations</b>	<u>6,282</u>	<u>2,175</u>	<u>4,505</u>	<u>(45)</u>
<b>Income from discontinued operations (Note 4)</b>	<u>36</u>	<u>415</u>	<u>4,161</u>	<u>609</u>
<b>Net income</b>	<u>6,318</u>	<u>2,590</u>	<u>8,666</u>	<u>564</u>
<b>Other comprehensive loss (Notes 2 and 13)</b>	<u>30</u>	<u>-</u>	<u>62</u>	<u>-</u>
<b>Comprehensive income</b>	<u>6,288</u>	<u>2,590</u>	<u>8,604</u>	<u>564</u>
<b>Basic per unit net earnings (Note 10)</b>				
- from continuing operations	0.24	0.08	0.18	0.00
- from discontinued operations	0.00	0.02	0.16	0.02
	<u>0.24</u>	<u>0.10</u>	<u>0.34</u>	<u>0.02</u>
<b>Diluted per unit net earnings (Note 10)</b>				
- from continuing operations	0.18	0.08	0.18	0.00
- from discontinued operations	0.00	0.02	0.16	0.02
	<u>0.18</u>	<u>0.10</u>	<u>0.34</u>	<u>0.02</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 Income	Accumulated Other Comprehensive Loss	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>-</b>	<b>(137,513)</b>	<b>94,950</b>
Net income (loss)	-	-	-	564	-	-	564
Equity distributions							
Trust units	-	-	-	-	-	(5,921)	(5,921)
Issuance of trust units pursuant to distribution reinvestment plan	6	-	-	-	-	-	6
Trust units repurchased pursuant to normal course issuer bid (Note 9)	(2,559)	-	1,216	-	-	-	(1,343)
Employee loans pursuant to employee unit purchase program	10	-	3	-	-	-	13
<b>Balance, June 30, 2006</b>	<b>214,998</b>	<b>1,680</b>	<b>4,043</b>	<b>10,982</b>	<b>-</b>	<b>(143,434)</b>	<b>88,269</b>
Net income	-	-	-	13,694	-	-	13,694
Equity distributions							
Trust units	-	-	-	-	-	(6,794)	(6,794)
Issuance of trust units pursuant to distribution reinvestment plan	6	-	-	-	-	-	6
Issuance of trust units pursuant to debenture conversion option	5	-	-	-	-	-	5
Trust units cancelled pursuant to normal course issuer bid (Note 9)	(13,257)	-	3,454	-	-	-	(9,803)
Employee loans pursuant to employee unit purchase program	23	-	-	-	-	-	23
Conversion option related to issued convertible debentures	-	1,800	-	-	-	-	1,800
<b>Balance, December 31, 2006</b>	<b>201,775</b>	<b>3,480</b>	<b>7,497</b>	<b>24,676</b>	<b>-</b>	<b>(150,228)</b>	<b>87,200</b>
<b>Transitional adjustment on adoption     of new accounting policy (Note 2)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>111</b>	<b>-</b>	<b>-</b>	<b>111</b>
<b>Comprehensive     income (loss) (Note 13)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>8,666</b>	<b>(62)</b>	<b>-</b>	<b>8,604</b>
<b>Equity distributions</b>							
Trust units	-	-	-	-	-	(8,502)	(8,502)
<b>Issuance of trust units pursuant to     distribution reinvestment plan</b>	<b>9</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>9</b>
<b>Issuance of trust units pursuant to     debenture conversion option (Note 7)</b>	<b>17,780</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>17,780</b>
<b>Trust units cancelled pursuant     to normal course issuer bid (Note 9)</b>	<b>(8,335)</b>	<b>-</b>	<b>1,084</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(7,251)</b>
<b>Employee loans pursuant to employee     unit purchase program</b>	<b>134</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>134</b>
<b>Conversion option related to issued     convertible debentures</b>	<b>-</b>	<b>300</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>300</b>
<b>Balance, June 30, 2007</b>	<b>211,363</b>	<b>3,780</b>	<b>8,581</b>	<b>33,453</b>	<b>(62)</b>	<b>(158,730)</b>	<b>98,385</b>

