

Consolidated Financial Statements

Lakeview Hotel Real Estate Investment Trust
June 30, 2009

Unaudited

**LAKEVIEW HOTEL REAL ESTATE
INVESTMENT TRUST**

Supplement to Consolidated Financial Statements
for the Six Months ended June 30, 2009 and 2008

**NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL
STATEMENTS**

Under National Instrument 51-109 Part 4 Subsection 4.3 (3)(a), if an auditor has not performed a review of interim financial statements, the statements must be accompanied by a notice indicating that they have not been reviewed by an auditor.

The unaudited interim financial statements of the Lakeview Hotel Real Estate Investment Trust for the six months ended June 30, 2009 and 2008 were prepared by, and are the responsibility of, the Trust's management.

The Lakeview Hotel Real Estate Investment Trust's independent auditor did not perform a review of these financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Lakeview Hotel Real Estate Investment Trust

CONSOLIDATED BALANCE SHEETS

Unaudited

	June 30 2009 \$	December 31 2008 \$
		<i>(audited)</i>
ASSETS		
Current		
Cash and cash equivalents	1,467,852	1,751,665
Reserve fund <i>[note 3]</i>	775,897	545,824
Deposits held in trust	300,000	300,000
Accounts receivable	1,532,447	1,479,824
Inventory	122,425	119,775
Prepaid expenses	1,240,790	187,549
Current portion of mortgages receivable <i>[note 4]</i>	2,331,110	150,000
Total current assets	<u>7,770,521</u>	<u>4,534,637</u>
Mortgages receivable <i>[note 4]</i>	841,764	4,902,767
Franchise fees and licenses <i>[note 5]</i>	126,514	166,188
Income properties <i>[notes 2, 6, 8, 9, 11 and 15]</i>	159,034,908	161,853,740
Investment in Lakeview Flag Licensing General Partnership <i>[note 7]</i>	154,039	120,171
	<u>167,927,746</u>	<u>171,577,503</u>
LIABILITIES AND UNITHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities <i>[note 15]</i>	4,074,958	3,154,468
Distributions payable	—	192,748
Loan payable <i>[note 8]</i>	4,200,000	4,200,000
Current portion of convertible debentures <i>[note 10]</i>	35,950	98,799
Current portion of mortgages payable <i>[note 11]</i>	2,633,311	9,362,752
Total current liabilities	<u>10,944,219</u>	<u>17,008,767</u>
Debentures <i>[note 9]</i>	9,608,736	9,519,251
Convertible debentures <i>[note 10]</i>	23,843,246	23,377,662
Mortgages payable <i>[note 11]</i>	83,670,477	77,999,532
Total liabilities	<u>128,066,678</u>	<u>127,905,212</u>
Unitholders' equity	<u>39,861,068</u>	<u>43,672,291</u>
	<u>167,927,746</u>	<u>171,577,503</u>

See accompanying notes

On behalf of the Board of Trustees:

"Gary Coleman"
Trustee

"Keith Levit"
Trustee

Lakeview Hotel Real Estate Investment Trust

CONSOLIDATED STATEMENTS OF LOSS AND
COMPREHENSIVE LOSS

Unaudited

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2009	2008	2009	2008
	\$	\$	\$	\$
REVENUE				
Rooms	7,592,028	8,321,629	15,350,471	16,283,839
Food, beverage and gift shop	737,379	939,012	1,504,435	2,043,748
Income from Lakeview Flag Licensing General Partnership <i>[note 7]</i>	149,909	156,913	331,298	318,298
Interest and miscellaneous	343,364	276,913	680,303	503,694
	8,822,680	9,694,467	17,866,507	19,149,579
EXPENSES				
Amortization				
Franchise fees and licenses	27,238	11,617	39,674	23,938
Income properties	1,670,211	1,522,152	3,343,262	2,939,962
Food, beverage and gift shop	299,672	381,441	600,721	829,967
General and administration <i>[note 15]</i>	2,353,424	1,859,314	4,099,838	3,545,893
Insurance	85,060	73,370	171,930	151,979
Interest				
Loan and other	51,077	6,127	108,922	9,983
Mortgages and debentures	2,432,512	2,188,627	4,874,098	3,998,228
Maintenance	171,372	241,705	356,926	476,771
Marketing <i>[note 15]</i>	597,250	624,093	1,149,771	1,264,879
Property taxes	508,230	479,680	993,924	838,710
Rent <i>[note 20]</i>	16,997	—	34,260	—
Salaries and benefits <i>[note 15]</i>	2,358,843	2,435,399	4,679,768	4,805,690
Supplies	183,654	218,184	335,399	445,481
Utilities	316,445	358,924	798,489	785,878
	11,071,985	10,400,633	21,586,982	20,117,359
Loss before income taxes	(2,249,305)	(706,166)	(3,720,475)	(967,780)
Recovery of income taxes - future	—	—	—	4,000
Net loss and comprehensive loss for the period	(2,249,305)	(706,166)	(3,720,475)	(963,780)
Basic and diluted net loss and comprehensive loss per Unit <i>[note 14]</i>	(0.115)	(0.037)	(0.192)	(0.050)

See accompanying notes

Lakeview Hotel Real Estate Investment Trust

**CONSOLIDATED STATEMENTS OF
UNITHOLDERS' EQUITY**

Unaudited

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2009	2008	2009	2008
	\$	\$	\$	\$
Unitholders' capital <i>[note 12]</i>				
Balance, beginning of period	59,040,134	59,021,720	59,040,134	59,021,720
Repayment of convertible debentures by issuance of Units	128,184	—	128,184	—
Conversion of debentures	—	18,438	—	18,438
Balance, end of period	59,168,318	59,040,158	59,168,318	59,040,158
Equity portion of convertible debentures				
Balance, beginning of period	3,760,355	2,883,536	3,760,355	2,883,536
Issuance of convertible debentures	—	954,268	—	954,268
Repayment of convertible debentures	(26,184)	—	(26,184)	—
Conversion of debentures	—	(1,759)	—	(1,759)
Issuance costs	—	(74,997)	—	(74,997)
Balance, end of period	3,734,171	3,761,048	3,734,171	3,761,048
Contributed capital				
Balance, beginning and end of period	401,745	345,900	401,745	345,900
Accumulated earnings (deficit)				
Balance, beginning of period	(179,581)	2,555,403	1,291,589	2,813,017
Net loss and comprehensive loss for the period	(2,249,305)	(706,166)	(3,720,475)	(963,780)
Balance, end of period	(2,428,886)	1,849,237	(2,428,886)	1,849,237
Accumulated distributions				
Balance, beginning of period	(21,014,280)	(15,484,743)	(20,821,532)	(13,363,180)
Distributions declared <i>[note 12]</i>	—	(2,121,760)	(192,748)	(4,243,323)
Balance, end of period	(21,014,280)	(17,606,503)	(21,014,280)	(17,606,503)
Unitholders' equity, end of period	39,861,068	47,389,840	39,861,068	47,389,840

