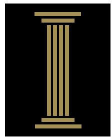


InnVest
R · E · I · T

2002 THIRD QUARTER REPORT TO UNITHOLDERS FOR THE PERIOD ENDING SEPTEMBER 30, 2002

Dear Fellow Unitholders

InnVest Real Estate Investment Trust is pleased to provide you with our first quarterly report for the third quarter of fiscal 2002 ended September 30th.

InnVest REIT was launched on July 26, 2002. Accordingly, our results cover a 67-day period. To allow unitholders to evaluate the Trust's performance, we have compared our quarterly results with the same period last year as well as the forecast provided in our prospectus, prorated to cover the same 67-day period.

Despite encouraging year-over-year gains in both revenue and operating income, our results were slightly below forecast. This reflects lower than anticipated operating revenue, which resulted from a weakening in demand during the month of September, specifically in the first two weeks, attributable to the 9/11 anniversary. This put pressure on the average daily rate in certain markets, which was partially offset by cost management initiatives and interest expense savings.

However, revenues increased 1.4% from last year, primarily reflecting improved occupancy in the period. Operating income was up 4.4%, reflecting top-line gains combined with strong cost control. Additionally, distributed income to unitholders was in line with our prorated forecast.

Overall, we believe the REIT has delivered a solid performance given the difficult business conditions in the hospitality sector.

Notably, the Trust's financial position continues to be strong, which will enable us to continue to invest in revenue-enhancing capital projects as well as capitalize on accretive acquisition opportunities. We have launched major capital projects in a number of hotels, including the Montreal Quality Inn, the Toronto Airport Quality Suites, the Toronto Downtown Quality Hotel and the North Bay Best Western.

Our outlook for InnVest REIT is confident, for a number of reasons:

- The Trust's balance sheet is strong;
- Our high quality properties have a leading position in the Trust's target markets; and
- Our cash position and borrowing capacity are healthy, which gives the Trust a significant competitive advantage as the economy recovers.

Additionally, we are seeing signs of a gradual recovery for the hospitality sector in the last half of 2002 and into 2003.

Looking ahead, we will continue to focus on maximizing the performance of each hotel in the portfolio, increasing operating efficiencies and maintaining distributable income. We appreciate your support and look forward to updating you on the Trust's progress going forward.

Sincerely,

Kenneth Gibson
President & Chief Executive Officer

The following discussion reviews the operating performance and financial condition of InnVest Real Estate Investment Trust (the "REIT" or "InnVest"), comprised of 114 hotels (11,602 rooms) and its franchise business.

Management's discussion and analysis of results of operations and financial condition ("MD&A") should be read in conjunction with the attached unaudited interim consolidated financial statements and notes thereto for the period from July 26, 2002 to September 30, 2002 and the Prospectus dated July 18, 2002. The financial statements of InnVest are prepared in accordance with generally accepted accounting principles in Canada and are presented in Canadian dollars.

The following table summarizes the operating results for the reporting period from July 26, 2002 to September 30, 2002 for the hotel portfolio and the franchise business.

Financial Highlights Summary

(In thousands of dollars, except per unit amounts)		July 26, 2002 to September 30, 2002
Hotel revenues	$	57,274
Hotel expenses		29,649
Operating income		27,625
EBITDA(1)		27,989
Net income	$	17,715
Net income per unit – basic	$	0.40
– diluted	$	0.37
Net income	$	17,715
Add (deduct)		
Depreciation and amortization		5,800
Future income taxes		(317)
Non-cash executive compensation		30
Funds from operations	$	23,228
Funds from operations per unit – basic	$	0.53
– diluted	$	0.48
Funds from operations	$	23,228
Amortization of fair value debt adjustment		(248)
Interest on convertible debentures		(1,342)
Reserve for capital expenditures and replacement of furniture, fixtures and equipment		(2,291)
Distributable income	$	19,347
Distributable income per unit – basic	$	0.47
– diluted	$	0.43
Distributions	$	4,596
Distributions – per unit	$	0.1119

(1) EBITDA – Earnings before interest expense, income and capital taxes and depreciation and amortization.

