

Consolidated Financial Statements

Lakeview Hotel Real Estate Investment Trust
December 31, 2009 and 2008

AUDITORS' REPORT

To the Unitholders of
Lakeview Hotel Real Estate Investment Trust

We have audited the consolidated balance sheets of **Lakeview Hotel Real Estate Investment Trust** as at December 31, 2009 and 2008 and the consolidated statements of loss and comprehensive loss, unitholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of **Lakeview Hotel Real Estate Investment Trust** as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Winnipeg, Canada,
April 27, 2010.

Ernst & Young LLP

Chartered Accountants

Lakeview Hotel Real Estate Investment Trust

CONSOLIDATED BALANCE SHEETS

[See note 1 regarding Going Concern]

As at December 31

	2009	2008
	\$	\$
ASSETS		
Current		
Cash and cash equivalents	1,331,392	1,751,665
Reserve fund <i>[note 3]</i>	651,321	545,824
Cash held in trust <i>[note 11]</i>	2,500,000	—
Deposits held in trust	—	300,000
Accounts receivable	1,075,291	1,479,824
Inventory	102,538	119,775
Prepaid expenses	157,864	187,549
Note receivable <i>[note 4]</i>	1,235,603	—
Current portion of mortgages receivable <i>[note 4]</i>	—	150,000
Total current assets	7,054,009	4,534,637
Mortgages receivable <i>[note 4]</i>	—	4,902,767
Franchise fees and licenses <i>[note 5]</i>	109,047	166,188
Income properties <i>[notes 2, 6, 8, 9, 11 and 15]</i>	156,281,492	161,853,740
Investment in Lakeview Flag Licensing General Partnership <i>[note 7]</i>	265,193	120,171
	163,709,741	171,577,503
LIABILITIES AND UNITHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities <i>[note 15]</i>	4,423,476	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>	38,073	98,799
Current portion of mortgages payable <i>[note 11]</i>	78,430,822	9,362,752
Total current liabilities	87,092,371	17,008,767
Debentures <i>[note 9]</i>	9,703,065	9,519,251
Convertible debentures <i>[note 10]</i>	24,375,086	23,377,662
Mortgages payable <i>[note 11]</i>	7,025,786	77,999,532
Total liabilities	128,196,308	127,905,212
Unitholders' equity	35,513,433	43,672,291
	163,709,741	171,577,503

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**

Years ended December 31

	2009	2008
	\$	\$
REVENUE		
Rooms	29,916,503	35,134,621
Food, beverage and gift shop	2,911,317	3,732,213
Income from Lakeview Flag Licensing General Partnership <i>[note 7]</i>	584,552	617,334
Interest and miscellaneous	1,089,164	1,264,173
	<u>34,501,536</u>	<u>40,748,341</u>
EXPENSES		
Amortization		
Franchise fees and licenses	57,141	48,534
Income properties	6,694,496	6,212,645
Food, beverage and gift shop	1,115,983	1,502,303
General and administration <i>[note 15]</i>	7,666,040	7,964,682
Insurance	341,749	319,743
Interest		
Loan and other	209,943	140,720
Mortgages and debentures	9,791,324	8,852,819
Maintenance	757,210	907,621
Marketing <i>[note 15]</i>	2,326,023	2,618,499
Property taxes	1,990,392	1,795,088
Rent <i>[note 20]</i>	74,396	38,161
Salaries and benefits <i>[note 15]</i>	9,324,300	10,081,393
Supplies	721,409	936,754
Utilities	1,499,240	1,584,807
	<u>42,569,646</u>	<u>43,003,769</u>
Loss before income taxes	(8,068,110)	(2,255,428)
Recovery of income taxes - future <i>[note 18]</i>	—	(734,000)
Net loss and comprehensive loss for the year	<u>(8,068,110)</u>	<u>(1,521,428)</u>
Basic and diluted net loss and comprehensive loss per Unit <i>[note 14]</i>	<u>(0.414)</u>	<u>(0.079)</u>

