

Consolidated Financial Statements

**Lakeview Hotel Real Estate Investment Trust**

December 31, 2006

## AUDITORS' REPORT

To the Unitholders of  
**Lakeview Hotel Real Estate Investment Trust**

We have audited the consolidated balance sheets of **Lakeview Hotel Real Estate Investment Trust** as at December 31, 2006 and 2005 and the consolidated statements of income, unitholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the **Lakeview Hotel Real Estate Investment Trust** as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Winnipeg, Canada,  
March 23, 2007 [except as to note 16  
which is as of April 16, 2007]

*Ernst + Young LLP*

Chartered Accountants



## Lakeview Hotel Real Estate Investment Trust

### CONSOLIDATED STATEMENTS OF INCOME

Year ended December 31

	2006	2005
	\$	\$
<b>REVENUE</b>		
Rooms	16,616,879	3,901,814
Food, beverage and gift shop	1,427,668	522,282
Interest and miscellaneous	756,771	324,485
	<b>18,801,318</b>	<b>4,748,581</b>
<b>EXPENSES</b>		
Amortization		
Deferred financing costs	242,790	111,089
Franchise fees and licenses	11,688	—
Income properties	2,238,411	493,349
Food, beverage and gift shop	730,722	318,568
General and administration <i>[note 14]</i>	3,621,315	825,114
Insurance	175,644	51,806
Interest – loan and other	128,283	—
Interest – mortgages and debentures	2,757,455	1,223,722
Maintenance	324,118	83,431
Marketing <i>[note 14]</i>	778,183	216,625
Property taxes	626,428	216,504
Salaries and benefits	3,630,610	863,811
Supplies	406,707	121,128
Utilities	620,535	174,822
	<b>16,292,889</b>	<b>4,699,969</b>
Income before the following	2,508,429	48,612
Income from Lakeview Flag Licensing General Partnership <i>[note 7]</i>	353,293	170,258
<b>Net income for the year</b>	<b>2,861,722</b>	<b>218,870</b>
Basic and diluted income per Unit <i>[note 13]</i>	<b>0.299</b>	<b>0.078</b>

*See accompanying notes*

## Lakeview Hotel Real Estate Investment Trust

### CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY

Year ended December 31

	2006	2005
	\$	\$
<b>Unitholders' capital</b>		
Balance, beginning of year	12,090,227	664,618
Issuance of Units by private placement	43,500,002	12,350,000
Issuance of Units on exercise of Unit options	116,000	—
Conversion of debentures	3,139,830	—
Issuance costs	(2,944,720)	(924,391)
Balance, end of year	55,901,339	12,090,227
<b>Equity portion of convertible debentures</b>		
Balance, beginning of year	1,588,896	1,155,178
Issuance of convertible debentures	—	433,718
Conversion of debentures	(765,060)	—
Balance, end of year	823,836	1,588,896
<b>Contributed capital</b>		
Balance, beginning of year	18,000	8,750
Issuance of Unit options	45,000	9,250
Issuance of Units on exercise of Unit options	(18,000)	—
Balance, end of year	45,000	18,000
<b>Accumulated earnings (deficit)</b>		
Balance, beginning of year	(229,264)	(448,134)
Net income for the year	2,861,722	218,870
Balance, end of year	2,632,458	(229,264)
<b>Accumulated distributions</b>		
Balance, beginning of year	(1,056,375)	(176,250)
Distributions declared	(3,955,176)	(880,125)
Balance, end of year	(5,011,551)	(1,056,375)
<b>Unitholders' equity, end of year</b>	<b>54,391,082</b>	<b>12,411,484</b>