Key Performance Indicators

Key performance indicators by geographic region in Canada for the period from July 26, 2002 to September 30, 2002 are as follows:

	Ontario	Quebec	East	West	REIT
Occupancy	75.8%	83.4%	88.4%	74.5%	78.7%
Average daily rate (ADR)	$ 92.60	$ 89.58	$ 91.41	$ 68.19	$ 88.09
Revenue per available room (RevPAR)	$ 70.19	$ 74.70	$ 80.82	$ 50.83	$ 69.33

Review of Operations

The forecast reported in the Prospectus dated July 18, 2002 (the "Offering") reflects expected operating results for the period from July 1, 2002 to September 30, 2002. As InnVest acquired its properties on July 25, 2002 the forecast results need to be adjusted for the period during which the properties were not owned by InnVest. The forecast adjusted for the first twenty five days is as follows:

	Forecast	Less 25 Days	Adjusted Forecast
Hotel revenues	$ 82,810	$ (23,161)	$ 59,649
Hotel expenses	42,422	(11,595)	30,827
Operating income	40,388	(11,566)	28,822
Other income and expenses	14,536	(3,995)	10,541
Income before income tax expense	25,852	(7,571)	18,281
Income tax expense (recovery)	(118)	32	(86)
Net income	$ 25,970	$ (7,603)	$ 18,367
Net income per unit			
– basic	$ 0.59	$ (0.18)	$ 0.41
– diluted	$ 0.53	$ (0.15)	$ 0.38
Net income	$ 25,970	$ (7,603)	$ 18,367
Add (deduct)			
Depreciation and amortization	8,125	(2,208)	5,917
Future income taxes	(435)	118	(317)
Funds from operations	$ 33,660	$ (9,693)	$ 23,967
Deduct			
Amortization of fair value adjustment	(341)	93	(248)
Reserve for capital expenditures and replacement of furniture, fixtures and equipment	(3,312)	926	(2,386)
Convertible debenture interest	(1,828)	486	(1,342)
Distributable income	$ 28,179	$ (8,188)	$ 19,991
Distributable income per unit			
– basic	$ 0.69	$ (0.20)	$ 0.49
– diluted	$ 0.61	$ (0.17)	$ 0.44

The following review of operations uses the adjusted forecast for comparative purposes:

Hotel Revenues

Hotel revenues primarily consist of revenue generated from room occupancy. Revenue from food and beverage services and other miscellaneous revenue streams associated with hotel operations such as space leases, vending commissions, movie rentals, parking and telephone are also included and account for approximately 7% of total revenue. Revenues earned from hotel operations fluctuate throughout the year, with the third quarter being the highest, due to the increased level of leisure travel in the summer months, and the first quarter being the lowest, as leisure travel is lower.

For the period ended September 30, 2002, revenues were $57,274, $2,375 or 4% less than the adjusted forecast. Over $2,000 of this variance can be explained by a decrease in demand during September, 2002, arising from the first anniversary of 9/11. This event is expected to be a one-time occurrence and is not reflective of the remainder of the reporting period.

The room revenue achieved for the entire quarter ended September 30, 2002, showed a 2.1% RevPAR and room revenue increase. This was the result of an increase in occupancy from 77.2% in 2001 to 78.9% in 2002 and flat ADR. The increase in occupancy was the net result of an improvement in demand compared to last year which was impacted by the events of September 11th countered by a new supply of hotel rooms in certain markets in which the hotel portfolio is located.

Hotel Expenses

Hotel expenses consist of direct operating expenses, property taxes, rent, insurance and management fees. Direct operating expenses include labour costs, room expenses, food and beverage expenses, administration, sales and marketing, maintenance, utilities and franchise fees.

For the reporting period, hotel expenses were $29,649, which is $1,178 less than the adjusted forecast, representing expense savings of 3.8% to the adjusted forecast.