See accompanying notes

Lakeview Hotel Real Estate Investment Trust

**CONSOLIDATED STATEMENTS OF
UNITHOLDERS' EQUITY**

Years ended December 31

	2009	2008
	\$	\$
Unitholders' capital <i>[note 12]</i>		
Balance, beginning of year	59,040,134	59,021,720
Repayment of convertible debentures by issuance of Units	128,184	—
Conversion of debentures	—	18,414
Balance, end of year	<u>59,168,318</u>	<u>59,040,134</u>
Equity portion of convertible debentures		
Balance, beginning of year	3,760,355	2,883,536
Issuance of convertible debentures	—	954,268
Repayment of convertible debentures	(26,184)	—
Conversion of debentures	—	(1,757)
Issuance costs	—	(75,692)
Balance, end of year	<u>3,734,171</u>	<u>3,760,355</u>
Contributed capital		
Balance, beginning of year	401,745	345,900
Issuance of Unit options <i>[note 13]</i>	—	55,845
Balance, end of year	<u>401,745</u>	<u>401,745</u>
Accumulated earnings (losses)		
Balance, beginning of year	1,291,589	2,813,017
Net loss and comprehensive loss for the year	(8,068,110)	(1,521,428)
Balance, end of year	<u>(6,776,521)</u>	<u>1,291,589</u>
Accumulated distributions		
Balance, beginning of year	(20,821,532)	(13,363,180)
Distributions declared <i>[note 12]</i>	(192,748)	(7,458,352)
Balance, end of year	<u>(21,014,280)</u>	<u>(20,821,532)</u>
Unitholders' equity, end of year	<u>35,513,433</u>	<u>43,672,291</u>

See accompanying notes

Lakeview Hotel Real Estate Investment Trust

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31

	2009	2008
	\$	\$
OPERATING ACTIVITIES		
Net loss for the year	(8,068,110)	(1,521,428)
Add (deduct) items not involving cash		
Amortization of income properties	6,694,496	6,212,645
Amortization of franchise fees and licenses	57,141	48,534
Compensation costs of Unit options <i>[note 13]</i>	—	55,845
Income from Lakeview Flag Licensing General Partnership <i>[note 7]</i>	(584,552)	(617,334)
Accretion on debt component of convertible debentures <i>[note 10]</i>	1,038,698	846,657
Accretion of debentures <i>[note 9]</i>	183,814	124,372
Accretion of mortgages payable	222,905	204,192
Decretion of mortgages receivable <i>[note 4]</i>	56,877	6,879
Loss on settlement of mortgages receivable <i>[note 4]</i>	98,244	—
Future income tax recovery	—	(734,000)
	<u>(300,487)</u>	<u>4,626,362</u>
Net change in non-cash working capital balances related to operations	1,722,218	1,000,865
Cash provided by operating activities	<u>1,421,731</u>	<u>5,627,227</u>
INVESTING ACTIVITIES		
Acquisition of income properties, cash consideration <i>[note 2]</i>	—	(13,841,391)
Additions to income properties	(1,122,248)	(2,469,551)
Increase in franchise fees and licenses	—	(58,290)
Advance of mortgages receivable <i>[note 4]</i>	—	(5,000,000)
Collection of mortgages and note receivable <i>[note 4]</i>	3,666,153	—
Transaction costs on mortgages receivable <i>[note 4]</i>	(4,110)	(59,646)
Distributions from Lakeview Flag Licensing General Partnership <i>[note 7]</i>	439,530	537,530
Cash provided by (used in) investing activities	<u>2,979,325</u>	<u>(20,891,348)</u>
FINANCING ACTIVITIES		
Unitholders' distributions		
Class A	(187,748)	(7,264,852)
Exchangeable Units	(5,000)	(193,500)
Proceeds from loan	—	7,000,000
Repayment of loan	—	(2,800,000)
Proceeds from mortgages payable	5,500,000	—
Repayment of mortgages payable	(7,432,409)	(2,211,080)
Proceeds of debentures <i>[note 9]</i>	—	10,250,000
Proceeds of convertible debentures <i>[note 10[d]]</i>	—	10,000,000
Financing costs on mortgages payable, debentures and convertible debentures	(196,172)	(1,648,315)
Cash held in trust	(2,500,000)	—
Cash provided by (used in) financing activities	<u>(4,821,329)</u>	<u>13,132,253</u>
Net decrease in cash and cash equivalents during the year	<u>(420,273)</u>	<u>(2,131,868)</u>
Cash and cash equivalents, beginning of year	1,751,665	3,883,533
Cash and cash equivalents, end of year	<u>1,331,392</u>	<u>1,751,665</u>
Supplemental cash flow information		
Cash paid for interest	8,565,514	7,736,253

See accompanying notes

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

1. GOING CONCERN, ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Going concern

These consolidated financial statements have been prepared on a going concern basis in accordance with Canadian generally accepted accounting principles ["GAAP"] which contemplates that Lakeview Hotel Real Estate Investment Trust ["Lakeview Hotel REIT"] will continue in operations and be able to realize its assets and discharge its liabilities and commitments in the normal course of business for the foreseeable future.