**Accumulated income and accumulated other comprehensive loss, June 30, 2007 - \$33,391**

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		Six Months Ended	
	June 30, 2007	June 30, 2006 (Restated - See Note 15)	June 30, 2007	June 30, 2006 (Restated - See Note 15)
<b>Operating activities</b>				
Income (loss) from continuing operations	6,282	2,175	4,505	(45)
Items not affecting cash:				
Depreciation and amortization	3,756	3,819	7,572	7,621
Future income taxes	(1,070)	66	(1,089)	-
Unrealized gain on marketable securities (Note 2)	(1,071)	-	(1,433)	-
Realized gain on marketable securities (Note 2)	(722)	-	(722)	-
Premium on repurchase of convertible debentures	348	-	348	-
Accretion on mortgages and convertible debentures (Note 6 and 7)	445	31	1,027	61
<b>Cash flows provided by continuing operations</b>	<b>7,968</b>	<b>6,091</b>	<b>10,208</b>	<b>7,637</b>
Cash flows provided by (used in) discontinued operations (Note 4)	(38)	472	(179)	633
Changes in non-cash working capital - continuing operations (Note 11)	(2,972)	(2,250)	(4,673)	(3,496)
Changes in non-cash working capital - discontinued operations (Note 4)	(58)	574	(140)	184
Decrease (increase) in property under development	51	(4,392)	1,551	(7,532)
Decrease in minority interest	-	(12)	-	8
	<b>4,951</b>	<b>483</b>	<b>6,767</b>	<b>(2,566)</b>
<b>Financing activities</b>				
Issuance of convertible debentures	60,000	-	60,000	-
Debt issuance costs	(2,362)	-	(2,362)	-
Redemption upon maturity of convertible debentures	-	-	(32,469)	-
Repurchase of convertible debentures pursuant to normal course issuer bid	(2,764)	-	(3,064)	(800)
Principal repayments on mortgages and capital leases	(871)	(8,872)	(1,753)	(9,731)
Repurchase of trust units pursuant to normal course issuer bid	(5,286)	-	(8,287)	(1,343)
Equity distributions	(4,321)	(3,069)	(8,289)	(5,790)
Proceeds from repayment of employee unit purchase program loan	10	-	134	-
	<b>44,406</b>	<b>(11,941)</b>	<b>3,910</b>	<b>(17,664)</b>
<b>Investing activities</b>				
Purchase of marketable securities	(22,929)	-	(37,201)	-
Dispositions of marketable securities	17,986	-	18,923	-
Net cash on dispositions (Note 4)	-	106	5,251	557
Acquisition of capital assets	(1,790)	(1,483)	(4,926)	(2,761)
Decrease (increase) in restricted cash	(269)	1,223	1,474	772
Decrease in long-term notes receivable	8	11	11	101
	<b>(6,994)</b>	<b>(143)</b>	<b>(16,468)</b>	<b>(1,331)</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>42,363</b>	<b>(11,601)</b>	<b>(5,791)</b>	<b>(21,561)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>43,990</b>	<b>21,523</b>	<b>92,144</b>	<b>31,483</b>
<b>Cash and cash equivalents, end of period</b>	<b>86,353</b>	<b>9,922</b>	<b>86,353</b>	<b>9,922</b>
<b>Cash interest paid</b>				
Mortgages and capital leases	2,528	2,862	5,097	5,451
Convertible debentures	3,477	3,276	7,097	5,073
	<b>6,005</b>	<b>6,138</b>	<b>12,194</b>	<b>10,524</b>

See accompanying Notes to the Interim Consolidated Financial Statements

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**  
Notes to the Interim 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. CHANGE IN ACCOUNTING POLICY**

These unaudited consolidated interim financial statements and notes have been prepared using the accounting policies that are consistent with the policies used in preparing the Trust's 2006 annual consolidated financial statements with the exception of the policies noted below. These financial statements do not include all disclosures required under Canadian generally accepted accounting principles for annual financial statements and should be read in conjunction with the annual consolidated financial statements.