*See accompanying notes*

## Lakeview Hotel Real Estate Investment Trust

### CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended December 31

	2006 \$	2005 \$
<b>OPERATING ACTIVITIES</b>		
Net income for the year	2,861,722	218,870
Add charges (deduct credits) to operations not requiring a current cash payment		
Amortization of income properties	2,238,411	493,349
Amortization of deferred financing costs	242,790	111,089
Amortization of franchise fees and licenses	11,688	—
Compensation costs of Unit options	45,000	9,250
Income from Lakeview Flag Licensing General Partnership	(353,293)	(170,258)
Accretion on debt component of convertible debentures	213,033	213,927
	<b>5,259,351</b>	<b>876,227</b>
Net change in non-cash working capital balances related to operations	157,287	(927,740)
<b>Cash provided by (used in) operating activities</b>	<b>5,416,638</b>	<b>(51,513)</b>
<b>INVESTING ACTIVITIES</b>		
Acquisition of income properties, cash consideration <i>[note 2]</i>	(60,704,137)	(14,600,558)
Additions to income properties	(708,849)	(82,399)
Increase in franchise fees and licenses	(158,681)	—
Distributions from Lakeview Flag Licensing General Partnership	339,570	163,170
<b>Cash used in investing activities</b>	<b>(61,232,097)</b>	<b>(14,519,787)</b>
<b>FINANCING ACTIVITIES</b>		
Increase in deferred financing costs	(525,032)	(214,481)
Unitholders' distributions		
Class A	(3,756,843)	(747,625)
Exchangeable Units	(198,333)	(132,500)
Proceeds from loan	4,780,000	—
Repayment of loan	(4,530,000)	—
Proceeds from mortgages	37,375,000	8,235,000
Repayment of mortgages	(12,555,442)	(202,742)
Proceeds of convertible debentures	—	1,500,000
Units issued by private placement	43,500,002	12,350,000
Cost of raising capital	(2,944,720)	(924,391)
Issuance of Units on exercise of Unit options	98,000	—
<b>Cash provided by financing activities</b>	<b>61,242,632</b>	<b>19,863,261</b>
<b>Net increase in cash and cash equivalents during the year</b>	<b>5,427,173</b>	<b>5,291,961</b>
Cash and cash equivalents, beginning of year	5,804,428	512,467
<b>Cash and cash equivalents, end of year</b>	<b>11,231,601</b>	<b>5,804,428</b>
<b>Supplemental cash flow information</b>		
Cash paid for interest	2,613,607	950,860

See accompanying notes

# Lakeview Hotel Real Estate Investment Trust

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

### 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

#### Organization and principles of consolidation

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

The 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. and 0760018 B.C. Ltd.

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. Transactions within the consolidated group are eliminated upon consolidation.

#### Significant accounting policies

##### [a] Cash and cash equivalents

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

##### [b] Inventory

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

# Lakeview Hotel Real Estate Investment Trust

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

### [c] Deferred financing costs

Deferred financing costs consist of costs incurred related to mortgage financing and to the offering of the debt component of convertible debentures. Deferred financing costs are stated at cost less accumulated amortization. Amortization is recorded using the straight-line method over the term to maturity of the related mortgages and convertible debentures.

### [d] Franchise fees and licenses

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

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

### [e] Income properties

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

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

Amortization is recorded as follows:

Buildings	40 years	straight-line
Parking lot	10 years	straight-line
Signs	10 years	straight-line
Furniture, fixtures and equipment	3 - 5 years	straight-line

## Lakeview Hotel Real Estate Investment Trust

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

#### [f] 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.

#### [g] Related parties

During 2006 and 2005, Lakeview Hotel REIT had transactions with the following related parties:

<b>Related parties</b>	<b>Nature of relationship</b>
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

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

## **Lakeview Hotel Real Estate Investment Trust**

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

December 31, 2006

#### **[i] Income taxes**

Lakeview Hotel REIT is an unincorporated closed-end real estate investment trust, governed by the laws of the Province of Manitoba. The Lakeview Hotel REIT is taxed as a “mutual fund trust” for income tax purposes. Pursuant to the Declaration of Trust, the Trustees of Lakeview Hotel REIT will make distributions or designate all taxable income earned, including the taxable part of net realized capital gains, by the Lakeview Hotel REIT to Unitholders. Consequently, no provision for income taxes is required under the liability method of accounting for income taxes.

On October 31, 2006, new income trust legislation proposals were released by the Canadian Finance Minister. The proposals included a new distribution tax on income trusts and publicly-traded limited partnerships classified as Specified Investment Flow-Throughs [“SIFT”]. The proposal contemplates that a real estate investment trust (“REIT”) which carries on Canadian hotel operations would be considered a SIFT.