See accompanying notes

Lakeview Hotel Real Estate Investment Trust

CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2009	2008	2009	2008
	\$	\$	\$	\$
OPERATING ACTIVITIES				
Net loss for the period	(2,249,305)	(706,166)	(3,720,475)	(963,780)
Add (deduct) items not involving cash				
Amortization of income properties	1,670,211	1,522,152	3,343,262	2,939,962
Amortization of franchise fees and licenses	27,238	11,617	39,674	23,938
Income from Lakeview Flag Licensing General Partnership <i>[note 7]</i>	(149,909)	(156,913)	(331,298)	(318,298)
Accretion on debt component of convertible debentures <i>[note 10]</i>	251,951	189,198	504,735	354,807
Accretion of debentures <i>[note 9]</i>	45,332	38,462	89,485	39,481
Accretion of mortgages payable	52,519	51,005	104,662	101,043
Decretion of mortgages receivable <i>[note 4]</i>	51,217	2,296	56,877	2,296
Loss on settlement of mortgages receivable <i>[note 4]</i>	98,244	—	98,244	—
Future income tax recovery	—	—	—	(4,000)
	(202,502)	951,651	185,166	2,175,449
Net change in non-cash working capital balances related to operations	(788,164)	(1,598,746)	(610,845)	(1,475,756)
Cash provided by (used in) operating activities	(990,666)	(647,095)	(425,679)	699,693
INVESTING ACTIVITIES				
Acquisition of income properties, cash consideration <i>[note 2]</i>	—	(10,028,181)	—	(10,028,181)
Additions to income properties	(304,788)	(668,475)	(524,430)	(1,132,720)
Deposits held in trust for hotel acquisition	—	9,918,683	—	(400,000)
Increase in franchise fees and licenses	—	(29,940)	—	(29,940)
Advance of mortgages receivable <i>[note 4]</i>	—	(4,000,000)	—	(4,000,000)
Collection of mortgages receivable <i>[note 4]</i>	1,578,882	—	1,728,882	—
Transaction costs on advance of mortgages receivable <i>[note 4]</i>	—	(40,725)	(4,110)	(40,725)
Distributions from Lakeview Flag Licensing General Partnership <i>[note 7]</i>	124,460	154,840	297,430	299,390
Cash provided by (used in) investing activities	1,398,554	(4,693,798)	1,497,772	(15,332,176)
FINANCING ACTIVITIES				
Unitholders' distributions				
Class A	—	(2,066,710)	(187,748)	(4,133,223)
Exchangeable Units	—	(55,050)	(5,000)	(110,100)
Proceeds from loan	—	2,800,000	—	2,800,000
Repayment of loan	—	(2,800,000)	—	(2,800,000)
Repayment of mortgages	(586,064)	(551,003)	(1,163,158)	(1,083,253)
Proceeds of debentures <i>[note 9]</i>	—	—	—	10,250,000
Proceeds of convertible debentures <i>[note 10 [d]]</i>	—	10,000,000	—	10,000,000
Financing costs on debentures and convertible debentures	—	(815,047)	—	(1,641,031)
Cash provided by (used in) financing activities	(586,064)	6,512,190	(1,355,906)	13,282,393
Net increase (decrease) in cash and cash equivalents during the period	(178,176)	1,171,297	(283,813)	(1,350,090)
Cash and cash equivalents, beginning of period	1,646,028	1,362,146	1,751,665	3,883,533
Cash and cash equivalents, end of period	1,467,852	2,533,443	1,467,852	2,533,443
Supplemental cash flow information				
Cash paid for interest	2,649,286	2,092,543	4,299,693	3,390,346

See accompanying notes

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009

Unaudited

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization and basis of presentation

Lakeview Hotel Real Estate Investment Trust ["Lakeview Hotel REIT"] is a closed-end real estate investment trust that was created pursuant to the Declaration of Trust dated February 11, 2004. Lakeview Hotel REIT was established under the laws of the Province of Manitoba and the laws of Canada applicable therein. Lakeview Hotel REIT issued Trust Units pursuant to a Qualifying Transaction, including a Plan of Arrangement which was completed on April 15, 2004. The Qualifying Transaction consisted of a private offering of Lakeview Hotel REIT Units, a public offering of Lakeview Hotel REIT subordinated convertible debentures, the acquisition of the Lakeview Inn & Suites, Fredericton, New Brunswick [the "Initial Property"] and the acquisition of a 49% interest in the Lakeview Flag Licensing General Partnership and a 50% interest in the Lakeview Flag Management General Partnership as described below. The principal purpose of Lakeview Hotel REIT is to provide Unitholders with an opportunity to participate in a diversified portfolio of hotel and extended-stay properties, and commercial and office properties ancillary thereto, located throughout Canada and the United States.

These consolidated financial statements include the accounts of Lakeview Hotel REIT's subsidiaries as follows: Lakeview Hotel REIT Operating Trust, Lakeview Flag Operating LP General Partner Inc., Lakeview Flag Operating Limited Partnership, 2330407 Manitoba Ltd., 1164656 Alberta Ltd., 1184720 Alberta Ltd., 1208406 Alberta Ltd., 1208417 Alberta Ltd., Vaughan Steeles Super 8 Ltd., 1227671 Alberta Ltd., 1236406 Alberta Ltd., 1236412 Alberta Ltd., 0759566 B.C. Ltd., 0760018 B.C. Ltd., 0760024 B.C. Ltd., 1312258 Alberta Ltd., 1317639 Alberta Ltd., 1323785 Alberta Ltd., 1360841 Alberta Ltd., 0816064 B.C. Ltd., 2178222 Ontario Inc., 1368641 Alberta Ltd., 0817928 B.C. Ltd. and 0824414 B.C. Ltd. Transactions within the consolidated group are eliminated upon consolidation.

The 50% interest in the Lakeview Flag Management General Partnership is proportionately consolidated as the partners jointly control this partnership. The 49% interest in the Lakeview Flag Licensing General Partnership is accounted for using the equity method.

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Significant accounting policies

These unaudited consolidated interim financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. They have also been prepared on a basis consistent with the December 31, 2008 audited financial statements and should be read in conjunction with the audited financial statements and the notes thereto.

[a] Cash and cash equivalents

Cash and cash equivalents consist of cash and guaranteed investment certificates with maturities of less than 90 days from the date of issuance and are readily convertible to cash.

[b] Inventory

Inventory is recorded at the lower of cost, on a first-in, first-out basis, and net realizable value.

[c] Franchise fees and licenses

Franchise fees include the application and initial fees associated with the transfer of membership of hotel franchises to Lakeview Hotel REIT. Franchise fees are stated at cost less accumulated amortization. Amortization is recorded using the straight-line method over the shorter of the term of the franchise agreement or the period over which management estimates the franchise will be retained.

Licenses include the costs associated with the purchase of the right to continue operation of existing video lottery terminals. Licenses are stated at cost less accumulated amortization. Amortization is recorded using the straight-line method over five years.

[d] Income properties

Income properties include land, buildings, parking lots, signs and furniture, fixtures and equipment.

Income properties are stated at the lower of cost less accumulated amortization or estimated net recoverable amount. Impairment of income properties is recognized when an event or change in circumstances causes the asset's carrying value to exceed the total undiscounted cash flows expected from its use and eventual disposition. The impairment loss is calculated by deducting the fair value of the asset from its carrying value.

Lakeview Hotel Real Estate Investment Trust

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Maintenance and repair costs are expensed against operations as incurred, while significant improvements, replacements and major renovations over \$30,000 are capitalized to income properties.

Amortization is recorded as follows:

Buildings	Straight-line over 40 years
Parking lots	Straight-line over 10 years
Signs	Straight-line over 10 years
Furniture, fixtures and equipment	Straight-line over 3 - 10 years

[e] Revenue recognition

Room revenue is recognized when the services are performed and collection is reasonably assured, which is generally on the night the rooms are rented.

Food and beverage revenue is recognized when the services are performed.

Interest income is recognized on an accrual basis using the effective interest method.

