

# **Royal Host Real Estate Investment Trust**

September 30, 2010 and 2009

Unaudited

**Royal Host Real Estate Investment Trust**  
**CONSOLIDATED BALANCE SHEETS**

*Unaudited (in thousands of dollars)*

	September 30, 2010 \$	December 31, 2009 \$
<b>ASSETS</b>		
<b>Current</b>		
Marketable securities	2,697	39,409
Accounts, notes and distributions receivable	5,118	4,710
Prepaid expenses	2,768	2,726
Inventories	2,254	2,140
Assets of discontinued operations	433	427
	<b>13,270</b>	<b>49,412</b>
Capital assets (note 3)	213,100	217,752
Intangible assets	483	2,358
Property held for sale	1,827	2,285
Restricted cash	1,424	2,732
	<b>230,104</b>	<b>274,539</b>
<b>LIABILITIES AND UNITHOLDERS' EQUITY</b>		
<b>Current</b>		
Bank indebtedness (note 3)	9,726	881
Accounts payable and accrued liabilities	8,520	10,379
Equity distributions payable	452	458
Interest accrued on convertible debentures	1,939	1,295
Mortgages (note 3)	1,125	56,761
Obligations under capital leases	74	70
Liabilities of discontinued operations	52	76
	<b>21,888</b>	<b>69,920</b>
Mortgages (note 3)	43,460	23,463
Convertible debentures (note 4)	144,364	147,292
Obligations under capital leases	58	108
Deferred revenue	590	461
Future income taxes	4,176	6,309
<b>Total liabilities</b>	<b>214,536</b>	<b>247,553</b>
Contingencies (note 10 )		
<b>Unitholders' equity</b>	<b>15,568</b>	<b>26,986</b>
	<b>230,104</b>	<b>274,539</b>

*See accompanying Notes to the Interim Consolidated Financial Statements*

**Royal Host Real Estate Investment Trust**  
**CONSOLIDATED STATEMENTS OF NET INCOME (LOSS) AND**  
**COMPREHENSIVE INCOME (LOSS)**

*Unaudited (in thousands of dollars, except per unit amounts)*

	<b>Three months ended September 30, 2010 \$</b>	Three months ended September 30, 2009 \$	<b>Nine months ended September 30, 2010 \$</b>	Nine months ended September 30, 2009 \$
<b>Hospitality revenue</b>				
Rooms	20,198	20,206	55,484	55,628
Food and beverage	2,809	2,920	9,937	10,099
Franchising and management	767	1,060	1,666	2,033
Other	860	1,010	2,661	3,096
	<b>24,634</b>	25,196	<b>69,748</b>	70,856
<b>Hospitality expenses</b>	<b>19,135</b>	17,879	<b>56,355</b>	54,627
	<b>5,499</b>	7,317	<b>13,393</b>	16,229
<b>Investment income</b>				
Distributions and interest	4	1,707	296	6,872
Realized and unrealized gains on held-for-trading securities	—	—	—	195
Other than temporary impairment on marketable securities	—	(4,009)	—	(4,009)
Realized gains on available-for-sale securities	—	42	12,747	900
	<b>4</b>	(2,260)	<b>13,043</b>	3,958
<b>Other expenses</b>				
Trust administration	588	579	2,215	1,643
Interest and accretion on mortgages and capital leases	1,133	1,982	4,416	5,808
Interest and accretion on convertible debentures	2,561	2,623	7,781	8,187
Gain on convertible debenture repurchases	(360)	(887)	(768)	(1,921)
Depreciation and amortization	3,091	3,203	9,500	9,656
Impairment of intangible assets	—	—	601	—
	<b>7,013</b>	7,500	<b>23,745</b>	23,373
Income (loss) from continuing operations before income taxes	(1,510)	(2,443)	2,691	(3,186)
Future income tax recovery	534	220	2,134	608
Income (loss) from continuing operations	(976)	(2,223)	4,825	(2,578)
Income (loss) from discontinued operations, net of income tax	(17)	121	(496)	(39)
Net income (loss)	(993)	(2,102)	4,329	(2,617)
Other comprehensive income (loss) (note 8)	(589)	6,189	(10,955)	6,067
Comprehensive income (loss)	(1,582)	4,087	(6,626)	3,450
<b>Basic earnings (loss) per unit:</b> (in dollars) (note 6)				
Income (loss) from continuing operations	(0.05)	(0.11)	0.27	(0.13)
Income (loss) from discontinued operations	—	0.01	(0.03)	—
Net income (loss)	(0.05)	(0.10)	0.24	(0.13)
<b>Diluted earnings (loss) per unit:</b> (in dollars) (note 6)				
Income (loss) from continuing operations	(0.05)	(0.11)	0.24	(0.13)
Income (loss) from discontinued operations	—	0.01	(0.01)	—
Net income (loss)	(0.05)	(0.10)	0.23	(0.13)

*See accompanying Notes to the Interim Consolidated Financial Statements*

## Royal Host Real Estate Investment Trust

### CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY

Unaudited (in thousands of dollars)

	Three months ended September 30, 2010 \$	Three months ended September 30, 2009 \$	Nine months ended September 30, 2010 \$	Nine months ended September 30, 2009 \$
<b>Trust units</b>				
Balance at beginning of period	142,505	154,653	143,343	163,213
Trust units issued pursuant to debenture conversion option	—	—	—	929
Trust units repurchased pursuant to normal course issuer bid (note 5)	(1,194)	(1,040)	(1,262)	(10,526)
Trust units repurchased pursuant to substantial issuer bid (note 5)	—	—	(776)	—
Employee loans pursuant to employee unit purchase program	28	13	34	10
Balance at end of period	141,339	153,626	141,339	153,626
<b>Equity component of convertible debentures</b>				
Balance at beginning of period	3,115	3,180	3,167	3,293
Trust units issued pursuant to debenture conversion option	—	—	—	(27)
Convertible debentures repurchased pursuant to normal course issuer bid (note 4)	(51)	(12)	(103)	(98)
Balance at end of period	3,064	3,168	3,064	3,168
<b>Contributed surplus</b>				
Balance at beginning of period	35,242	26,928	34,667	21,024
Trust units repurchased pursuant to normal course issuer bid	829	765	874	6,645
Trust units repurchased pursuant to substantial issuer bid (note 5)	—	—	530	—
Employee loans pursuant to employee unit purchase program	—	—	—	24
Balance at end of period	36,071	27,693	36,071	27,693
<b>Accumulated income</b>				
Balance at beginning of period	63,413	59,025	58,091	59,540
Net income (loss)	(993)	(2,102)	4,329	(2,617)
Balance at end of period	62,420	56,923	62,420	56,923
<b>Accumulated distributions</b>				
Balance at beginning of period	(225,155)	(218,924)	(222,425)	(210,309)
Distributions on trust units	(1,359)	(2,071)	(4,089)	(10,686)
Balance at end of period	(226,514)	(220,995)	(226,514)	(220,995)
<b>Accumulated other comprehensive income (loss)</b>				
Balance at beginning of period	(223)	(122)	10,143	—
Other comprehensive income (loss) (note 8)	(589)	6,189	(10,955)	6,067
Balance at end of period	(812)	6,067	(812)	6,067
<b>Total unitholders' equity</b>	<b>15,568</b>	<b>26,482</b>	<b>15,568</b>	<b>26,482</b>

See accompanying Notes to the Interim Consolidated Financial Statements

**Royal Host Real Estate Investment Trust**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

*Unaudited (in thousands of dollars)*

	Three months ended September 30, 2010 \$	Three months ended September 30, 2009 \$	Nine months ended September 30, 2010 \$	Nine months ended September 30, 2009 \$
<b>OPERATING ACTIVITIES</b>				
Income (loss) from continuing operations	(976)	(2,223)	4,825	(2,578)
Adjustments for items not involving cash (note 7)	2,667	6,397	(4,382)	11,105
	1,691	4,174	443	8,527
Cash flows used in discontinued operations	(17)	(44)	(47)	(173)
Net changes in non-cash working capital – continuing operations (note 7)	509	758	(1,650)	(1,370)
Net changes in non-cash working capital – discontinued operations	65	16	(30)	(211)
	2,248	4,904	(1,284)	6,773
<b>FINANCING ACTIVITIES</b>				
Increase in (repayment of) bank indebtedness	9,726	(28)	8,845	12,907
Repurchases of convertible debentures pursuant to normal course issuer bids	(1,419)	(1,334)	(3,127)	(3,581)
Repurchases of trust units pursuant to normal course issuer bids and substantial issuer bid	(365)	(275)	(631)	(3,881)
Convertible debenture repayment at maturity	—	—	—	(7,288)
Distributions on trust units	(1,359)	(2,665)	(4,089)	(11,335)
Principal repayments on mortgages and capital leases	(10,605)	(895)	(35,707)	(2,638)
Mortgage refinancing costs	—	—	(283)	—
Proceeds from repayment of employee unit purchase loans	28	13	34	34
	(3,994)	(5,184)	(34,958)	(15,782)
<b>INVESTING ACTIVITIES</b>				
Proceeds on dispositions of marketable securities	—	1,644	38,556	11,631
Purchase of marketable securities	(54)	—	(54)	(47)
Acquisitions of capital assets	(2,792)	(2,217)	(3,568)	(3,591)
Net acquisitions on expansion of property – discontinued operations	—	(186)	—	(5,787)
Decrease in restricted cash	206	468	1,308	1,443
Net cash on insurance recovery	—	168	—	975
	(2,640)	(123)	36,242	4,624
<b>Decrease in cash</b>	<b>(4,386)</b>	<b>(403)</b>	<b>—</b>	<b>(4,385)</b>
<b>Cash, beginning of period</b>	<b>4,386</b>	<b>2,458</b>	<b>—</b>	<b>6,440</b>
<b>Cash, end of period</b>	<b>—</b>	<b>2,055</b>	<b>—</b>	<b>2,055</b>
Cash interest received	2	1	43	92
Cash interest paid				
Mortgages and capital leases	1,018	1,926	4,612	5,621
Convertible debentures	1,613	1,678	5,785	6,798
Total cash interest paid	2,631	3,604	10,397	12,419