For existing SIFT’s, there will be a four year transition period; the provisions will apply beginning with their 2011 taxation year.

If the new provisions are applicable to Lakeview Hotel REIT, once they are substantively enacted, Lakeview Hotel REIT would record future income tax liabilities in respect of temporary differences that are expected to reverse after 2010.

#### **[j] Net income per unit**

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

#### **[k] 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.

## **Lakeview Hotel Real Estate Investment Trust**

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

December 31, 2006

#### **[l] Financial instruments**

Financial instruments include cash and cash equivalents, reserve fund, deposits held in trust, accounts receivable, accounts payable and accrued liabilities, distributions payable, loan payable, convertible debentures and mortgages payable. It is management's opinion that Lakeview Hotel REIT is not exposed to significant currency or credit risks arising from these financial instruments. Lakeview Hotel REIT is exposed to interest 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. Unless otherwise stated, the book value of Lakeview Hotel REIT's financial assets and liabilities approximates their fair value.

#### **[m] Use of estimates**

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

## Lakeview Hotel Real Estate Investment Trust

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

#### 2. ACQUISITION OF HOTELS

In 2006 and 2005, Lakeview Hotel REIT acquired certain hotels. The acquisitions have been accounted for by the purchase method with the results of operations from the acquired hotels included in the Lakeview Hotel REIT's earnings from the date of their respective acquisitions. The assets and liabilities acquired at fair value were as follows:

##### 2006

	Acquisition date	Land \$	Building \$	Parking lot \$	Furniture, fixtures and equipment \$	Working capital \$	Cash consideration \$
<b>Alberta</b>							
Lakeview Inn & Suites – Okotoks *****	2006-01-06	1,253,772	4,327,535	—	680,000	4,482	6,265,789
Lakeview Inn & Suites – Fort Saskatchewan *****	2006-01-13	1,007,686	6,086,424	—	310,000	(4,686)	7,399,424
Lakeview Inn & Suites – Edson	2006-04-07	413,076	3,876,568	—	350,000	(6,653)	4,632,991
Lakeview Inn & Suites – Whitecourt	2006-05-31	528,341	4,702,231	—	450,000	(14,606)	5,665,966
Holiday Inn Express – Sherwood Park **	2006-06-01	954,199	10,187,302	—	700,000	(26,579)	11,814,922
<b>British Columbia</b>							
Lakeview Inn & Suites - Chetwynd	2006-10-24 and 2006-11-09	519,350	6,517,629	—	476,150	14,235	7,527,364
Lakeview Inn & Suites - Fort St. John ****	2006-10-16 and 2006-11-10	709,204	7,516,100	—	872,050	38,275	9,135,629
<b>Ontario</b>							
Super 8 - Toronto North ***	2006-03-17	1,427,622	6,076,832	202,561	553,288	1,749	8,262,052
		<b>6,813,250</b>	<b>49,290,621</b>	<b>202,561</b>	<b>4,391,488</b>	<b>6,217</b>	<b>60,704,137</b>

\*\* Management estimates conversion to Lakeview Inn & Suites within five years from acquisition.

\*\*\* Management estimates conversion to Lakeview Inn & Suites within two years from acquisition.

\*\*\*\* Includes the Fogg n'Suds Restaurant.

\*\*\*\*\* Converted to Lakeview Inn & Suites hotels on July 1, 2006.

Cash consideration for the purchase of the hotels in 2006 was financed by a combination of first mortgages [note 10], the Pre-Approved Line of Credit [note 9], proceeds from private placement of Units on April 27 and November 8, 2006 [note 11] and working capital.

