

## LAKEVIEW HOTEL REIT MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE MONTHS ENDED MARCH 31, 2011

June 29, 2011

Management's discussion and analysis of financial conditions and results of operations (MD&A) should be read in conjunction with the unaudited consolidated financial statements for the three months ended March 31, 2011. The consolidated financial statements for the three months ended March 31, 2011, have been prepared by and are the responsibility of management and have been prepared in accordance with International Financial Reporting Standards (IFRS).

### OVERVIEW AND PORTFOLIO SUMMARY

Lakeview Hotel Real Estate Investment Trust (Lakeview Hotel REIT) is an unincorporated closed-end mutual fund trust created pursuant to a Declaration of Trust dated February 11, 2004. The Qualifying Transaction was completed on April 15, 2004 through a private offering of Lakeview Hotel REIT units, a public offering of Lakeview Hotel REIT subordinate convertible debentures, and the acquisition of the Lakeview Inn & Suites - Fredericton hotel. Through March 31, 2011 Lakeview Hotel REIT had acquired 18 hotels including the Fredericton property.

The results of their operations are included in the March 31, 2011 audited consolidated financial statements of Lakeview Hotel REIT.

The table below provides details on the hotels owned by Lakeview Hotel REIT as of March 31, 2011.

Property	Date of Purchase	Date of Conversion to Lakeview Brand	Number of Rooms
Lakeview Inn & Suites - Fredericton, NB	April 15, 2004	April 15, 2004	97
Best Western Black Gold Inn - Drayton Valley, AB	June 1, 2005	December 1, 2005	91
Ramada Limited & Suites - Hinton, AB	November 4, 2005	November 4, 2005	55
Best Western Okotoks Lodge - Okotoks, AB	January 6, 2006	July 1, 2006	64
Best Western Fort Inn & Suites - Fort Saskatchewan, AB	January 13, 2006	July 1, 2006	69
Super 8 Toronto North - Vaughan, ON	March 17, 2006	N/A	82
Super 8 Motel - Edson, AB	April 7, 2006	April 7, 2006	45
Ramada Limited - Whitecourt, AB	May 31, 2006	May 31, 2006	50
Holiday Inn Express & Suites - Sherwood Park, AB	June 1, 2006	N/A	90
Ramada Limited - Fort St. John, BC	October 16, 2006 and November 10, 2006	October 16, 2006	71
Days Inn - Chetwynd, BC	October 24, 2006 and November 9, 2006	October 24, 2006	58
Lakeview Inn & Suites - Fort Nelson, BC	January 8, 2007	January 8, 2007	82
Lakeview Inn & Suites - Edson Airport West, AB	April 16, 2007	April 16, 2007	69
Holiday Inn Express & Suites - Brooks, AB	May 15, 2007	May 15, 2007	77

Residence Inn Marriott – Calgary, AB	June 22, 2007	June 22, 2007	120
Best Western – Slave Lake, AB	November 15, 2007	January 3, 2008	68
Four Points by Sheraton – Prince George, BC	April 3, 2008	N/A	74
Days Inn – Ottawa Airport, ON	August 1, 2008	N/A	81
Total room count			<u>1343</u>

In addition to income earned from hotel operations Lakeview Hotel REIT also earns income from licensing fees charged to certain Lakeview Inn & Suites hotels which are owned by Lakeview Management Inc. (a unitholder of Lakeview Hotel REIT) and include hotels in Bathurst, New Brunswick; Brandon, Manitoba; Grand Forks, North Dakota; Halifax, Nova Scotia; and Miramichi, New Brunswick.

As at June 29, 2011 the following units of Lakeview Hotel REIT were issued and outstanding:


	Class A Units	19,057,806
	Class V Special Trust Units and Exchangeable Units	
<u>500,000</u>	Total Units that participate pro rata in distribution	
	<u>19,557,806</u>	
	Class T Special Trust Unit (1)	<u><u>1</u></u>

- (1) The holder of the Class T Special Trust Unit has the right to appoint one-third of the total number of trustees. The Class T Special Trust Unit is non-voting, non-transferable and is not entitled to any distribution or economic interest in Lakeview Hotel REIT.

## OUTLOOK

Lakeview REIT, as gauged by its hotel revenues, is now in a strong upward trend. The first quarter of 2011 saw a 22% increase in RevPar over the first quarter of 2010. Occupancy was up by 22.6%. In 14 of the last 16 months the REIT has seen increases in year-over-year monthly room revenues. The only months where year-over-year revenues have not increased have been during the spring break up period where weather related road restrictions have huge impacts on drilling activity. Forecasts for drilling activity are looking very positive and the REIT is expecting improved operating results to continue into the second half of 2011.

Markets experiencing exceptional results include Fort Nelson, BC, where the deep shale gas in the Horn River basin continues to be developed; Drayton Valley, AB, where new technology has resulted in a resurgence of activity in the Pembina Cardium formation; and Slave Lake, AB, which will undergo a massive redevelopment as a result of the destruction caused by the forest fire. The overall outlook in Alberta is much improved. Many of Lakeview REIT's properties will benefit from wind energy, pipeline, and carbon capture projects in the region.



With the improvements in operations, the REIT is now becoming cash flow positive. As cash flow continues to improve, the REIT will have two priorities. These are to reduce its indebtedness; and to reinvest in its properties in order to remain competitive in the markets in which it operates.

## KEY PERFORMANCE MEASURES

Occupancy Percentage, Average Room Rate and RevPar are three important indicators used by the hotel industry in general to measure the performance of a hotel and compare performance to other hotel operations. The key performance measures for the Lakeview Hotel REIT are as follows:

	Three months ended March 31	
	2011	2010
<b>Occupancy Percentage</b> <sup>(1)</sup>	<b>60.65%</b>	<b>49.49%</b>
<b>Average Room Rate</b> <sup>(1)</sup>	<b>\$113.50</b>	<b>\$114.03</b>
<b>RevPar</b> <sup>(1)</sup>	<b>\$68.84</b>	<b>\$56.43</b>
<b>Rooms Occupied</b>	<b>73,310</b>	<b>59,946</b>

*Note (1): Occupancy Percentage measures the level of hotel room utilization and is calculated by dividing the number of rooms rented for a given period by the number of rooms available for the period.*

*Average Room Rate measures the average room price for all guest rooms by dividing total room revenues by the number of rooms rented.*

*RevPar (Revenue per available room) is calculated by multiplying the Occupancy Percentage by the Average Room Rate and is a measure of efficiency based on all available rooms regardless of whether they are occupied or not.*

These measures are not recognized under International Financial Reporting Standards "IFRS" and the method we use in calculating these numbers may not be comparable to other companies. They should not be used as an alternative to net earnings (loss) determined in accordance with IFRS as an indicator of performance. These numbers can be used to supplement other information presented in understanding the performance of our hotels in a historical perspective.

Occupancy and RevPar increased for the three months ended March 31, 2011 compared to the three months ended March 31, 2010, while average room rate decreased for the same period. Occupancy increased due to the improved economic conditions and general increases in resource activity in the areas where Lakeview Hotel REIT owns hotels.