As discussed in note 11, Lakeview Hotel REIT was not in compliance with the Fixed Charge Coverage Ratio ["FCCR"] requirement for a number of hotels pledged as security under its long-term mortgage agreements with its primary mortgage lender. All long-term mortgage agreements with the primary mortgage lender are cross-collateralized. As a result, the entire balance of the long-term mortgages with the primary lender are in default and can be deemed as payable on demand and, accordingly, has been reclassified as current liabilities. Included in current liabilities at December 31, 2009 is a \$4,200,000 demand loan [note 8] and \$78,210,359 of mortgages payable [note 11] to Lakeview Hotel REIT's primary mortgage lender. At December 31, 2009, Lakeview Hotel REIT had a working capital deficiency of \$80,038,362 [2008 - \$12,474,130]. Management's understanding based on discussions with the primary lenders is that there is currently no indication that repayment of the loan or mortgages will be demanded in 2010.

There is significant doubt about the appropriateness of the going concern assumption because of the material uncertainty caused by the current market conditions and default under the loan agreements. Lakeview Hotel REIT has experienced declines in room revenues, reflecting a weak economic environment and a marked slowdown in the natural gas industry in the vicinity of several of Lakeview Hotel REIT's properties. The outlook for the hotel industry remains uncertain and the weakness is likely to continue until the economy improves, resulting in uncertainty as to whether Lakeview Hotel REIT will be able to meet its financial obligations as they become due.

Management continues to assess various strategies to improve operating results and cash flows and to adjust its capital structure. This includes the implementation of marketing initiatives aimed toward maximizing revenues, various cost reduction measures and seeking out alternative sources of debt or equity. While management believes that progress is being made in implementation of these strategies, there is no assurance as to their outcome or success. Further, Lakeview Hotel REIT's results for 2009 and future periods are subject to numerous uncertainties arising from depressed natural gas prices and a weak general economy.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

Lakeview Hotel REIT's ability to continue as a going concern is subject to the continued support of its lenders and related parties [note 15]. Specifically, Lakeview Hotel REIT's ability to continue to meet its financial obligations as they become due are dependent on the primary mortgage lender not demanding immediate repayment prior to the maturity dates and the related parties deferring collection of marketing, accounting, reservation, licensing and management fees. The consolidated financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis was not appropriate for these consolidated financial statements, then adjustments would be necessary in the carrying value of assets and liabilities, the reported revenue and expenses and the balance sheet classifications used. These adjustments may be material.

Organization and basis of presentation

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 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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

Significant accounting policies

[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 and 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, and estimated net recoverable amount. Long-lived assets are reviewed at the individual hotel level, the lowest level for which identifiable cash flows are largely independent, when testing for and measuring impairment. A two-step process is used to assess the impairment of long-lived assets held for use, with the first step determining when impairment is recognized and the second step measuring the amount of the impairment. Impairment losses are recognized when the carrying amount of long-lived assets exceeds the sum of the undiscounted cash flows expected to result from their use and eventual disposition and are measured as the amount by which the long-lived asset's carrying amount exceeds its fair value.

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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

Amortization is recorded on a straight-line basis as follows:

Buildings	40 years
Parking lots	10 years
Signs	10 years
Furniture, fixtures and equipment	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 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 adjusts the estimated liability based on redemption experience and additional points awarded and such adjustments are recorded in the results of operations.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

[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 income 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 year divided by the weighted average number of Units outstanding during the year. 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. 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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

[k] Use of estimates

The preparation of financial statements in accordance with Canadian GAAP 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 revenue 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, cash held in trust 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, mortgages receivable and note 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 and debentures on the consolidated statements of loss and comprehensive loss.

[m] New accounting standards adopted in 2009

Goodwill and intangible assets

In February 2008, the Canadian Institute of Chartered Accountants ["CICA"] approved 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. This standard was adopted by Lakeview Hotel REIT effective January 1, 2009.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

The adoption of Section 3064 had no impact on Lakeview Hotel REIT's 2009 consolidated financial statements.

Financial instruments - disclosures

CICA Handbook Section 3862, "Financial Instruments - Disclosures", was amended to include enhanced disclosures about inputs to fair value measurement including the fair value hierarchy determinations for financial instruments.