[f] Related parties

During 2009 and 2008, Lakeview Hotel REIT had transactions with the following related parties:

<u>Related parties</u>	<u>Nature of relationship</u>
Lakeview Management Inc. ["LMI"]	Unitholder and administrator
Free to Guest Movies Ltd.	A company related to LMI
Lakeview Flag Licensing General Partnership	Equity investee
Lakeview Flag Management General Partnership	Joint venture investee
XYZ Design Inc.	A company related to LMI
Keith Levit Photography	A business owned by the President and Trustee

[g] Lakeview Perks Loyalty Program

In 2006, LMI introduced the Lakeview Perks Loyalty Program. Members of the Lakeview Perks Loyalty Program earn points based on their spending at Lakeview Inn & Suites hotels and Lakeview Resorts. Points can be redeemed for hotel stays at participating hotels or other services

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or merchandise. The future redemption liability is included in accounts payable and accrued liabilities and is estimated based on points awarded and management's assessment of anticipated point redemptions and point value.

Management will adjust the estimated liability based on redemption experience and additional points awarded and such adjustments will be recorded in the results of operations.

[h] Income taxes

In June 2007, the Government of Canada enacted new legislation imposing additional income taxes upon publicly traded income trusts classified as Specified Investment Flow-Throughs ["SIFT"], which include a real estate investment trust ["REIT"] that carries on Canadian hotel operations effective January 1, 2011. Prior to June 2007, Lakeview Hotel REIT estimated the future income tax on certain temporary differences between amounts recorded on its balance sheet for book and tax purposes at a nil effective tax rate. Under the legislation, Lakeview Hotel REIT now estimates the effective tax rate on the post 2010 reversal of these temporary differences to be 28%. Temporary differences reversing before 2011 will still give rise to nil future income taxes.

While Lakeview Hotel REIT believes it will be subject to additional tax under the new legislation, the estimated effective tax rate on temporary difference reversals after 2011 may change in future periods. As the legislation is new, future technical interpretations of the legislation could occur and could materially affect management's estimate of the future income tax liability.

The amount and timing of reversals of temporary differences will also depend on Lakeview Hotel REIT's future operating results, acquisitions and dispositions of assets and liabilities, and distribution policy. A significant change in any of the preceding assumptions could materially affect Lakeview Hotel REIT's estimate of the future tax liability.

[i] Net loss and comprehensive loss per unit

Net loss and comprehensive loss per unit is based on the consolidated net loss for the period divided by the weighted average number of units outstanding during the period. Diluted loss per unit is computed in accordance with the treasury stock method and based on the weighted average number of units and dilutive unit equivalents.

[j] Stock-based compensation plan

Lakeview Hotel REIT has a Unit Purchase Plan as described in note 13. The fair value method is used to determine the expense for stock-based awards granted to employees and non-employees.

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Under the fair value method, compensation cost is measured at fair value at the date of grant using the Black-Scholes option pricing model. The compensation expense is expensed over the vesting period with a corresponding credit to contributed surplus. Consideration paid on the exercise of Unit options plus the amount of previously recognized expense is credited to unitholders' capital when the options are exercised.

[k] Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

[l] Financial instruments

Lakeview Hotel REIT has the following financial assets and liabilities:

- Cash and cash equivalents, reserve fund and deposits held in trust are classified as "assets held-for-trading" and are measured at fair value. Gains and losses resulting from the periodic revaluation are recorded in net loss.
- Accounts receivable and mortgages receivable are classified as "loans and receivables" and are recorded at cost, which upon their initial measurement is equal to their fair value. Subsequent measurements are recorded at amortized cost using the effective interest method. Under the effective interest method, transaction costs are added to the receivable to which they relate. Over its term, the long-term receivable will decrease to its face value with the decrement being applied against interest income earned on the mortgages receivable. The reduced interest income is reflected on the consolidated statements of loss and comprehensive loss.

Accounts payable and accrued liabilities, distributions payable, loan payable, debentures, convertible debentures and mortgages payable are classified as "other financial liabilities" and are initially measured at their fair value. Subsequent measurements are recorded at amortized cost using the effective interest method. Under the effective interest method, financing 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 debentures and convertible debentures on the consolidated statements of loss and comprehensive loss.

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Fair value is based on quoted market prices when available. However, when financial instruments lack an available trading market, fair value is determined using management's estimates and is calculated using market factors with similar characteristics and risk profiles.

[m] New accounting standards adopted in 2009

Goodwill and intangible assets

The CICA has issued a new accounting standard, Section 3064, "Goodwill and Intangible Assets", which establishes new standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Section 1000, "Financial Statement Concepts", was also amended to provide consistency with Section 3064. The new and amended standards were adopted by Lakeview Hotel REIT on January 1, 2009. The adoption of the new standards has not had a significant impact on the consolidated financial statements.

[n] Future accounting changes

Business combinations, consolidated financial statements and non-controlling interests

The CICA has issued new accounting standards, Section 1582, "Business Combinations", Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests", which establish new standards for consolidated financial statements and business combinations. The definition of a business is expanded and described as an integrated set of activities and assets that are capable of being managed to provide a return to investors or economic benefits to owners, members or participants. Net assets, non-controlling interests and goodwill acquired in a business combination will be recorded at fair value. Non-controlling interests will be reported as a component of equity. In addition, acquisition costs will be expensed when incurred. The new and amended standards will be effective for the Lakeview Hotel REIT's 2011 fiscal year. The objective of these new sections is to harmonize Canadian generally accepted accounting principles with International Financial Reporting Standards ["IFRS"]. When these standards are adopted by Lakeview Hotel REIT, acquisition costs will be expensed through the income statement. Other impacts of these standards are still being assessed.

International Financial Reporting Standards ["IFRS"]

In 2005, the Accounting Standards Board [AcSB] announced that the accounting standards in Canada are to converge with IFRS. On February 13, 2008, the CICA had confirmed that the use of IFRS will be required by January 1, 2011, with appropriate comparative data from the prior year. Under IFRS, the primary audience is capital markets and, as a result, there is significantly

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more disclosure required, specifically for quarterly reporting. Further, while IFRS uses a conceptual framework similar to Canadian generally accepted accounting principles, there are significant differences in accounting policy that must be addressed. Lakeview Hotel REIT has begun assessing the adoption of IFRS for 2011, by beginning its assessment of the key accounting differences between Canadian generally accepted accounting principles and IFRS as it relates to the accounting policies of Lakeview Hotel REIT.

2. ACQUISITION OF HOTELS

In 2008, Lakeview Hotel REIT acquired certain hotels. The acquisitions have been accounted for by the purchase method with the results of operations from the acquired hotels included in Lakeview Hotel REIT's earnings from the date of their respective acquisitions. The assets and liabilities acquired at fair value were as follows:

2008

(audited)

	Acquisition date	Land \$	Buildings \$	Signs \$	Furniture, fixtures and equipment \$	Working capital \$	Mortgage payable - first \$	Cash consider- ation \$
British Columbia								
Four Points by Sheraton - Prince George	2008-04-03	1,032,184	8,231,667	65,869	775,000	4,675	—	10,109,395
Ontario								
Days Inn - Ottawa Airport	2008-08-01	—	9,958,538	50,000	672,979	50,479	(7,000,000)	3,731,996
		<u>1,032,184</u>	<u>18,190,205</u>	<u>115,869</u>	<u>1,447,979</u>	<u>55,154</u>	<u>(7,000,000)</u>	<u>13,841,391</u>

Cash consideration for the purchase of the hotels in 2008 was financed from proceeds from the public offering of debentures on March 28, 2008 [note 9], the loan payable [note 8] and working capital.

No hotels were acquired during the six-month period ended June 30, 2009.

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3. RESERVE FUND

Pursuant to the Hotel Management Agreements with Lakeview Flag Management General Partnership, the Lakeview Hotel REIT properties are required to reserve funds in a separate account for on-going capital repairs, replacements and/or improvements of the property including but not limited to the regular repair, replacement and maintenance of the furniture, fixtures and equipment. Under the terms of the Hotel Management Agreements, the properties are required to make monthly deposits into the reserve account equal to not less than 2% of monthly gross revenue.