## RESULTS OF OPERATIONS

The following is a comparison of the operating results for the three months ended March 31, 2011 compared to the results of operations for the comparable period in 2010:

	<b>Three months ended</b>	
	<b>March 31</b>	
	2011	2010
Hospitality Revenue		
Room	8,371,140	6,830,877
Food & Beverage	796,837	678,116
Other	461,861	527,427
Total Revenue	<u>9,629,838</u>	<u>8,036,420</u>
Expenses	10,724,190	10,163,798
Net Loss before future income tax expense	<u>(1,094,352)</u>	<u>(2,127,378)</u>
Basic and diluted Loss before income tax per unit	(0.056)	(0.109)
Net Loss	<u>(1,094,352)</u>	<u>(2,127,378)</u>
Basic and diluted Loss per Unit	(0.056)	(0.109)
Reconciliation to Funds from Operations		
Add (deduct)		
Amortization of income properties	1,441,544	1,612,940
Amortization of franchise fees	8,109	8,734
Distributions from Lakeview Flag Licensing General Partnership	258,720	29,400
Distributions from Lakeview Flag Management General Partnership	103,250	-
Income from Lakeview Flag Licensing General Partnership	(147,846)	(115,379)
Income from Lakeview Flag Management General Partnership	(112,518)	(92,339)
Funds from Operations	<u>456,907</u>	<u>(684,022)</u>
Basic and diluted Funds from Operations per unit	0.023	(0.035)
Contributions to reserve account	(181,846)	(157,620)
Adjusted Funds from Operations	<u>275,061</u>	<u>(841,642)</u>
Basic and diluted adjusted Funds from Operations per unit	0.014	(0.043)
Reconciliation to distributable income		
Accretion on debt component of convertible debentures	319,841	283,420
Accretion of debentures	54,516	49,061
Accretion of mortgages payable	63,850	63,264
Loss on disposal of income properties	17,293	-
Distributable Income	<u>730,561</u>	<u>(445,897)</u>
Basic and diluted distributable income per unit	0.037	(0.023)
Distributions	-	-

## OPERATING RESULTS REVIEW – THREE MONTHS ENDED MARCH 31, 2011

Room Revenue - For the quarter ended March 31, 2011 room revenue increased by \$1,540,263, from \$6,830,877 for the quarter ended March 31, 2010, to \$8,371,140. The increase is related to the improved economic conditions and to general increases in resource activity, which impacted a number of hotels owned by Lakeview Hotel REIT.

Food & Beverage and Gift Shop - Revenue is earned from restaurant facilities in the Lakeview Inn & Suites - Drayton Valley, the Lakeview Inn & Suites - Fort St. John, the Lakeview Inn & Suites - Fort Saskatchewan, and Four Points by Sheraton - Prince George. Revenue increased for the period due to higher occupancies in the hotels that have restaurants.

Other Income - The decrease for the quarter ended March 31, 2011 is due to the receipt of a non-refundable deposit in the first quarter of 2010 for \$125,000.

Expenses - Expenses for the quarter of 2011 increased by \$560,392 from \$10,163,798 for the first quarter ended March 31, 2010 to \$10,724,190. This increase was made up primarily from an increase in salaries and benefits (\$240,000), administration expense (\$210,000) and utilities (\$120,000).

Net Loss - Net Loss decreased from a loss of \$2,127,378 for the quarter ended March 31, 2010, to a loss of \$1,094,352 for the quarter ended March 31, 2011. The decrease of the loss is due to better performance of the hotels due to an improvement in economic conditions and increases in resource activity.

#### **NON IFRS FINANCIAL MEASURES**

Included in this MD&A are certain non IFRS financial measures, which are a measure of Lakeview Hotel REIT's historical or future financial performances that are not calculated or presented in accordance with IFRS. These measures may not be comparable to similar measures presented by other entities and include distributable income, funds from operations, and adjusted funds from operations.

#### **DISTRIBUTABLE INCOME**

Distributable income is commonly used in the Real Estate Investment Trust industry to measure financial performance. Lakeview Hotel REIT calculates distributable income to reflect distributable cash which is defined in Lakeview Hotel REIT's Declaration of Trust as:

All revenues received or receivable including net realized capital gains and such other amounts as the Trust may receive from time to time, by the Trust in the applicable period adjusted for:

- i. Administrative and operational expenses and other obligations of the Trust,

- ii. Amounts which may be used for acquisitions or other business purposes,
- iii. Amounts required for replacement reserves, and
- iv. Such other amounts as the Trustees deem appropriate and necessary.

Distributable income is used by management to determine the level of distributions paid to unit holders and as a result is a useful supplemental measure of the Lakeview Hotel REIT's operating performance for investors.

Distributable income increased by \$1,176,458 from \$(445,897) for the quarter ended March 31, 2010 to \$730,561 for the quarter ended March 31, 2011.

### **FUNDS FROM OPERATIONS AND ADJUSTED FUNDS FROM OPERATIONS**

Funds from operations (FFO) is a standard industry wide measure of a real estate entity's operating performance. The Real Property Association of Canada defines FFO as net income (computed in accordance with generally accepted accounting principles) excluding gains (or losses) from sales of depreciable real estate and extraordinary items, plus depreciation and amortization, plus future income taxes and after adjustment for equity accounted for entities, and non controlling interests.

FFO provides another useful measure of Lakeview Hotel REIT's performance as FFO excludes the effect of real estate amortization and gains and losses from sales of real estate, all of which are based on historical cost accounting and which may be of limited significance in evaluating current performance. Management believes that such a measure is useful in comparison of operating performance between periods and with other REITs. FFO, for the three months ended March 31, 2011, was \$456,907 compared to \$(684,022) for the same period in 2010.

Adjusted funds from operation (AFFO) has a further adjustment to funds from operations by taking into account the impact of capital requirements for Lakeview Hotel REIT and is calculated by deducting the contribution to the reserve account from FFO. Adjusted funds from operations increased by \$1,116,703 from \$(841,642) for the three months ended March 31, 2010 to \$275,061 for the three months ended March 31, 2011.

### **LIQUIDITY AND CASH FLOW**

At March 31, 2011 Lakeview Hotel REIT had cash of \$1,730,575 and a balance in the reserve fund of \$523,349. 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.

The agreements for the mortgages with the primary lender 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. 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 favour of the lender. The cash collateral replaced the two letters of credit provided by Lakeview Management Inc.

As at December 31, 2010 Lakeview Hotel REIT was not in compliance with the FCCR requirements for 10 of the hotel properties. However, during 2011, Lakeview Hotel REIT entered into a loan commitment agreement with the mortgage lender to refinance on the closing date of June 29, 2011 the seven mortgages maturing from February 1, 2011 to July 1, 2011 [with total carrying values of \$27,501,018 as at December 31, 2010 and \$27,249,463 as at March 31, 2011] and \$2,200,000 of the \$4,200,000 loan payable. As part of the loan commitment agreement, the lender has agreed to enter into a forbearance agreement regarding its right to demand repayment of all of the mortgages as a result of the non-compliance of the FCCR requirement at December 31, 2010. The refinanced mortgages will have a 3 year term with annual fixed interest rates at 4.35% above the 3-year Canadian dollar fixed interest SWAP rate. Total loan fees of 1% of the loan amount are due on or before September 1, 2011. Also as part of the loan commitment agreement, Lakeview Hotel REIT is committed to obtain refinancing from alternate mortgage lender(s) for one income property with a mortgage maturing January 1, 2012, and for another one of two income properties with mortgages maturing on May 1, 2012 and December 1, 2012, respectively. If Lakeview Hotel REIT has not received refinancing for these two income properties by September 1, 2011 and the related mortgages are not repaid by December 31, 2011, this will be considered an event of default and repayment of all of the mortgages can be demanded at any time. As a result of this contingency and the possibility that a number of the hotels will not be in compliance with the FCCR requirement at December 31, 2011, as well as the cross collateralization of all of the mortgages, \$82,330,416 of mortgages have all been classified as current liabilities as at March 31, 2011.

During 2008 Lakeview Hotel REIT had advanced amounts under a mezzanine loan arrangement with an independent hotel developer and its related parties for three hotels in British Columbia and Alberta. The amounts were registered as mortgages and classified as mortgages receivable. 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.

During 2009, all mortgage charges were discharged and a promissory note was taken back for the balance owing of \$1,272,874. The borrowers have been in default of their monthly payments since September, 2009.