*See accompanying Notes to the Consolidated Interim Financial Statements*

## **Royal Host Real Estate Investment Trust**

### **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

Three and nine months ended September 30, 2010 and 2009

*Unaudited (in thousands of dollars, except per unit amounts)*

#### **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.

The accompanying unaudited interim consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). The accounting principles used in these financial statements are consistent with those used in the annual consolidated financial statements of the year ended December 31, 2009. These financial statements do not include all the information and disclosure required by GAAP for annual financial statements, and should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2009.

Revenues earned from hotel operations fluctuate throughout the year, with the second and third quarters typically higher than the first and fourth due to the increased level of leisure travel in the summer months.

#### **2. FUTURE CHANGES IN ACCOUNTING POLICIES**

##### **Future Accounting Changes**

###### **International Financial Reporting Standards (“IFRS”)**

The Canadian Accounting Standards Board (“AcSB”) confirmed that the adoption of IFRS would be effective for the interim and annual periods beginning on or after January 1, 2011 for Canadian publicly accountable profit-oriented enterprises. IFRS will replace Canadian GAAP for these enterprises. Comparative IFRS information for the previous fiscal year will also have to be reported. These new standards will be effective for Royal Host in the first quarter of 2011.

Royal Host is currently in the process of evaluating the potential impact of IFRS to its consolidated financial statements as part of the Trust’s IFRS transition project. This is an ongoing process as the International Accounting Standards Board (“IASB”) and the AcSB issue new standards and recommendations. Royal Host’s consolidated financial position, as disclosed in the Trust’s Canadian GAAP financial statements, may be significantly different when presented in accordance with IFRS.

###### **Business Combinations**

The CICA issued Section 1582, “Business Combinations”, which replaces Section 1581, “Business Combinations”. This new standard aligns accounting for business combinations under Canadian GAAP with IFRS and is effective for business combinations entered into on or after January 1, 2011. The adoption of the revised standard is expected to impact Royal Host's financial statements only to the extent that business combinations are entered into after the effective date.

## Royal Host Real Estate Investment Trust

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Three and nine months ended September 30, 2010 and 2009

Unaudited (in thousands of dollars, except per unit amounts)

### 3. MORTGAGES

	September 30, 2010	December 31, 2009
	\$	\$
Mortgages, secured by hotel properties	44,585	80,224
Less: current portion	(1,125)	(56,761)
	43,460	23,463

Principal repayments required for the twelve months ending September 30:

	\$
2011	1,266
2012	12,368
2013	24,744
2014	6,568
Total principal outstanding	44,946
Debt issuance costs	(361)
	44,585

During the three months ending September 30, 2010, the Trust repaid a mortgage pool in the amount of \$10,218 utilizing its cash on hand and the line of credit facility. The eight properties that previously secured the mortgage pool are now unencumbered.

The Trust has a line of credit, secured by six properties, for which the availability is subject to an earnings test. The capacity of the line is subject to an earnings test based on the operating results of the secured properties to a maximum of \$20,700. The amount drawn on the operating line as of September 30, 2010 was \$ 9,726 (December 31, 2009 - \$881).

### 4. CONVERTIBLE DEBENTURES

	September 30, 2010	December 31, 2009
	\$	\$
6.00% Convertible Unsecured Subordinated Debentures, Series B	44,107	44,477
6.25% Convertible Unsecured Subordinated Debentures, Series C	48,410	50,658
5.90% Convertible Unsecured Subordinated Debentures, Series D	51,847	52,157
	144,364	147,292

#### (a) 6.00% Convertible Unsecured Subordinated Debentures, Series B

Commencing on September 10, 2010, Royal Host initiated a normal course issuer bid to repurchase a maximum of \$4,163 in principal of its issued and outstanding 6.00% convertible debentures. During the three and nine months ended September 30, 2010, Royal Host repurchased none of the 6.00% convertible debentures pursuant to this bid.

Commencing on September 10, 2009, Royal Host initiated a normal course issuer bid to repurchase a maximum of \$4,200 in principal of its issued and outstanding 6.00% convertible debentures. During the three and nine months ended September 30, 2010, Royal Host repurchased \$277 and \$619 in principal of the 6.00% convertible debentures with an aggregate cost of \$206 (average cost \$74.53) and \$464 (average cost of \$74.98) pursuant to this bid.

## **Royal Host Real Estate Investment Trust**

### **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

Three and nine months ended September 30, 2010 and 2009

*Unaudited (in thousands of dollars, except per unit amounts)*

#### **4. CONVERTIBLE DEBENTURES (CONT'D)**

##### **(a) 6.00% Convertible Unsecured Subordinated Debentures, Series B (CONT'D)**

Commencing on September 10, 2008, Royal Host initiated a normal course issuer bid to repurchase a maximum of \$5,500 in principal of its issued and outstanding 6.00% convertible debentures. During the three and nine months ended September 30, 2009 none of Royal Host's convertible debentures were purchased pursuant to this bid.

During the nine months ended September 30, 2009, \$952 of Royal Host's 6.00% convertible debentures were converted into trust units.

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

Commencing on September 10, 2010, Royal Host initiated a normal course issuer bid to repurchase a maximum of \$5,010 in principal of its issued and outstanding 6.25% convertible debentures. During the three and nine months ended September 30, 2010, Royal Host repurchased none of the 6.25% convertible pursuant to this bid.

Commencing on September 10, 2009, Royal Host initiated a normal course issuer bid to repurchase a maximum of \$5,200 in principal of its issued and outstanding 6.25% convertible debentures. During the three and nine months ended September 30, 2010, Royal Host repurchased \$1,429 and \$2,760 in principal of the 6.25% convertible debentures with an aggregate cost of \$1,141 (average cost \$79.87) and \$2,250 (average cost \$81.51) pursuant to this bid.

Commencing on September 10, 2008, Royal Host initiated a normal course issuer bid to repurchase a maximum of \$5,900 in principal of its issued and outstanding 6.25% convertible debentures. During the three and nine months ended September 30, 2009, Royal Host repurchased \$nil and \$2,772 in principal of the 6.25% convertible debentures with an aggregate cost of \$nil and \$1,902 (average cost \$68.60) pursuant to this bid.

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

Commencing on September 10, 2010, Royal Host initiated a normal course issuer bid to repurchase a maximum of \$5,400 in principal of its issued and outstanding 5.90% convertible debentures. During the three and nine months ended September 30, 2010, Royal Host repurchased none of the 5.90% convertible debentures pursuant to this bid.

Commencing on September 10, 2009, Royal Host initiated a normal course issuer bid to repurchase a maximum of \$5,400 in principal of its issued and outstanding 5.90% convertible debentures. During the three and nine months ended September 30, 2010, Royal Host repurchased \$96 and \$571 in principal of the 5.90% convertible debentures with an aggregate cost of \$71 (average cost of \$73.87) and \$413 (average cost of \$72.28) pursuant to this bid.

Commencing on September 10, 2009, Royal Host initiated a normal course issuer bid to repurchase a maximum of \$5,400 in principal of its issued and outstanding 5.90% convertible debentures. During the three and nine months ended September 30, 2009, Royal Host repurchased \$95 in principal of the 5.90% convertible debentures with an aggregate cost of \$56 (average cost of \$58.49) pursuant to this bid.

Commencing on September 10, 2008, Royal Host initiated a normal course issuer bid to repurchase a maximum of \$6,000 in principal of its issued and outstanding 5.90% convertible debentures. During the three and nine months ended September 30, 2009, Royal Host repurchased \$2,168 and \$2,758 in principal of the 5.90% convertible debentures with an aggregate cost of \$1,262 (average cost of \$58.23) and \$1,608 (average cost of \$58.29) pursuant to this bid.

## Royal Host Real Estate Investment Trust

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Three and nine months ended September 30, 2010 and 2009

Unaudited (in thousands of dollars, except per unit amounts)

## 5. NORMAL COURSE ISSUER BID AND SUBSTANTIAL ISSUER BID

### Normal Course Issuer Bid

Commencing on January 8, 2010, Royal Host initiated a normal course issuer bid to repurchase a maximum of 1.3 million of its issued and outstanding trust units. During the three and nine months ended September 30, 2010, Royal Host repurchased -152,400 and 161,100 units with an aggregate cost of \$365 (average price of \$2.40) and \$388 (average price \$2.41) pursuant to this bid. Subsequent to September 30, 2010, Royal Host repurchased no trust units pursuant to this bid.