The fair value of a financial instrument is the amount of consideration that could be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. In certain circumstances, however, the initial fair value may be based on other observable current market transactions in the same instrument without modification or on a valuation technique using market-based inputs.

Fair value measurements recognized in the balance sheets are categorized using a fair value hierarchy that reflects the significance of inputs used in determining the fair value.

- Level 1 inputs - unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 inputs - inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs - inputs for the asset or liability that are not based on observable market data [unobservable inputs]. These unobservable inputs reflect the entity's own assumptions about the assumptions that the market participants would use in pricing the asset or liability, and are developed based on the best information available in the circumstances.

Each type of fair value is categorized based on the lowest level that is significant to the fair value measurement in its entirety.

The additional disclosure requirements are provided in note 17.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

Credit risk and the fair value of financial assets and financial liabilities

In January, 2009, the CICA Emerging Issues Committee issued EIC-173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. It requires an entity to consider its own credit risk and the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities, including derivative instruments. This EIC is applicable retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after January 20, 2009. The adoption of this standard had no significant impact on Lakeview Hotel REIT's 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 unitholders' equity. In addition, acquisition costs will be expensed when incurred. The new and amended standards will be effective for Lakeview Hotel REIT's 2011 fiscal year. The objective of these new sections is to harmonize Canadian GAAP 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"]

The Canadian Accounting Standards Board ["AcSB"] confirmed that the adoption of IFRS will be effective for the interim and annual periods beginning on or after January 1, 2011 for Canadian publicly accountable profit-oriented enterprises, with appropriate comparative data from the prior year. These standards will be effective for Lakeview Hotel REIT in the first quarter of 2011. Lakeview Hotel REIT is currently in the process of evaluating the potential impact of IFRS to its consolidated financial statements. This will be an ongoing process as the International Accounting Standards Board and the AcSB issue new standards and recommendations. The consolidated financial performance and financial position as disclosed in Lakeview Hotel REIT's current GAAP consolidated financial statements will be significantly different when presented in accordance with IFRS.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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:

	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 in 2009.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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 fund account equal to not less than 2% of monthly gross revenue.

	2009	2008
	\$	\$
Reserve fund, beginning of year	545,824	1,237,214
Allocations to reserve fund	774,515	1,160,788
Use of reserve fund	<u>(669,018)</u>	<u>(1,852,178)</u>
Reserve fund, end of year	<u>651,321</u>	<u>545,824</u>

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 AND NOTE RECEIVABLE

The mortgages receivable represented 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 2009, \$3,628,882 was collected on the mortgages receivable and a further \$98,244 was forgiven on settlement as described below.

During 2009, all mortgage charges were discharged and a promissory note was taken back for the balance owing of \$1,272,874. The note receivable bears interest at 12% per annum and is to be repaid by blended monthly payments of \$50,000 from August 31, 2009 to June 30, 2010, and a final payment of \$841,764 on July 31, 2010. As at December 31, 2009, \$37,271 was collected on the note receivable and the interest receivable balance included in accounts receivable was \$49,560. The borrowers have been in default of their monthly payments since September, 2009.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

The carrying value of the note 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. The note receivable is collateralized by a transfer of land owned by the borrowers, second and/or third charges against other lands owned by the borrowers and corporate and personal guarantees from the borrowers. Management believes that the full amount of the note receivable and interest receivable outstanding at December 31, 2009 will be collected and/or recovered from the collateral. Accordingly, there were no impairment provisions recorded for the note receivable as at December 31, 2009. However, there exists uncertainty as to the recovery of the full amount of the note receivable. In 2009, interest income recognized on the mortgage receivable was \$306,038 [2008 - \$339,344] and on the note receivable was \$68,565 [2008 - nil].