## Lakeview Hotel Real Estate Investment Trust

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

#### 2005

	Acquisition date	Land \$	Building \$	Furniture, fixtures and equipment \$	Working capital \$	Mortgage payable - second \$	Cash consideration \$
<b>Alberta</b>							
Black Gold Inn – Drayton Valley *	2005-06-01	578,234	6,914,756	1,100,000	(11,498)	(1,000,000)	7,581,492
Lakeview Inn & Suites – Hinton	2005-11-04	417,825	5,588,402	1,000,000	12,839	—	7,019,066
		996,059	12,503,158	2,100,000	1,341	(1,000,000)	14,600,558

\* Converted to a Lakeview Inn & Suites on December 1, 2005.

Cash consideration for the purchase of the hotels in 2005 was financed by first mortgages on the respective properties [note 10] and proceeds from private placement of convertible debentures and Units [notes 8 and 11].

### 3. RESERVE FUND

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

## Lakeview Hotel Real Estate Investment Trust

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Up until March 1, 2006, the date the mortgage on the Initial Property [mortgage [b] note 10] was repaid in full, the mortgage lender had required the Initial Property, pursuant to a Deposit Trust Agreement, to reserve funds in a trust account for on-going capital repairs, replacements and/or improvements of the Initial Property including but not limited to the regular repair, replacement and maintenance of the furniture, fixtures and equipment. Under the terms of the Deposit Trust Agreement, the Initial Property was required to make monthly deposits into the trust account during the term of the mortgage equal to 4% of estimated annual room revenue divided by twelve [12]. Reserve funds were available for current repairs and maintenance subject to the approval by the mortgage lender.

	2006	2005
	\$	\$
Reserve fund, beginning of year	175,615	107,630
Allocations to reserve fund	567,710	144,115
Use of reserve fund	(120,546)	(76,130)
Reserve fund, end of year	<b>622,779</b>	175,615

#### 4. DEFERRED FINANCING COSTS

	2006	2005
	\$	\$
Cost	1,168,497	643,465
Less accumulated amortization	(414,652)	(171,862)
	<b>753,845</b>	471,603

#### 5. FRANCHISE FEES AND LICENSES

	2006	2005
	\$	\$
Cost	158,681	—
Less accumulated amortization	(11,688)	—
	<b>146,993</b>	—

## Lakeview Hotel Real Estate Investment Trust

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

#### 6. INCOME PROPERTIES

	2006			2005		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
	\$	\$	\$	\$	\$	\$
Land	8,535,631	—	8,535,631	1,722,381	—	1,722,381
Buildings	67,936,961	1,557,159	66,379,802	18,375,603	374,927	18,000,676
Parking lot	204,899	16,134	188,765	—	—	—
Signs	154,144	6,995	147,149	—	—	—
Furniture, fixtures and equipment	7,131,731	1,284,406	5,847,325	2,458,613	251,356	2,207,257
	<b>83,963,366</b>	<b>2,864,694</b>	<b>81,098,672</b>	<b>22,556,597</b>	<b>626,283</b>	<b>21,930,314</b>

#### 7. INVESTMENT IN LAKEVIEW FLAG LICENSING GENERAL PARTNERSHIP

On April 15, 2004, Lakeview Hotel REIT indirectly acquired a 49% interest in Lakeview Flag Licensing General Partnership with nominal initial capitalization of \$49 and issuance of the Lakeview Flag Operating Limited Partnership Class E Units [exchangeable into 500,000 Units, the "Exchangeable Units"] and 500,000 Class V Special Trust Units and 1 Class T Special Trust Unit of Lakeview Hotel REIT. The principal purpose of the Lakeview Flag Licensing General Partnership is to hold the trademarks, trade names, operating procedures, systems, related items and goodwill associated therewith of the hotel flags known as "Lakeview Inn & Suites" and "Lakeview Resorts" ["Lakeview Flag"]. Although the exchange amount was \$1,000,000, the transaction was recorded at the carrying value of \$1 in accordance with Canadian generally accepted accounting principles applicable to related party transactions because the 49% interest in Lakeview Flag Licensing General Partnership was acquired from a company controlled by certain Unitholders of Lakeview Hotel REIT and the exchange amount was not supported by independent evidence.

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

## Lakeview Hotel Real Estate Investment Trust

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

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 been converted to a Lakeview Inn & Suites hotel. The license fees are earned effective as of the date of conversion.