	Six Months Ended	Year Ended
	June 30	December 31
	2009	2008
	\$	\$
		<i>(audited)</i>
Reserve fund, beginning of period	545,824	1,237,214
Allocations to reserve fund	383,199	1,160,788
Use of reserve fund	(153,126)	(1,852,178)
Reserve fund, end of period	775,897	545,824

During 2008, included in the use of reserve fund was an amount of \$720,000 withdrawn to fund operations. This amount was the allocations to reserve fund in the prior years that was in excess of the 2% of monthly gross revenue requirement.

4. MORTGAGES RECEIVABLE

The mortgages receivable represent amounts advanced under a mezzanine loan arrangement with an independent hotel developer and its related parties for three hotels in British Columbia and Alberta. The mortgages receivable earned interest at 12% per annum compounded and payable monthly. Payments of interest only were received on the mortgages. The principal was due no later than the maturity of the mortgages, which was on the third anniversary of the date upon which the last advance under the loan was made. Lakeview Hotel REIT made its final advance of \$1,000,000 on August 1, 2008. During the six-month period ended June 30, 2009, \$1,728,882 was collected on the mortgages receivable and \$98,244 was forgiven on settlement as described below. Subsequent to June 30, 2009, a further \$1,900,000 was collected on the mortgages receivable. Details of the mortgages are as follows:

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	June 30	December 31
	2009	2008
	\$	\$
		<i>(audited)</i>
Principal	3,172,874	5,000,000
Transaction costs	63,756	59,646
Decretion of mortgages receivable	(63,756)	(6,879)
	3,172,874	5,052,767
Less current portion	(2,331,110)	(150,000)
	841,764	4,902,767

As Lakeview Hotel REIT invests in mortgages to facilitate acquisitions, credit risks arise in the event that the borrowers default on the repayment of their mortgages to Lakeview Hotel REIT. The maximum exposure to credit risk associated with mortgages receivable occurs if all borrowers default on repayment of their mortgages to Lakeview Hotel REIT. Therefore, the carrying value of the mortgages receivable balance represents Lakeview Hotel REIT's maximum exposure to related credit risk without taking into account any collateral held or any other credit enhancements. Lakeview Hotel REIT had mitigated this risk by registering first and/or second mortgage charges against two different hotel properties owned by the borrower as well as against other collateral security. The mortgages receivable were also secured by an assignment of leases and material contracts on three properties and corporate and personal guarantees from the borrowers. As a result of the above and in accordance with the settlement of the mortgages receivable as described below, Lakeview Hotel REIT considers the credit quality of these financial assets to be adequate. Accordingly, there were no impairments or impairment provisions recorded for mortgages receivable as at June 30, 2009.

Subsequent to June 30, 2009, all mortgage charges were discharged and a promissory note was taken back for the balance owing of \$1,272,874. The promissory note receivable earns interest at 12% per annum. Blended payments of principal and interest in the amount of \$50,000 are to be paid on the note at the end of each month beginning August 31, 2009. A final principal payment of \$841,764 is due on July 31, 2010. Due to the early settlement of the mortgages receivable, the transaction costs have been fully amortized as at June 30, 2009.

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5. FRANCHISE FEES AND LICENSES

	June 30 2009	December 31 2008
	\$	\$
		<i>(audited)</i>
Cost	261,379	261,379
Less accumulated amortization	(134,865)	(95,191)
	<u>126,514</u>	<u>166,188</u>

6. INCOME PROPERTIES

	June 30 2009			December 31 2008		
				<i>(audited)</i>		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
	\$	\$	\$	\$	\$	\$
Land	15,493,719	—	15,493,719	15,493,719	—	15,493,719
Buildings	144,592,931	9,256,786	135,336,145	144,204,778	7,455,700	136,749,078
Parking lots	496,291	112,459	383,832	492,373	88,204	404,169
Signs	534,138	107,349	426,789	534,138	80,642	453,496
Furniture, fixtures and equipment	14,921,480	7,527,057	7,394,423	14,789,121	6,035,843	8,753,278
	<u>176,038,559</u>	<u>17,003,651</u>	<u>159,034,908</u>	<u>175,514,129</u>	<u>13,660,389</u>	<u>161,853,740</u>

7. INVESTMENT IN LAKEVIEW FLAG LICENSING GENERAL PARTNERSHIP

On April 15, 2004, Lakeview Hotel REIT indirectly acquired a 49% interest in Lakeview Flag Licensing General Partnership with nominal initial capitalization of \$49 and issuance of the Lakeview Flag Operating Limited Partnership Class E Units [exchangeable into 500,000 Units, the "Exchangeable Units"] and 500,000 Class V Special Trust Units and 1 Class T Special Trust Unit of Lakeview Hotel REIT. The principal purpose of the Lakeview Flag Licensing General

Lakeview Hotel Real Estate Investment Trust

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Partnership is to hold the trademarks, trade names, operating procedures, systems, related items and goodwill associated therewith of the hotel flags known as "Lakeview Inn & Suites" and "Lakeview Resorts" ["Lakeview Flag"]. Although the exchange amount was \$1,000,000, the transaction was recorded at the carrying value of \$1 in accordance with Canadian generally accepted accounting principles applicable to related party transactions because the 49% interest in Lakeview Flag Licensing General Partnership was acquired from a company controlled by certain Unitholders of Lakeview Hotel REIT and the exchange amount was not supported by independent evidence.

Lakeview Flag Licensing General Partnership earns income, pursuant to the Sub-franchise Agreement and the License Agreements with the respective hotels, through the payment to it of a license fee equal to 4% of gross room revenue received from the following Lakeview Inn & Suites hotels which are owned by LMI and located as follows:

Bathurst, New Brunswick [Canada]
Brandon, Manitoba [Canada]
Grand Forks, North Dakota [United States of America]
Halifax, Nova Scotia [Canada]
Miramichi, New Brunswick [Canada]

In addition, pursuant to the Sub-franchise Agreement and License Agreement, Lakeview Flag Licensing General Partnership earns a license fee of 4% of gross room revenue from each Lakeview Hotel REIT property that has opened as or has been converted to a Lakeview Inn & Suites hotel or Lakeview Signature Inn. The license fees are earned effective as of the date of opening or conversion.

The Lakeview Flag Licensing General Partnership also earned a license fee of 4% of gross room revenue from the Lakeview Inn & Suites – Tumbler Ridge [located in British Columbia] for the period September 1, 2008 to July 15, 2009, the Lakeview Inn & Suites – Hudson's Hope [also located in British Columbia] for the period September 17, 2008 to June 30, 2009 and the Lakeview Inn & Suites – Fox Creek [located in Alberta] for the period November 4, 2008 to June 30, 2009 [note 4].

Gross room revenue is the gross income resulting from all room sales made to customers or guests of the respective hotels and does not include any sales tax which is collected and remitted to the appropriate tax authority by the hotels.

Lakeview Hotel Real Estate Investment Trust

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Investment in Lakeview Flag Licensing General Partnership:

	Six Months Ended June 30 2009 \$	Year Ended December 31 2008 \$
		<i>(audited)</i>
Investment, beginning of period	120,171	40,367
Equity income	331,298	617,334
Distribution received	(297,430)	(537,530)
Investment, end of period	154,039	120,171

8. LOAN PAYABLE

	June 30 2009 \$	December 31 2008 \$
		<i>(audited)</i>
Loan payable	4,200,000	4,200,000

The loan payable was drawn under a pre-approved line of credit facility provided by Lakeview Hotel REIT's primary mortgage lender. The loan payable bears interest at the Canadian dollar bankers' acceptance rate plus 4.25% to 5% floating per annum, due on demand, collateralized by first mortgages on certain income properties. The effective interest rate was 5.20% for the six months ended June 30, 2009 [2008-7.42%].

