

Consolidated Financial Statements

Lakeview Hotel Real Estate Investment Trust

September 30, 2010

Unaudited

**LAKEVIEW HOTEL REAL ESTATE
INVESTMENT TRUST**

Supplement to Consolidated Financial Statements
for the Nine Months ended September 30, 2010 and 2009

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

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

The unaudited interim financial statements of the Lakeview Hotel Real Estate Investment Trust for the nine months ended September 30, 2010 and 2009 were prepared by, and are the responsibility of, the Trust's management.

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

Lakeview Hotel Real Estate Investment Trust

CONSOLIDATED BALANCE SHEETS

(See note 1 regarding Going Concern)

Unaudited

	September 30 2010	December 31 2009
	\$	\$
	<i>(audited)</i>	
ASSETS		
Current		
Cash	1,459,871	1,331,392
Reserve fund <i>[note 2]</i>	260,332	651,321
Cash held in trust <i>[note 10]</i>	2,500,000	2,500,000
Accounts receivable	1,955,351	1,075,291
Inventory	109,837	102,538
Prepaid expenses	710,345	157,864
Note receivable <i>[note 3]</i>	—	1,235,603
Total current assets	6,995,736	7,054,009
Franchise fees and licenses <i>[note 4]</i>	82,845	109,047
Income properties <i>[notes 5, 7, 8, 10 and 14]</i>	151,533,406	156,281,492
Investment in Lakeview Flag Licensing General Partnership <i>[note 6]</i>	251,280	265,193
	158,863,267	163,709,741
LIABILITIES AND UNITHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities <i>[note 14]</i>	6,648,948	4,423,476
Loan payable <i>[note 7]</i>	4,200,000	4,200,000
Current portion of convertible debentures <i>[note 9]</i>	—	38,073
Current portion of mortgages payable <i>[note 10]</i>	78,734,744	78,430,822
Total current liabilities	89,583,692	87,092,371
Debentures <i>[note 8]</i>	9,854,215	9,703,065
Convertible debentures <i>[note 9]</i>	25,241,691	24,375,086
Mortgages payable <i>[note 10]</i>	4,878,426	7,025,786
Total liabilities	129,558,024	128,196,308
Unitholders' equity	29,305,243	35,513,433
	158,863,267	163,709,741

See accompanying notes

On behalf of the Board of Trustees:

"Gary Coleman"
Trustee

"Keith Levit"
Trustee

Lakeview Hotel Real Estate Investment Trust

**CONSOLIDATED STATEMENTS OF LOSS AND
COMPREHENSIVE LOSS**

Unaudited

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2010	2009	2010	2009
	\$	\$	\$	\$
REVENUE				
Rooms	8,814,503	7,971,535	23,157,362	23,322,006
Food, beverage and gift shop	667,594	707,895	2,080,165	2,212,330
Income from Lakeview Flag Licensing General Partnership <i>[note 6]</i>	154,583	147,640	397,687	478,938
Interest and miscellaneous	207,985	205,714	726,635	886,017
	<u>9,844,665</u>	<u>9,032,784</u>	<u>26,361,849</u>	<u>26,899,291</u>
EXPENSES				
Amortization				
Franchise fees and licenses	8,734	8,733	26,202	48,407
Income properties	1,636,127	1,670,341	4,993,624	5,013,603
Food, beverage and gift shop	242,105	255,662	735,139	856,383
General and administration <i>[note 14]</i>	1,996,647	1,849,144	5,377,280	5,948,982
Insurance	83,462	75,749	260,061	247,679
Interest				
Loan and other	55,184	50,584	155,487	159,506
Mortgages and debentures	2,468,668	2,453,221	7,398,687	7,327,319
Maintenance	195,029	190,909	572,977	547,835
Marketing <i>[note 14]</i>	630,243	618,579	1,726,494	1,768,350
Property taxes	483,754	500,227	1,454,546	1,494,151
Provision for impairment of note receivable <i>[note 3]</i>	1,396,062	—	1,396,062	—
Rent <i>[note 19]</i>	22,397	20,792	58,120	55,052
Salaries and benefits <i>[note 14]</i>	2,438,544	2,342,653	6,963,026	7,022,421
Supplies	213,835	199,952	554,168	535,351
Utilities	321,280	325,592	1,022,166	1,124,081
	<u>12,192,071</u>	<u>10,562,138</u>	<u>32,694,039</u>	<u>32,149,120</u>
Net loss and comprehensive loss for the period	(2,347,406)	(1,529,354)	(6,332,190)	(5,249,829)
Basic and diluted net loss and comprehensive loss per Unit <i>[note 13]</i>	(0.120)	(0.078)	(0.324)	(0.270)