5. FRANCHISE FEES AND LICENSES

	2009 \$	2008 \$
Cost	206,632	261,379
Less accumulated amortization	<u>(97,585)</u>	<u>(95,191)</u>
	<u>109,047</u>	<u>166,188</u>

6. INCOME PROPERTIES

	2009			2008		
	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	144,768,287	11,064,380	133,703,907	144,204,778	7,455,700	136,749,078
Parking lots	715,710	142,480	573,230	492,373	88,204	404,169
Signs	534,138	134,056	400,082	534,138	80,642	453,496
Furniture, fixtures and equipment	15,124,523	9,013,969	6,110,554	14,789,121	6,035,843	8,753,278
	<u>176,636,377</u>	<u>20,354,885</u>	<u>156,281,492</u>	<u>175,514,129</u>	<u>13,660,389</u>	<u>161,853,740</u>

As a result of the current market conditions and decline in room revenues as discussed in note 1, management assessed the potential impairment of income properties on an individual hotel basis. Impairment is recognized when the carrying value of the hotel's assets exceed the total undiscounted cash flows expected from its use and eventual disposition. The estimate of undiscounted cash flows include the forecast of each hotel's projected cash flows for the years

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

2010 to 2019 and the disposal value of the hotel after 2019. The following assumptions are used in the forecast and estimates:

- Lakeview Hotel REIT will continue to own and operate the hotels on a long-term basis [at least 10 years].
- Long-term debt will be re-financed at maturity at reasonable commercial terms [refer to note 11 regarding mortgages in default and repayment that can be demanded at any time].
- Market conditions for items such as occupancy rates and room rates will gradually recover to historical peak levels by 2015.
- Disposal value is estimated using the 2019 forecasted cash flow multiplied by a capitalization rate of 11%.

The estimated total undiscounted cash flow calculated based on the above assumptions exceeds the carrying value of the assets of each hotel under review. Accordingly, no impairment provision was recorded as at December 31, 2009. Actual results will differ from the forecast estimates and assumptions and the differences may be significant. The future long-term cash flows forecast is also dependent on the going concern assumptions as discussed in note 1. Should Lakeview Hotel REIT not be able to continue on a going concern basis, the liquidation value of the income properties will be significantly different from the carrying value.

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 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 GAAP 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 Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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 June 30, 2009, the Lakeview Inn & Suites - Hudson's Hope [also located in British Columbia] for the period September 17, 2008 to July 15, 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.

Investment in Lakeview Flag Licensing General Partnership:

	2009	2008
	\$	\$
Investment, beginning of year	120,171	40,367
Equity income	584,552	617,334
Distribution received	(439,530)	(537,530)
Investment, end of year	265,193	120,171

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

8. LOAN PAYABLE

	2009 \$	2008 \$
Loan payable	<u>4,200,000</u>	<u>4,200,000</u>

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 4.98% in 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.

	2009 \$	2008 \$
Principal	10,250,000	10,250,000
Financing costs	(855,121)	(855,121)
Accretion of debentures	308,186	124,372
	<u>9,703,065</u>	<u>9,519,251</u>

The accretion of debentures of \$183,814 [2008 - \$124,372] is included in interest expense.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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
	<u>28,394,023</u>	<u>5,605,977</u>	<u>34,000,000</u>

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

Debenture	2009			
	Effective interest rate %	Original face amount \$	Converted to 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
		<u>29,500,000</u>	<u>1,480,000</u>	<u>28,020,000</u>

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

Debtenture	2009				December 31, 2009
	Face amount outstanding \$	Holder's conversion option \$	Accretion \$	Financing costs \$	
Current					
9% Subordinated Convertible Debtentures	40,000	(11,566)	13,249	(3,610)	38,073
Long-term					
6.5% Series C Convertible Redeemable Subordinated Debtentures	18,000,000	(3,062,813)	1,751,213	(1,058,428)	15,629,972
8.5% Series D Convertible Redeemable Subordinated Debtentures	9,980,000	(952,360)	433,541	(716,067)	8,745,114
	27,980,000	(4,015,173)	2,184,754	(1,774,495)	24,375,086
	28,020,000	(4,026,739)	2,198,003	(1,778,105)	24,413,159

Debtenture	2008			
	Effective interest rate %	Original face amount \$	Converted to Units \$	Face amount outstanding \$
10% Subordinated Convertible Debtentures	18%	4,500,000	4,398,000	102,000
9% Subordinated Convertible Debtentures	18%	1,500,000	1,460,000	40,000
6.5% Series C Convertible Redeemable Subordinated Debtentures	11%	18,000,000	—	18,000,000
8.5% Series D Convertible Redeemable Subordinated Debtentures	11%	10,000,000	20,000	9,980,000
		34,000,000	5,878,000	28,122,000