9. DEBENTURES

Effective March 28, 2008, Lakeview Hotel REIT, through a public offering, issued \$10,250,000 Series A Senior Secured Debentures [the "Debentures"]. The Debentures mature on June 20, 2012 and bear interest at an annual rate of 8.125% payable monthly in cash with the first payment having occurred on April 30, 2008. The Debentures are secured by a first charge on the Four Points by Sheraton - Prince George hotel, an assignment of the insurance policy on the property, an assignment of rents and leases of the property and an assignment of material contracts and agreements. The Debentures are redeemable in full from time to time at Lakeview Hotel REIT's sole option on not less than 30 days' prior written notice, at a price equal to 110% of the principal amount plus accrued and unpaid interest up to, but excluding the date of redemption.

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	June 30 2009	December 31 2008
	\$	\$
		<i>(audited)</i>
Principal	10,250,000	10,250,000
Financing costs	(855,121)	(855,121)
Accretion of debentures	213,857	124,372
	9,608,736	9,519,251

10. CONVERTIBLE DEBENTURES

At initial measurement, the convertible debentures were allocated to debt and equity components based on the estimated cost of borrowing without the conversion option as follows:

	Debt	Equity	Total
	\$	\$	\$
10% Subordinated Convertible Debentures	3,344,822	1,155,178	4,500,000
9% Subordinated Convertible Debentures	1,066,282	433,718	1,500,000
6.5% Series C Convertible Redeemable Subordinated Debentures	14,937,187	3,062,813	18,000,000
8.5% Series D Convertible Redeemable Subordinated Debentures	9,045,732	954,268	10,000,000
	28,394,023	5,605,977	34,000,000

The details of the series of convertible debentures are outlined in the tables below:

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June 30, 2009				
Debenture	Effective interest rate %	Original face amount \$	Converted to trust units \$	Face amount outstanding \$
9% Subordinated Convertible Debentures	18%	1,500,000	1,460,000	40,000
6.5% Series C Convertible Redeemable Subordinated Debentures	11%	18,000,000	—	18,000,000
8.5% Series D Convertible Redeemable Subordinated Debentures	11%	10,000,000	20,000	9,980,000
		29,500,000	1,480,000	28,020,000

December 31, 2008 <i>(audited)</i>				
Debenture	Effective interest rate %	Original face amount \$	Converted to trust units \$	Face amount outstanding \$
10% Subordinated Convertible Debentures	18%	4,500,000	4,398,000	102,000
9% Subordinated Convertible Debentures	18%	1,500,000	1,460,000	40,000
6.5% Series C Convertible Redeemable Subordinated Debentures	11%	18,000,000	—	18,000,000
8.5% Series D Convertible Redeemable Subordinated Debentures	11%	10,000,000	20,000	9,980,000
		34,000,000	5,878,000	28,122,000

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Debenture	2009				
	Face amount outstanding \$	Holders' conversion option \$	Accretion \$	Financing costs \$	June 30, 2009 \$
Current					
9% Subordinated Convertible Debentures	40,000	(11,566)	11,126	(3,610)	35,950
Long-term					
6.5% Series C Convertible Redeemable Subordinated Debentures	18,000,000	(3,062,813)	1,359,334	(1,058,428)	15,238,093
8.5% Series D Convertible Redeemable Subordinated Debentures	9,980,000	(952,360)	293,580	(716,067)	8,605,153
	27,980,000	(4,015,173)	1,652,914	(1,774,495)	23,843,246
	28,020,000	(4,026,739)	1,664,040	(1,778,105)	23,879,196
2008 <i>(audited)</i>					
Debenture	Face amount outstanding \$	Holders' conversion option \$	Accretion \$	Financing costs \$	December 31, 2008 \$
Current					
10% Subordinated Convertible Debentures	102,000	(26,184)	32,707	(9,724)	98,799
Long-term					
9% Subordinated Convertible Debentures	40,000	(11,566)	9,212	(3,610)	34,036
6.5% Series C Convertible Redeemable Subordinated Debentures	18,000,000	(3,062,813)	991,065	(1,058,428)	14,869,824
8.5% Series D Convertible Redeemable Subordinated Debentures	9,980,000	(952,360)	162,229	(716,067)	8,473,802
	28,020,000	(4,026,739)	1,162,506	(1,778,105)	23,377,662
	28,122,000	(4,052,923)	1,195,213	(1,787,829)	23,476,461

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The accretion of the debt component, which increases the debt component from the initial carrying amount, is included in interest expense and totalled \$504,735 and \$354,807 respectively for the six months ended June 30, 2009 and 2008.

[a] 10% Subordinated Convertible Debentures

On April 15, 2004, under a public offering, Lakeview Hotel REIT issued \$4,500,000 of 10% Subordinated Convertible Debentures.

On April 15, 2009, the remaining \$102,000 outstanding of 10% Subordinated Convertible Debentures were repaid in full by issuance of 283,050 Class A Units.

[b] 9% Subordinated Convertible Debentures

On May 30, 2005, under a private offering, Lakeview Hotel REIT issued \$1,500,000 of 9% Subordinated Convertible Debentures.

The debentures bear interest at 9%, mature in five years from date of issue and are subordinate only to property specific conventional mortgage financing and any vendor take-back mortgage financing. The debentures are convertible by the holder at any time after the date of issue at \$2.90 per Unit.

[c] 6.5% Series C Convertible Redeemable Subordinated Debentures

On June 20, 2007, under a public offering, Lakeview Hotel REIT issued \$18,000,000 of 6.5% Series C Convertible Redeemable Subordinated Debentures.

The debentures bear interest at 6.5%, mature June 30, 2012 and are subordinate only to property specific conventional mortgage financing and any vendor take-back mortgage financing. The debentures are convertible by the holder at any time after the date of issue at \$5.55 per Unit.

At any time after three years from the issue date but prior to four years from the issue date, Lakeview Hotel REIT has the right to redeem all, but not less than all, debentures at par plus accrued interest provided that the volume-weighted average trading price of the Units during a 20 consecutive trading day period ending five trading days before notice of redemption is given is not less than 125% of the conversion price. On maturity, the debentures are repayable at par plus any accrued and unpaid interest in cash, or at the option of Lakeview Hotel REIT, in Units [based on a

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Unit conversion price equal to 95% of the weighted average of the trading price of the Units during the preceding 20 trading day period], or in any other combination thereof.

[d] 8.5% Series D Convertible Redeemable Subordinated Debentures

On May 8, 2008, under a public offering, Lakeview Hotel REIT issued \$10,000,000 of 8.5% Series D Convertible Redeemable Subordinated Debentures.

The debentures bear interest at 8.5%, mature May 31, 2013 and are subordinate only to property specific conventional mortgage financing, any vendor take-back mortgage financing and the Series A Senior Secured Debentures issued March 28, 2008 [note 9]. The debentures are convertible by the holder at any time prior to maturity at \$3.75 per Unit.

The debentures will not be redeemable prior to May 31, 2011. On and after May 31, 2011, but prior to May 31, 2012, the debentures will be redeemable, in whole or in part from time to time at Lakeview Hotel REIT's sole option on not more than 60 days and not less than 30 days notice at a price payable in cash, equal to the principal amount plus accrued and unpaid interest, provided that the volume-weighted average trading price of the Units on the TSXV during 20 consecutive trading days ending on the fifth trading day preceding the date on which notice of redemption is given is not less than 150% of the conversion price.