The note receivable is collateralized by a transfer of land located at Tumbler Ridge, British Columbia owned by the borrowers, second and/or third charges against other lands owned by the borrowers and corporate and personal guarantees from the borrowers. In August 2010, Lakeview Hotel REIT was informed that a Receiver-Manager was appointed over the assets on the Tumbler Ridge land by way of a joint appointment made by the Business Development Bank of Canada and Concentra Financial Services Associations, holders of first mortgage security on the Tumbler Ridge assets. Subsequently, Lakeview Hotel REIT learned that the Tumbler Ridge property was listed for sale and in 2011 also learned that an offer on the property had been accepted. Management believes that there are significant uncertainties as to the final proceeds once a sale is actually concluded. Therefore, after payment to the holders of the first mortgage security, it is uncertain as to whether Lakeview Hotel REIT will be able to recover any of the note receivable or interest receivable outstanding at March 31, 2011 from the proceeds of the sale of the Tumbler Ridge property, or from any of the other collateral. Accordingly, during 2010 Lakeview Hotel REIT recorded a provision for impairment of note receivable for the entire \$1,235,603 note receivable and \$160,459 of interest receivable that had accrued to September 30, 2010.

Based on its cash flow forecast, available financing, the potential for further deferral of payment of fees to related parties and cooperation of its major lender, management believes Lakeview Hotel REIT will be able to meet financial obligations as they come due.

Should there be a future expansion of Lakeview Hotel REIT, it may be financed through cash and term deposits on hand, the raising of capital by the sale of units, the issuance of convertible debentures, senior secured debentures, and through additional mortgage financing.

The table below reconciles net income to cash provided by operating activities for the three months ended March 31, 2011 and 2010.

	Three months ended March 31	
	2011	2010
Net Loss for the period	(1,094,352)	(2,127,378)
Add charges (deduct credits) to operations not requiring a current cash payment		
Amortization of income properties	1,441,544	1,612,940
Amortization of franchise fees and licenses	8,109	8,734
Income from Lakeview Flag Management General Partnership	(112,518)	(92,339)
Income from Lakeview Flag Licensing General Partnership	(147,846)	(115,379)
Accretion on debt component of convertible debentures	319,841	283,420
Accretion of mortgages payable	63,850	63,264
Accretion of debentures	54,516	49,061
Loss on disposal of income properties	17,293	-
	<hr/>	<hr/>
Net change in non-cash working capital balances related to operations	550,437	(317,677)
	<u>154,589</u>	<u>1,057,917</u>
Cash provided by operating activities	705,026	740,240

#### **CASH PROVIDED BY OPERATING ACTIVITIES**

Cash provided by operating activities was \$705,026 for the three months ended March 31, 2011 which decreased from \$740,240 cash provided by operating activities in the three months ended March 31, 2010.

#### **CASH USED IN INVESTING ACTIVITIES**

In the three months ended March 31, 2011 and 2010 cash was used for renovations and capital additions to hotels.

#### **CASH PROVIDED BY FINANCING ACTIVITIES**

In the three months ended March 31, 2010 and 2011, no cash was raised through financing activities and cash was used to repay mortgage principal.

#### **DISTRIBUTIONS**

Effective September 1, 2005 the Trustees approved a change in the distribution policy from quarterly distributions of \$0.05 per unit to monthly distributions. Lakeview Hotel REIT paid monthly distributions of \$0.03 per unit to April 30, 2006. Effective for the May 31, 2006 distribution payment, the Trustees approved an increase in the regular

monthly cash distribution from \$0.03 to \$0.0333 per unit. Effective for the Unitholders of record on November 30, 2006 and the distribution payable on December 29, 2006 the Trustees approved a further increase in the monthly distribution from \$0.0333 per unit to \$0.0367 per unit.

After careful review and assessment, the Board of Trustees determined that it was prudent and in the best interests of Unitholders to reduce the monthly distribution to \$0.01 per unit effective with the distribution payable December 31, 2008. On February 24, 2009 the Board of Trustees suspended further monthly distributions.

The following table reconciles cash provided by operating activities to distributable income:

	<b>Three months ended March 31</b>	
	2011	2010
Cash provided by (used in) operating activities	705,026	740,240
Add (Deduct)		
Net change in non-cash working capital balances related to operations	(154,589)	(1,057,917)
Distributions from Lakeview Flag Management General Partnership	103,250	-
Distributions from Lakeview Flag Licensing General Partnership	258,720	29,400
	912,407	(288,277)
Deduct:		
Contribution to reserve fund	(181,846)	(157,620)
	730,561	(445,897)

## SELECTED FINANCIAL INFORMATION

	<b>Three months ended March 31</b>	
	2011	2010
Total Revenue	9,629,838	8,036,420
Net Loss Before Future Income Tax Expenses	(1,094,352)	(2,127,378)
Basic and diluted income before tax per unit	(0.056)	(0.109)
Total Assets	116,979,628	123,552,329
Total Long-term Liabilities	35,825,543	36,409,476

Revenues have increased and net loss has decreased for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 due to overall improvement in economic activity and an increase in resource based activities.

## SUMMARY OF QUARTERLY RESULTS

	IFRS Reporting					Canadian GAAP		
	Q1-11	Q4-10	Q3-10	Q2-10	Q1-10	Q4-09	Q3-09	Q2-09
Hospitality Revenue								
Rooms	8,371,140	7,706,385	8,814,503	7,511,982	6,830,877	6,594,497	7,971,535	7,592,028
Food, Beverage & Gift Shop	796,837	852,082	667,594	734,455	678,116	698,987	707,895	737,379
Other	461,861	446,304	478,895	428,931	527,427	308,761	353,354	493,273
Total Revenue	9,629,838	9,004,771	9,960,992	8,675,368	8,036,420	7,602,245	9,032,784	8,822,680
Expenses	10,724,190	10,785,915	12,238,721	10,393,419	10,163,798	10,420,526	10,562,138	11,071,985
Net (Loss)	(1,094,352)	(1,781,144)	(2,277,729)	(1,718,051)	(2,127,378)	(2,818,281)	(1,529,354)	(2,249,305)
Basic and Diluted Income (Loss) per unit	(0.056)	(0.091)	(0.116)	(0.088)	(0.109)	(0.144)	(0.078)	(0.115)
Occupancy Percentage <sup>(1)</sup>	60.65%	54.45%	61.36%	53.66%	49.49%	46.64%	54.47%	52.96%
Average Room Rate <sup>(1)</sup>	\$113.50	\$113.98	\$115.93	\$115.41	\$114.03	\$113.91	\$118.65	\$116.45
RevPar <sup>(1)</sup>	\$68.84	\$62.06	\$71.13	\$61.93	\$56.43	\$53.13	\$64.63	\$61.67

Note (1): Occupancy percentage, average room rate and RevPar are not recognized under IFRS and the method we use in calculating these numbers may not be comparable to other companies. They should not be used as an alternative to net earnings (loss) determined in accordance with IFRS as an indicator of performance. These numbers can be used to supplement other information presented in understanding the performance of our hotels in a historical perspective.

### GOING CONCERN

The unaudited financial statements have been prepared on a going concern basis in accordance with International Financial Reporting Standards (IFRS) 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.

Under "Liquidity and Cash Flow", 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. Although it entered into a loan commitment agreement in 2011 with its primary mortgage lender to refinance on closing date of June 29, 2011 the mortgages maturing in 2011 and to refinance \$2,200,000 of the demand loan payable and the

agreement included a commitment to enter into a forbearance agreement with respect to the lender's right to demand repayment of the mortgages as a result of the non-compliance with the FCCR requirement as at December 31, 2010, there remains uncertainties relating to Lakeview Hotel REIT's ability to fulfill its commitments under the agreement with respect to the refinancing in 2011 with alternate lender(s) of two of three income properties that have current mortgages with maturity dates in 2012. As all long-term mortgage agreements with the primary mortgage lender are cross-collateralized, the entire balance of the long-term mortgages with the primary lender may be in default by December 31, 2011 and will be deemed as payable on demand. Therefore, these mortgages remain classified as current liabilities at March 31, 2011.