**(a) Financial Instruments and Comprehensive Income**

The Canadian Institute of Chartered Accountants (CICA) has issued new guidance related to financial instruments that are effective for the Trust commencing January 1, 2007.

CICA Handbook Section 3855, "*Financial Instruments - Recognition and Measurement*" provides guidance on when a financial instrument must be recognized on the balance sheet and how it is to be measured. It also provides guidance on the presentation of gains and losses on financial instruments. The Trust has elected to apply the following treatment to each of its significant categories of financial instruments:

Cash equivalents	Held-to-maturity
Marketable securities	Held for trading or available-for-sale
Mortgages	Amortized cost
Convertible debentures	Amortized cost

CICA Handbook Section 1530, "*Comprehensive Income*" requires an entity to recognize unrealized gains and losses on financial instruments that are classified as available-for-sale in "other comprehensive income", an account included in unitholders' equity. When such gains and losses are realized they are recognized in net income.

Unrealized gains or losses on financial instruments classified as held for trading are recognized in net income based on the change in the fair market value of the financial instrument in the period.

For periods prior to January 1, 2007 Royal Host deferred and amortized debt issuance costs on a straight-line basis over the term of the debt. Commencing January 1, 2007, debt issuance costs are no longer classified as assets on the balance sheet or amortized over the term of the debt. CICA Handbook Section 3855, "*Financial Instruments - Recognition and Measurement*" prescribes that under the effective interest method, debt issuance costs must be applied against the debt to which they relate. Over the term of the debt the long term liability will increase to the face value of the debt, with the accretion being included in interest on mortgages or interest on convertible debentures on the consolidated statement of net income and comprehensive income.

The adoption of these new accounting standards on January 1, 2007 has resulted in an adjustment to certain opening financial statement accounts. Prior periods' statements have not been restated for the adoption of these new accounting policies. The adoption of the new accounting policies is done on a prospective basis. As a result of adopting these standards as at January 1, 2007 deferred debt issuance costs decreased from \$7.4 million to \$nil. Mortgages decreased from \$126.9 million to \$125.3 million, convertible debentures decreased from \$189.7 million to \$183.9 million and accumulated income increased by \$0.1 million. These changes are the result of the implementation of the new accounting guidance described in the paragraph above. The balances of cash and cash equivalents, and marketable securities were not impacted by the adoption of these new policies.

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**  
Notes to the Interim Consolidated Financial Statements  
(unaudited)

**3. ROYAL PRIVATE RESIDENCE CLUB**

A subsidiary of Royal Host developed, for resale, the Royal Private Residence Club, a residential condominium, on a property adjacent to the Grand Okanagan Lakefront Resort and Conference Centre in Kelowna, British Columbia. Revenue and cost of sales (including commissions and other selling costs) are recorded at the time each condominium sale is closed, and title and possession have been transferred to the buyer.

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

The operations of properties and businesses that were disposed of during the period ended June 30, 2007 or subsequent thereto, or that are held for sale as at June 30, 2007, have been included in discontinued operations on the consolidated statements of net income and comprehensive income, and reflected as assets and liabilities of discontinued operations and property held for sale on the consolidated balance sheets.

Effective December 31, 2006, Royal Host sold its timeshare business unit for \$1.2 million, resulting in a loss on disposition of \$0.3 million.

During the period ending June 30, 2007, Royal Host sold its US management business, resulting in a gain on disposition of approximately \$4.2 million.

On February 23, 2005, Royal Host completed the sale of its 50% interest in a hotel property located in Toronto, Ontario to a condominium developer. The net cost of winding up the business, to a maximum of \$2.0 million, is to be reimbursed by the purchaser to Royal Host in the form of a non-interest bearing VTB mortgage (included in accounts receivable).