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

Debtenture	2008				December 31, 2008
	Face amount outstanding \$	Holder's conversion option \$	Accretion \$	Financing costs \$	
Current					
10% Subordinated Convertible Debtentures	102,000	(26,184)	32,707	(9,724)	98,799
Long-term					
9% Subordinated Convertible Debtentures	40,000	(11,566)	9,212	(3,610)	34,036
6.5% Series C Convertible Redeemable Subordinated Debtentures	18,000,000	(3,062,813)	991,065	(1,058,428)	14,869,824
8.5% Series D Convertible Redeemable Subordinated Debtentures	9,980,000	(952,360)	162,229	(716,067)	8,473,802
	<u>28,020,000</u>	<u>(4,026,739)</u>	<u>1,162,506</u>	<u>(1,778,105)</u>	<u>23,377,662</u>
	<u>28,122,000</u>	<u>(4,052,923)</u>	<u>1,195,213</u>	<u>(1,787,829)</u>	<u>23,476,461</u>

The accretion of the debt component, which increases the debt component from the initial carrying amount, is included in interest expense and totalled \$1,038,698 in 2009 [2008 - \$846,657].

[a] 10% Subordinated Convertible Debtentures

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

On April 15, 2009, the remaining \$102,000 outstanding of 10% Subordinated Convertible Debtentures were repaid in full by issuance of 283,050 Class A Units [note 12].

[b] 9% Subordinated Convertible Debtentures

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

The debtentures 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 debtentures are convertible by the holder at any time after the date of issue at \$2.90 per Unit.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

[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 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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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.

11. MORTGAGES PAYABLE

	2009 \$	2008 \$
[a] 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 [note 9] and the Days Inn - Ottawa Airport	78,210,359	80,362,284
[b] Mortgage payable, bore 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 were due on the mortgage. The mortgage was refinanced by [c] and [d] below in 2009	—	7,000,000
[c] Mortgage payable, bearing interest at 7% per annum, due August 21, 2014, 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	5,246,249	—
[d] Mortgage payable, bearing interest at 9.5% per annum, due August 1, 2011, 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 are due on the mortgage	2,000,000	—
	<u>85,456,608</u>	<u>87,362,284</u>
Less current portion	<u>78,430,822</u>	<u>9,362,752</u>
	<u>7,025,786</u>	<u>77,999,532</u>

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

The agreements for the mortgages in [a] 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 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. Accordingly, at December 31, 2008, the mortgages payable were 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 by LMI in favor of the mortgage lender to draw upon in the event of default. In November, 2009, Lakeview Hotel REIT entered into an "Escrow Agreement" with the lender whereby it transferred \$2,500,000 to be held in trust with an escrow agent in favor of the lender. This cash collateral replaced the two letters of credit provided by LMI as noted above.

As at December 31, 2009, Lakeview Hotel REIT was not in compliance with the FCCR requirement for eleven of the hotel properties. As a result, and since the mortgages are cross collateralized by each of the underlying properties, repayment of the mortgages in [a] can be demanded at any time. Accordingly, these mortgages have all been classified as current liabilities as at December 31, 2009.

The agreement for the mortgage payable in [c] contains a cross-default provision with Lakeview Hotel REIT's other debt obligations. Therefore, as a result of the non-compliance of the financial covenant for the mortgages noted above, Lakeview Hotel REIT is also not in compliance with this mortgage agreement as at December 31, 2009. Subsequent to year end, Lakeview Hotel REIT obtained an agreement from the lender to waive its rights to demand repayment of the mortgage as a result of this covenant breach. Accordingly, the portion of the mortgage in [c] not due in 2010 continues to be classified as a long-term liability.

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

	\$
2010	2,733,575
2011	31,323,895
2012	30,713,316
2013	5,014,632
2014	16,342,154
Total principal outstanding	86,127,572
Financing costs	(1,293,414)
Accretion of mortgages	622,450
	<u>85,456,608</u>

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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	59,040,133	1	—	59,040,134
Repayment of convertible debentures by issuance of Units <i>[note 10]</i>	128,184	—	—	128,184
Balance, December 31, 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	18,774,756	500,000	1
Repayment of convertible debentures by issuance of Units <i>[note 10]</i>	283,050	—	—
Balance, December 31, 2009	19,057,806	500,000	1

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

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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 year ended December 31, 2009, distributions of \$0.01 [2008 - \$0.39] per Class A Unit and per Exchangeable Unit were declared, totalling \$192,748 [2008 - \$7,458,352].

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 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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

"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 1,000,000 Units.