Included in current liabilities at March 31, 2011 is a \$4,200,000 demand loan and \$75,314,171 of mortgages payable to Lakeview Hotel REIT's primary mortgage lender. In addition, a \$2,000,000 second mortgage on the Days Inn - Ottawa Airport matures on August 1, 2011. Also, the \$5,016,245 first mortgage payable on the Days Inn Ottawa Airport, although due August 21, 2014 has been fully included as a current liability because the waiver of the lender's rights to demand repayment of this mortgage as a result of the covenant breach at December 31, 2010 on the mortgages with the primary mortgage lender was received after the reporting date of March 31, 2011. Due to the items included in current liabilities, Lakeview Hotel REIT had a working capital deficiency of \$87,078,100 at March 31, 2011. Currently, management is in the process of arranging for the refinancing of the two of three income properties as committed to in the loan commitment agreement discussed above and for the refinancing of the Days Inn - Ottawa Airport second mortgage.

Management continues to employ various strategies to improve operating results and cash flows and to assess strategies to adjust its capital structure. This includes 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 the implementation of these strategies and refinancing can be arranged for the mortgages required under the agreement with the primary lender and the second mortgage maturing in 2011, there is no assurance as to their outcome or success. Further, Lakeview Hotel REIT's results for future periods are subject to uncertainties arising from the pace of recovery of the economy and from fluctuations in oil and gas prices.

Lakeview Hotel REIT's ability to continue as a going concern is also subject to the continued support of related parties. Specifically, Lakeview Hotel REIT has deferred payment of certain marketing, accounting, reservation, licensing and management fees to related parties.

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 to the carrying value of assets and liabilities, the reported revenue and expenses and the balance sheet classifications used. These adjustments may be material.

## RELATED PARTY TRANSACTIONS

Lakeview Hotel REIT recorded the following transactions with related parties during the three months ended March 31, 2011:

1. Marketing expenses in the amount of \$59,823 were charged by Lakeview Management Inc. to Lakeview Hotel REIT for the three months ended March 31, 2011. The marketing expense is currently calculated at 1% of gross room revenue of the hotel.

Accounting fees in the amount of \$144,087 were charged by Lakeview Management Inc. to Lakeview Hotel REIT for the three months ended March 31, 2011. The fee is prorated based on an annual fee of \$30,000 per hotel owned by Lakeview Hotel REIT during the year. The fee is subject to annual increases related to changes in the consumer price index in the province where each hotel is located.

Reservation fees in the amount of \$89,736 were charged by Lakeview Management Inc. to Lakeview Hotel REIT for the three months ended March 31, 2011. The reservation fee which is charged at 1.5% of room revenue, provides Lakeview Hotel REIT access to the reservation system maintained by Lakeview Management Inc.

Accrued payables as at March 31, 2011 related to the above charges were \$1,883,400.

2. License fees for the three months ended March 31, 2011 were charged by Lakeview Flag Licensing General Partnership to Lakeview Hotel REIT in the amount of \$239,793 of which 51% or \$122,294 is payable to Lakeview Management Inc. The license fees are charged based on 4% of gross room revenue for the period. Lakeview Hotel REIT has a 49% interest in Lakeview Flag Licensing General Partnership and Lakeview Management Inc. has a 51% interest.

At March 31, 2011 accrued payables related to the above were \$217,752.

3. Management fees for the three months ended March 31, 2011 were charged by Lakeview Flag Management General Partnership to Lakeview Hotel REIT in the amount of \$450,171 of which 75% or \$337,628 is payable to Lakeview Management Inc. The management fees are charged based on 5% of gross revenue for limited service hotels and 4% for full service hotels. Lakeview Hotel REIT and Lakeview Management Inc. each has a 50% interest in the Lakeview Flag Management General Partnership, however, Lakeview Management Inc receives 75% of the fees less expenses and Lakeview Hotel REIT receives 25% of the fees.

At March 31, 2011 accrued payables related to the above were \$1,800,575.

4. A movie rental fee in the amount of \$44,756 was charged by Free to Guest Movies Ltd. to Lakeview Hotel REIT for the three months ended March 31, 2011. Free to Guest Movies Ltd. is a company related to Lakeview Management Inc. through common control.

#### **5. Services Agreement**

Lakeview Hotel REIT has entered into a services agreement (the "Services Agreement") with Lakeview Management Inc. Pursuant to that agreement, Lakeview Management Inc. provides the services of certain of its senior officers to Lakeview Hotel REIT. Specifically, Lakeview Management Inc. provides the services of its President, Mr. Keith Levit, its Executive Vice-President, Mr. Avrum Senensky, its Chief Financial Officer, Mr. Rudy Beyer. Mr. Levit serves as Lakeview Hotel REIT's President, Mr. Senensky serves as Lakeview Hotel REIT's Executive Vice-President, Mr. Beyer serves as Lakeview Hotel REIT's Chief Financial Officer. Each has agreed to devote the amount of time necessary to the proper management of Lakeview Hotel REIT.

Effective October 1, 2006, Lakeview Management Inc. began charging 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. Asset management fees for the three months ended March 31, 2011 were charged in the amount of \$90,988.

The Services Agreement provides that Lakeview Management Inc.'s remuneration may only be varied at the discretion of the Governance and Compensation Committee of the Trustees. Lakeview Management Inc. also provides Lakeview Hotel REIT with support services consisting of certain accounting and human resource services, office space and equipment use and the necessary clerical and secretarial personnel for the administration of the day-to-day activities of Lakeview Hotel REIT. The initial term of the Services Agreement was for five years, expiring on April 14, 2009, and has been renewed until April 14, 2014.

#### **6. Hotel Management Agreements**

Pursuant to the Property Management Agreement, Lakeview Management Inc. and Lakeview Hotel REIT jointly manage the Lakeview Hotel REIT hotels through the Lakeview Flag Management General Partnership. Lakeview Management G.P. II Inc. (a wholly owned subsidiary of Lakeview Management Inc.) receives an allocation of Lakeview Flag Management General Partnership's income equivalent to a management fee of 3.75% of gross annual revenues for each limited service hotel and 3% of gross annual revenues for each full service hotel (less the share of applicable Lakeview Flag Management General Partnership expenses). Lakeview Hotel REIT receives an equivalent of 1.25% of gross annual revenue for limited service hotels and 1% of gross annual revenue for full service hotels. Lakeview Management Inc. is

initially paid \$30,000 per hotel for accounting services subject to annual increases related to changes in the consumer price index in the province each hotel is located in.

The management fees charged by the Lakeview Flag Management General Partnership and the accounting fees charged by Lakeview Management Inc. include all services such as Managerial Services, Pre-opening and Initial Training and Accounting Services. The joint management structure is designed to ultimately provide Lakeview Hotel REIT with an ongoing source of management fee revenue and to lessen Lakeview Hotel REIT's requirements for employees and office space. The initial term of each individual Hotel Management Agreement is 50 years.