The Trust is actively seeking a buyer for a hotel property in Ontario. During the fourth quarter of 2006, the Trust recorded a property impairment provision in discontinued operations of \$0.7 million relating to this property.

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**  
Notes to the Interim Consolidated Financial Statements  
(unaudited)

**5. CAPITAL ASSETS**

	<i>(in \$000's)</i>		
	Gross Book Value	Accumulated Amortization	Net Book Value
<b>June 30, 2007</b>			
Buildings	323,799	75,581	248,218
Land	37,192	-	37,192
Furniture, fixtures, and equipment	49,525	40,765	8,760
Other	1,274	407	867
	<u>411,790</u>	<u>116,753</u>	<u>295,037</u>
Capital assets under development	2,543	-	2,543
Intangible assets:			
Franchise rights and management contracts	27,414	20,122	7,292
	<u>441,747</u>	<u>136,875</u>	<u>304,872</u>
		<i>(in \$000's)</i>	
	Gross Book Value	Accumulated Amortization	Net Book Value
<b>December 31, 2006</b>			
Buildings	321,413	71,018	250,395
Land	37,192	-	37,192
Furniture, fixtures, and equipment	48,532	39,029	9,503
Other	1,247	381	866
	<u>408,384</u>	<u>110,428</u>	<u>297,956</u>
Capital assets under development	2,157	-	2,157
Intangible assets:			
Franchise rights and management contracts	27,414	19,131	8,283
	<u>437,955</u>	<u>129,559</u>	<u>308,396</u>

During the three and six months ended June 30, 2007, respectively, capital additions to Royal Host's hotel properties totalled \$1.8 million (June 30, 2006 - \$2.1 million) and \$4.1 million (June 30, 2006 - \$3.4 million).

**6. MORTGAGES**

	<i>(in \$000's)</i>	
	<b>June 30, 2007</b>	December 31, 2006
Mortgages secured by hotel properties	123,979	126,928
Less: current portion	3,214	3,108
	<u>120,765</u>	<u>123,820</u>

Principal repayments required for the twelve months ending June 30:

	<i>(in \$000's)</i>
2008	3,214
2009	3,441
2010	59,725
2011	25,156
2012	13,063
Subsequent	20,793
Total principal outstanding	125,392
Debt issuance costs	(1,413)
	<u>123,979</u>

**ROYAL HOST REAL ESTATE INVESTMENT TRUST**  
Notes to the Interim Consolidated Financial Statements  
(unaudited)

**7. CONVERTIBLE DEBENTURES**

	<i>(in \$000's)</i>	
	<u>June 30,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
9.25% Convertible Unsecured Subordinated Debentures	-	38,021
7.90% Convertible Unsecured Subordinated Debentures, Series A	<b>23,297</b>	35,000
6.00% Convertible Unsecured Subordinated Debentures, Series B	<b>52,940</b>	58,464
6.25% Convertible Unsecured Subordinated Debentures, Series C	<b>55,416</b>	58,225
5.90% Convertible Unsecured Subordinated Debentures, Series D	<b>57,338</b>	-
	<b>188,991</b>	189,710
Less: current portion	-	38,021
	<b>188,991</b>	<b>151,689</b>

Principal repayments required for the twelve months ending June 30:

	<i>(in \$000's)</i>
2008	-
2009	23,786
2010	-
2011	-
2012	-
Subsequent	175,963
Total principal outstanding	199,749
Debt issuance costs	(7,342)
Equity conversion option	(3,416)
	<b>188,991</b>

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

During the six months ended June 30, 2007, \$5.6 million of Royal Host's 9.25% convertible unsecured subordinated debentures were converted into 0.8 million trust units. The remaining \$32.5 million of the 9.25% convertible unsecured subordinated debentures were redeemed upon maturity on March 1, 2007.