Commencing on January 12, 2009, Royal Host initiated a normal course issuer bid to repurchase a maximum of 1.5 million of its issued and outstanding trust units. During the three and nine months ended September 30, 2009, Royal Host repurchased -132,800 and 1,338,156 units with an aggregate cost of \$273 (average price of \$2.08) and \$3,881 (average price \$2.84) pursuant to this bid.

### Substantial Issuer Bid

On November 4, 2009, Royal Host initiated a substantial issuer bid ("SIB"), pursuant to which Royal Host offered to purchase for cancellation up to 5 million of its issued and outstanding trust units at a price of \$2.45 per trust unit. The offer remained open for acceptance until December 14, 2009 and unitholders tendered 1.2 million units which Royal Host purchased and cancelled. At December 14, 2009, Royal Host extended the offer to remain open for acceptance until January 11, 2010. Unitholders tendered a further 99,102 units during the extension period which Royal Host purchased and cancelled.

## 6. PER UNIT CALCULATIONS

As at September 30, 2010, a total of 18,044,468 trust units (December 31, 2009 – 18,304,670) were issued and outstanding. The following table reconciles the basic and diluted per unit computations:

	Three months ended September 30, 2010				Three months ended September 30, 2009	
	Loss	Units	Per unit	Income	Units	Per unit
	\$	(in thousands) #	amount \$	(loss) \$	(in thousands) #	amount \$
<b>Basic earnings (loss) per unit</b>						
Loss from continuing operations	(976)	18,142	(0.05)	(2,223)	19,707	(0.11)
Income (loss) from discontinued operations	(17)	18,142	—	121	19,707	0.01
Basic loss per unit	(993)	18,142	(0.05)	(2,102)	19,707	(0.10)
<b>Diluted earnings (loss) per unit</b>						
Loss from continuing operations	(976)	18,142	(0.05)	(2,223)	19,707	(0.11)
Income (loss) from discontinued operations	(17)	18,142	—	121	19,707	0.01
Diluted loss per unit	(993)	18,142	(0.05)	(2,102)	19,707	(0.10)

**Royal Host Real Estate Investment Trust**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

Three and nine months ended September 30, 2010 and 2009

Unaudited (in thousands of dollars, except per unit amounts)

**6. PER UNIT CALCULATIONS (CONT'D)**

	Nine months ended September 30, 2010				Nine months ended September 30, 2009	
	Income (loss) \$	Units (in thousands) #	Per unit amount \$	Loss \$	Units (in thousands) #	Per unit amount \$
<b>Basic earnings (loss) per unit</b>						
Income (loss) from continuing operations	4,825	18,187	0.27	(2,578)	19,859	(0.13)
Loss from discontinued operations	(496)	18,187	(0.03)	(39)	19,859	—
Basic earnings (loss) per unit	4,329	18,187	0.24	(2,617)	19,859	(0.13)
<b>Diluted earnings (loss) per unit</b>						
Income (loss) from continuing operations	4,825	18,187	—	(2,578)	19,859	(0.13)
Interest on assumed conversion of convertible debentures	4,507	20,478	—	—	—	—
Diluted earnings (loss) from continuing operations	9,332	38,665	0.24	(2,578)	19,859	(0.13)
Loss from discontinued operations	(496)	38,665	(0.01)	(39)	—	—
Diluted earnings (loss) per unit *	8,836	38,665	0.23	(2,617)	19,859	(0.13)

\* All potential dilutive securities issued relate to convertible debentures which were anti-dilutive for the three months ended September 30, 2010 and the three and nine months ended September 30, 2009.

**7. SUPPLEMENTAL CASH FLOW INFORMATION**

	Three months ended September 30, 2010 \$	Three months ended September 30, 2009 \$	Nine months ended September 30, 2010 \$	Nine months ended September 30, 2009 \$
<b>Adjustments for items not involving cash</b>				
Depreciation and amortization	3,091	3,203	9,500	9,656
Impairment of intangible assets	—	—	601	—
Future income tax recovery (recovery) expense	(534)	(220)	(2,134)	(608)
Other than temporary impairment on marketable securities	—	4,009	—	4,009
Realized and un realized gains on held-for-trading securities	—	—	—	(195)
Realized gains on available-for-sale securities	—	(42)	(12,747)	(900)
Gain on convertible debenture repurchases	(360)	(887)	(768)	(1,921)
Accretion on mortgages and capital leases	183	61	300	197
Accretion on convertible debentures	287	273	866	867
<b>Adjustments for items not involving cash</b>	<b>2,667</b>	<b>6,397</b>	<b>(4,382)</b>	<b>11,105</b>

**Royal Host Real Estate Investment Trust**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

Three and nine months ended September 30, 2010 and 2009

*Unaudited (in thousands of dollars, except per unit amounts)*

**7. SUPPLEMENTAL CASH FLOW INFORMATION (CONT'D)**

	<b>Three months ended September 30, 2010</b>	Three months ended September 30, 2009	<b>Nine months ended September 30, 2010</b>	Nine months ended September 30, 2009
	\$	\$	\$	\$
<b>Net changes in non-cash working capital – continuing operations</b>				
<b>Decrease (increase) in:</b>				
Accounts, notes and distributions receivable	217	(607)	(408)	(2,093)
Prepaid expenses	615	(88)	(42)	(983)
Inventories	12	(2)	(114)	99
	<b>844</b>	<b>(697)</b>	<b>(564)</b>	<b>(2,977)</b>
<b>Increase (decrease) in:</b>				
Accounts payable and accrued liabilities	(932)	846	(1,859)	961
Interest accrued on convertible debentures	668	668	644	519
Deferred revenue	(71)	(59)	129	127
	<b>(335)</b>	<b>1,455</b>	<b>(1,086)</b>	<b>1,607</b>
<b>Net change in non-cash working capital – continuing operations</b>	<b>509</b>	<b>758</b>	<b>(1,650)</b>	<b>(1,370)</b>

**8. OTHER COMPREHENSIVE INCOME (LOSS)**

Other comprehensive income (loss) includes the following:

	<b>Three months ended September 30, 2010</b>	Three months ended September 30, 2009	<b>Nine months ended September 30, 2010</b>	Nine months ended September 30, 2009
	\$	\$	\$	\$
Unrealized gains (losses) generated on available-for-sale securities	(589)	2,222	1,792	2,958
Other than temporary impairment on available-for-sale securities transferred to net income (loss)	—	4,009	—	4,009
Realized gains on available-for-sale securities transferred to net income (loss)	—	(42)	(12,747)	(900)
<b>Other comprehensive income (loss)</b>	<b>(589)</b>	<b>6,189</b>	<b>(10,955)</b>	<b>6,067</b>

## **Royal Host Real Estate Investment Trust**

### **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

Three and nine months ended September 30, 2010 and 2009

*Unaudited (in thousands of dollars, except per unit amounts)*

#### **9. RELATED PARTY TRANSACTIONS**

At September 30, 2010, Clarke Inc. owned approximately 29% of Royal Host's issued and outstanding trust units and, as such, is a related party (December 31, 2009 – 29%).

During the three and nine months ended September 30, 2010, the Trust incurred professional and management fees of \$335 and \$1,198 for services supplied by Clarke Inc. (three and nine months ended September 30, 2009 - \$300 and \$500 respectively). As at September 30, 2010, \$36 was owing in respect of these fees (December 31, 2009 - \$458).

During the three and nine months ended September 30, 2010, the Trust incurred leasing costs for office space provided by a Company controlled by a Trustee of Royal Host of \$27 (three and nine months ended September 30, 2009 - \$nil and \$nil). As at September 30, 2010, \$nil was owing in respect of these fees (December 31, 2009 - \$nil).

During the three and nine months ended September 30, 2010, the Trust incurred consulting fees for services provided by a Company controlled by a Trustee of Royal Host of \$nil (three and nine months ended September 30, 2009 - \$nil and \$100). As at September 30, 2010, \$nil was owing in respect of these fees (December 31, 2009 - \$nil).

#### **10. CONTINGENCIES**

Royal Host has certain matters outstanding with taxation authorities related to its 2008 reorganization. Royal Host believes its positions on these matters are valid and that ultimately no amount will be payable. However, if Royal Host's positions are not ultimately sustained on one or more of these matters, material amounts would be payable.

**2010** *Q3*

MANAGEMENT'S  
DISCUSSION AND  
ANALYSIS

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# **MANAGEMENT'S DISCUSSION & ANALYSIS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010**

Management's Discussion & Analysis ("MD&A") presents management's view of the financial position and performance of Royal Host Real Estate Investment Trust ("Royal Host" or "the Trust") for the three and nine months ended September 30, 2010 compared with the three and nine months ended September 30, 2009. This interim MD&A should be read in conjunction with the information disclosed within the unaudited, interim consolidated financial statements and notes thereto for the three and nine months ended September 30, 2010. This interim MD&A is prepared as at November 12, 2010 (unless otherwise stated). All dollar amounts are shown in thousands of Canadian dollars unless otherwise indicated. Additional information relating to the Trust, including risk factors as described on pages 33 to 42 of the Trust's Annual Information Form ("AIF") dated as of March 8, 2010 is hereby incorporated by reference into this interim MD&A, and can be obtained from SEDAR at [www.sedar.com](http://www.sedar.com).