#### **7. License Agreements**

Pursuant to the License Agreements, Lakeview Management Inc. and Lakeview Hotel REIT jointly license certain hotel properties through Lakeview Flag Licensing General Partnership. An individual license agreement has been entered into with each of the Lakeview branded hotels owned by Lakeview Hotel REIT. Income is also earned through the payment of a license fee equal to 4% of gross room revenue (the "Continuing License Fee") received from the following hotels which are owned by Lakeview Management Inc. and are located as follows: (i) Lakeview Inn & Suites - Miramichi, New Brunswick, (ii) Lakeview Inn & Suites - Brandon, Manitoba, (iii) Lakeview Inn & Suites - Bathurst, New Brunswick, (iv) Lakeview Inn & Suites - Halifax, Nova Scotia, (v) Lakeview Inn & Suites - Grand Forks, North Dakota.

In addition to the 4% Continuing License Fee, the License Agreements provide for the payment by Lakeview Hotel REIT to Lakeview Management Inc. of a reservation fee equal to 1.5% of gross room revenue which provides for access of the hotels to the online reservation system maintained and provided by Lakeview Management Inc.

The License Agreements also provide that each Lakeview branded hotel in Lakeview Hotel REIT will pay a Marketing Fee equal to 1% of gross room revenue which will be used by Lakeview Management Inc. for all expenses relating to the advertising, marketing and promotion of Lakeview Inns & Suites and Lakeview Resorts including but not limited to production costs, costs to purchase media time and space, publications costs, costs for national or regional directories of Lakeview Inn & Suites and Lakeview Resorts, salaries, long distance telephone charges, travel costs, office supplies and other administrative costs. The initial term of each individual License Agreement is 50 years.

All transactions are in the normal course of operations and are recorded at exchange value.

## **SIGNIFICANT ACCOUNTING POLICIES**

Note 1 to Lakeview Hotel REIT's unaudited consolidated financial statements for the three months ended March 31, 2011 summarizes Lakeview Hotel REIT's significant accounting policies.

### **ADOPTION OF IFRS**

Lakeview Hotel REIT has adopted International Financial Reporting Standards ["IFRS"] as issued by the International Accounting Standards Board ["IASB"] as its basis of financial reporting commencing with its interim consolidated financial statements for the three months ended March 31, 2011. Lakeview Hotel REIT's date of transition to IFRS is January 1, 2010.

These interim consolidated financial statements have been prepared in accordance with IAS 34 - Interim Financial Reporting and IFRS 1 - First Time Adoption of International Financial Reporting Standards using the accounting policies Lakeview Hotel REIT expects to adopt in its annual consolidated financial statements as at and for the year ended December 31, 2011. Subject to certain transition elections as disclosed below, Lakeview Hotel REIT has consistently applied the same accounting policies in its opening IFRS balance sheet at January 1, 2010 and throughout all periods presented as if these policies had always been in effect. The IASB requires that an entity adopting IFRS make an explicit and unreserved statement of compliance with IFRS in its first annual financial statements under IFRS. Lakeview Hotel REIT will make this statement when it issues its 2011 annual consolidated financial statements.

Prior to the adoption of IFRS, Lakeview Hotel REIT prepared its financial statements in accordance with Canadian Generally Accepted Accounting Principles ["Canadian GAAP"].

One of the significant accounting policies most affected by the adoption of IFRS was the policy on income properties as described below.

### **Income Properties**

Income properties include land, buildings, parking lots, signs, furniture, fixtures and equipment and automobiles. Lakeview Hotel REIT accounts for its income properties under the cost model whereby the assets are initially recorded at cost and subsequently amortized over their useful lives, unless an impairment is identified requiring a write-down to estimated fair value. The cost initially recognized with respect to a building is further allocated amongst its significant component parts with each part being amortized separately. Lakeview Hotel REIT has identified the significant components of a building to be the roof, PTAC units, interior finishing [including wallpaper, paint, flooring and carpeting] and the HVAC system-swimming pool.

### **IFRS 1 - First-time Adoption of IFRS**

IFRS generally requires an entity to apply all IFRS retrospectively, as though IFRS had been in place since inception. However, IFRS provides certain mandatory exceptions and permits limited optional exemptions. The following are the optional exemptions applied by Lakeview Hotel REIT in the preparation of its first financial statements under IFRS.

#### **i. Fair value as deemed cost**

Lakeview Hotel REIT has elected to measure certain items of income property at fair value as of the date of transition to IFRS and use that fair value as deemed cost in the opening IFRS balance sheet.

#### **ii. Business combinations**

IFRS 1 provides the option to apply IFRS 3 - Business Combinations, retrospectively or prospectively from the transition date. Applying the standard retrospectively would require restatement of all business combinations that occurred prior to the transition date. Lakeview Hotel REIT elected not to retrospectively apply IFRS 3 to business combinations that occurred prior to its transition date and accordingly, such business combinations have not been restated.

The following is a reconciliation of Lakeview Hotel REIT's equity as reported in accordance with Canadian GAAP to IFRS at January 1, 2010 [date of transition to IFRS].

	<b>January 1, 2010</b>		
	<b>Canadian GAAP</b>	<b>Effect of Transition to IFRS</b>	<b>IFRS</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>ASSETS</b>			
Cash	1,331,392	(3,143)	1,328,249
Reserve fund	651,321	-	651,321
Cash held in trust	2,500,000	-	2,500,000
Accounts receivable	1,075,291	-	1,075,291
Inventory	102,538	-	102,538
Prepaid expenses	157,864	-	157,864
Note receivable	1,235,603	-	1,235,603
Franchise fees and licenses	109,047	-	109,047
Income properties	156,281,492	(39,821,958)	116,459,534
Investment in Lakeview Flag Licensing General Partnership	265,193	-	265,193
Investment in Lakeview Flag Management General Partnership	-	255,605	255,605
<b>Total assets</b>	<b>163,709,741</b>	<b>(39,569,496)</b>	<b>124,140,245</b>
<b>LIABILITIES</b>			
Accounts payable and accrued liabilities	4,423,476	252,462	4,675,938
Loan payable	4,200,000	-	4,200,000
Debentures	9,703,065	-	9,703,065
Convertible debentures	24,413,159	-	24,413,159
Mortgages payable	85,456,608	-	85,456,608
<b>Total liabilities</b>	<b>128,196,308</b>	<b>252,462</b>	<b>128,448,770</b>
<b>UNITHOLDERS' EQUITY [DEFICIT]</b>			
Unitholders' capital	59,168,318	-	59,168,318
Equity portion of convertible debentures	3,734,171	-	3,734,171
Contributed capital	401,745	-	401,745
Accumulated loss and comprehensive loss	(6,776,521)	(39,821,958)	(46,598,479)
Accumulated distributions	(21,014,280)	-	(21,014,280)
<b>Total Unitholders' equity [deficit]</b>	<b>35,513,433</b>	<b>(39,821,958)</b>	<b>(4,308,525)</b>
<b>Total liabilities and Unitholders' equity [deficit]</b>	<b>163,709,741</b>	<b>(39,569,496)</b>	<b>124,140,245</b>



The following is a reconciliation of Lakeview Hotel REIT's equity as reported in accordance with Canadian GAAP to IFRS at December 31, 2010.