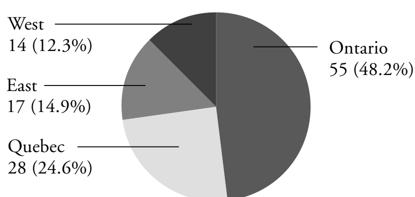
When compared to the same time period in the previous year, hotel expenses decreased modestly by $54 or 0.2%. Property taxes and insurance increased by 7.9%, an increase which was more than offset by decreases in operating expenses. Operating expenses decreased by $264 or 1.1%, when compared with the previous year as a result of the effect of cost controls initiated by management.

Operating Income

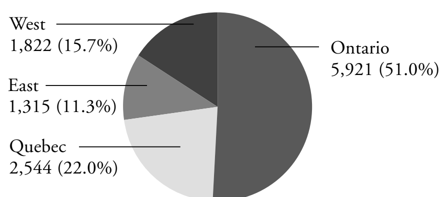
Operating income for the reporting period was $27,625 versus the $28,822 reflected in the adjusted forecast. The $1,197 variance for the period from July 26, 2002 to September 30, 2002 can all be attributed to the month of September. The negative variance can be even isolated further in that the decline in business because of the anniversary of 9/11 accounts for the shortfall. When comparing the reporting period to the same time period for the previous year, operating income showed reasonable growth, increasing $869 or 3.2%.

Operating income generated by geographical region of Canada is as follows:

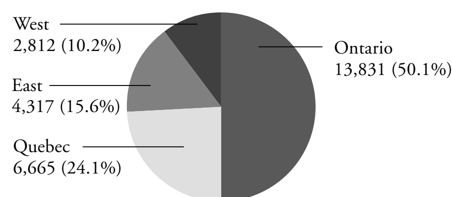
Number of Hotels by Region



Number of Hotel Rooms by Region



Regional Operating Income



Other Income and Expenses

Other income and expenses consist of interest on mortgages, corporate and administrative costs, capital tax, franchise business income, other income and depreciation and amortization.

The net amount of other income and expenses for the reporting period was $9,996, $545 less than the adjusted forecast. This results substantially from lower than forecast interest of $291 and corporate and administrative expenses of $74. Depreciation and amortization was below the adjusted forecast by $118, due to less than forecast refurbishments completed in the summer months, while the franchise business results were $66 better than forecast. Interest expense savings are expected to be realized throughout the forecast year. These savings are the result of locking in $211,000 of mortgage debt for an average term of 5.1 years at base rates of 0.74% less than forecast in the IPO.

Net Income

Net income for the reporting period was $17,715 or $0.40 per unit – basic (diluted – $0.37) versus the adjusted forecast of $18,367 or $0.41 per unit – basic (diluted – $0.38).

Income Taxes

Current income taxes and the draw down on future income taxes are consistent with the adjusted forecast. These amounts are net of the future income tax expense recorded as a result of depreciation recorded for accounting purposes being greater than capital cost allowance allowed for income tax purposes.

Distributable Income

Distributable income for the reporting period was $19,347 or $0.47 per unit – basic (diluted – $0.43), compared to the adjusted forecast of $19,991 or $0.49 per unit – basic (diluted – $0.44).

Changes in Financial Condition

Investing Activities

As disclosed in the Offering, InnVest purchased the 114 hotel portfolio for $741,872 and the franchise business for $22,175. Acquisition costs of $6,700 were incurred along with $22,945 in issue costs. Hotel Properties decreased by $5,439, the net of capital additions and depreciation during the period.

In the reporting period, investing activities were limited to a modest amount of capital expenditures as part of the regular refurbishment program and setting aside the 4% of revenues for the furniture, fixture and equipment reserve (“FF&E reserve”). For the period ended September 30, 2002 a total amount of $361 was spent on capital expenditures. The FF&E reserve was increased by $2,291, compared to the $2,386 included in the adjusted forecast.

The normal reserve for replacement of furniture, fixtures and equipment and capital improvements are managed over a longer term. This reserve is maintained to ensure that the properties remain competitive in their markets. For the remainder of the forecast period, approximately $10,000 will be spent as part of the refurbishment program.