## **Non-GAAP Measures**

This interim MD&A includes certain non-GAAP measures (measures that are not calculated or presented in accordance with GAAP). Because these measures are not defined under GAAP, Royal Host's method of calculation may not be comparable to similar 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. This information is disclosed because the Trust believes these measures are useful in supplementing the reader's understanding of the Trust's performance.

This interim MD&A includes the following non-GAAP measures: Revenue per Available Room ("RevPAR"), Average Daily Rate ("ADR"), Occupancy, Hospitality Gross Margin, Cash Flows From Continuing, Discontinued and Total Operations, Distributable Income (and Basic and Diluted per Unit Distributable Income), Standardized Distributable Income, Funds from Operations and Adjusted Funds from Operations.

Management and the Board of Trustees use these measurements, among other purposes, to assess each property's market position among its competitive set and to assess Management's effectiveness in optimizing each property's transitory room inventory.

## **Cautionary Statement Regarding Forward-looking Information and Statements**

This interim MD&A sets out Management's assessment of the Trust's future plans and operations and contains forward-looking statements as defined under applicable Canadian securities legislation. These forward-looking statements typically contain the words "anticipate", "believe", "estimate", "expect", "may", "will", "should", "plan" or other similar terms and contain estimates or assumptions about the outcome of future events. These forward-looking statements are provided in the interest of providing readers with information regarding the Trust. Readers are cautioned that Management's expectations, estimates and assumptions, although considered reasonable, may prove to be incorrect and readers should not place undue reliance on forward-looking statements. 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 interim 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 above. The Trust's actual results could differ materially from those expressed in, or implied by, these forward-looking statements. The forward-looking information contained in this interim MD&A is expressly qualified by this cautionary statement. Royal Host does not undertake to update 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).

## OVERVIEW

During the third quarter of 2010, business across the Trust's properties increased slightly compared to the same period in the prior year, reflected in higher occupancy rates. Competition remains intense, as seen in the decline in the average daily rate as compared to the prior year. Royal Host and its hotel management companies continue to focus on revenue generation, cost control and liquidity management.

In the quarter, Royal Host:

- Announced its intention to convert to a dividend paying corporation;
  
- Generated overall Occupancy of 61.9% (2009 – 59.4%), Average Daily Rate of \$96.12 (2009 - \$98.52) and Revenue per Available Room of \$59.49 (2009 - \$58.54);
  
- Generated \$5.5 million of hospitality gross margin (2009 - \$7.3 million) from \$24.6 million of hospitality revenue (2009 - \$25.2 million);
  
- Repaid a mortgage pool in the amount of \$10,218 utilizing cash on hand and the Trust's credit facility. Seven of the eight properties that previously secured the mortgage pool are now unencumbered.
  
- Launched a complete renovation of the Oakville Holiday Inn to modernize and refresh the property as part of \$2.8 million in capital spending in the quarter;
  
- Had a comprehensive loss of \$1.6 million, including an other comprehensive loss of \$0.6 million (2009 – comprehensive income of \$4.1 million, including other comprehensive income of \$6.2 million and income of \$0.1 million from discontinued operations);
  
- Realized net loss of \$1.0 million (2009 – net loss of \$2.1 million), or loss of \$0.05 per unit (2009 – loss of \$0.10 per unit).

## Selected Financial Information

Highlights of the interim consolidated financial statements for the three and nine months ended September 30, 2010 compared to the three and nine months ended September 30, 2009 are as follows:

(\$000's, except as otherwise noted)	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Hospitality Revenue (Continuing Operations)	<b>24,634</b>	25,196	<b>69,748</b>	70,856
Hospitality Expenses	<b>19,135</b>	17,879	<b>56,355</b>	54,627
Hospitality Gross Margin <sup>(2)</sup>	<b>5,499</b>	7,317	<b>13,393</b>	16,229
Hospitality Gross Margin % <sup>(2)</sup>	<b>22.3%</b>	29.0%	<b>19.2%</b>	22.9%
Investment Income (loss)	<b>4</b>	(2,260)	<b>13,043</b>	3,958
Other Expenses	<b>7,013</b>	7,500	<b>23,745</b>	23,373
Future Income Tax Recovery	<b>(534)</b>	(220)	<b>(2,134)</b>	(608)
Income (Loss) From Continuing Operations	<b>(976)</b>	(2,223)	<b>4,825</b>	(2,578)
Income (Loss) From Discontinued Operations <sup>(1)</sup>	<b>(17)</b>	121	<b>(496)</b>	(39)
Net Income (Loss)	<b>(993)</b>	(2,102)	<b>4,329</b>	(2,617)
Basic Per Unit Net Income (Loss) (\$)				
From Continuing Operations	<b>(0.05)</b>	(0.11)	<b>0.27</b>	(0.13)
From Discontinued Operations	-	0.01	<b>(0.03)</b>	-
	<b>(0.05)</b>	(0.10)	<b>0.24</b>	(0.13)
Distributable Income <sup>(2)</sup>	<b>754</b>	3,205	<b>(2,221)</b>	5,725
Distributions Declared on Trust Units <sup>(3)</sup>	<b>1,359</b>	2,071	<b>4,089</b>	8,611
Basic Per Unit Distributable Income (\$) <sup>(2)</sup>	<b>0.04</b>	0.16	<b>(0.12)</b>	0.29
Per Unit Distributions Declared (\$)	<b>0.075</b>	0.105	<b>0.225</b>	0.435
Weighted Average Number of Trust Units Outstanding (000's)	<b>18,142</b>	19,707	<b>18,187</b>	19,859
Number of Trust Units Outstanding, as at September 30 (000's)	<b>18,044</b>	19,618	<b>18,044</b>	19,618
Closing Trust Unit Trading Price as at September 30 (\$)	<b>2.35</b>	2.17	<b>2.35</b>	2.17

As at November 12, 2010, Royal Host had 17,869,768 trust units outstanding.

<sup>(1)</sup> Discontinued operations are comprised of the Grand Okanagan Lakefront Resort and Conference Centre, the Holiday Inn Edmonton - The Palace, the El Rancho Motor Hotel & Convention Centre, the Travelodge Hotel Burlington on the Lake, the Thriftlodge Fort Nelson and the Sundial Inn, as described below in "Discontinued Operations".

<sup>(2)</sup> Items represent non-GAAP financial measures.

<sup>(3)</sup> Excludes the special distribution declared in February 2009, payable to Unitholders of record on December 29, 2008.

## **Hospitality Revenue**

For the three months ended September 30, 2010, hospitality revenue decreased by \$562 to \$24,634 from \$25,196. Room revenue was relatively static, with a slight decrease of \$8 to \$20,198 from \$20,206 in the prior year, despite an increase in RevPAR of 1.6% to \$59.49 from \$58.54 in 2009. The small decline in reported room revenue was due to fluctuations in the number of rooms available for rent in 2010 versus 2009. (Refer to "Key Performance Drivers And Measures" section of this MD&A).

Food and beverage revenue derived from restaurants and lounges, banquets and room service, decreased \$111 to \$2,809 compared to the third quarter of 2009 (\$2,920) due to the loss of a significant catering contract in 2010, changes in the guest sales mix and softness in certain markets. Franchising and management revenue decreased by \$293 to \$767 compared to \$1,060 in the third quarter of 2009 as the Trust exited the business of managing hotels for third parties.

For the nine months ended September 30, 2010, hospitality revenue decreased by \$1,108 to \$69,748 from \$70,856 in the prior year. Room revenue decreased by \$144 to \$55,484 from \$55,628 in the prior year, as ADR declined from \$99.50 (year-to-date 2009) to \$97.09 (year-to-date 2010) which was largely offset by an increase in occupancy from 54.7% to 56.7%. Food and beverage revenue derived from restaurants and lounges, banquets and room service, decreased slightly compared to the nine months ended 2009 by \$162 to \$9,937 (2009 - \$10,099). Franchising and management revenue decreased \$367 to \$1,666 in the nine months ended September 30, 2010 (2009 - \$2,033).

## **Hospitality Expenses**

For the three months ended September 30, 2010, hospitality expenses increased by \$1,256 to \$19,135 (2009 - \$17,879). Approximately \$420 of hospitality expense in the quarter relate to one-time charges due to the restructuring of operations. Management fees increased compared to the same quarter in 2009 due to the increased use of external management companies. All 31 hotels were managed by external management companies in the third quarter of 2010 compared to 7 in the third quarter of 2009. Accounting and payroll processing charges increased from the third quarter of 2009 to 2010 due to the outsourcing of these functions. These increases have been offset by a decrease in payroll for corporate administration in the third quarter of 2010 compared to 2009. This cost reduction is a direct result of the Trust's decision to contract out the management of all hotel properties in 2010.

For the nine months ended September 30, 2010, hospitality expenses increased by \$1,728 to \$56,355 from \$54,627 in 2009. Management fees have increased year to date as of September 30, 2010 compared to 2009. Additionally, accounting and payroll processing charges increased for the year to date as of September 2010 compared to 2009. These increases have been offset by a decrease in payroll for corporate administration.