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

During the three months ended June 30, 2007, \$8.0 million (2006 - \$nil) of Royal Host's 7.90% convertible unsecured subordinated debentures were converted into 1.3 million trust units. During the six months ended June 30, 2007, \$10.2 million (2006 - \$nil) of Royal Host's 7.90% convertible unsecured subordinated debentures were converted into 1.7 million trust units. Subsequent to June 30, 2007, \$40,000 of the debentures were converted into 7,000 trust units.

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

During the three months ended June 30, 2007, \$1.7 million (2006 - \$nil) of Royal Host's 6.00% convertible unsecured subordinated debentures were converted into 0.2 million trust units. During the six months ended June 30, 2007, \$2.2 million (2006 - \$nil) of Royal Host's 6.00% convertible unsecured subordinated debentures were converted into 0.3 million trust units. Subsequent to June 30, 2007, \$0.2 million of the debentures were converted into 29,342 trust units.

**(d) 6.25% Convertible Unsecured Subordinated Debentures, Series C**

During the three and six months ended June 30, 2007, \$32,000 (2006 - \$nil) of Royal Host's 6.25% convertible unsecured subordinated debentures were converted into 4,570 trust units.

**ROYAL HOST REAL ESTATE INVESTMENT TRUST**  
Notes to the Interim Consolidated Financial Statements  
(unaudited)

**7. CONVERTIBLE DEBENTURES** (continued)

**(e) 5.90% Convertible Unsecured Subordinated Debentures, Series D**

In June 2007, \$60.0 million of convertible unsecured subordinated debentures were issued with a term of 7 years. These debentures bear interest at 5.90% per annum and are payable semi-annually in arrears on June 30 and December 31 in each year commencing December 31, 2007.

The Series D debentures may not be redeemed by Royal Host prior to June 30, 2010. On or after June 30, 2010, but prior to June 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 \$8.90 per unit. After June 30, 2011, but prior to the maturity date of June 30, 2014, 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 June 30, 2014, 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 \$8.90 per trust unit at any time from the date of issue to close of business on the day prior to the maturity date, June 30, 2014.

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, \$57.3 million was recorded as a long-term liability with the balance of \$0.3 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 7 year term, with the accretion being included in interest on convertible debentures on the consolidated statement of income and comprehensive income.

**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 June 30, 2007 are as follows:

	<i>(in \$000's)</i>	
	<b>June 30, 2007</b>	December 31, 2006
Present value of future minimum lease payments	<b>755</b>	617
Less: current portion of principal payments	<b>432</b>	375
	<b>323</b>	242

Total repayments required for the twelve months ending June 30:

	<i>(in \$000's)</i>
	2008
	475
	2009
	131
	2010
	81
	2011
	81
	2012
	74
	Subsequent
	-
Future minimum lease payments	842
Less: amounts representing interest	87
Present value of future minimum lease payments	755

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**  
Notes to the Interim Consolidated Financial Statements  
(unaudited)

**9. NORMAL COURSE ISSUER BIDS**

**(a) Trust Units**

Commencing on December 29, 2006, Royal Host initiated a normal course issuer bid to repurchase a maximum of 2.0 million of its issued and outstanding trust units. During the three months ended June 30, 2007, 0.7 million trust units with an aggregate cost of \$5.3 million (average cost of \$7.42 per unit) were repurchased pursuant to this bid. During the six months ended June 30, 2007, 1.0 million trust units with an aggregate cost of \$7.2 million (average cost of \$7.30 per unit) were repurchased. As at June 30, 2007, 0.8 million of these units were cancelled with the remaining 0.2 million units being cancelled subsequent thereto. Subsequent to June 30, 2007, 0.5 million trust units with an aggregate cost of \$3.5 million (average cost of \$7.23 per unit) were repurchased pursuant to this bid.

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 June 30, 2006, no trust units were repurchased. During the six months ended June 30, 2006, 0.2 million trust units with an aggregate cost of \$1.3 million (average cost of \$5.93 per unit) were repurchased and cancelled pursuant to this bid.