Financing Activities

At closing of the Offering, a total of $211,000 was advanced by InnVest’s major mortgage lender. An additional $109,000 of mortgage debts was assumed from the hotel properties acquired, which had a fair value of approximately $112,000. On closing, $5,708 of mortgage debt was repaid from advances from InnVest’s major mortgage lender. Total regular scheduled principal payments during the reporting period were $992.

Liquidity and Capital Resources

Liquidity is being generated from cash flow from hotel operations, bank operating lines available of $25,000 and by the Trust's ability to finance certain unencumbered or under-leveraged assets. Funds generated from operations before changes in working capital were $23,228 versus the $23,967 adjusted forecast.

During the reporting period, InnVest distributed $0.1119 per unit and declared a regular monthly distribution of $0.09375 for the month of September, 2002, which was paid in October, 2002. InnVest has available an unused $25,000 operating loan facility and four hotel properties which remain unencumbered which could generate approximately $6,300 in mortgage proceeds based on 50% loan to value. InnVest also has an unused acquisition facility of $40,000 available to acquire hotel properties and an unused loan facility of $24,000 to fund 50% of capital expenditures incurred.

Risks and Uncertainties

The hotel portfolio and the franchise business were, and the REIT similarly is, subject to the normal operating risks common to the hotel industry as described under "Risk Factors" in InnVest's Annual Information Form.

Outlook

InnVest's management expects that the lower revenue experienced in September will continue to affect operating results for the short term. However, the impact of lower operating revenue will continue to be offset by improved cost control and interest cost savings. Additionally, there are signs of a gradual recovery for the hospitality sector in the second half of 2002 and into 2003.

Although we continue to strive to meet our forecast earnings in a challenging economic environment, we remain confident that the shortfall in operating revenue will not affect our forecast distribution. Our cash resources and borrowing capacity are healthy, giving InnVest a significant competitive advantage as the economy recovers.

As at September 30, 2002 (Unaudited) (in thousands of dollars)

Assets

Current Assets		
Cash (Note 4)	$	43,542
Accounts receivable		10,239
Prepaid expenses and other assets		6,573
		60,354
Hotel properties (Note 5)		855,296
Licence contracts (Note 6)		26,078
Deferred financing costs, net of accumulated amortization of $281		7,032
	$	948,760

Liabilities

Current Liabilities		
Accounts payable and accrued liabilities	$	23,092
Acquisition related liabilities		7,307
Current portion of long-term debt (Note 8)		8,924
		39,323
Long-term debt (Note 8)		312,718
Future income taxes (Note 9)		122,168
		474,209
Commitments and contingencies (Note 10)		

Equity

Unitholders' equity (Note 11)		399,551
Convertible debentures (Note 11)		75,000
		474,551
	$	948,760

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF NET INCOME

For the period from July 26, 2002 to September 30, 2002 (Unaudited) (in thousands of dollars, except per unit amounts)

Hotel revenues	$	57,274
Hotel expenses		
Operating expenses		23,631
Property taxes, rent and insurance		4,081
Management fees		1,937
		29,649
Operating income		27,625
Other (income) and expenses		
Interest on mortgages		4,194
Corporate and administrative		472
Capital tax		366
Franchise business income		(786)
Other income		(50)
Depreciation and amortization		5,800
		9,996
Income before income tax expense		17,629
Income tax expense (recovery) (Note 9)		
Current		231
Future		(317)
		(86)
Net income	$	17,715
Net income per unit – basic (Note 12)	$	0.40
– diluted (Note 12)	$	0.37

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF UNITHOLDERS' EQUITY

For the period from July 26, 2002 to September 30, 2002 (Unaudited) (in thousands of dollars)

Issue of trust units, net of issue costs (Note 11)	$	277,055
Issue of trust units to purchase hotel properties (Note 11)		110,689
Executive compensation, fair value		30
Net income		17,715
Interest on convertible debentures		(1,342)
Unit distributions		(4,596)
Closing unitholders' equity	$	399,551

The accompanying notes are an integral part of these consolidated financial statements.