## **Investment Income**

Total investment income was \$4 in the third quarter of 2010 compared to a loss of \$2,260 in the third quarter of 2009. During the third quarter of 2010, the Trust's only source of investment income was the interest earned on bank balances. In the third quarter of 2009, the Trust earned \$1,707 of distribution income offset by other-than-temporary impairment of marketable securities of \$4,009.

For the nine months ended September 30, 2010, investment income increased \$9,085 to \$13,043 due to an \$11,652 increase in the realized gains on the sale of securities in 2010. This increase was partially offset by a decrease in distribution income of \$6,576 due to the Trust's sale of distribution earning securities in 2010. Finally, there has been no other-than-temporary impairment of securities in 2010 to reduce investment income compared to the \$4,009 year to date reduction taken as of September 30, 2009.

## **Other Expenses**

For the three months ended September 30, 2010, other expenses totaled \$7,013, a decrease of \$487 from the 2009 level of \$7,500. Mortgage interest expense decreased \$849 due to the payout of two mortgage pools in 2010. This decrease was partially offset by a reduction in the gain on convertible debenture repurchases of \$527 in the third quarter of 2010 compared to 2009. In the third quarter of 2010, the Trust repurchased \$1,797 face value of convertible debentures at an average price of approximately \$79 per \$100 face value of debenture. This resulted in a smaller gain on convertible debenture repurchases than in the third quarter of 2009, when the Trust repurchased \$2,289 face value of convertible debentures at an average price of approximately \$58 per \$100 face value of debenture.

For the nine months ended September 30, 2010, other expenses increased \$372 to \$23,745 from \$23,373 in 2009. 2010 has had reduced gains on convertible debenture repurchases, an impairment charge on intangible assets with no comparable charge in 2009 as well as an increase in trust administration costs. These items have been partially offset by a decrease in mortgage interest expense and a decreased convertible debenture interest expense.

## **Future Income Tax Recovery**

For the three months ended September 30, 2010, the future income tax recovery of \$534 is \$314 higher than the recovery in 2009 of \$220. For the nine months ended September 30, 2010, the future income tax recovery of \$2,134 exceeded the same period in 2009 by \$1,526. The increases in both the 3 month and 9 month periods in 2010 over 2009 are both due to a change in estimate from prior periods.

## **Other Comprehensive Income (Loss)**

For the three months ended September 30, 2010, the Trust recognized other comprehensive loss of \$589, a decrease of \$6,778 when compared to the same period in 2009 in which the Trust recognized other comprehensive income of \$6,189. The decrease is due to unrealized losses on available for sale securities in 2010 as unit prices of portfolio investments declined in the quarter whereas 2009 had significant unrealized gains in the quarter and an other-than-temporary impairment of \$4,009 which was transferred out of accumulated other comprehensive income.

For the nine months ended September 30, 2010 the other comprehensive loss of \$10,955 was \$17,022 greater than the same period in 2009 in which the Trust recognized other comprehensive income of \$6,067. This decrease was primarily due to realized gains that were transferred out of accumulated other comprehensive income as the Trust sold a significant amount of investment holdings with unrealized gains in 2010. Comparatively, during the nine months ended September 30, 2009 other comprehensive income increased significantly primarily due to the increase in value of investments held by the Trust.

## Summary of Quarterly Financial Results

Note: the sum of quarterly per unit figures may not equal annual per unit figures

(\$000's, except as otherwise noted)	2010				2009			2008
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Revenue	<b>24,634</b>	<b>24,371</b>	<b>20,740</b>	22,746	25,196	23,968	21,684	25,266
Income (Loss)								
From Continuing Operations	<b>(976)</b>	(926)	<b>6,727</b>	1,151	(2,223)	1,128	(1,482)	(86,261)
From Discontinued Operations	<b>(17)</b>	(30)	<b>(449)</b>	17	121	(92)	(69)	205
	<b>(993)</b>	(956)	<b>6,278</b>	1,168	(2,102)	1,036	(1,551)	(86,056)
Per Unit Results (\$)								
Income (Loss) from Continuing Operations								
Basic	<b>(0.05)</b>	(0.05)	<b>0.37</b>	0.06	(0.11)	0.06	(0.07)	(4.13)
Diluted	<b>(0.05)</b>	(0.05)	<b>0.20</b>	0.06	(0.11)	0.06	(0.07)	(4.13)
Income (Loss) from Total Operations								
Basic	<b>(0.05)</b>	(0.05)	<b>0.35</b>	0.06	(0.10)	0.06	(0.07)	(4.12)
Diluted	<b>(0.05)</b>	(0.05)	<b>0.19</b>	0.06	(0.10)	0.06	(0.07)	(4.12)

Royal Host is a diversified hospitality trust that delivers Unitholder value through hotel ownership, investment and franchising. Royal Host's portfolio of Canadian hotels operate under a variety of recognizable brands as set forth in the table below, as well as a number of unbranded properties. The Trust's hotel portfolio is further enhanced by a stable franchising business and a portfolio of publicly-traded securities from within the hospitality and service sectors.

## Royal Host at a Glance

	ONTARIO			ATLANTIC			WESTERN			TOTAL		
	# of Hotels	# of Rooms	% of Guest Rooms	# of Hotels	# of Rooms	% of Guest Rooms	# of Hotels	# of Rooms	% of Guest Rooms	# of Hotels	# of Rooms	% of Guest Rooms
Travelodge® Thriftlodge®	9	1,215	33.1	-	-	-	4	404	11.0	13	1,619	44.1
Country Inns & Suites®	-	-	-	4	280	7.6	3	231	6.3	7	511	13.9
Independent	1	256	7.0	-	-	-	1	130	3.5	2	386	10.5
Hilton®	1	323	8.8	-	-	-	-	-	-	1	323	8.8
Super 8®	2	159	4.3	-	-	-	2	134	3.7	4	293	8.0
Holiday Inn®	2	254	6.9	-	-	-	-	-	-	2	254	6.9
Best Western®	-	-	-	-	-	-	1	160	4.4	1	160	4.4
Ramada®	1	124	3.4	-	-	-	-	-	-	1	124	3.4
	16	2,331	63.5	4	280	7.6	11	1,059	28.9	31	3,670	100.0
Full Service	8	1,418	60.8	-	-	-	2	290	27.4	10	1,708	46.5
Limited Service	8	913	39.2	4	275	100.0	9	769	72.6	21	1,962	53.5

The Trust's hotel portfolio of mostly mid-scale and lower mid-scale hotel properties is diversified geographically among seven provinces and territories and derives its revenues from numerous customer segments. The majority of the Trust's hotels derive the bulk of their revenue from corporate and transient oriented leisure segments; they depend less on the group tour segments as they are not situated in locations generally considered to be primary destination leisure markets. Approximately 75% - 80% of the Trust's room revenue is derived from transient room nights with the remainder derived from group business.

## Revenue

31 hotels / 3,670 rooms	Three months ended September 30			Nine months ended September 30		
	2010	2009	Variance	2010	2009	Variance
Room revenue	20,198	20,206	(8)	55,484	55,628	(144)
Food and beverage	2,809	2,920	(111)	9,937	10,099	(162)
Franchise and management	767	1,060	(293)	1,666	2,033	(367)
Other revenue	860	1,010	(150)	2,661	3,096	(435)
<b>Total revenue</b>	<b>24,634</b>	<b>25,196</b>	<b>(562)</b>	<b>69,748</b>	<b>70,856</b>	<b>(1,108)</b>

## Key Performance Drivers and Measures

### RevPAR, Occupancy and ADR

The hospitality industry and hotel real estate investment trusts commonly use three lodging statistics as key performance indicators:

- **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.

31 hotels / 3,670 rooms	Three months ended September 30, 2010			Three months ended September 30, 2009		
	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR
Region						
Ontario	61.5%	\$93.15	\$57.28	58.7%	\$95.34	\$55.99
Western	58.7%	\$103.07	\$60.50	58.6%	\$104.49	\$61.21
Atlantic	77.5%	\$96.26	\$74.56	68.5%	\$102.47	\$70.20
Total	61.9%	\$96.12	\$59.49	59.4%	\$98.52	\$58.54

31 hotels / 3,670 rooms	Nine months ended September 30, 2010			Nine months ended September 30, 2009		
	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR
Region						
Ontario	57.1%	\$95.37	\$54.41	54.5%	\$98.43	\$53.65
Western	54.7%	\$102.54	\$56.12	54.9%	\$102.54	\$56.26
Atlantic	61.2%	\$92.19	\$56.44	56.3%	\$96.97	\$54.62
Total	56.7%	\$97.09	\$55.05	54.7%	\$99.50	\$54.47

*Occupancy has been calculated including all available room nights at the Trust's hotels; available room nights have not been adjusted to exclude rooms/room nights unavailable during renovations.*

## ONTARIO

In Ontario, RevPAR increased by \$1.29, or 2.3%, from the third quarter of 2009 to \$57.28 in 2010. Paid occupancy had a relative increase of approximately 4.7% to 61.5% in the third quarter of 2010, which was partially offset by a relative decrease of 2.3% in ADR to \$93.15. The Trust has 16 hotels in Ontario operating in 12 different municipalities and has a fairly diverse set of marketplaces. Toronto, London, Chatham, Oakville, Trenton and Thunder Bay hotels had relative increases in occupancy from the third quarter of 2009 to 2010 ranging from 5.5% to 38.9%. Conversely, the markets in Timmins, Ottawa and North Bay were softer in the third quarter of 2010 compared to 2009 with relative decreases in occupancy ranging from 5.2% to 20.3%.