See accompanying notes

Lakeview Hotel Real Estate Investment Trust

**CONSOLIDATED STATEMENTS OF
UNITHOLDERS' EQUITY**

Unaudited

	Three Months Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
	\$	\$	\$	\$
Unitholders' capital [note 11]				
Balance, beginning of period	59,179,884	59,168,318	59,168,318	59,040,134
Repayment of convertible debentures by issuance of Units	—	—	—	128,184
Convertible debentures matured [note 9 [a]]	—	—	11,566	—
Balance, end of period	59,179,884	59,168,318	59,179,884	59,168,318
Equity portion of convertible debentures				
Balance, beginning of period	3,722,605	3,734,171	3,734,171	3,760,355
Convertible debentures matured [note 9 [a]]	—	—	(11,566)	(26,184)
Balance, end of period	3,722,605	3,734,171	3,722,605	3,734,171
Contributed capital				
Balance, beginning of period	401,745	401,745	401,745	401,745
Issuance of Unit options [note 12]	124,000	—	124,000	—
Balance, end of period	525,745	401,745	525,745	401,745
Accumulated earnings (losses)				
Balance, beginning of period	(10,761,305)	(2,428,886)	(6,776,521)	1,291,589
Net loss and comprehensive loss for the period	(2,347,406)	(1,529,354)	(6,332,190)	(5,249,829)
Balance, end of period	(13,108,711)	(3,958,240)	(13,108,711)	(3,958,240)
Accumulated distributions				
Balance, beginning of period	(21,014,280)	(21,014,280)	(21,014,280)	(20,821,532)
Distributions declared [note 11]	—	—	—	(192,748)
Balance, end of period	(21,014,280)	(21,014,280)	(21,014,280)	(21,014,280)
Unitholders' equity, end of period	29,305,243	38,331,714	29,305,243	38,331,714