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

	2009		2008	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Unit options outstanding, beginning of year	342,000	4.03	232,500	4.28
Unit options granted	—	—	109,500	3.50
Unit options outstanding, end of year	342,000	4.03	342,000	4.03
Range of exercise price of Unit options outstanding, end of year	—	3.25 to 4.62	—	3.25 to 4.62
Unit options vested, end of year	342,000	4.03	342,000	4.03
Expiry date	2011 to 2013		2011 to 2013	

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

The fair values of the options issued in 2008 were estimated using the Black-Scholes option pricing model with the following assumptions and results:

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.

14. BASIC AND DILUTED NET LOSS PER UNIT

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

	<u>2009</u>	<u>2008</u>
Weighted average Units	<u>19,477,156</u>	<u>19,272,512</u>

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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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:

	2009	2008
	\$	\$
Accounts payable and accrued liabilities to		
LMI	614,721	136,923
Lakeview Flag Licensing General Partnership <i>[note 7]</i>	501,629	156,226
Lakeview Flag Management General Partnership <i>[note 16]</i>	761,138	237,068
Trustees of Lakeview Hotel REIT	10,000	9,920
Marketing expenses paid to		
Free to Guest Movies Ltd.	179,925	160,704
LMI	196,253	394,930
Included in general and administration expense		
Accounting fees paid to		
LMI	564,011	530,879
Asset management fees paid to		
LMI	477,753	459,897
Reservation fees paid to		
LMI	294,380	394,930
License fees paid to		
Lakeview Flag Licensing General Partnership <i>[note 7]</i>	786,499	1,053,858
Management fees paid to		
Lakeview Flag Management General Partnership <i>[note 16]</i>	1,211,490	1,421,802
Professional fees paid to		
XYZ Design Inc.	1,498	5,637
Letter of credit standby fees paid to LMI	90,164	—
Included in salaries and benefits		
Trustees' fees	39,500	—
Capitalized to income properties		
Professional fees paid to		
XYZ Design Inc.	4,549	50,201
Keith Levit Photography	—	22,695
Development fees paid to LMI	—	35,549

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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.

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.

Beginning on June 11, 2009, LMI charged 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 was 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 was 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. In November, 2009, Lakeview Hotel REIT provided cash collateral to replace the letters of credit provided by LMI and the standby fee was terminated.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

16. INVESTMENT IN LAKEVIEW FLAG MANAGEMENT GENERAL PARTNERSHIP

Lakeview Hotel REIT indirectly acquired a 50% interest in 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:

	2009	2008
	\$	\$
Assets - current	<u>256,856</u>	<u>80,157</u>
Liabilities - current	<u>1,251</u>	<u>1,487</u>
Revenue	427,233	474,143
Expenses	48	36
Net income	<u>427,185</u>	<u>474,107</u>
Cash flows		
Cash provided by operating activities	252,258	422,863
Cash used in financing activities	<u>(250,250)</u>	<u>(422,750)</u>
Net increase in cash	<u>2,008</u>	<u>113</u>

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

17. FINANCIAL INSTRUMENTS

[a] Fair values

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

The fair values of the \$78,210,359 of mortgages payable to the primary lender are the principal balances outstanding of \$78,697,228 as Lakeview Hotel REIT is not in compliance with the financial covenant and repayment of the mortgages can be demanded at any time [note 11]. The carrying values of the \$5,246,249 and \$2,000,000 mortgages approximate fair values as they were advanced close to year end and their interest rates approximate market rates at year end.

Lakeview Hotel REIT's cash and cash equivalents, reserve fund, cash held in trust, deposits held in trust, accounts receivable, accounts payable and accrued liabilities and distributions payable are carried at amortized cost, which approximates their fair value due to the immediate or short-term nature of these financial instruments.

The carrying value of the mortgages receivable and note receivable approximates their fair value as they were advanced close to year end and due to the short-term maturity of the note receivable.

The carrying value of the loan payable approximates the fair value as it is a demand loan with a floating interest rate based on market interest rates.

Based on trading value and other market factors, the estimated fair value of the debentures and the 10% and 9% convertible debentures approximates their carrying value and the estimated fair values of the 6.5% and 8.5% convertible debentures were \$12,600,000 [2008 - \$8,101,000] and \$6,500,000 [2008 - \$5,400,000] at December 31, 2009, respectively.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

The following table presents the financial instruments recorded at the fair value in the consolidated balance sheets, classified using the fair value hierarchy described above:

	2009			2008		
	Level 1 \$	Level 2 \$	Level 3 \$	Level 1 \$	Level 2 \$	Level 3 \$
Financial assets						
Cash and cash equivalents	1,331,392	—	—	1,751,665	—	—
Reserve fund	651,321	—	—	545,824	—	—
Cash held in trust	2,500,000	—	—	—	—	—
Deposits held in trust	—	—	—	300,000	—	—

[b] Risk management

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 the 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.