**(b) 9.25% Convertible Unsecured Subordinated Debentures**

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 six months ended June 30, 2007, no debentures were repurchased pursuant to this bid.

**(c) 7.90% Convertible Unsecured Subordinated Debentures, Series A**

Commencing on November 23, 2006, Royal Host initiated a normal course issuer bid to repurchase up to \$3.5 million in principal of its issued and outstanding 7.90% convertible debentures. During the three months ended June 30, 2007, \$0.7 million in principal of the 7.90% convertible debentures were repurchased with an aggregate cost of \$0.8 million (average cost of \$122.97) pursuant to this bid. During the six months ended June 30, 2007, \$1.0 million in principal of the 7.90% convertible debentures were repurchased with an aggregate cost of \$1.2 million (average cost of \$121.13) pursuant to this bid. As at June 30, 2007, \$0.3 million in principal of the 7.9% convertible debenture repurchases were not yet cancelled. Subsequent to June 30, 2007 Royal Host repurchased and cancelled \$0.4 million of debentures (average cost of \$120.21).

**(d) 6.00% Convertible Unsecured Subordinated Debentures, Series B**

Commencing on March 30, 2007, Royal Host initiated a normal course issuer bid to repurchase up to \$5.9 million in principal of its issued and outstanding 6.00% convertible debentures. During the three and six months ended June 30, 2007, \$1.2 million in principal of the 6.00% convertible debentures were repurchased with an aggregate cost of \$1.3 million (average cost of \$108.22) pursuant to this bid. Subsequent to June 30, 2007, Royal Host repurchased and cancelled \$0.4 million of debentures (average cost of \$105.94).

**(e) 6.25% Convertible Unsecured Subordinated Debentures, Series C**

Commencing on March 30, 2007, Royal Host initiated a normal course issuer bid to repurchase up to \$6.0 million in principal of its issued and outstanding 6.25% convertible debentures. During the three and six months ended June 30, 2007, \$0.4 million in principal of the 6.25% convertible debentures were repurchased with an aggregate cost of \$0.4 million (average cost of \$106.29) pursuant to this bid. As at June 30, 2007, \$0.2 million in principal of the 6.25% convertible debenture repurchases were not yet cancelled. Subsequent to June 30, 2007, Royal Host repurchased and cancelled \$25,000 of debentures (average cost of \$104.50).

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**ROYAL HOST REAL ESTATE INVESTMENT TRUST**  
Notes to the Interim Consolidated Financial Statements  
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**10. PER UNIT CALCULATIONS**

As at June 30, 2007, a total of 26,368,006 trust units (December 31, 2006 - 24,500,976) were issued and outstanding. Per unit computations are based on the weighted average number of trust units outstanding for the period.

<b>For the three months ended June 30, 2007:</b>		
<i>(in \$000's)</i>	Weighted Average Units <i>(in 000's)</i>	Per Unit (\$)
Basic earnings - continuing operations	6,282	0.24
Basic earnings - discontinued operations	36	0.00
<b>Basic earnings - total operations</b>	<b>6,318</b>	<b>0.24</b>
Basic earnings - continuing operations	6,282	
Add: notional conversion of convertible debentures	2,380	22,034
Diluted earnings - continuing operations	8,662	0.18
Diluted earnings - discontinued operations	36	0.00
<b>Diluted earnings - total operations</b>	<b>8,698</b>	<b>0.18</b>
<b>For the three months ended June 30, 2006:</b>		
<i>(in \$000's)</i>	Weighted Average Units <i>(in 000's)</i>	Per Unit (\$)
Basic earnings - continuing operations	2,175	0.08
Basic earnings - discontinued operations	415	0.02
<b>Basic earnings - total operations</b>	<b>2,590</b>	<b>0.10</b>
Basic earnings - continuing operations	2,175	
Add: notional conversion of convertible debentures	-	-
Diluted earnings - continuing operations	2,175	0.08
Diluted earnings - discontinued operations	415	0.02
<b>Diluted earnings - total operations</b>	<b>2,590</b>	<b>0.10</b>
<b>For the six months ended June 30, 2007:</b>		
<i>(in \$000's)</i>	Weighted Average Units <i>(in 000's)</i>	Per Unit (\$)
Basic earnings - continuing operations	4,505	0.18
Basic earnings - discontinued operations	4,161	0.16
<b>Basic earnings - total operations</b>	<b>8,666</b>	<b>0.34</b>
Basic earnings - continuing operations	4,505	
Add: notional conversion of convertible debentures	-	-
Diluted earnings - continuing operations	4,505	0.18
Diluted earnings - discontinued operations	4,161	0.16
<b>Diluted earnings - total operations</b>	<b>8,666</b>	<b>0.34</b>