See accompanying notes

Lakeview Hotel Real Estate Investment Trust

CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2010	2009	2010	2009
	\$	\$	\$	\$
OPERATING ACTIVITIES				
Net loss for the period	(2,347,406)	(1,529,354)	(6,332,190)	(5,249,829)
Add (deduct) items not involving cash				
Amortization of income properties	1,636,127	1,670,341	4,993,624	5,013,603
Amortization of franchise fees and licenses	8,734	8,733	26,202	48,407
Provision for impairment of note receivable [note 3]	1,396,062	—	1,396,062	—
Compensation costs of Unit options [note 12]	124,000	—	124,000	—
Income from Lakeview Flag Licensing General Partnership [note 6]	(154,583)	(147,640)	(397,687)	(478,938)
Accretion on debt component of convertible debentures [note 9]	300,465	266,540	868,532	771,275
Accretion of debentures [note 8]	51,717	46,543	151,150	136,028
Accretion of mortgages payable	63,143	55,330	190,138	159,992
Decretion of mortgages receivable [note 3]	—	—	—	56,877
Loss on settlement of mortgages receivable [note 3]	—	—	—	98,244
	<u>1,078,259</u>	<u>370,493</u>	<u>1,019,831</u>	<u>555,659</u>
Net change in non-cash working capital balances related to operations	48,032	927,798	1,016,162	316,953
Cash provided by operating activities	<u>1,126,291</u>	<u>1,298,291</u>	<u>2,035,993</u>	<u>872,612</u>
INVESTING ACTIVITIES				
Additions to income properties	(53,712)	(455,512)	(245,538)	(979,942)
Collection of mortgages/note receivable [note 3]	—	1,974,915	—	3,703,797
Transaction costs on mortgages receivable [note 3]	—	—	—	(4,110)
Distributions from Lakeview Flag Licensing General Partnership [note 6]	362,600	122,500	411,600	419,930
Cash provided by investing activities	<u>308,888</u>	<u>1,641,903</u>	<u>166,062</u>	<u>3,139,675</u>
FINANCING ACTIVITIES				
Unitholders' distributions				
Class A	—	—	—	(187,748)
Exchangeable Units	—	—	—	(5,000)
Proceeds from mortgages payable	—	7,500,000	—	7,500,000
Repayment of mortgages payable	(687,789)	(7,611,909)	(2,033,576)	(8,775,067)
Repayment of convertible debentures [note 9 [a]]	—	—	(40,000)	—
Financing costs on mortgages payable, debentures and convertible debentures	—	(196,172)	—	(196,172)
Cash used in financing activities	<u>(687,789)</u>	<u>(308,081)</u>	<u>(2,073,576)</u>	<u>(1,663,987)</u>
Net increase in cash and cash equivalents during the period	<u>747,390</u>	<u>2,632,113</u>	<u>128,479</u>	<u>2,348,300</u>
Cash and cash equivalents, beginning of period	712,481	1,467,852	1,331,392	1,751,665
Cash and cash equivalents, end of period	<u>1,459,871</u>	<u>4,099,965</u>	<u>1,459,871</u>	<u>4,099,965</u>
Supplemental cash flow information				
Cash paid for interest	1,605,872	1,622,436	5,849,759	5,922,129
<i>See accompanying notes</i>				

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

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 10, 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 classified as current liabilities. Included in current liabilities at September 30, 2010 is a \$4,200,000 demand loan [note 7] and \$76,502,178 of mortgages payable [note 10] to Lakeview Hotel REIT's primary mortgage lender. At September 30, 2010, Lakeview Hotel REIT had a working capital deficiency of \$82,587,956. Management's understanding based on discussions with the primary lender is that there is currently no indication that repayment of the loan or mortgages will be demanded within the next year prior to their maturity dates. By September 30, 2011, seven of these mortgages will mature. While Lakeview Hotel REIT believes it will be able to renew these mortgages as they come due, the cash flow of Lakeview Hotel REIT remains constrained and it is unclear what interest rates will be on the mortgage renewals. Renewing mortgages at higher interest rates could create challenges for Lakeview Hotel REIT.

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.

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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

Unaudited

Lakeview Hotel REIT's ability to continue as a going concern is subject to the continued support of its lenders and related parties [note 14]. 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 as well as refinancing the mortgages as they become due and the related parties deferring collection of marketing, accounting, reservation, licensing and management fees.

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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

Unaudited

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.

Significant accounting policies

These unaudited consolidated interim financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. They have also been prepared on a basis consistent with the December 31, 2009 audited financial statements and should be read in conjunction with the audited financial statements and the notes thereto.

[a] Inventory

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

[b] 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.

[c] Income properties

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

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. Income properties are tested for recoverability when events or changes in circumstances indicate that their carrying value may not be recoverable. 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

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

Unaudited

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.

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
Automobiles	5 years

[d] 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.

[e] Related parties

During 2010 and 2009, 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

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

Unaudited

[f] 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.

[g] 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.

[h] Net loss and comprehensive loss per Unit

Net loss and comprehensive loss per Unit is based on the consolidated net loss for the period divided by the weighted average number of Units outstanding during the period. Diluted loss per

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

Unit is computed in accordance with the treasury stock method and based on the weighted average number of Units and dilutive unit equivalents.

[i] Stock-based compensation plan

Lakeview Hotel REIT has a Unit Purchase Plan as described in note 12. 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.

[j] 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.

[k] Financial instruments

Lakeview Hotel REIT has the following financial assets and liabilities:

- Cash, reserve fund and cash 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 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.
- Accounts payable and accrued liabilities, 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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

[I] Future accounting changes

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.