On and after May 31, 2012, but prior to the Maturity Date, the debentures will be redeemable in whole or in part from time to time at Lakeview Hotel REIT's sole option on not more than 60 days and not less than 30 days notice at a price payable in cash, equal to the principal amount thereof, plus accrued and unpaid interest, provided that the current market price is not less than 125% of the conversion price.

On maturity, the debentures are repayable at par plus any accrued and unpaid interest in cash.

During 2008, \$20,000 of the debentures were converted at a price of \$3.75 into 5,333 Class A Units.

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11. MORTGAGES PAYABLE

	June 30 2009 \$	December 31 2008 \$
		<i>(audited)</i>
Mortgages payable, bearing interest at 5.88% to 6.74% per annum, due February 1, 2011 to July 1, 2014, collateralized by first charges on certain income properties, an assignment of the insurance policy on the income properties, an assignment of rents and leases of the income properties and an assignment of material contracts and agreements. The mortgages are cross-collateralized by each of the underlying properties with the exception of the Four Points by Sheraton – Prince George <i>[note 9]</i> and Days Inn - Ottawa Airport	79,303,788	80,362,284
Mortgage payable, bearing interest at 7% per annum, due August 1, 2009, collateralized by a first charge on the Days Inn - Ottawa Airport, an assignment of the insurance policy on the income property, an assignment of rents and leases of the income property and a guarantee by both Lakeview Hotel REIT and Lakeview Flag Operating Limited Partnership. Payments of interest only are due on the mortgage	7,000,000	7,000,000
	86,303,788	87,362,284
Less current portion	2,633,311	9,362,752
	83,670,477	77,999,532

The long-term mortgage agreements contain financial covenants that require each individual hotel property, pledged as security for these mortgages, to maintain a minimum 1.30 Fixed Charge Coverage Ratio ["FCCR"], calculated on an annual basis, as defined in the mortgage agreements. As at December 31, 2008, Lakeview Hotel REIT was not in compliance with the FCCR requirement for six of the hotel properties. In addition, based on management's forecast, Lakeview Hotel REIT is not expected to meet the FCCR requirement for these six hotel properties at December 31, 2009. In 2009, Lakeview Hotel REIT obtained an agreement from its lender to forbear its rights and remedies as a result of the FCCR covenant breach at December 31, 2008 and the expected FCCR covenant breach at December 31, 2009. Accordingly, the mortgages payable are classified as long-term liabilities in these financial statements. As conditions for the lender's agreement, two letters of credit of \$1,250,000 each were provided in favor of the mortgage lender that it can draw upon in the event of default. In addition, a forbearance fee of \$350,000 is to be paid by Lakeview Hotel REIT. \$200,000 of this fee was paid by June 30, 2009.

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Subsequent to June 30, 2009, Lakeview Hotel REIT completed the refinancing of the \$7,000,000 mortgage on the Days Inn – Ottawa Airport. The Lakeview Hotel REIT obtained a commitment letter for a mortgage of \$5,500,000, bearing interest at 7% per annum, due five years from the date of advance, collateralized by a first charge on the Days Inn – Ottawa Airport, an assignment of the insurance policy on the income property, an assignment of rents and leases of the income property and a guarantee from Lakeview Hotel REIT. In addition, a mortgage in the amount of \$2,000,000 will be granted by the existing first mortgage holder bearing interest at 9.5% per annum, due in 2011. It will be collateralized by a second ranking charge on the Days Inn – Ottawa Airport and an assignment of the insurance policy on the income property second behind the first mortgage holder. Payments of interest only will be due on the mortgage.

Estimated future principal repayments over the next five years and thereafter, based on the repayment schedules of the mortgages, are as follows:

	\$
Remainder of 2009	1,287,376
2010	2,734,495
2011	31,325,271
2012	30,714,791
2013	5,016,217
Thereafter	15,818,673
Total principal outstanding	86,896,823
Financing costs	(1,097,242)
Accretion of mortgages	504,207
	<u>86,303,788</u>

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12. UNITHOLDERS' CAPITAL

	Class A Units \$	Class V Special Trust Units and Exchangeable Units \$	Class T Special Trust Unit \$	Total Unitholders' capital \$
Balance, December 31, 2007	59,021,719	1	—	59,021,720
Conversion of debentures <i>[note 10]</i>	18,414	—	—	18,414
Balance, December 31, 2008 <i>(audited)</i>	59,040,133	1	—	59,040,134
Repayment of convertible debentures by issuance of Units <i>[note 10]</i>	128,184	—	—	128,184
Balance, June 30, 2009	59,168,317	1	—	59,168,318

Units issued during 2009 and 2008 are summarized as follows:

	Class A Units #	Class V Special Trust Units and Exchangeable Units #	Class T Special Trust Unit #
Balance, December 31, 2007	18,769,423	500,000	1
Conversion of debentures <i>[note 10]</i>	5,333	—	—
Balance, December 31, 2008 <i>(audited)</i>	18,774,756	500,000	1
Repayment of convertible debentures by issuance of Units <i>[note 10]</i>	283,050	—	—
Balance, June 30, 2009	19,057,806	500,000	1

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The beneficial interest in Lakeview Hotel REIT is divided into interests of one class and of equal value, referred to as Class A Units, of unlimited number. All Class A Units participate pro rata in any distribution declared on Class A Units and have one vote per Unit.

Exchangeable Units were issued by Lakeview Flag Operating Limited Partnership [note 7]. The Exchangeable Units are exchangeable into 500,000 Class A Units of Lakeview Hotel REIT at the option of the holder. The Exchangeable Units entitle the holders to cash distributions equivalent to the amount of cash distributions that would be allocated to 500,000 Class A Units. In addition, the following were issued in conjunction with the issuance of the Exchangeable Units:

- 500,000 Class V Special Trust Units, one vote per Unit, excluding the right to vote in respect of the election of Trustees, no entitlement to any distribution declared payable on Class A Units, except as declared by Trustees subject to certain restrictions, cancelled proportionately upon exchange of securities exchangeable into Class A Units.
- One Class T Special Trust Unit, non-transferable, non-voting, right to appoint one-third of the total number of Trustees, no right to any distributions or economic interest in Lakeview Hotel REIT.

Distributions to Unitholders

For the six-month periods ended June 30, 2009 and 2008 respectively, distributions of \$0.01 and \$0.22 per Class A Unit and per Exchangeable Unit were declared, totalling \$192,748 and \$4,243,323.

For the three-month period ended June 30, 2008, distributions of \$.011 per Class A Unit and per exchangeable Unit were declared, totalling \$2,121,760. No distributions were declared for the three-month period ended June 30, 2009.

Distribution policy

The following is a summary of the Lakeview Hotel REIT distribution policy, the full provisions of which are contained in the Declaration of Trust:

Subject to the obligations of the Trustees in respect of the Class V Units, the Trustees may, on or before each Distribution Record Date, and shall on or before the December 31 Distribution Record Date, declare payable, to the Unitholders of record on such Distribution Record Date, all or any part of the Distributable Cash of the Trust for the Distribution Period ending on such Distribution Record Date determined in accordance with the Declaration of Trust, and the proportionate share

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of each Unit of the amount so payable shall be determined by dividing such amount by the number of Units outstanding on that Distribution Record Date. Each Unitholder's share thereof shall be equal to the proportionate share per Unit multiplied by the number of Units owned of record by the Unitholder on that Distribution Record Date and shall be paid to each such Unitholder on the Distribution Payment Date next following the Distribution Record Date.