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:

	2006	2005
	\$	\$
Investment, beginning of year	16,367	9,279
Equity income	353,293	170,258
Distribution received	(339,570)	(163,170)
Investment, end of year	<b>30,090</b>	16,367

#### 8. CONVERTIBLE DEBENTURES

On April 15, 2004, under the public offering, the Lakeview Hotel REIT issued \$4,500,000 of subordinate convertible debentures.

The convertible debentures bear interest at 10%, mature in five years from date of issue and are subordinate only to property specific conventional mortgage financing and any vendor take-back mortgage financing. The convertible debentures are convertible by the holder at any time during the third year after the date of issue at the following conversion price per Unit: \$2.50 in year three; \$3.00 in year four; and \$3.50 in year five. At any time after three years from the issue date, Lakeview Hotel REIT has the right to redeem all, but not less than all, convertible debentures at par plus accrued interest. On maturity, the convertible 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.

## Lakeview Hotel Real Estate Investment Trust

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

During the period April 16, 2006 to December 31, 2006, \$2,327,000 of the convertible debentures issued April 15, 2004 were converted at a price of \$2.50 into 930,800 Class A Units.

On May 30, 2005, under a private offering, the Lakeview Hotel REIT issued \$1,500,000 of subordinate convertible debentures.

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

During 2006, \$580,000 of the convertible debentures issued May 30, 2005 were converted at a price of \$2.90 into 199,990 Class A Units.

The following allocation of the convertible debentures to debt and equity components is based on an estimated cost of borrowing without conversion option at 18% per annum.

	Debt \$	Equity \$	Total \$
Issue date – April 15, 2004	3,344,822	1,155,178	4,500,000
Issue date – May 30, 2005	1,066,282	433,718	1,500,000
	<b>4,411,104</b>	<b>1,588,896</b>	<b>6,000,000</b>
		2006 \$	2005 \$
Debt component at issue date		4,411,104	4,411,104
Accretion of debt component of convertible debentures		537,526	324,493
Conversion of debentures		(2,374,770)	—
		<b>2,573,860</b>	<b>4,735,597</b>

The debt portion of the convertible debentures is accounted for as a liability. The accretion of the debt component, which increases the debt component from the initial carrying amount, is included in interest expense.

## Lakeview Hotel Real Estate Investment Trust

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006

#### 9. LOAN PAYABLE

	2006	2005
	\$	\$
Loan payable	<b>250,000</b>	—

As at December 31, 2006, the Lakeview Hotel REIT has available a Pre-Approved Line of Credit of up to \$2,780,000. The loan payable bears interest at the Canadian dollar bankers' acceptance rate plus 5% floating per annum, due on demand, collateralized by first mortgages on certain income properties. The effective interest rate was 9.17% in 2006.

#### 10. MORTGAGES PAYABLE

	2006	2005
	\$	\$
[a] Mortgages payable, bearing interest at 5.93% to 6.36% per annum, due February 1, 2011 to January 1, 2012, 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, an assignment of material contracts and agreements and are cross-collateralized by each of the underlying properties	<b>36,829,515</b>	—
[b] Mortgage payable, bore interest at 8.81% per annum, due August 1, 2018. Repaid in full in 2006 with proceeds from mortgages in [a]	—	2,858,447
[c] Mortgage payable, bore interest at prime plus 1.25% per annum, due on demand. The effective interest rate was 7.01% [2005 – 6.19%]. Repaid in full in 2006 with proceeds from mortgages in [a]	—	4,481,058
[d] Mortgage payable, bore interest at 5.5% per annum, due June 1, 2007. Repaid in full in 2006	—	1,000,000
[e] Mortgage payable, bore interest at prime plus 1.5% per annum, due on demand. The effective interest rate was 7.24% [2005 – 6.35%]. Repaid in full in 2006	—	3,670,452
	<b>36,829,515</b>	12,009,957
Less current portion	<b>1,011,987</b>	476,977
	<b>35,817,528</b>	11,532,980

Estimated future principal repayments over the next five years and thereafter are as follows:

## Lakeview Hotel Real Estate Investment Trust

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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	\$
2007	1,011,987
2008	1,087,648
2009	1,155,458
2010	1,227,499
2011	27,718,865
Thereafter	4,628,058
	<b>36,829,515</b>

The fair value of the mortgages approximates their carrying value.