2. 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.

	Nine Months Ended September 30 2010 \$	Year Ended December 31 2009 \$
		<i>(audited)</i>
Reserve fund, beginning of period	651,321	545,824
Allocations to reserve fund	570,879	774,515
Use of reserve fund	(961,868)	(669,018)
Reserve fund, end of period	260,332	651,321

Under approval by the Trustees, included in the use of reserve fund during 2010 were amounts withdrawn to fund operations.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

Unaudited

3. MORTGAGES AND NOTE RECEIVABLE

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. 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 for a total advance of \$5,000,000 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 was 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 September 30, 2010, \$37,271 was collected on the note receivable and the interest receivable balance that has accrued to September 30, 2010 is \$160,459. The borrowers have been in default of their monthly payments since September, 2009.

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 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. On August 11, 2010, Lakeview Hotel REIT was informed that D. Manning and Associates was appointed receiver-manager 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. Subsequent to September 30, 2010, Lakeview Hotel REIT learned that the Tumbler Ridge property is to be listed for sale. Management believes 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 September 30, 2010 from the proceeds of the sale of the Tumbler Ridge property or from any of the other collateral. Accordingly, 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 at September 30, 2010.

For the three months ended September 30, 2010 and 2009, interest income recognized on the mortgage receivable was \$0 [2009 - \$16,690] and on the note receivable was \$37,373 [2009 -

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

\$31,362]. For the nine months ended September 30, 2010 and 2009, interest income recognized on the mortgage receivable was \$0 [2009 - \$306,038] and on the note receivable was \$110,900 [2009 - \$31,362]. No further interest will be accrued on the note receivable subsequent to September 30, 2010.

4. FRANCHISE FEES AND LICENSES

	September 30 2010 \$	December 31 2009 \$
		<i>(audited)</i>
Cost	206,632	206,632
Less accumulated amortization	(123,787)	(97,585)
	<u>82,845</u>	<u>109,047</u>

5. INCOME PROPERTIES

	September 30 2010			December 31 2009 <i>(audited)</i>		
	Cost \$	Accumulated amortization \$	Net book value \$	Cost \$	Accumulated amortization \$	Net book value \$
Land	15,493,719	—	15,493,719	15,493,719	—	15,493,719
Buildings	144,768,287	13,780,173	130,988,114	144,768,287	11,064,380	133,703,907
Parking lots	715,710	196,158	519,552	715,710	142,480	573,230
Signs	541,328	174,116	367,212	534,138	134,056	400,082
Furniture, fixtures and equipment	15,336,411	11,195,857	4,140,554	15,124,523	9,013,969	6,110,554
Automobile	26,460	2,205	24,255	—	—	—
	<u>176,881,915</u>	<u>25,348,509</u>	<u>151,533,406</u>	<u>176,636,377</u>	<u>20,354,885</u>	<u>156,281,492</u>

As a result of the current market conditions and decline in room revenues as discussed in note 1, management assesses 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. A recoverability test was

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

performed as at December 31, 2009 with no impairment provision recognized. Management believes that events and circumstances have not changed significantly since December 31, 2009 and accordingly, no impairment provision was recorded as at September 30, 2010.

6. 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 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

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

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 3].

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:

	Nine Months Ended September 30 2010 \$	Year Ended December 31 2009 \$
		<i>(audited)</i>
Investment, beginning of period	265,193	120,171
Equity income	397,687	584,552
Distribution received	(411,600)	(439,530)
Investment, end of period	251,280	265,193

7. LOAN PAYABLE

	September 30 2010 \$	December 31 2009 \$
		<i>(audited)</i>
Loan payable	4,200,000	4,200,000

The loan payable was drawn under a pre-approved line of credit facility provided by Lakeview Hotel REIT's primary mortgage lender. The loan payable bears interest at the Canadian dollar bankers' acceptance rate plus 4.25% to 5% floating per annum, due on demand, collateralized by first mortgages on certain income properties. The effective interest rate was 4.94% and 5.06% respectively for the nine-month periods ended September 30, 2010 and 2009.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

8. 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. 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.