	December 31, 2010			
	Canadian GAAP \$	Effect of Transition to IFRS \$	YTD 2010 IFRS Impact \$	IFRS \$
<b>ASSETS</b>				
Cash	1,436,789	(3,143)	3,035	1,436,681
Reserve Fund	359,868	-	-	359,868
Cash held in trust	2,510,108	-	-	2,510,108
Accounts receivable	1,486,356	-	-	1,486,356
Inventory	122,084	-	-	122,084
Prepaid expenses	190,632	-	-	190,632
Franchise fees and licenses	74,631	-	-	74,631
Income properties	147,950,405	(39,821,958)	2,325,102	110,453,549
Investment in Lakeview Flag Licensing General Partnership	263,217	-	-	263,217
Investment in Lakeview Flag Management General Partnership	-	255,605	180,479	436,084
<b>Total Assets</b>	<b>154,394,090</b>	<b>(39,569,496)</b>	<b>2,508,616</b>	<b>117,333,210</b>
<b>LIABILITIES</b>				
Accounts payable and accrued liabilities	6,356,743	252,462	183,514	6,792,719
Loan payable	4,200,000	-	-	4,200,000
Debentures	9,907,313	-	-	9,907,313
Convertible debentures	25,543,873	-	-	25,543,873
Mortgages payable	82,978,132	-	-	82,978,132
<b>Total liabilities</b>	<b>128,986,061</b>	<b>252,462</b>	<b>183,514</b>	<b>129,422,037</b>
<b>UNITHOLDERS' EQUITY [DEFICIT]</b>				
Unitholders' capital	59,179,884	-	-	59,179,884
Equity portion of convertible debentures	3,722,605	-	-	3,722,605
Contributed capital	525,745	-	-	525,745
Accumulated loss and comprehensive loss	(17,005,925)	(39,821,958)	2,325,102	(54,502,781)
Accumulated distributions	(21,014,280)	-	-	(21,014,280)
<b>Total Unitholders' equity [deficit]</b>	<b>25,408,029</b>	<b>(39,821,958)</b>	<b>2,325,102</b>	<b>(12,088,827)</b>
<b>Total liabilities and Unitholders' equity [deficit]</b>	<b>154,394,090</b>	<b>(39,569,496)</b>	<b>2,508,616</b>	<b>117,333,210</b>

As can be seen from the above tables the largest impact of IFRS is related to Lakeview Hotel REIT's revaluation of certain of its income properties to reflect fair value at transition date. The impact of the

revaluation resulted in a net \$39,800,000 decrease of the value of its income properties. The reduction adjustments were derived through the use of third party independent appraisals and management's valuation of hotels.

The following is a reconciliation of Lakeview Hotel REIT's net loss and comprehensive loss as reported in accordance with Canadian GAAP to IFRS for the year ended December 31, 2010 and the three months ended March 31, 2010.

	Year Ended December 31 2010 \$	Three Months Ended March 31 2010 \$
Net loss and comprehensive loss as reported under Canadian GAAP	(10,229,404)	(2,197,056)
Differences increasing the reported amount		
Amortization	278,619	69,678
Reversal of provision for impairment of income properties under Canadian GAAP	2,000,000	-
Reversal of loss on derecognition of income properties under Canadian GAAP	46,483	-
	<u>2,325,102</u>	<u>69,678</u>
Net loss and comprehensive loss as reported under IFRS	(7,904,302)	(2,127,378)

#### **Investment in Jointly Controlled Entity**

In accordance with Canadian GAAP, Lakeview Hotel REIT accounted for its 50% interest in the jointly controlled Lakeview Flag Management General Partnership (LFMGP) by the proportionate consolidation method. Lakeview Hotel REIT's 50% partnership interest entitles it to 25% of LFMGP's assets, liabilities, revenue and expenses. Under the proportionate consolidation method, Lakeview Hotel REIT combined its share of these items on a line-by-line basis with similar items in its own financial statements.

On transition to IFRS, Lakeview Hotel REIT chose to account for its interest in LFMGP by the equity method. Under this method, the investment in LFMGP is initially recorded at cost and then subsequently adjusted to reflect Lakeview Hotel REIT's 25% share of the net income [loss] of the LFMGP. Distributions received from LFMGP reduce the carrying amount of the investment.

The difference in the two methods of accounting does not have an impact on Unitholders' deficit or net loss and comprehensive loss. Only the presentation on the consolidated financial statements is affected.

### Income Properties

In accordance with IFRS 1, Lakeview Hotel REIT elected to measure certain items of income property at fair value as of the date of transition to IFRS and use that fair value as deemed cost in the opening IFRS balance sheet. Certain other items of income property were carried forward at the net book value under Canadian GAAP with accumulated amortization restated at January 1, 2010 to reflect the carrying amount of the item as if it had always been amortized in accordance with IFRS. These items of income property had fair values in excess of the carrying values under Canadian GAAP at January 1, 2010. The impact of these elections were as follows:

	January 1, 2010
	\$
Reduction of income properties to fair value	
Land	(2,180,482)
Building	(36,542,259)
Restated Canadian GAAP carrying value	
Building	(1,099,217)
	<u>(39,821,958)</u>

The transition to IFRS has resulted in a difference in amortization resulting from changes to the opening cost and carrying values of income properties. In addition, changes were made to the building componentization resulting in differences in useful lives and, accordingly, the amortization charge. For the three months ended March 31, 2010 and for the year ended December 31, 2010 respectively, amortization of income properties decreased by \$69,678 and \$278,619.

In addition to the decrease in amortization for the year ended December 31, 2010, a provision for impairment of income properties of \$2,000,000 and a loss on derecognition of income properties of \$46,483 previously recognized under Canadian GAAP during the same period were reversed under IFRS as the impairment associated with the income property and the derecognition of income property during 2010 formed part of the income property's fair value at the date of transition to IFRS.

### Adjustment to the Statements of Cash Flows

The changes made to the consolidated balance sheets and net loss and comprehensive loss have resulted in reclassifications of various amounts on the statements of cash flows, however, as there have been no material changes to the net cash flows, no reconciliations have been presented.

### Capital Resources and Capital Expenditures

At March 31, 2011 Lakeview Hotel REIT had a reserve fund of \$523,349 made up as follows:

Reserve Fund December 31, 2010	359,868
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Contributions during the period	181,846
Distributions during the period	<u>(18,365)</u>
Reserve Fund March 31, 2011	<u>523,349</u>

It is expected that the reserve fund plus the monthly contributions will be sufficient to fund maintenance expenditures required for the hotels owned by Lakeview Hotel REIT. As new hotels are acquired the need for capital expenditures is assessed and quantified.

On June 20, 2007, through a public offering, Lakeview Hotel REIT issued \$18,000,000 of Series C subordinate convertible redeemable debentures bearing interest at 6.5% maturing on June 30, 2012. The Series C debentures are convertible by the holder at any time after the date of issue at \$5.55 per unit.

On 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. 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 to equal 110% of the principal amount plus accrued and unpaid interest up to, but excluding the date of redemption.

On May 8, 2008 through a public offering, Lakeview Hotel REIT issued \$10,000,000 of 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. The debentures are convertible by the holder at any time prior to maturity at \$3.75 per unit. On maturity the debentures are repayable at par plus any accrued and unpaid interest in cash. From May 8, 2008 to December 31, 2008 \$20,000 of the debentures were converted at a price of \$3.75 into 5,333 Class A units.

## **MORTGAGES PAYABLE**

The long-term mortgage agreements with the primary mortgage lender 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. In November 2009, Lakeview Hotel REIT entered an "Escrow Agreement" with the lender whereby it transferred \$2,500,000 to be held in trust with an escrow agent in favour of the lender. The cash collateral replaced the two letters of credit provided by LMI.

As at December 31, 2010 Lakeview Hotel REIT was not in compliance with the FCCR requirements for 10 of the hotel properties. However, in

2011, Lakeview Hotel REIT entered into a loan commitment agreement with the mortgage lender to refinance on the closing date of June 29, 2011 the seven mortgages maturing from February 1, 2011 to July 1, 2011 [with total carrying values of \$27,249,463 as at March 31, 2011] and \$2,200,000 of the \$4,200,000 loan payable. As part of the loan commitment agreement, the lender has agreed to enter into a forbearance agreement regarding its right to demand repayment of all of the mortgages as a result of the non-compliance of the FCCR requirement at December 31, 2010. The refinanced mortgages will have a 3 year term with annual fixed interest rates at 4.35% above the 3-year Canadian dollar fixed interest SWAP rate. Total loan fees of 1% of the loan amount are due on or before September 1, 2011. Also as part of the loan commitment agreement, Lakeview Hotel REIT is committed to obtain refinancing from alternate mortgage lender(s) for one income property with a mortgage maturing January 1, 2012, and for another one of two income properties with mortgages maturing on May 1, 2012 and December 1, 2012, respectively. If Lakeview Hotel REIT has not received refinancing for these two income properties by September 1, 2011 and the related mortgages are not repaid by December 31, 2011, this will be considered an event of default and repayment of all of the mortgages can be demanded at any time. As a result of this contingency and the possibility that a number of the hotels will not be in compliance with the FCCR requirement at December 31, 2011, as well as cross-collateralization of all of the mortgages, \$82,330,416 of mortgages have all been classified as current liabilities as at March 31, 2011.