#### 11. UNITHOLDERS' CAPITAL

	Class A Units \$	Class V Special Trust Units and Exchangeable Units \$	Class T Special Trust Units \$	Total Unitholders' capital \$
<b>Balance, December 31, 2004</b>	664,617	1	—	664,618
Issuance of Units in private placement – May 30, 2005	2,000,000	—	—	2,000,000
Issuance of Units in private placement – September 2, 2005	10,350,000	—	—	10,350,000
Issuance costs	(924,391)	—	—	(924,391)
<b>Balance, December 31, 2005</b>	12,090,226	1	—	12,090,227
Issuance of Units in private placement – April 27, 2006	<b>11,500,002</b>	—	—	<b>11,500,002</b>
Issuance of Units in private placement – November 8, 2006	<b>32,000,000</b>	—	—	<b>32,000,000</b>
Issuance costs	<b>(2,944,720)</b>	—	—	<b>(2,944,720)</b>
Conversion of debentures [note 8]	<b>3,139,830</b>	—	—	<b>3,139,830</b>
Issuance of Units on exercise of Unit options	<b>116,000</b>	—	—	<b>116,000</b>
<b>Balance, December 31, 2006</b>	<b>55,901,338</b>	<b>1</b>	—	<b>55,901,339</b>

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Units issued during 2006 and 2005 are summarized as follows:

	Class A Units #	Class V Special Trust Units and Exchangeable Units #	Class T Special Trust Units #
<b>Balance, December 31, 2004</b>	675,000	500,000	1
Issuance of Units in private placement – May 30, 2005	800,000	—	—
Issuance of Units in private placement – September 2, 2005	3,450,000	—	—
<b>Balance, December 31, 2005</b>	4,925,000	500,000	1
Issuance of Units in private placement – April 27, 2006	<b>3,538,462</b>	—	—
Issuance of Units in private placement – November 8, 2006	<b>8,000,000</b>	—	—
Conversion of debentures <i>[note 8]</i>	<b>1,130,790</b>	—	—
Issuance of Units on exercise of Unit options	<b>50,000</b>	—	—
<b>Balance, December 31, 2006</b>	<b>17,644,252</b>	<b>500,000</b>	<b>1</b>

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

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

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

## Lakeview Hotel Real Estate Investment Trust

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In connection with the private placement of Units in May, 2005, LMI agreed to subordinate its entitlement to the first \$0.30 per Unit per year of distributions on the Units and Exchangeable Units it owns, directly or indirectly, to the distributions to be made to all other Unitholders for a period of three years ending May 30, 2008.

#### **Distributions to Unitholders**

For the year ended December 31, 2006, distributions of \$0.40 [2005 - \$0.265] per Class A Unit and per Exchangeable Unit, totalling \$3,955,176 [2005 - \$880,125] were declared.

#### **Distribution policy**

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

Subject to the obligations of the Trustees in respect of the Class V Units, the Trustees may, on or before each Distribution Record Date, and shall on or before the December 31 Distribution Record Date, declare payable, to the Unitholders of record on such Distribution Record Date, all or any part of the Distributable Cash of the Trust for the Distribution Period ending on such Distribution Record Date determined in accordance with the Declaration of Trust, and the proportionate share of each Unit of the amount so payable shall be determined by dividing such amount by the number of Units outstanding on that Distribution Record Date. Each Unitholder's share thereof shall be equal to the proportionate share per Unit multiplied by the number of Units owned of record by the Unitholder on that Distribution Record Date and shall be paid to each such Unitholder on the Distribution Payment Date next following the Distribution Record Date.

"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;
- [d] Amounts that may be payable on the Class V Units; and
- [e] 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.

## Lakeview Hotel Real Estate Investment Trust

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### 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 ten percent (10%) of the total number of issued and outstanding units.