	September 30 2010 \$	December 31 2009 \$ <i>(audited)</i>
Principal	10,250,000	10,250,000
Financing costs	(855,121)	(855,121)
Accretion of debentures	459,336	308,186
	<u>9,854,215</u>	<u>9,703,065</u>

The accretion of debentures of \$51,717 [2009 - \$46,543] for the three months ended September 30, 2010 and 2009 respectively and of \$151,150 [2009 - \$136,028] for the nine months ended September 30, 2010 and 2009 respectively is included in interest expense.

9. 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 \$
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>25,049,201</u>	<u>4,450,799</u>	<u>29,500,000</u>

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

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

Debenture	September 30, 2010			
	Effective interest rate %	Original face amount \$	Converted to Units \$	Face amount outstanding \$
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
		28,000,000	20,000	27,980,000

Debenture	September 30, 2010				
	Face amount outstanding \$	Holders' conversion option \$	Accretion \$	Financing costs \$	September 30, 2010 \$
Long-term					
6.5% Series C Convertible Redeemable Subordinated Debentures	18,000,000	(3,062,813)	2,390,081	(1,058,428)	16,268,840
8.5% Series D Convertible Redeemable Subordinated Debentures	9,980,000	(952,360)	661,278	(716,067)	8,972,851
	27,980,000	(4,015,173)	3,051,359	(1,774,495)	25,241,691

Debenture	December 31, 2009 (audited)			
	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
		29,500,000	1,480,000	28,020,000

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

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

The accretion of the debt component, which increases the debt component from the initial carrying amount, is included in interest expense and totalled \$300,465 and \$266,540 respectively for the three months ended September 30, 2010 and 2009 and \$868,532 and \$771,275 respectively for the nine months ended September 30, 2010 and 2009.

[a] 9% Subordinated Convertible Debentures

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

At maturity, on May 30, 2010, the remaining \$40,000 in face value outstanding of 9% Subordinated Convertible Debentures were repaid in full with cash.

[b] 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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

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.

[c] 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 8]. The debentures are convertible by the holder at any time prior to maturity at \$3.75 per Unit.

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

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

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

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

10. MORTGAGES PAYABLE

	September 30 2010 \$	December 31 2009 \$
		<i>(audited)</i>
[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 <i>[note 8]</i> and the Days Inn - Ottawa Airport	76,502,178	78,210,359
[b] 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	5,110,992	5,246,249
[c] 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	2,000,000
	<u>83,613,170</u>	<u>85,456,608</u>
Less current portion	<u>78,734,744</u>	<u>78,430,822</u>
	<u>4,878,426</u>	<u>7,025,786</u>

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. 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

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

Unaudited

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 September 30, 2010 and December 31, 2009.

The agreement for the mortgage payable in [b] 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, 2009. 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. Accordingly, the portion of the mortgage in [b] not due within the next year 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:

	\$
Remainder of 2010	700,000
2011	31,323,895
2012	30,713,314
2013	5,014,634
2014	16,342,153
Total principal outstanding	84,093,996
Financing costs	(1,293,414)
Accretion of mortgages	812,588
	<u>83,613,170</u>

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

11. UNITHOLDERS' CAPITAL

	Class A Units \$	Class V Special Trust Units and Exchangeable Units \$	Class T Special Trust Unit \$	Convertible Debenture Conversion Options Not Exercised \$	Total Unitholders' capital \$
Balance, December 31, 2008	59,040,133	1	—	—	59,040,134
Repayment of convertible debentures by issuance of Units	128,184	—	—	—	128,184
Balance, December 31, 2009 <i>(audited)</i>	59,168,317	1	—	—	59,168,318
Convertible debentures matured [note 9 [a]]	—	—	—	11,566	11,566
Balance, September 30, 2010	59,168,317	1	—	11,566	59,179,884

Units issued during 2009 are summarized as follows:

	Class A Units #	Class V Special Trust Units and Exchangeable Units #	Class T Special Trust Unit #
Balance, December 31, 2008	18,774,756	500,000	1
Repayment of convertible debentures by issuance of Units	283,050	—	—
Balance, December 31, 2009 <i>(audited)</i> and September 30, 2010	19,057,806	500,000	1

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

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

Unaudited

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

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

Distributions to Unitholders

No distributions were declared for the three-month periods ended September 30, 2010 or 2009. For the nine-month period ended September 30, 2009, distributions of \$0.01 per Class A Unit and per Exchangeable Unit were declared, totalling \$192,748. No distributions were declared for the nine-month period ended September 30, 2010.

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

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

owned of record by the Unitholder on that Distribution Record Date and shall be paid to each such Unitholder on the Distribution Payment Date next following the Distribution Record Date.

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

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

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

12. 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:

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

	Nine Months Ended September 30 2010		Year Ended December 31 2009 <i>(audited)</i>	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Unit options outstanding, beginning of period	342,000	4.03	342,000	4.03
Unit options granted	775,000	.28	—	—
Unit options forfeited	(188,250)	3.84	—	—
Unit options outstanding, end of period	928,750	.94	342,000	4.03
Range of exercise price of Unit options outstanding, end of period	—	.28 to 4.62	—	3.25 to 4.62
Unit options vested, end of period	928,750	.94	342,000	4.03
Expiry date	2011 to 2015		2011 to 2013	

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

	2010 Options
Distribution yield	0.0%
Expected volatility	64.4%
Risk-free interest rate	2.4%
Estimated compensation costs	\$124,000

The compensation costs were expensed at the date of grant.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

13. BASIC AND DILUTED NET LOSS PER UNIT

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
Weighted average Units	<u>19,557,806</u>	19,557,806	<u>19,557,806</u>	19,449,977

The effect of the options under the Unit Purchase Plan issued to certain Trustees and management [note 12] and the conversion of the convertible debentures [note 9] are not presented as they would have an anti-dilutive effect on the loss per Unit.

14. 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:

	September 30 2010 \$	December 31 2009 \$
Accounts payable and accrued liabilities to		(audited)
LMI	1,567,573	614,721
Lakeview Flag Licensing General Partnership [note 6]	459,727	501,629
Lakeview Flag Management General Partnership [note 15]	1,318,468	761,138
Trustees of Lakeview Hotel REIT	9,000	10,000
XYZ Design Inc.	906	—

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

	Three Months Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
	\$	\$	\$	\$
Marketing expenses paid to				
Free to Guest Movies Ltd.	45,780	46,916	139,614	133,008
LMI	59,478	51,604	152,625	154,879
Included in general and administration expense				
Accounting fees paid to				
LMI	142,063	140,868	426,172	423,086
Asset management fees paid to				
LMI	114,436	118,997	346,808	360,083
Reservation fees paid to				
LMI	89,216	77,408	228,935	232,319
License fees paid to				
Lakeview Flag Licensing				
General Partnership <i>[note 6]</i>	238,065	207,189	611,813	620,744
Management fees paid to				
Lakeview Flag Management				
General Partnership <i>[note 15]</i>	349,014	321,291	933,021	939,709
Professional fees paid to				
XYZ Design Inc.	862	805	862	1,498
Letter of credit standby fees paid to				
LMI	—	49,019	—	59,581
Included in salaries and benefits				
Trustees' fees	9,000	11,000	25,110	29,500
Capitalized to income properties				
Professional fees paid to				
XYZ Design Inc.	—	—	—	4,549

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

Unaudited

Under the License Agreement [note 6], 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% of gross room revenue

[Gross room revenue is defined in note 6].