ADR in the third quarter of 2010 was down approximately 2.3% from 2009 in Ontario. Five of the hotels had an increase in ADR in the third quarter of 2010, up to 2.3%; seven of the hotels had a decrease in ADR from 1.2% to 4.4%; while the remaining four hotels had a decrease in ADR from 6.4% to 10.3%.

Year to date in 2010, an increase in relative occupancy of 4.7% in Ontario has been the main reason behind an increase of 1.4% in RevPAR from year to date in 2009.

## WESTERN

In Western Canada, RevPAR decreased by \$0.71, or 1.2%, from the third quarter of 2009 to \$60.50 in 2010. Paid occupancy had a relative increase of approximately 0.2% to 58.7% in the third quarter of 2010, which was more than offset by a decrease of 1.4% in ADR to \$103.07. Yellowknife, Red Deer, AB and Brooks, AB experienced relative increases in occupancy from 15.6% to 33.3% from the third quarter of 2009 to 2010. These were primarily offset by decreases in relative occupancy in Calgary and Lethbridge between 9% and 14% in 2010. Occupancy rates in Saskatchewan and Manitoba were relatively static from the third quarter of 2009 to 2010.

ADR in the third quarter of 2010 was down approximately 1.4% from the third quarter of 2009 to 2010. Three markets in particular had an increase in ADR from 2009 ranging from 2.6% to 10.7%, these markets being Winnipeg, Yellowknife and Saskatoon. Six markets had a decrease in ADR ranging from 1.8% to 13.1%.

Year to date in 2010, strength in the Yellowknife and Saskatchewan markets have been virtually offset by weakness in the Alberta markets to yield a 0.2% decrease in RevPAR from 2009 to \$56.12.

## ATLANTIC

In Atlantic Canada, RevPAR increased by \$4.36, or 6.2%, from the third quarter of 2009 to \$74.56 in 2010. Paid occupancy had a relative increase of approximately 13.1% to 77.5% in the third quarter of 2010, which was partly offset by a relative decrease in ADR of approximately 6.1% to \$96.26. While all four hotels in Atlantic Canada experienced occupancy increases, Dartmouth and Moncton had the most significant relative increases, at 27.7% and 16.3% respectively. This robust increase in

occupancy was tempered somewhat by a decrease in ADR from the third quarter of 2009 ranging from 3.1% to 8.8% for the four hotels.

Year to date in 2010, an 8.7% relative increase in occupancy rate in Atlantic Canada has been the primary driver of an increase of 3.3% in RevPAR.

## Distributable Income, Standardized Distributable Cash, Funds From Operations and Adjusted Funds From Operations

Distributable Income, Standardized Distributable Cash, Funds from Operations and Adjusted Funds from Operations are non-GAAP measures commonly used by hotel real estate investment trusts. As a non-GAAP measure, the calculation of each of these measures and reporting practices varies widely.

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

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

### Distributable Income

Distributable Income is commonly used to measure the performance of real estate investment trusts. Management believes that Distributable Income provides useful supplemental information. Distributable Income is not a measure defined by GAAP, nor does it have a standard definition, and as such may not be comparable to measures by other trusts that use similar terms. Royal Host calculates Distributable Income by deducting a provision for capital replacement (calculated as 4.0% of rooms and food and beverage revenue) from cash flows from total operations, as presented in the Trust's unaudited, interim Consolidated Financial Statements.

Distributable Income (\$'000's, except as otherwise noted)	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Cash Flows from (used in) Operating Activities	2,248	4,904	(1,284)	6,773
Changes in Non-Cash Working Capital	(574)	(774)	1,680	1,581
Cash Flows from Total Operations	1,674	4,130	396	8,354
Provision for Capital Replacement <sup>(1)</sup>	(920)	(925)	(2,617)	(2,629)
Distributable Income	754	3,205	(2,221)	5,725
Distributions Declared				
Monthly	1,359	2,071	4,089	8,611
Basic Per Unit Distributable Income (\$) <sup>(2)</sup>	0.04	0.16	(0.12)	0.29
Diluted Per Unit Distributable Income (\$) <sup>(2)</sup>	0.04	0.10	(0.12)	0.23
Per Unit Distributions Declared (\$) <sup>(2)</sup>	0.075	0.105	0.225	0.435

(1) This provision is calculated as 4.0% of rooms and food and beverage revenue (as originally reported).

(2) Based on a weighted-average number of trust units of 18,142,443 (basic and diluted) (2009 – 19,706,548 (basic) and 49,970,950 (diluted)) and 18,185,629 (basic and diluted) (2009 – 19,859,364 (basic) and 49,986,590 (diluted)) for the three and nine months ended September 30, 2010 and 2009 respectively.

Distributable Income decreased comparatively for the three months ended September 30, 2010 by \$2,451 to \$754, or \$0.04 per unit (2009 – \$3,205, or \$0.16 per unit), due primarily to a decrease in cash flow from total operations of \$2,456 from three months ending 2009 to 2010. This decrease was largely driven by two factors – (1) a decrease in distribution income of \$1,703 due to sale of distribution yielding investments subsequent to the third quarter of 2009 but prior to the third quarter of 2010, and (2) an increase in hospitality expenses of \$1,256 as Royal Host makes the transition from internally managed hotels to 100% of hotels being managed by third party management companies, effective June 2010.

The table below illustrates the components of cash flows from total operations.

### CASH FLOWS FROM TOTAL OPERATIONS

(\$000's, except as otherwise noted)	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
<b>CONTINUING OPERATIONS</b>				
Hospitality Gross Margin	5,499	7,317	13,393	16,229
Distributions and Interest	4	1,707	296	6,872
Other Expenses:				
Trust Administration	(588)	(579)	(2,215)	(1,643)
Interest on Mortgages and Capital Leases	(950)	(1,921)	(4,116)	(5,611)
Interest on Convertible Debentures	(2,274)	(2,350)	(6,915)	(7,320)
Cash Flows from Continuing Operations	1,691	4,174	443	8,527
<b>DISCONTINUED OPERATIONS</b>				
Cash Flows used in Discontinued Operations	(17)	(44)	(47)	(173)
<b>CASH FLOWS FROM TOTAL OPERATIONS</b>	<b>1,674</b>	<b>4,130</b>	<b>396</b>	<b>8,354</b>
Net changes in non-cash working capital – continuing operations	509	758	(1,650)	(1,370)
Net changes in non-cash working capital – discontinued operations	65	16	(30)	(211)
<b>CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES</b>	<b>2,248</b>	<b>4,904</b>	<b>(1,284)</b>	<b>6,773</b>

During the third quarter of 2010, Royal Host's continuing operations generated \$1,691 of cash flow, representing a \$2,483 decrease from 2009. This was mainly due to a decrease in distribution income and reduced hospitality gross margin partially offset by a decline in mortgage interest.

During the three months ended September 30, 2010, Royal Host's discontinued operations consumed \$17 in cash flow compared to \$44 consumed in the same period in 2009.

For the three months ended September 30, 2010, changes in non-cash working capital generated \$574 of cash flow compared to \$774 in the same period in 2009, mainly due to a decrease in prepaid expenses in the quarter of \$615 along with an increase in interest accrued on convertible debentures of \$668. The aforementioned factors were mitigated by a decrease in accounts payable of \$932 in the third quarter of 2010, which was a use of cash.

### Standardized Distributable Cash

The Interpretive Release issued by the Canadian Institute of Chartered Accountants recommends disclosure of Standardized Distributable Cash. This is provided in the table below.

Standardized Distributable Cash is defined as the periodic cash flows from operating activities determined in accordance with GAAP, including the effect of changes in non-cash working capital and any operating cash flows provided for or used in discontinued operations, less adjustments for:

- A) total capital expenditures; and
- B) restrictions on distributions arising from compliance with financial covenants and limitations arising from the existence of a minority interest in a subsidiary.

The Interpretive Release recommends the analysis of the relationship between Standardized Distributable Cash, distributions (including unit repurchases through normal course and substantial issuer bids or any other unit transactions executed in exchange for cash in the normal course of business), and investing and financing activities.

(\$000's, except as otherwise noted)	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Cash Flows From (used in) Operating Activities	2,248	4,904	(1,284)	6,773
Capital Expenditures	(2,792)	(2,217)	(3,568)	(3,591)
Standardized Distributable Cash	(544)	2,687	(4,852)	3,182
Distributions Declared	1,359	2,071	4,089	8,611
Repurchases of Trust Units	365	275	631	3,881
Total Cash Distributions and Unit Repurchases	1,724	2,346	4,720	12,492

The table below reconciles Standardized Distributable Cash and Distributable Income.

(\$000's, except as otherwise noted)	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Standardized Distributable Cash	(544)	2,687	(4,852)	3,182
Capital Expenditures greater than Provision for Capital Replacement	1,872	1,292	951	962
Increase (Decrease) in Non-cash Working Capital	(574)	(774)	1,680	1,581
Distributable Income	754	3,205	(2,221)	5,725

The calculation of Standardized Distributable Cash includes the effect of changes in non-cash working capital, whereas the calculation of Distributable Income excludes the effect of changes in non-cash working capital. Furthermore, the calculation of Standardized Distributable Cash includes the deduction of total capital expenditures, whereas the calculation of Distributable Income includes the deduction of the Trust's provision for capital replacement (calculated as 4.0% of total rooms and food and beverage revenue).