For the period from July 26, 2002 to September 30, 2002 (Unaudited) (in thousands of dollars)

Operating Activities		
Net income	$	17,715
Add (deduct) items not affecting funds from operations		
Depreciation and amortization		5,800
Future income tax recovery		(317)
Non-cash executive compensation		30
Funds from operations		23,228
Amortization of fair value debt adjustment		(248)
Changes in non-cash working capital		10,810
		33,790
Financing Activities		
Proceeds from long-term debt		211,000
Repayment of long-term debt		(223,885)
Issue of trust units, net of issue costs		277,055
Unit distributions		(4,596)
Interest on convertible debentures		(1,342)
Deferred financing costs		(7,313)
		250,919
Investing Activities		
Capital expenditures on hotel properties		(361)
Asset acquisitions (Note 3)		(248,113)
Changes in non-cash working capital related to investing activities		7,307
Restricted cash		(11,930)
		(253,097)
Increase in cash during the period		31,612
Cash, beginning of period		–
Cash, end of period	$	31,612
Supplemental disclosure of cash flow information:		
Cash paid for interest	$	3,112
Cash paid for income taxes	$	665

The accompanying notes are an integral part of these consolidated financial statements.

As at September 30, 2002 (Unaudited) (all dollar amounts are in thousands, except per unit amounts)

1. Basis of Presentation

InnVest Real Estate Investment Trust (the "REIT") is an unincorporated open-ended real estate investment trust governed by the laws of Ontario. The REIT was established pursuant to a Declaration of Trust dated January 1, 2002. On July 25, 2002, the REIT raised $300,000 on the Toronto Stock Exchange. The proceeds in conjunction with debentures and the issuance of additional units were utilized to acquire a portfolio of 114 Canadian hotels with 11,602 guest rooms operated under international brands (see Note 3). The Consolidated Statements represent operations measured from the acquisition date, July 26, 2002 to September 30, 2002.

Revenues earned from hotel operations fluctuate throughout the year, with the third quarter being the highest, due to the increased level of leisure travel in the summer months, and the first quarter being the lowest, as leisure travel is lower.

2. Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the REIT and its subsidiaries and the proportionate share of the assets, liabilities, revenues and expenses of joint ventures, including the REIT's 50% interest in Choice Hotels Canada Inc ("CHC").

Use of Estimates

The preparation of the REIT's financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the reporting period. As is the case with real estate, estimates have been made to determine the recoverability of accounts receivable and properties and investments. Actual results could differ from those estimates.

Hotel Properties

Hotel properties consisting of land, buildings and furniture and equipment are stated at the lower of cost, net of accumulated depreciation and the net recoverable amount.

Depreciation

Depreciation is provided on a straight-line basis over a period not to exceed the following:

Buildings	– 40 years
Building renovations	– 7 years
Furniture and equipment	– 7 years
Paving	– 10 years

Inventories

Materials and supply inventories are valued at the lower of cost and net realizable value.

Deferred Financing Costs

Deferred financing costs consist of commitment fees, underwriting costs and legal costs associated with the sourcing of new debt and the renewal of existing debt of the REIT. These costs are amortized over the term of the applicable debt.

Licence Contracts

Licence contracts are recorded at the value attributed to the discounted cash flow of the expected earning stream under the contract terms at the time of acquisition. These costs are amortized over the average life or expected renewal life of the contracts, which is estimated to be twenty years.

Revenue Recognition

Revenues from hotel operations are recognized when services are provided and ultimate collection is reasonably assured.

Monthly revenues from licence contracts are based on gross room revenue as reported by the franchisees and are recorded when earned with an appropriate provision for estimated uncollectible amounts. Initial franchise fees are recorded as income when the cash has been received and upon execution of binding contracts.

Income Taxes

Pursuant to the terms of the Declaration of Trust, the trustees of the REIT are required to make distributions or designate all taxable income earned, including the taxable part of net realized capital gains, by the REIT to unitholders and to deduct such distributions and designations for income tax purposes. Therefore, no provision for income taxes is required on income earned by the REIT.