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 10]. 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

September 30, 2010
Unaudited

15. 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:

	September 30 2010 \$	December 31 2009 \$
		<i>(audited)</i>
Assets - current	<u>439,893</u>	<u>256,856</u>
Liabilities - current	<u>3,357</u>	<u>1,251</u>

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

	Three Months Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
	\$	\$	\$	\$
Revenue	116,337	107,098	311,006	336,640
Expenses	10	13	75	43
Net Income	116,327	107,085	310,931	336,597
Cash flows				
Cash provided by operating activities	125,750	82,794	127,327	251,922
Cash used in financing activities	(130,000)	(80,000)	(130,000)	(250,250)
Increase (decrease) in cash	(4,250)	2,794	(2,673)	1,672

16. FINANCIAL INSTRUMENTS

[a] Fair values

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

The fair values of the \$76,502,178 of mortgages payable to the primary lender are the principal balances outstanding of \$76,827,004 as Lakeview Hotel REIT is not in compliance with the financial covenant and repayment of the mortgages can be demanded at any time [note 10]. The carrying values of the \$5,110,992 and \$2,000,000 mortgages approximate fair values as they were recently advanced and their interest rates approximate current market rates.

Lakeview Hotel REIT's cash, reserve fund, cash held in trust, accounts receivable and accounts payable and accrued liabilities 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 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 approximates their carrying value and the estimated fair values of the 6.5% and 8.5% convertible debentures are \$9,900,000 and \$6,000,000 at September 30, 2010 respectively.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

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

	September 30			December 31		
	2010			2009		
	Level 1	Level 2	Level 3	<i>(audited)</i>		
	\$	\$	\$	Level 1	Level 2	Level 3
				\$	\$	\$
Financial assets						
Cash	1,459,871	—	—	1,331,392	—	—
Reserve fund	260,332	—	—	651,321	—	—
Cash held in trust	2,500,000	—	—	2,500,000	—	—

[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.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

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 \$1,955,351 as at September 30, 2010 and \$1,075,291 as at December 31, 2009 is net of allowances for bad debts, estimated by management based on prior experience and its assessment of the current economic environment. No customer accounts for more than 10% of the accounts receivable balance.

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

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 10, 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 \$76,502,178 are included in current liabilities. Although the mortgages can be demanded at any time, there is currently no indication that repayment will be demanded within the next year prior to their maturity dates. Also included in current liabilities is a \$4,200,000 demand loan from Lakeview Hotel REIT's primary mortgage lender [note 7]. While the loan is due on demand, there is also currently no indication that repayment will be demanded within the next year.

Also, during 2009, the Trustees announced a suspension of monthly distributions to Unitholders following the February, 2009 distribution in order to preserve capital.

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

Management has considered liquidity risk in using the going concern assumption as described in note 1.

17. INCOME TAXES

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

	September 30 2010 \$	December 31 2009 \$
		<i>(audited)</i>
Future tax assets		
Net taxable temporary difference	1,593,000	1,593,000
Taxable portion of non-capital loss carry forward	909,000	909,000
Valuation allowance	(2,502,000)	(2,502,000)
	<u>—</u>	<u>—</u>

Based on its assets and liabilities as at September 30, 2010 and December 31, 2009, 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 net taxable temporary differences and the non-capital loss carry forward of \$3,245,963 will reverse after January 1, 2011, resulting in \$2,502,000 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.

18. 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

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

Unaudited

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.

	September 30 2010 \$	December 31 2009 \$
		<i>(audited)</i>
Capital structure		
Loan payable	4,200,000	4,200,000
Debentures	9,854,215	9,703,065
Convertible debentures	25,241,691	24,413,159
Mortgages payable	83,613,170	85,456,608
Total debt	122,909,076	123,772,832
Unitholders' equity	29,305,243	35,513,433
Total capital	152,214,319	159,286,265

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 September 30, 2010 and December 31, 2009 respectively, the total of mortgage loans payable is 47.3% and 48.4% of the total gross book value of income properties.

As disclosed in note 10, 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.

In addition, following the February, 2009 distributions, monthly distributions were suspended.

19. 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:

Lakeview Hotel Real Estate Investment Trust

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010
Unaudited

	<u>\$</u>
Remainder of 2010	10,591
2011	42,365
2012	42,365
2013	42,365
2014	42,365
Thereafter	1,334,497
	<u>1,514,548</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.