The agreement for the mortgage payable for the Days Inn Ottawa 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 was also not in compliance with this mortgage agreement as at December 31, 2010. During 2010, 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.

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

Remainder of 2011	\$30,612,740
2012	\$30,713,315
2013	\$5,014,633
2014	\$16,342,154
Total principal outstanding	<u>\$82,682,842</u>
Financing costs	(\$1,293,414)
Accretion of mortgages	<u>\$940,988</u>
	<u>\$82,330,416</u>

## PROPOSED TAX CHANGE TO THE INCOME TRUST RULES

On March 29, 2007 the Minister of Finance tabled in the House of Commons a Bill that contained legislation to implement a previously announced proposal concerning the taxation of certain publicly traded trusts including income trusts. The Bill would apply to publicly traded trusts which existed prior to November 1, 2006 commencing with taxation years in 2011. The Trust has evaluated and considered the options available to address the taxation changes under the Bill and determined that no action is required by the Trust before December 31, 2011. The Trust continues to study two options available to address the changes from the Bill; conversion to a corporation or retaining the structure it currently has.

The Bill contemplates that a REIT which carries on Canadian hotel operations such as Lakeview Hotel REIT will not be a Qualifying REIT but would be considered a "specified investment flow-through trust or partnership (a SIFT)". As a "SIFT" certain distributions will not be deductible in computing the "SIFT's" taxable income and these entities will be, in effect, taxed as corporations on the amount of the non-deductible distributions.

On September 22, 2007, Bill C-52 was substantially enacted which resulted in a 46.4% tax rate to be applied to distributions for Lakeview Hotel REIT in the 2011 taxation year. Future tax assets that have been calculated as a result of the new legislation have been reduced by an equivalent valuation allowance as it can not 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.

## FUTURE ACCOUNTING CHANGES

### **Financial Instruments - Classification and Measurement - IFRS 9**

IFRS 9 was issued in November 2009 and is the first step in replacing current IAS 39 - *Financial Instruments: Recognition and Measurement*. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2013. Lakeview Hotel REIT is currently evaluating the impact of IFRS 9 on its consolidated financial statements.

### **Consolidated Financial Statements - IFRS 10**

IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supersedes IAS 27 - Consolidated and Separate Financial Statements and SIC-12 Consolidation - Special Purpose Entities and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. Lakeview Hotel REIT is currently evaluating the impact of this standard on its consolidated financial statements.

### **Joint Ventures - IAS 28 and IFRS 11**

IAS 28 was amended in 2011 which prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. This may affect the accounting for jointly controlled entities which Lakeview Hotel REIT currently proportionately consolidates under IFRS. IFRS 11 was issued in 2011 and establishes principles for financial reporting by parties to a joint arrangement. IAS 28 and IFRS 11 are effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. Lakeview Hotel REIT is currently evaluating the impact of IAS 28 and IFRS 11 on its consolidated financial statements.

### **Disclosure of Interests in Other Entities - IFRS 12**

IFRS 12 applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. Lakeview Hotel REIT is currently evaluating the impact of this standard on its consolidated financial statements.

### **Fair Value Measurements - IFRS 13**

IFRS 13 defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosures about fair value

measurements. The IFRS 13 applies to IFRS's that require or permit fair value measurements or disclosures about fair value measurements except in specified circumstances. IFRS 13 is to be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted. Lakeview Hotel REIT is currently evaluating the impact of this standard on its consolidated financial statements.

### **OFF- BALANCE SHEET ARRANGEMENTS**

As at December 31, 2010 Lakeview Hotel REIT had no undisclosed Off-Balance Sheet Arrangements.

### **RISKS AND UNCERTAINTIES**

Lakeview Hotel REIT's operations are subject to risks that could cause future operating results to differ significantly from its performance in the past. An event arising from one of the risks listed below could materially affect Lakeview Hotel REIT's business, prospects, financial condition, results of operations or cash flows. The following description of risks does not include all possible risks, and there may be other risks of which the Trustees are not currently aware.

### **MARKET INFLUENCES**

The Units, and other listed securities of Lakeview Hotel REIT may be subject to wide fluctuations in response to variations in operating results, the gain or loss of significant properties, market conditions in the industry, as well as general economic conditions or other risk factors set out herein. There can be no assurance that an active public market for the Units or the other listed securities of Lakeview Hotel REIT will be sustained.

A publicly traded real estate investment trust will not necessarily trade at values determined solely by reference to the underlying value of its real estate assets. Accordingly, the Units may trade at a premium or a discount to values implied by the amount paid by the Trust for the Hotel Assets, Hotel Operations and Hotel Properties. In addition, the market price for the Units may be affected by changes in general market conditions, fluctuations in the markets for equity securities and numerous other factors beyond the control of Lakeview Hotel REIT.

### **REAL PROPERTY OWNERSHIP**

All real property investments are subject to elements of risk. Such investments are affected by general economic conditions, local real estate markets and various other factors.

Certain significant expenditures, including property taxes, maintenance costs, debt repayments, insurance costs and related charges must be made throughout the period of ownership of real property regardless of whether the property is producing any income.

Real property investments tend to be relatively illiquid, with the degree of liquidity generally fluctuating in relations with demand for and the perceived desirability of such investments. Such liquidity may tend to limit Lakeview Hotel REIT's ability to vary its portfolio promptly in response to changing economic or investment conditions. If the trust were to be required to liquidate its real property investments, the proceeds might be significantly less than the aggregate carrying value of its properties.

Lakeview Hotel REIT will be subject to the risks associated with debt financing, including the risk that any indebtedness will not be able to be refinanced or that the terms of such refinancing will not be as favourable as the terms of existing indebtedness.

### **THE HOTEL INDUSTRY**

Ownership of hotels and interests in the Operating Partnership, the Licensing Partnership and the Management Partnership subjects Lakeview Hotel REIT to the operating risks inherent in the hotel industry. These risks arise from a wide range of factors, including changes in general and local economic conditions, seasonal variations in cash flow, overbuilding in the hotel industry, varying levels of demand for rooms and related services, fluctuations in the price of equipment and supplies, changes in the availability and cost of labour, competition from other hotels, changes in travel patterns, the recurring need for renovation, refurbishment and improvement of hotel properties, changes in governmental regulations that influence or determine wages, prices and construction and maintenance costs, changes in trends, technology and service requirements in the hotel industry, changes in interest rates, the availability of financing for operating or capital trends, and changes in real estate and other taxes and other operating expenses. There can be no assurance that regulatory compliance or downturns or prolonged adverse conditions in the hotel industry or real estate or capital markets or national or local economies will not have a material adverse effect on results of operations or the value of Lakeview Hotel REIT's hotel portfolio.