The REIT's corporate subsidiaries are subject to tax on their taxable income. Income taxes are accounted for using the liability method, whereby future income tax assets and liabilities are determined based on differences between the carrying amount of the balance sheet items and their corresponding tax values. Future income taxes are computed using substantively enacted corporate income tax rates for the years in which tax and accounting basis differences are expected to reverse.

Future income tax liabilities of the REIT result primarily from income tax and accounting basis differences in corporate subsidiaries of the REIT.

Convertible Debentures

Convertible debentures of $75,000 are recorded as equity as the REIT has the ability to satisfy the obligation through the issue of units. Interest on the debentures is charged against unitholders' equity (see Note 11).

Executive Compensation Plan

The senior executives participate in an incentive plan that involves the issue of REIT units. The benefits of this plan are recorded on a straight-line basis over the vesting period. The measurement of the benefit is recorded as of the date of grant and each distribution date (see Note 11).

3. Asset Acquisitions

On July 25, 2002, the REIT issued 30,000,000 units on the Toronto Stock Exchange at $10 per unit. The proceeds of $300,000 in conjunction with the issuance of $75,000 convertible debentures and 11,068,910 units at a price of $10 per unit for gross proceeds of $110,689 were utilized to acquire a portfolio of 114 Canadian hotels. As consideration for the purchase of the hotel portfolio, the REIT paid cash, issued units, assumed certain existing mortgages relating to the hotels and issued convertible debentures.

The net assets acquired are as follows:

Cash	$	19,356
Current assets		19,115
Hotel properties		860,212
Licence contracts		26,320
		925,003
Future income tax liability		(122,485)
Assumption of existing long-term debt		(334,775)
Current liabilities		(14,585)
	$	453,158

The net consideration paid consists of the following:

Units	$	110,689
Payment of land transfer tax and other acquisition costs		6,700
Convertible debentures		75,000
Cash		260,769
	$	453,158

The REIT is continuing to evaluate the net assets acquired, and based on this ongoing evaluation, the purchase price allocation may be adjusted in future periods.

4. Cash

Cash	$	31,612
Restricted cash		11,930
	$	43,542

Substantially all the restricted cash is being held by various mortgage lenders of the REIT, and is available to undertake capital refurbishments. The REIT maintains a line of credit of $25,000 which currently has not been utilized.

5. Hotel Properties

The consolidated financial statements include the proportionate share of joint ventures (Note 7).

		Cost		Accumulated Depreciation		Net Book Value
Land	$	58,798	$	–	$	58,798
Buildings		751,961		3,461		748,500
Furniture and equipment		49,814		1,816		47,998
	$	860,573	$	5,277	$	855,296

6. Licence Contracts

Licence contracts consist of a 50% interest in CHC and various other licence contracts.

		Cost		Accumulated Amortization		Net Book Value
Licence contracts	$	26,320	$	242	$	26,078

7. Joint Ventures

The following represents the proportionate share of the REIT's interest in joint ventures:

Assets	$	6,641
Liabilities		3,744
Revenues		1,455
Expenses		703

8. Long-term Debt

Mortgages payable	$	321,642
Less: current portion		(8,924)
Total long-term debt	$	312,718

Substantially all of the REIT's assets have been pledged as security under various debt agreements. At September 30, 2002, long-term debt has a weighted average interest rate of 7.6%. The long-term debt is repayable in blended monthly payments of principal and interest totalling $2,610 per month, and matures at various dates from May 1, 2003 to October 1, 2018.

Scheduled repayment of long-term debt is as follows:

2003	$	8,924
2004		6,685
2005		5,224
2006		141,493
2007		7,408
2008 and thereafter		151,908
	$	321,642

The estimated fair value of the REIT's long-term debt at September 30, 2002 was approximately $321,250. This estimate was determined by discounting expected cash flows at the interest rates currently being offered to the REIT for debt of the same remaining maturities.

Long-term debt includes $5,708 which is subject to floating interest rates. Interest expense will increase by $57 for every 1% increase in the base Bankers' Acceptance rate. The REIT has a mortgage loan facility with its major mortgage lender to repay other mortgage debts as they mature.