"Distributable Cash of the Trust" for the period ending on a Distribution Record Date shall be the amount calculated, for the period commencing immediately following the preceding Distribution Record Date and ending on such Distribution Record Date [each, a "Distribution Period"], as all revenues received or receivable, including net realized capital gains and such other amounts as Lakeview Hotel REIT may receive from time to time in the applicable period, less:

- [a] Administrative and operational expenses and other obligations;
- [b] Amounts which may be used for acquisitions or other business purposes;
- [c] Amounts required for replacement reserves; and
- [d] Such other amounts as the Trustees deem appropriate and necessary.

Items of income or expense not provided for above shall be included in such calculation on such basis as may be considered appropriate by the Trustees.

13. UNIT PURCHASE PLAN

The Trustees have established a Unit Purchase Plan to provide incentives to Trustees, management and other participants to carry out the business of Lakeview Hotel REIT. The aggregate number of Units reserved for issuance under this plan shall not exceed five percent [5%] of the total number of issued and outstanding Units. Subsequent to June 30, 2009, the Unit Purchase Plan was amended such that the aggregate number of Units reserved for issuance under the plan shall not exceed 1,000,000 Units.

The Unit options outstanding and exercisable under the Unit Purchase Plan are summarized as follows:

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	Six Months Ended June 30 2009		Year Ended December 31 2008 <i>(audited)</i>	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Unit options outstanding, beginning of period	342,000	4.03	232,500	4.28
Unit options granted	—	—	109,500	3.50
Unit options outstanding, end of period	342,000	4.03	342,000	4.03
Range of exercise price of Unit options outstanding, end of period	—	3.25 to 4.62	—	3.25 to 4.62
Unit options vested, end of period	342,000	4.03	342,000	4.03
Expiry date	2011 to 2013		2011 to 2013	

The fair values of the options were estimated using the Black-Scholes option pricing model with the following assumptions and results:

	2008 Options <i>(audited)</i>
Distribution yield	12.6%
Expected volatility	49.2%
Risk-free interest rate	3.0%
Estimated compensation costs	\$55,845

The compensation costs were expensed at the date of grant.

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14. BASIC AND DILUTED LOSS PER UNIT

The basic and diluted loss per Unit is calculated based on the following:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Weighted average Units	19,514,259	19,271,064	19,395,169	19,270,243

The effect of the options under the Unit Purchase Plan issued to certain Trustees and management [note 13] and the conversion of the convertible debentures [note 10] are not presented as they would have an anti-dilutive effect on the loss per Unit.

15. RELATED PARTY TRANSACTIONS

In addition to the related party transactions disclosed elsewhere in these consolidated financial statements, during the normal course of business, Lakeview Hotel REIT had the following transactions and balances recorded at their exchange value with related parties:

	June 30 2009 \$	December 31 2008 \$
		<i>(audited)</i>
Accounts receivable from Lakeview Flag Management General Partnership [note 16]	9,000	—
Accounts payable and accrued liabilities to LMI	673,141	136,923
Lakeview Flag Licensing General Partnership [note 7]	287,166	156,226
Lakeview Flag Management General Partnership [note 16]	433,260	237,068
Trustees of Lakeview Hotel REIT	27,500	9,920

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	Three Months Ended June 30		Six Months Ended June 30	
	2009 \$	2008 \$	2009 \$	2008 \$
Marketing expenses paid to				
Free to Guest Movies Ltd.	46,671	53,457	86,092	101,318
LMI	48,983	93,984	103,275	195,527
Included in general and administration expense				
Accounting fees paid to				
LMI	141,388	131,167	282,218	255,850
Asset management fees paid to				
LMI	120,623	108,100	241,086	216,303
Reservation fees paid to				
LMI	73,475	93,809	154,911	195,352
License fees paid to				
Lakeview Flag Licensing				
General Partnership <i>[note 7]</i>	196,223	250,461	413,555	521,149
Management fees paid to				
Lakeview Flag Management				
General Partnership <i>[note 16]</i>	304,736	339,222	618,418	666,480
Professional fees paid to				
XYZ Design Inc.	—	—	693	—
Letter of credit standby fees paid to				
LMI	10,562	—	10,562	—
Included in salaries and benefits				
Trustees' fees	10,000	—	18,500	—
Capitalized to income properties				
Professional fees paid to				
XYZ Design Inc.	4,213	19,593	4,549	34,510
Keith Levit Photography	—	22,695	—	22,695

Under the License Agreement *[note 7]*, the following annual fees are paid by Lakeview Hotel REIT to LMI for accounting services, marketing services and access to the on-line reservation system.

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Accounting fee	\$30,000 per annum per hotel
Reservation fee	1.5% of gross room revenue
Marketing fee	1% [2008 – 1.5%] of gross room revenue

[Gross room revenue is defined in note 7].

The reservation and marketing fees are paid to LMI when properties have been converted to Lakeview Inn & Suites hotels.

The accounting fee shall be increased annually by the year-over-year increase in the Consumer Price Index for the province in which the hotel is located.

Pursuant to a Services Agreement between Lakeview Hotel REIT and LMI, LMI has been engaged as the administrator of Lakeview Hotel REIT, to administer the affairs of Lakeview Hotel REIT on a day-to-day basis and perform the record keeping and reporting functions of the Trustees. The initial term of the Services Agreement was 5 years expiring on April 14, 2009 and was renewed until April 14, 2014. In consideration, Lakeview Hotel REIT issued to LMI, at the inception of the agreement, options to acquire 50,000 Units, fully vested and exercisable upon issuance at \$1.00 per Unit. LMI exercised its options concurrently with the closing of the Qualifying Transaction.

Effective October 1, 2006, LMI began to charge an asset management fee based on 0.3% of the net book value of income properties. The fee is paid monthly on the last day of every month and is based on the net book value of income properties at the end of the previous month.

Effective June 11, 2009, LMI also began to charge a standby fee on the \$2,500,000 of letters of credit it provided in favour of the primary mortgage lender on behalf of Lakeview Hotel REIT [note 11]. The fee is calculated at 2% of the letter of credit amount per annum plus a monthly fee calculated by multiplying the letter of credit amount by the rate that is the difference between the weighted average interest rate on the mortgages held by the mortgage lender (6.31%) and the rate of interest received on funds invested.

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16. INVESTMENT IN LAKEVIEW FLAG MANAGEMENT GENERAL PARTNERSHIP

Lakeview Hotel REIT indirectly acquired a 50% interest in the Lakeview Flag Management General Partnership with initial nominal capitalization of \$50, entitling it to 25% of Lakeview Flag Management General Partnership's net income.

Pursuant to a Property Management Agreement, Lakeview Flag Management General Partnership provides hotel management services to each limited service Lakeview Hotel REIT property for a fee equal to 5% of gross revenue and to each full service Lakeview Hotel REIT property for a fee equal to 4% of gross revenue. Gross revenue includes all income derived from the properties and their operations.

Lakeview Hotel REIT's 25% share of the assets, liabilities, revenues, expenses and cash flows are as follows:

	June 30 2009 \$	December 31 2008 \$
		<i>(audited)</i>
Assets - current	140,204	80,157
Liabilities - current	2,272	1,487

	Three Months Ended June 30		Six Months Ended June 30	
	2009 \$	2008 \$	2009 \$	2008 \$
Revenue	109,044	113,142	229,542	222,306
Expenses	19	9	30	19
Net income	109,025	113,133	229,512	222,287
Cash flows				
Cash provided by operating activities	26,093	112,702	169,128	207,878
Cash used in financing activities	(45,250)	(112,750)	(170,250)	(208,750)
Decrease in cash	(19,157)	(48)	(1,122)	(872)

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17. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial instruments include cash and cash equivalents, reserve fund, deposits held in trust, accounts receivable, mortgages receivable, accounts payable and accrued liabilities, distributions payable, loan payable, debentures, convertible debentures and mortgages payable.