## Funds From Operations and Adjusted Funds From Operations

(\$000's, except as otherwise noted)	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Cash Flows From Total Operations	1,674	4,130	396	8,354
Realized Gains on Available-For-Sale Securities	-	42	12,747	900
Realized and Unrealized Gains on Held-For-Trading Securities	-	-	-	195
Accretion on Mortgages and Capital Leases	(183)	(61)	(300)	(198)
Accretion on Convertible Debentures	(287)	(273)	(866)	(867)
Gain on Repurchases of Convertible Debentures	360	887	768	1,921
Funds From Operations	1,564	4,725	12,745	10,305
Provision for Capital Replacement	(920)	(925)	(2,617)	(2,629)
Adjusted Funds From Operations	644	3,800	10,128	7,676
Per Unit Funds From Operations (\$)				
Basic <sup>(1)</sup>	0.09	0.24	0.70	0.52
Diluted <sup>(1)</sup>	0.08	0.13	0.42	0.33
Per Unit Adjusted Funds From Operations (\$)				
Basic <sup>(1)</sup>	0.04	0.19	0.56	0.39
Diluted <sup>(1)</sup>	0.04	0.11	0.37	0.27

<sup>(1)</sup> Based on a weighted-average number of trust units of 18,142,443 (basic) and 38,346,992 (diluted) (2009 - 19,706,548 (basic) and 49,970,950 (diluted)) and 18,185,629 (basic) and 47,335,062 (diluted) (2009 - 19,859,364 (basic) and 49,986,590 (diluted)) for the three and nine months ended September 30, 2010, respectively.

For the three months ended September 30, 2010, the Trust recorded Funds from Operations of \$1,564 (2009 - \$4,725). The decrease from 2009 is primarily due to a decrease in the gross margin and decline in distribution income in the quarter.

Adjusted Funds from Operations for the three months ended September 30, 2010 was \$644 (2009 - \$3,800).

## Distributions to Unitholders

During the first three quarters of 2010, the Trust maintained monthly distributions of \$0.025 per trust unit. Distributions declared in the three months ended September 30, 2010 totaled \$1,359 compared to \$2,071 in 2009.

Royal Host sets monthly distributions based on, among other considerations, financial performance, projected cash flows, capital requirements and working capital requirements.

## Seasonality

The hospitality industry is seasonal in nature and the periods during which individual properties experience higher demand vary depending primarily on location. While the Trust's revenue is typically higher in the second and third quarters, as compared to the first and fourth quarters, several of the Trust's costs, including property taxes and interest, are fixed and other costs, such as

utilities, are largely fixed. Consequently, profitability varies significantly from quarter to quarter and distributions in certain quarters typically exceed the Trust's corresponding Distributable Income.

## **Discontinued Operations**

Discontinued operations is comprised of the four properties sold in 2008: Travelodge Hotel Burlington on the Lake, El Rancho Motor Hotel & Convention Centre, Holiday Inn Edmonton – The Palace, and Grand Okanagan Lakefront Resort and Conference Centre, as well as the Thriftlodge Fort Nelson, which was destroyed by fire in 2008 and the Sundial Inn which was decommissioned in 2008. The trust recorded an impairment charge on the Sundial Inn property of \$458 in the nine months ended September 30, 2010 to reflect estimated current net realizable value.

## **Liquidity and Capital Resources**

The Trust's principal sources of funds to satisfy cash requirements are cash flows from hospitality operations and sales of its portfolio of marketable securities.

As at September 30, 2010, Royal Host had drawn \$9,726 on its credit facility leaving undrawn credit facilities of \$10,974, marketable securities of \$2,697 (December 31, 2009 - \$39,409), and access to potential additional borrowing on its nineteen unencumbered properties. Royal Host's undrawn credit facility, additional borrowing potential and marketable securities, together with its future cash flows, are expected to be sufficient to fund anticipated cash requirements over the next year.

As at September 30, 2010, the Trust also had restricted cash of \$1,424 (December 31, 2009 - \$2,732) in the form of funds held by lenders, pursuant to financing arrangements for future planned capital expenditures.

## **Capital Structure**

As at September 30, 2010, mortgages and convertible debentures had an aggregate carrying value of \$188,949 (December 31, 2009 - \$227,516). Principal outstanding at September 30, 2010 totaled \$194,607 (December 31, 2009 - \$234,080).

Royal Host's "Adjusted Total Indebtedness" (excluding convertible debentures) is limited by its Declaration of Trust to 45% of gross book value. As at September 30, 2010, Royal Host's Adjusted Total Indebtedness to gross book value was 15.0% (December 31, 2009 – 23.3%). As at September 30, 2010, Royal Host's debt (including convertible debentures) to gross book value was 56.0% (December 31, 2009 – 67.1%).

## **Mortgages**

As at September 30, 2010, the carrying value of the Trust's mortgages was \$44,585 (December 31, 2009 - \$80,224). The carrying value reflects total outstanding principal of \$44,946 (December 31, 2009 - \$80,607) less \$361 of debt issuance costs (December 31, 2009 - \$245). The \$35,660 decrease in principal during the year is attributable to the repayment of two mortgage pools during the year of \$23,499 (relating to 11 hotels) in June and \$10,218 (relating to 8 hotels) in August, totaling \$33,717. In addition, regularly scheduled mortgage principal repayments made during 2010 were \$1,943.

## MORTGAGE MATURITIES

As at September 30, 2010	Principal Outstanding (\$000's)	Interest Rate	Security
October 2011	11,793	8.46%	1 hotel property
April 2013	4,878	8.50%	2 hotel properties
June 2013	20,895	6.82%	2 hotel properties
October 2013	<u>7,380</u>	7.37%	1 hotel property
Total	44,946		

As at September 30, 2010, the Trust has 19 operating hotel properties which have not been directly pledged as mortgage security. The Trust has a secured revolving credit facility with a maximum availability dependant on a valuation test. At September 30, 2010, the maximum availability of the facility is \$20,700 of which \$9,726 was drawn. The facility is secured by six hotel properties with interest accruing at the bank's prime lending rate plus a spread of 0.25% to 1.25% per annum.

## Related Party Transactions

At September 30, 2010, Clarke Inc. owned approximately 29% (2009 – 29%) of Royal Host's issued and outstanding trust units and, as such, is a related party.

During the three and nine months ended September 30, 2010, the Trust incurred professional and management fees totaling \$335 (2009 - \$300) and \$1,198 (2009 - \$500) for services provided by Clarke Inc.

## Intent to Convert to a Corporation

During the quarter, the Trust announced its intention to convert to a dividend paying corporation through a plan of arrangement intended to take effect as of January 1, 2011. While the Trust had previously indicated that it would not pursue a conversion in the near term, the Trustees have determined that a conversion at this time is appropriate to allow for a restructuring that will better achieve the objectives of the business and take advantage of growth opportunities that exist. It is anticipated that Royal Host will incorporate a new wholly-owned subsidiary ("Newco") and enter into an arrangement agreement with Newco. Under the terms of the arrangement, the Trust's Unitholders will receive one common share of Newco for each unit of the Trust held and Newco will assume all of the covenants and obligations of the Trust in connection with the Trust's outstanding convertible debentures. The plan of arrangement is subject to a positive vote in favour of the arrangement by the holders of at least 66 2/3% of Royal Host's Units represented at a special meeting of Unitholders. An information circular containing a summary of the arrangement agreement will be mailed to Unitholders in November, 2010 with the full text of the arrangement agreement filed on SEDAR at [www.sedar.com](http://www.sedar.com).

The Trust's proposed conversion to a corporation will effectively address all issues that related to Bill C-52. In June 2007, Bill C-52 (the "Bill") was enacted for the taxation of publicly traded trusts, including income trusts. The Bill imposes additional income taxes, 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 of such entities as dividends. The Bill applies to publicly traded trusts which existed prior to November 1, 2006 starting with taxation years ending in 2011. An exception to this legislation exists for those trusts that qualify as a real estate investment trust ("Qualifying REIT") in accordance with the legislation. Pursuant to the legislation, a REIT which carries on Canadian hotel operations will not be a Qualifying REIT. An existing trust may lose its relief from taxation in the interim periods to 2011 where it undergoes "undue

expansion". Based on the "normal growth" guidelines, Royal Host can issue approximately \$156 million in equity in 2010 and maintain its relief from taxation in 2011.

## **Environmental Matters**

The Trust is exposed to certain environmental risks in conducting regular operations including contamination of owned property and improper care and handling of raw materials and wastes.

Royal Host regularly reviews its operations and facilities to identify any potential environmental contamination or liability. These reviews identified no material remediation issues and potential risks and there have been no material events arising subsequently that would indicate additional obligations. Royal Host believes it complies materially with all relevant environmental laws and regulations. The Trust is not aware of any pending or proceeding actions against it or any of its subsidiaries relating to environmental issues.