9. Future Income Taxes

The future income tax liability at September 30, 2002 of $122,168 relates to temporary differences arising from the differences in net book value and tax basis of the subsidiaries' capital costs.

The provision for income taxes is summarized as follows:

Income before income tax expense	$	17,629
Income tax based on a basic and weighted average rate of 38.34%		6,759
Tax effect of income attributable to unitholders		(7,076)
Future income tax recovery		(317)
Large corporation tax		231
Income tax recovery	$	(86)

The balance of future income tax liabilities arises from the following:

Financing costs and other assets	$	(2,006)
Licence contracts		4,108
Property investments with a cost basis for accounting purposes greater than the cost basis for tax purposes, due to accelerated tax depreciation methods and business combinations recognized using the purchase method of accounting		120,066
	$	122,168

10. Commitments and Contingencies

Lease commitments

The REIT is committed under various operating leases to minimum annual rental payments as follows for each of the next five years:

2003	$	390
2004		305
2005		243
2006		206
2007		155
	$	1,299

Total minimum lease payments for the remaining term of the operating leases aggregate to approximately $1,299. In addition, the REIT is committed under long-term land leases to minimum annual lease payments of approximately $1,296. The land leases expire between 2023 and 2088. Rentals that are determined as a percentage of revenues with no minimum amounts are excluded from these figures.

11. Unitholders' Equity

The REIT was established pursuant to a Declaration of Trust dated January 1, 2002 when one unit was issued for ten dollars. The REIT is authorized to issue an unlimited number of units, each of which represents equal undivided beneficial interest in any distributions from the REIT. All units are of the same class with equal rights and privileges.

On July 18, 2002 the REIT entered into an underwriting agreement whereby the REIT raised gross proceeds of $300,000 pursuant to an initial public offering (the "Offering") through the issuance of 30,000,000 units at a price of $10 per unit (exceeding any over-allotment option). The offering closed on July 25, 2002 ("the closing date"). Costs relating to the Offering, including underwriters' fees, are $22,945 and are charged directly to unitholders' equity. At the closing date, the REIT also issued an additional 11,068,910 units at a price of $10 per unit. The REIT units issued and convertible debentures were utilized to acquire a portfolio of 114 Canadian hotels.

	# of Units		Amount
Units issued from the Offering, net of issue costs	30,000,000	$	277,055
Units issued to purchase hotel properties (Note 3)	11,068,910		110,689
Units issued to Trustees of the REIT	7,000		–
Executive units accrued	3,029		30
Executive unit distributions – reinvested	554		–
Total units at September 30, 2002	41,079,493	$	387,774

Executive Compensation Plan

The senior executives participate in the executive compensation plan under which units are granted by the Board of Trustees from time to time. The REIT has reserved a maximum of 1,000,000 units for issuance under the plan. A unit granted through the plan entitles the holder to receive on the vesting date the then current fair market value of the unit plus the value of the cash distributions that would have been paid on the unit if it had been issued on the date of grant assuming the reinvestment of the distribution into REIT units. The payment will be satisfied through the issuance of units.

On July 17, 2002, the Board of Trustees approved the granting of 49,500 units to the senior executives for services rendered. The units granted on July 17, 2002 vest equally over a three year period on each annual anniversary date of grant.

The following table summarizes the status of the executive compensation plan at September 30, 2002:

Date of Grant	Compensation Period	Executive	Units Accumulated Units Declared	Total on Distribution
July 17, 2002	July 17, 2002	49,500	554	50,054

Convertible Debentures

The convertible debentures bear interest at the rate of 9.75% per annum payable semi-annually in arrears and mature on June 30, 2007. Each $1,000 principal amount of convertible debentures is convertible at the option of the holder into 93.0233 units (representing a conversion price of $10.75 per unit). The convertible debentures are redeemable, in whole or from time to time in part, on and after July 1, 2005 at the option of the REIT, provided that the volume-weighted average trading price of the units for a stipulated period prior to the date on which the notice of redemption is given exceeds 115% of the conversion price. The REIT has the option to satisfy its obligation to pay the principal amount of the convertible debentures due at maturity or upon redemption, in whole or in part by issuing the number of units equal to the principal amount of convertible debentures then outstanding divided by 95% of the volume-weighted average trading price of the units for a stipulated period prior to the date of redemption or maturity, as applicable.