Lakeview Hotel REIT's carrying value of accounts receivable, accounts payable and accrued liabilities and distributions payable approximates their fair value due to the immediate or short-term nature of these instruments.

The carrying value of the mortgages receivable approximates its fair value as it represents the settlement amount subsequent to June 30, 2009.

The carrying value of the loan payable and mortgages payable approximates the fair value as interest rates are consistent with current rates.

Based on trading value and other market factors, the estimated fair value of the debentures and the 9% convertible debentures approximates their carrying value and the estimated fair values of the 6.5% and 8.5% convertible debentures are \$8,101,000 and \$5,400,000, respectively.

Management's involvement in operations helps identify risks and variations from expectations. Lakeview Hotel REIT does not manage risk through the use of hedging transactions. As part of the overall operation of Lakeview Hotel REIT, management considers the avoidance of undue concentrations of risk.

It is management's opinion that Lakeview Hotel REIT is not exposed to significant currency risks arising from these financial instruments because it has only minimal foreign currency transactions.

Interest rate risk

Lakeview Hotel REIT is exposed to interest rate risk as it relates to the loan payable with prime-based floating interest rates and the renewal or refinancing of its long-term debts as they become due.

Fluctuations in interest rates create a cash flow risk which is minimized by obtaining long-term mortgages. There is a risk that interest rates will fluctuate subsequent to the date Lakeview Hotel REIT commits to a fixed interest rate with the lender. Obtaining long-term mortgages with fixed interest rates minimizes cash flow risk.

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Credit risk

The amount of accounts receivable disclosed in the consolidated balance sheet of \$1,532,447 as at June 30, 2009 and \$1,479,824 as at December 31, 2008 is net of allowances for bad debts, estimated by management based on prior experience and their assessment of the current economic environment. No customer accounts for more than 10% of the accounts receivable balance.

Historically there have been no collection issues with respect to accounts receivable and Lakeview Hotel REIT does not believe it is subject to any significant concentration of credit risk.

See note 4 for management's assessment of the credit risk relating to the mortgages receivable and the actions taken to mitigate it.

Liquidity risk

Lakeview Hotel REIT's objective is to have sufficient liquidity to meet liabilities when due. Lakeview Hotel REIT monitors its cash balances and cash flows generated from operations to meet requirements. Lakeview Hotel REIT recently completed the re-financing of the \$7,000,000 mortgage on the Days Inn - Ottawa Airport with long-term mortgages [note 11]. Included in current liabilities is a \$4,200,000 demand loan from Lakeview Hotel REIT's primary mortgage lender. While the loan is due on demand, there is currently no indication that repayment will be demanded in 2009. Also during 2009, the Trustees announced a suspension of monthly distributions to Unitholders following the February 2009 distribution in order to preserve capital.

Based on its 2009 cash flow forecast and available financing, while there can be no assurance, management believes Lakeview Hotel REIT will be able to meet financial obligations as they come due.

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18. INCOME TAXES

Significant components of Lakeview Hotel REIT's future tax assets are shown below:

	June 30 2009	December 31 2008
	\$	\$
Future tax assets		<i>(audited)</i>
Net taxable temporary difference	46,000	46,000
Valuation allowance	(46,000)	(46,000)
	—	—

Due to new legislation enacted by the Government of Canada in June 2007 that imposed additional income taxes upon publicly traded income trusts effective January 1, 2011 and as based on its assets and liabilities as at June 30, 2009, Lakeview Hotel REIT has estimated the amount of its temporary differences and the periods in which these differences will reverse. Lakeview Hotel REIT estimates that approximately \$164,000 net taxable temporary differences will reverse after January 1, 2011, resulting in \$46,000 of future income tax assets. The future tax assets have been reduced by an equivalent valuation allowance as it cannot be determined at this time whether it is more likely or not that Lakeview Hotel REIT will realize the benefits of the future tax assets. The taxable temporary differences relate primarily to the income properties and financing costs associated with long term debt.

19. CAPITAL MANAGEMENT

Lakeview Hotel REIT defines capital as the aggregate of unitholders' equity and interest-bearing debt. The objectives of Lakeview Hotel REIT's capital management program are to maintain a level of capital that complies with the debt restrictions according to Lakeview Hotel REIT's Declaration of Trust, complies with existing debt service coverage ratio covenants, provides a return to Unitholders by delivering monthly cash distributions, optimizes the cost of capital, funds its business strategies and builds long-term Unitholder value.

In managing its capital structure, Lakeview Hotel REIT monitors performance throughout the year to ensure anticipated cash distributions, working capital requirements and capital expenditures are funded from operations, available cash on deposit and available sources of financing. Lakeview Hotel REIT will make adjustments to its capital structure to meet the objectives of the broader

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corporate strategy or in response to changes in economic conditions and risk. In order to maintain or adjust the capital structure, Lakeview Hotel REIT may issue debt and/or issue or redeem units.

Lakeview Hotel REIT monitors its capital by the following methods, including [but not limited to]:

- Maintaining an overall Debt Service Coverage ratio with its primary mortgage lender defined as earnings before interest, income taxes, depreciation and amortization [earnings base] to mortgage interest and principal payments [debt service] of no less than 1.10.
- Restricting the total of all mortgage loans on all income properties from being greater than 75% of the appraised value of the income properties in accordance with the Declaration of Trust. As at June 30, 2009 and December 31, 2008 respectively, the total of mortgage loans payable is 49.0% and 49.8% of the total estimated current value of income properties.

	June 30 2009 \$	December 31 2008 \$
	<i>(audited)</i>	
Capital structure		
Loan payable	4,200,000	4,200,000
Debentures	9,608,736	9,519,251
Convertible debentures	23,879,196	23,476,461
Mortgages payable	86,303,788	87,362,284
Total debt	123,991,720	124,557,996
Unitholders' equity	39,861,068	43,672,291
Total capital	163,852,788	168,230,287

	Three Months Ended June 30		Six Months Ended June 30	
	2009 \$	2008 \$	2009 \$	2008 \$
Debt service coverage ratio				
Earnings base	1,931,733	3,022,357	4,645,481	6,004,331
Debt service	1,957,690	1,835,526	3,914,038	3,671,052
Debt service coverage ratio	0.99	1.65	1.19	1.64

Lakeview Hotel REIT is also subject to financial covenants in its mortgages payable, which are measured on an annual basis and include customary terms and conditions for borrowings of this

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nature. These include the Debt Service Coverage ratio presented above as well as FCCR for each individual hotel property pledged as security under the mortgages. As disclosed in note 11, Lakeview Hotel REIT was not in compliance with the FCCR requirements for six of the hotel properties as at December 31, 2008 and a forbearance agreement was obtained from the lender in 2009.

For the six months ended June 30, 2008, cash distributions to Unitholders exceeded Lakeview Hotel REIT's distributable income, as defined in the Declaration of Trust. Following the February 2009 distributions, monthly distributions were suspended.

20. LEASE COMMITMENT

Lakeview Hotel REIT has entered into an operating lease for land for the Days Inn - Ottawa Airport property. The future minimum annual lease payments under this operating lease for the next five years and thereafter are as follows:

	\$
Remainder of 2009	19,064
2010	40,247
2011	42,365
2012	42,365
2013	42,365
Thereafter	1,376,863
	<u>1,563,269</u>

In addition, Lakeview Hotel REIT is required to pay a percentage rent equal to 1.5% of the annual gross revenues of the Days Inn - Ottawa Airport up to \$2,000,000 and 1% of the annual gross revenues in excess of \$2,000,000.