The hotel industry is highly competitive. Lakeview Hotel REIT competes with other national and international limited and full-service hotel companies. Hotels owned by Lakeview Hotel REIT also compete with various regional and local hotels. A number of Lakeview Hotel REIT's competitors are larger, operate more hotels, have substantially greater financial and other resources and are more widely recognized in the USA and Canada than Lakeview Hotel REIT. In addition, some of Lakeview Hotel REIT's competitors operate or may in the future develop hotel properties that have locations superior to those of Lakeview Hotel REIT's hotels. Competitive factors in the hotel industry include room rates, quality of accommodations, name recognition, service levels and convenience of location. There can be no assurance that demographic, geographic or other changes in markets in which the Lakeview Hotel REIT

hotels are located will not adversely affect the convenience or desirability of certain of Lakeview Hotel REIT's hotels. Furthermore, there can be no assurance that new or existing competitors will not significantly reduce room rates or offer greater conveniences, services or amenities or significantly expand or improve facilities in markets in which Lakeview Hotel REIT's hotels compete, thereby adversely affecting Lakeview Hotel REIT's results of operations and the value of its hotel portfolio.

### **STAFFING**

Lakeview Hotel REIT is operating in a competitive labour market in Alberta and northern British Columbia. The difficulty in retaining qualified hotel staffing could potentially impact on the results of Lakeview Hotel REIT and the value of its hotel portfolio.

### **AVAILABILITY OF CASH FLOW**

Because items such as principal repayments and capital expenditures may be required, cash may not be available for distributions.

Hotel properties require continuing renovation, refurbishment and capital improvements to remain competitive. While Lakeview Hotel REIT believes that it will have adequate financial resources to fund such renovations, refurbishments and improvements, there can be no assurance that such funding will be available when required.

### **RISK ASSOCIATED WITH DEBT FINANCING**

As a result of incurring debt, the Trust is subject to a number of risks associated with debt financing, including the risk that cash flow from operations will be insufficient to meet required payments of principal and interest; the risk that, to the extent that the Trust maintains floating rate indebtedness, interest rates will fluctuate; and risks resulting from the fact that the agreements governing loan and credit facilities contain covenants imposing certain limitations on the Trust's ability to acquire and dispose of assets. Lakeview Hotel REIT is not in compliance with some of these covenants. Please see "Mortgages Payable" section as well as note 10 to the notes to the consolidated financial statements dated December 31, 2010 for further information.

There can be no assurance that the Trust will be able to repay or refinance existing indebtedness and any other indebtedness when it matures or that the terms of such refinancing will be favourable. The Trust's leverage may have important consequences. For example, the Trust's ability to obtain additional financing for acquisitions, working capital, capital expenditures or other purposes, if necessary, may be impaired or such financing may not be available on favourable terms. A substantial decrease in operating cash flow or an increase in expenses could make it difficult for the Trust to meet applicable debt service requirements and force the Trust to modify its operations. The Trust may have higher levels of debt than some of its competitors, placing it at a competitive disadvantage. In such circumstances, if

Lakeview Hotel REIT were in need of capital to repay indebtedness in accordance with its terms or otherwise, it could be required to liquidate one or more of its hotel properties at times which may not permit realization of the maximum return of such investments or could be required to agree to additional financing at unfavourable terms.

### **AVAILABILITY OF GROWTH OPPORTUNITIES**

There can be no assurance that Lakeview Hotel REIT will be able to acquire assets on an accretive basis or that distributions to Unitholders will be reinstated.

### **ASSUMPTIONS OF MANAGEMENT**

Lakeview Hotel REIT's plan of operation is based, in part, upon a financial plan prepared by management which is based on assumptions concerning future events which management consider to be reasonable in the circumstances, but which are inherently subject to uncertainty and variation which may be material. There can be no assurance that the development and implementation of Lakeview Hotel REIT's proposed business plan will be successfully completed or completed as planned. There is absolutely no representation that any of Lakeview Hotel REIT's plans will be realized in whole or in part.

### **ENVIRONMENTAL MATTERS**

As an owner of real property, Lakeview Hotel REIT will be subject to various federal, provincial and municipal laws relating to environmental matters. Such laws provide that Lakeview Hotel REIT could be liable for the costs of removal of certain hazardous substances and remediation of certain hazardous locations. The failure to remove or remedy such substances or locations, if any, could adversely affect Lakeview Hotel REIT's ability to sell such real estate or to borrow using such real estate as collateral and could potentially also result in claims against Lakeview Hotel REIT. Lakeview Hotel REIT is not aware of any pending or threatened investigations or actions by environmental regulatory authorities in connection with any of its properties or any pending or threatened claims relating to environmental conditions at its properties.

### **UNITHOLDER LIABILITY**

On September 16, 2005, *The Investment Trust Unitholders; Protection Act* (Manitoba) came into force. This legislation creates a statutory limitation on the liability of beneficiaries of Manitoba income trusts such as Lakeview Hotel REIT. The legislation provides that a Unitholder will not be, as a beneficiary, liable for any act, default, obligation, or liability of Lakeview Hotel REIT.

To the extent that the principles of relevant provincial, territorial and Canadian laws recognizing the limitation of liability of trust beneficiaries have not been definitively established with respect to trusts formed under the laws of one jurisdiction which have operations located in other jurisdictions and beneficiaries who are resident in

other jurisdictions, it is possible that the statutory limitation described above may not be applicable to Unitholders or certain of them. See also "Declaration of Trust - Unitholder Liability".

## **INVESTMENT CONCENTRATION**

The hotels currently in Lakeview Hotel REIT's portfolio are concentrated in Alberta and northern British Columbia. As a result, the financial performance of Lakeview Hotel REIT and its ability to pay distributions will be significantly dependent on economic and market conditions in those regions. There can be no assurance that Lakeview Hotel REIT can or will diversify its hotel portfolio by acquiring hotels in other regions.

## **BRAND CONCENTRATION**

Lakeview Hotel REIT is subject to potential risks associated with the concentration of its hotels under a limited number of brands. A negative image or other adverse event that becomes associated with the "Lakeview" brand could adversely affect the Trust's Hotel Operations and Licensed Lakeview Properties operated under that brand. It may also decrease the market for hotels that want to license the "Lakeview" brand.

## **DEPENDENCE ON NATURAL RESOURCES INDUSTRIES**

Lakeview Hotel REIT is significantly dependent on the oil and gas industries in Alberta, and on the mining and lumber industries in British Columbia. A downturn in the market for the raw materials produced by these industries or a change in commodity prices has had and could continue to have a significant material adverse effect on Lakeview Hotel REIT's business.

## **RELATIONSHIP WITH LAKEVIEW**

The financial performance of Lakeview Hotel REIT will depend in part of the performance of Lakeview as the provider of management and accounting services to Lakeview Hotel REIT pursuant to the Services Agreement.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

There have been no changes in the Lakeview Hotel REIT's internal controls over financial reporting that occurred during the year ended December 31, 2010 that have materially affected or are reasonably likely to materially affect the Lakeview Hotel REIT's internal controls over financial reporting.

## **FORWARD-LOOKING STATEMENTS**

This Management Discussion and Analysis may contain forward-looking statements including those in the Outlook section which reflect our expectations regarding the future growth, results of operations, performance and business prospects, and opportunities of the Lakeview Hotel REIT. Such forward-looking statements reflect our current beliefs and are based on information currently available to us. Forward-looking statements involve significant risks and uncertainties. A number of factors could cause actual results to differ materially

from results discussed in the forward-looking statements, including the effects, as well as changes in national and local business conditions, levels of travel in hotel market areas, political conditions and events, competitive pressures and changes in government policy or regulations. Although the forward-looking statements contained in this MD&A are based on what we believe to be reasonable assumptions, we cannot assure readers that actual results will be consistent with these forward-looking statements.

#### **ADDITIONAL INFORMATION**

Additional information relating to Lakeview Hotel REIT, including all public filings, is available at [www.sedar.com](http://www.sedar.com).