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

	2006		2005	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Unit options outstanding, beginning of year	50,000	1.96	25,000	2.00
Unit options granted	62,500	3.25	25,000	1.92
Unit options exercised	(50,000)	1.96	—	—
Unit options outstanding, end of year	62,500	3.25	50,000	1.96
Range of exercise price of Unit options outstanding, end of year	—	3.25	—	1.92 to 2.00
Unit options vested, end of year	62,500	3.25	50,000	1.96
Expiry date	2011		2009 to 2010	

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

	2006 Options	2005 Options
Distribution yield	11.4%	13.0%
Expected volatility	60.8%	51.4%
Risk-free interest rate	4.3%	3.4%
Estimated compensation costs	\$45,000	\$9,250

The compensation costs were expensed at the date of grant.

## Lakeview Hotel Real Estate Investment Trust

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#### 13. BASIC AND DILUTED INCOME PER UNIT

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

	2006	2005
Weighted average Units	9,569,490	2,791,667

The effect of the options under the Unit Purchase Plan issued to certain Trustees *[note 12]* and conversion of the convertible debentures *[note 8]* are not presented as they would have an anti-dilutive effect on the income 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:

	2006	2005
	\$	\$
Accounts payable and accrued liabilities to		
LMI	59,580	20,692
Lakeview Flag Licensing General Partnership <i>[note 7]</i>	44,043	20,568
Lakeview Flag Management General Partnership <i>[note 15]</i>	64,580	23,949
Marketing expenses paid to		
Free to Guest Movies Ltd.	83,940	11,158
LMI	118,965	25,443
Included in general and administration expense		
Accounting fees paid to		
LMI	242,237	52,500
Asset management fees paid to		
LMI	53,069	—
Reservation fees paid to		
LMI	178,451	38,164
License fees paid to		
Lakeview Flag Licensing General Partnership <i>[note 7]</i>	475,870	101,770
Management fees paid to		
Lakeview Flag Management General Partnership <i>[note 15]</i>	693,500	174,954
Professional fees paid to		
XYZ Design Inc.	4,100	—

## Lakeview Hotel Real Estate Investment Trust

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

Accounting fee	\$30,000 per annum per hotel
Reservation fee	1.5% of gross room revenue
Marketing fee	1% of gross room revenue
[Gross room revenue is defined in note 7]	

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

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

Pursuant to a Services Agreement between Lakeview Hotel REIT and LMI, LMI has been engaged as the administrator of Lakeview Hotel REIT, to administer the affairs of the 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 is 5 years expiring on April 14, 2009. 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.

#### **15. INVESTMENT IN LAKEVIEW FLAG MANAGEMENT GENERAL PARTNERSHIP**

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

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

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

	2006	2005
	\$	\$
Assets – current	24,532	8,136
Liabilities – current	1,379	521
Revenue	231,267	58,327
Expenses	229	419
Net income	231,038	57,908
Cash flows		
Cash provided by operating activities	216,516	51,647
Cash used in financing activities	(215,500)	(51,500)
Increase in cash	1,016	147

#### 16. SUBSEQUENT EVENTS

- [a] Effective January 8, 2007, the Lakeview Hotel REIT acquired a newly constructed hotel located in Fort Nelson, British Columbia for total consideration of \$9,645,314 plus closing adjustments. The hotel was immediately converted to a Lakeview Inn & Suites hotel. The cash consideration for this purchase was financed by proceeds from the private placement of Class A Units on November 8, 2006 [note 11].

Effective April 16, 2007, the Lakeview Hotel REIT acquired a newly constructed hotel located in Edson, Alberta for total consideration of \$7,800,000 plus closing adjustments. The hotel is flagged as a Lakeview Inn & Suites hotel. The cash consideration for this purchase was financed through the funding of previously approved mortgages on income properties.

The Lakeview Hotel REIT continues to pursue other hotel acquisition opportunities which will be financed by a combination of mortgages, Pre-Approved Line of Credit, Unit and debenture offerings and working capital.

- [b] Subsequent to year end, the Lakeview Hotel REIT entered into various commitments for an estimated \$800,000 of renovations to the Lakeview Inn & Suites in Fort Saskatchewan.