The convertible debenture balance has been recorded as equity as the REIT has the ability to satisfy its obligations (principal and interest) under the terms of such instrument through the issue of units.

12. Per Unit Information

Net income per unit calculations are based on the following:

			Weighted Average Units
Net income	$	17,715	41,075,910
Interest on convertible debentures		(1,342)	–
Net income – basic		16,373	41,075,910
Interest on convertible debentures		1,342	6,976,744
Dilutive effect of executive compensation plan		–	50,054
Net income – diluted	$	17,715	48,102,708

Distributable income per unit calculations are based on the following:

			Weighted Average Units
Distributable income – basic	$	19,347	41,075,910
Interest on convertible debentures		1,342	6,976,744
Dilutive effect of executive compensation plan		–	50,054
Distributable income – diluted	$	20,689	48,102,708

Funds from operations per unit calculations are based on the following:

			Weighted Average Units
Funds from operations	$	23,228	41,075,910
Interest on convertible debentures		(1,342)	–
Funds from operations – basic		21,886	41,075,910
Interest on convertible debentures		1,342	6,976,744
Dilutive effect of executive compensation plan		–	50,054
Funds from operations – diluted	$	23,228	48,102,708
Funds from operations per unit – basic	$	0.53	
– diluted	$	0.48	

13. Distributable Income

Net income	$	17,715
Add (deduct)		
Depreciation and amortization		5,800
Amortization of fair value debt adjustment		(248)
Future income tax recovery		(317)
Reserve for capital expenditures and replacement of furniture, fixtures, and equipment		(2,291)
Non-cash executive compensation		30
Interest on convertible debentures		(1,342)
		1,632
Distributable income	$	19,347
Distributable income per unit – basic	$	0.47
– diluted	$	0.43

Distributable income is a measure of cash flow that is not required under Canadian generally accepted accounting principles, and, accordingly, may not be comparable to similar measures used by other organizations. Distributable income per unit has been calculated on a basis consistent with that prescribed by Canadian generally accepted accounting principals for calculating earnings per share.

14. Financial Instruments

Fair Value

The REIT's financial instruments include cash, accounts receivable, accounts payable and accrued liabilities, and long-term debt. The carrying values of cash, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to the short term nature of these financial assets and liabilities.

The fair value of long-term debt is based on quoted market values for the debentures and on management estimates for mortgages. The management estimates are based on discounting cash flows required under the mortgages at the interest rate currently estimated to be available for loans with similar terms. Based on these estimates, the fair value of the REIT's long-term debt as at September 30, 2002 is less than its carrying value by approximately $392.

Interest Rate Risk

The majority of the REIT's long-term debt bears interest at fixed rates and there are no maturities of long-term debt until May 1, 2003. Accordingly, the REIT is not currently subject to any material interest rate risk.

Credit Risk

Due to the nature of the hotel business, the REIT is not exposed to any significant credit risk.

15. Management Agreements

The REIT has entered into a Management Agreement for hotel management and accounting services and an Administrative Services Agreement ("the Management Agreements") with Westmont Hospitality Management Canada Limited ("Westmont"). Westmont is controlled by a minority unitholder of the REIT. The Management Agreements will expire on July 25, 2012. During the period ended September 30, 2002, the fees charged to the REIT pursuant to the Management Agreements were $2,347. Additional salaries of REIT employees not covered by the Management Agreements, in the amount of $77, were paid by Westmont and reimbursed by the REIT. Included in accounts payable and accrued liabilities are amounts outstanding at September 30, 2002 totalling $1,023.

Westmont provides project management and general contractor services for construction and renovation projects for certain of the REIT's properties. Fees and expenses of approximately $6 were incurred during the period and have been capitalized with the improvements.

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