Credit risk

The amount of accounts receivable disclosed in the consolidated balance sheets of \$1,075,291 as at December 31, 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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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 note receivable and the actions taken to mitigate it.

Liquidity risk

Lakeview Hotel REIT is currently subject to substantial liquidity risk. Liquidity risk arises when Lakeview Hotel REIT is unable to meet its financial obligations as they fall due. Lakeview Hotel REIT manages liquidity risk through cash flow forecasting and regular monitoring of cash requirements including anticipated investing and financing activities.

As described in note 11, Lakeview Hotel REIT was not in compliance with the FCCR financial covenants under the mortgage agreements with its primary lender. As a result, repayment of the mortgages can be demanded at any time and mortgages payable of \$78,210,359 are included in current liabilities. Although the mortgages can be demanded at any time, there is currently no indication that repayment will be demanded in 2010. Also included in current liabilities is a \$4,200,000 demand loan from Lakeview Hotel REIT's primary mortgage lender [note 8]. While the loan is due on demand, there is also currently no indication that repayment will be demanded in 2010.

Also during 2009, the Trustees announced a suspension of monthly distributions to Unitholders following the February, 2009 distribution in order to preserve capital. Management has considered liquidity risk in using the going concern assumption as described in note 1.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

18. INCOME TAXES

The provision for income taxes varies from the amount that would be expected if computed by applying the Canadian federal and provincial statutory income tax rates to loss before income taxes as shown in the following table:

	2009 \$	2008 \$
Loss before income taxes	(8,068,110)	(2,255,428)
Temporary differences and non-tax deductible expenses	4,822,147	2,255,428
Income subject to tax	<u>(3,245,963)</u>	<u>—</u>
Combined federal and provincial income tax at statutory rate of 31%	(1,006,000)	—
Valuation allowance	1,006,000	—
Income trust future tax recovery	—	(734,000)
Income tax recovery	<u>—</u>	<u>(734,000)</u>

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

	2009 \$	2008 \$
Future tax assets		
Net taxable temporary difference	1,593,000	46,000
Taxable portion of non-capital loss carryforward	909,000	—
Valuation allowance	<u>(2,502,000)</u>	<u>(46,000)</u>
	<u>—</u>	<u>—</u>

Based on its assets and liabilities as at December 31, 2009 and 2008, Lakeview Hotel REIT estimated the amount of its temporary differences and the periods in which these differences will reverse. Lakeview Hotel REIT estimates that approximately \$5,713,000 [2008 - \$164,000] net taxable temporary differences and the non-capital loss carryforward of \$3,245,963 will reverse after January 1, 2011, resulting in \$2,502,000 [2008 - \$46,000] of future 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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

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 financial covenants in the mortgages payable [including contributions to the replacement reserve fund], 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 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 or redeem units, repay outstanding debt, issue new debt, refinance existing debt under different terms, acquire or dispose of assets or adjust its capital spending to manage its current and projected debt levels.

	2009	2008
	\$	\$
Capital structure		
Loan payable	4,200,000	4,200,000
Debentures	9,703,065	9,519,251
Convertible debentures	24,413,159	23,476,461
Mortgages payable	85,456,608	87,362,284
Total debt	123,772,832	124,557,996
Unitholders' equity	35,513,433	43,672,291
Total capital	159,286,265	168,230,287

In accordance with the Declaration of Trust, Lakeview Hotel REIT ensures the total of all mortgage loans on all income properties is restricted from being greater than 75% of the appraised value of the income properties. As at December 31, 2009 and 2008 respectively, the total of mortgage loans payable is 48.4% and 49.8% of the total estimated current value of income properties.

As disclosed in note 11, as at December 31, 2009, Lakeview Hotel REIT was not in compliance with the FCCR requirements for 11 of the hotel properties on which mortgages are held with the primary mortgage lender.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

In addition, for the years ended December 31, 2009 and 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:

	<u>\$</u>
2010	40,247
2011	42,365
2012	42,365
2013	42,365
2014	42,365
Thereafter	<u>1,334,497</u>
	<u>1,544,204</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.