## **Disclosure Controls and Procedures**

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Trust is communicated to Management on a timely basis to allow timely and appropriate decisions regarding required public disclosure.

An evaluation of the effectiveness of the design and operation of the Trust's disclosure controls and procedures was conducted as of September 30, 2010 by Management under the supervision of the Chief Financial Officer and the Trustee acting in the capacity of Chief Executive Officer. Based on that evaluation, these individuals concluded that the design and operation of these disclosure controls and procedures were effective as at September 30, 2010.

## **Internal Controls Over Financial Reporting and Disclosure**

Management is responsible for establishing and maintaining adequate internal controls over financial reporting ("ICFR") to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP.

Management, under the supervision of the Chief Financial Officer and the Trustee acting in the capacity of Chief Executive Officer, has evaluated the effectiveness of the Trust's ICFR using the COSO framework, published by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that the design and operating effectiveness of the Trust's ICFR were effective as of September 30, 2010.

## **Key Accounting Policies and Estimates**

Note 2 to the consolidated financial statements for the year ended December 31, 2009 includes a summary of the Trust's significant accounting policies.

The application of some of these policies requires the Trust to make estimates of future events that may have a material effect on current or future financial results. These estimates require experience and judgment 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**

International Financial Reporting Standards ("IFRS")

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, the AcSB confirmed in February

2008 that International Financial Reporting Standards will replace Canadian GAAP in 2011 for profit-oriented Canadian publicly accountable enterprises. Accordingly, the Trust will be required to adopt IFRS on January 1, 2011 for its interim periods and its fiscal year ended December 31, 2011. Comparative interim and annual information will be required for the year ending December 31, 2010.

The Trust's changeover plan to IFRS has been developed and its implementation has begun throughout the financial reporting environment. The changeover is being led by the Chief Financial Officer with the assistance of Royal Host finance staff. External advisors have also been engaged to assist in the transition to IFRS.

**Royal Host IFRS changeover plan: Assessment as of September 30, 2010**

<b>Key activity</b>	<b>Milestones/deadlines</b>	<b>Effort accomplished/remaining effort to complete</b>
<p><b>Financial statement preparation:</b></p> <p>Identification of differences in Canadian GAAP and IFRS accounting policies</p> <p>Selection of IFRS accounting policies</p> <p>Selection of IFRS 1 accounting policy choices</p> <p>Quantification of changes in accounting policy choices</p> <p>Identification of additional financial statement disclosure under IFRS</p>	<p>To be finalized before commencement of IFRS reporting in 2011.</p> <p>Assessment ongoing until reporting date but to be finalized during 4<sup>th</sup> quarter, 2010.</p>	<p>IFRS 1 accounting policy choices identified and critical items under review.</p> <p>Major Trust specific accounting policy choices identified.</p> <p>Full disclosure under IFRS to be performed internally for all quarters in 2010.</p>
<p><b>Information technology:</b></p> <p>Execution for running 2010 general ledger for both Canadian GAAP and IFRS determined</p> <p>Processing changes identified</p> <p>Additional data gathering (disclosures)</p>	<p>To be completed for parallel processing of 2010 general ledgers; 1<sup>st</sup> quarter, 2010.</p>	<p>IT assessment complete. No requirement for parallel general ledger in 2010.</p>
<p><b>Human capital and training:</b></p> <p>IFRS expertise identified and developed at all levels of the business (subsidiaries, parent, audit committee and board of directors)</p> <p>Additional human capital determined</p>	<p>Development ongoing until reporting date.</p>	<p>IFRS transition team chosen with expert technical resources identified.</p>
<p><b>Business activities:</b></p> <p>Financial covenants</p> <p>Compensation arrangements</p>	<p>Covenants/Incentive schemes to be recalculated under IFRS during the transition period in 2010. Covenant differences under IFRS to be communicated to financial institution as necessary.</p>	<p>Canadian GAAP dependant covenants identified.</p> <p>All GAAP applicable compensation agreements identified.</p>
<p><b>Policies &amp; control environment:</b></p> <p>ICFR:</p> <p>Accounting policy determination,</p>	<p>Accounting policy choice selection reviewed and approved by management</p>	<p>Accounting policy amendment team assembled.</p>

documentation and implementation	and audit committee before November 2010.	
Review of policy choice selection and implementation	CEO/CFO certification process updated by November 2010.	

\*\*\*Royal Host IFRS changeover plan may be amended anytime until the reporting date (January 1, 2011). Any change to the changeover plan will be identified in subsequent financial statement reporting periods.

#### First-Time Adoption of IFRS

The significant decisions under IFRS 1 which are currently being reviewed relate to:

<b>Relevant exemptions available under IFRS 1</b>	<b>Application</b>
Fair value or revaluation of deemed cost	The Trust may elect to measure an item of property, plant or equipment at the date of transition to IFRS at its fair value and use this value as its deemed cost at that date. At this time, the Trust is still assessing the application of this first time adoption option.

While work is still being undertaken on all areas of IFRS 1, it is not believed that any other decisions made under the provisions of IFRS 1, other than those noted above, will have a material impact on the financial statements of the Trust on transition.

#### Accounting Policies

The IFRS transition team continues to monitor and analyze differences in Canadian GAAP and IFRS accounting policies as they relate to the Trust. Based on the Trust's analysis to date, the following standards present the most significant differences the Trust will face upon transition to IFRS:

- Income Taxes (IAS 12)
- Property, Plant and Equipment (IAS 16)
- Financial Instruments - Presentation (IAS 32)
- Impairment of Assets (IAS 36)

The policy differences mentioned above does not represent an exhaustive list of differences the Trust will face upon transition to IFRS. Instead, the Trust believes at this time, these policy differences are the most relevant to the Trust's financial reporting. It is also important to note that the International Accounting Standards Board have various ongoing projects that could impact the breadth and depth of differences between IFRS and Canadian GAAP accounting policies before and after the date of transition. The IFRS transition team will monitor any new developments from these standard setters and analyze the impact that changes to IFRS standards may have on the Trust's consolidated financial statements. The Trust's analysis of differences between IFRS and Canadian GAAP accounting policies is not complete nor is the impact of these differences quantifiable at this time. The Trust expects to be able to reasonably determine and estimate the impact of these differences on the consolidated financial statements as the changeover plan progresses in the later part of the fiscal year. At that time, any quantifiable differences that can be reasonably determined and estimated will be disclosed.

#### Internal Control over Financial Reporting and Disclosure Controls and Procedures

As mentioned above, optional IFRS 1 exemptions and exceptions and accounting policy alternatives have been analyzed to date. In line with this analysis, the Trust has assessed the required changes to disclosure controls and procedures and controls over financial reporting that are associated with these various options and alternatives. Where the Trust has identified any potential changes, disclosure and financial reporting controls will be updated to ensure these controls remain adequate.

### Financial Reporting Expertise

The IFRS transition team has researched literature from various sources to assess the differences between IFRS and Canadian GAAP standards, IFRS 1 exemptions and exceptions, system applications and functions that could be used to enhance and assist with the IFRS changeover. The IFRS transition team will continually refine its IFRS knowledge base and hold training sessions for the remainder of the Trust's finance team that are impacted by the IFRS transition through the fourth quarter of 2010. In line with the Audit Committee charter, all members must have a sufficient level of financial literacy. As is the case, management has begun to work with these members to provide technical resources concerning IFRS as well as detailed status updates regarding the IFRS changeover plan. As 2010 progresses, management will continue to work closely with the Audit Committee to enhance their IFRS knowledge and the Trust's progress towards transition.

### Business Activities

The Trust has spent considerable time analyzing other business areas that may be affected due to the adoption of IFRS. The major other areas that may be impacted by this transition are:

#### 1) Borrowing

The Trust has a number of borrowing facilities that require certain covenant ratios to be maintained. The IFRS transition team has worked closely with the treasury function of the Trust to discuss any impact IFRS adjustments will have on these covenants. The treasury function will correspond with lenders when an accurate impact on these covenants can be determined.

#### 2) Declaration of Trust

The Declaration of Trust contains certain policies that are determined by amounts from the Trust's financial statements. The IFRS transition team will continue to monitor the impact of IFRS on the policies contained in the Declaration of Trust and keep the Audit Committee and Board of Trustees apprised of any potential impact.

### IT Systems

The Trust has performed a detailed analysis regarding the impact the IFRS transition will have on IT systems. The Trust believes that due to the nature of adjustments that need to be made on transition to IFRS no significant impact is expected with regards to the Trust's IT systems.

## **Outlook**

In its October 2010 Monetary Policy Report, the Bank of Canada suggests that the economic outlook for Canada has changed and now expects the economic recovery to be more gradual than previously projected. Real GDP is forecast to grow by 3.0% in 2010, 2.3% in 2011 and 2.6% in 2012. The Canadian economy is expected to return to full capacity and inflation return to the 2% target by the end of 2012.

PKF Consulting Inc, a hotel focused consulting group, released a market outlook in October, 2010 that forecast the Canadian hotel market will record a 4.1% increase to revenue per available room (RevPAR) in 2010 and projected a further 3.9% increase in 2011. These increases come after a 12% decline in 2009.

The improving economic conditions in Canada and positive projections for the hotel sector are encouraging for future results of the Trust. Royal Host continues its work to position hotel properties and its franchise business to take advantage of these positive trends.