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**10. PER UNIT CALCULATIONS (continued)**

For the six months ended June 30, 2006:

	<u>(in \$000's)</u>	Weighted Average Units <u>(in 000's)</u>	<u>Per Unit (\$)</u>
Basic loss - continuing operations	(45)		0.00
Basic earnings - discontinued operations	609		0.02
<b>Basic earnings - total operations</b>	<u>564</u>	26,062	<u>0.02</u>
Basic loss - continuing operations	(45)		
Add: notional conversion of convertible debentures	-	-	
Diluted loss - continuing operations	(45)		0.00
Diluted earnings - discontinued operations	609		0.02
<b>Diluted earnings - total operations</b>	<u>564</u>	26,062	<u>0.02</u>

The diluted earnings per unit for the three months ended June 30, 2007 exclude the trust units related to the conversion options on the 7.90% Series A, convertible unsecured subordinated debenture. The remainder of trust units related to the conversion options of the Series B, C and D convertible debentures are dilutive.

The diluted earnings per unit for the six months ended June 30, 2007 exclude the trust units related to the conversion options of all convertible debentures into trust units because all of the conversions are anti-dilutive.

The diluted earnings per unit for the three and six months ended June 30, 2006 exclude trust units related to the conversion options of all convertible debentures into trust units because all of the conversions are anti-dilutive.

**11. CHANGES IN NON-CASH WORKING CAPITAL**

	Three Months Ended <i>(in \$000's)</i>		Six Months Ended <i>(in \$000's)</i>	
	<u>June 30, 2007</u>	<u>June 30, 2006</u>	<u>June 30, 2007</u>	<u>June 30, 2006</u>
<b>(Increase) decrease in:</b>				
Accounts and notes receivable	<b>(558)</b>	(626)	<b>(646)</b>	(727)
Prepaid expenses	<b>(1,044)</b>	(1,197)	<b>(1,663)</b>	(1,614)
Inventories	<b>(68)</b>	(56)	<b>(39)</b>	(40)
	<u><b>(1,670)</b></u>	<u>(1,879)</u>	<u><b>(2,348)</b></u>	<u>(2,381)</u>
<b>Increase (decrease) in:</b>				
Accounts payable and accrued liabilities	<b>(805)</b>	608	<b>(687)</b>	(443)
Interest accrued on convertible debentures	<b>(596)</b>	(828)	<b>(1,430)</b>	(208)
Other liabilities	<b>67</b>	(131)	<b>43</b>	(233)
Deferred revenue	<b>32</b>	32	<b>(203)</b>	(60)
Future income taxes	-	(52)	<b>(48)</b>	(171)
	<u><b>(1,302)</b></u>	<u>(371)</u>	<u><b>(2,325)</b></u>	<u>(1,115)</u>
	<u><b>(2,972)</b></u>	<u>(2,250)</u>	<u><b>(4,673)</b></u>	<u>(3,496)</u>

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**12. FUTURE INCOME TAXES**

The net future income tax liability is calculated as follows:

	<i>(in \$000's)</i>	
	<u>June 30, 2007</u>	<u>December 31, 2006</u>
Tax assets relating to subsidiary operating losses and temporary differences on current items	1,490	931
Tax liabilities relating to temporary differences in long-term items	<u>(6,769)</u>	<u>(7,479)</u>
	<u><b>(5,279)</b></u>	<u><b>(6,548)</b></u>

On June 12, 2007, Bill C-52 *An Act to implement certain provisions of the budget tabled in Parliament on March 19, 2007* ("Bill C-52") received Third Reading in the Canadian House of Commons. Bill C-52 includes legislative provisions to implement proposal originally announced on October 31, 2006 and amended on March 27, 2007 relating to the taxation of certain income trust and partnerships under the Tax Act. Pursuant to the October 31, 2006 proposals, commencing on January 1, 2011 (provided Royal Host does not exceed "normal growth" as defined in guidelines issued by the Department of Finance) certain distributions from Royal Host which would have otherwise been taxed as ordinary income generally will be characterized as dividends, in addition to Royal Host generally being subject to tax on certain income at tax rates that approximate those applicable to corporations. Returns of capital generally are (and under the October 31, 2006 proposals will continue to be) tax-deferred for Unitholders who are resident in Canada for purposes of the Tax Act (and reduce such Unitholder's adjusted cost base in Unit for purposes of the Tax Act). Distributions, whether of income or capital, to a Unitholder who is not resident in Canada for purposes of the Tax Act, or that is a partnership that is not a "Canadian partnership" for purposes of the Tax Act, generally will be subject to Canadian withholding tax.

On June 12, 2007 the taxation changes in Bill C-52 became substantively enacted. The future income tax recovery of \$1.1 million recorded during the three months ended June 30, 2007 includes \$0.3 million related to the legislation passed in Bill C-52.

**13. ACCUMULATED OTHER COMPREHENSIVE LOSS**

	<i>Three Months Ended (in \$000's)</i>		<i>Six Months Ended (in \$000's)</i>	
	<u>June 30, 2007</u>	<u>June 30, 2006</u>	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Accumulated other comprehensive income, beginning of period	(32)	-	-	-
Other comprehensive income	(30)		(62)	
Accumulated other comprehensive income, end of period	<u><b>(62)</b></u>	<u>-</u>	<u><b>(62)</b></u>	<u>-</u>

Other comprehensive income above, and on the consolidated statements of net income and comprehensive loss, includes the following:

	<i>Three Months Ended (in \$000's)</i>		<i>Six Months Ended (in \$000's)</i>	
	<u>June 30, 2007</u>	<u>June 30, 2006</u>	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Unrealized gains generated on available for sale assets	692	-	660	-
Realized gains on available for sale assets transferred to net income	(722)	-	(722)	-
Other comprehensive income	<u><b>(30)</b></u>	<u>-</u>	<u><b>(62)</b></u>	<u>-</u>

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**14. STATEMENT OF CASH FLOWS**

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.

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.

The terms of the distribution policy for Royal Host is set in the Declaration of Trust. Cash distributions to Unitholders shall not be less than the Trust's income for the year, as calculated in accordance with the Income Tax Act.

**15. COMPARATIVE FIGURES AND RESTATEMENT**

Certain comparative figures have been reclassified to conform to the presentation adopted for 2007.

Royal Host's financial statements for the periods ended December 31, 2002 through June 30, 2006 included changes in property under development and minority interest in cash from investing activities on Royal Host's Consolidated Statements of Cash Flows. Changes in property under development and minority interest have been retroactively restated to be included in cash from operating activities.

The effects of the restatement for the three months ended June 30, 2006 are as follows: cash provided by (used in) operating activities decreased by \$4.4 million to \$0.4 million, and cash used in investing activities increased by \$4.4 million to (\$0.1 million).

The effects of the restatement for the six months ended June 30, 2006 are as follows: cash provided by (used in) operating activities decreased by \$7.5 million to (\$2.5 million), and cash used in investing activities increased by \$7.5 million to (\$1.3 million).

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