
# 2005 First Quarter Report to Unitholders

for the three months ended
March 31, 2005

## LETTER TO UNITHOLDERS

The first three months of the calendar year typically generate lower than average operating levels given the seasonal nature of the Canadian hotel industry. This along with lower than normal occupany levels, due to the combined effect of spring break and Easter in March rather than April, gave rise to a distributable loss in the quarter. This impact was mostly felt in Ontario, and was partially offset by improvements in other provinces. The REIT continues to benefit from owning a diverse portfolio of hotels.

On March 31, 2005, the REIT finalized the acquisition of the Oakville Holiday Inn Select and Conference and Banquet Centre for $28.5 million plus transaction costs. The hotel features a restaurant, lounge, meeting facilities and an indoor swimming pool. It is expected that the acquisition will provide stable accretive cash flow and provide long-term benefits to unitholders through value appreciation and further diversification.

During the first quarter, the REIT identified three hotels that do not support the long-term objectives of the REIT. As a result, the REIT has listed these properties for sale. This decision prompted a $1.5 million writedown for accounting purposes but this writedown has no impact on our distributable income as the writedown is a non-cash item. We anticipate finalizing the sale of these three properties within the year and upon redeploying the net cash proceeds, these transactions will be accretive to earnings and cash flow.

For the quarter, InnVest's revenue per available room ("RevPAR") improved by 10.2% as RevPAR increased from $40.86 last year to $45.02 this year. This was primarily due to an improvement in average daily rate as it went from $77.13 last year to $84.59 this year, an increase of 9.7%. This is mainly due to the nature of the hotels we acquired in 2004 which typically have higher rates than our original portfolio of hotels.

Continuing with the strategy of investing in the hotels, approximately $5.3 million for capital asset improvements was deployed during the first quarter.

## FINANCIAL REVIEW

Room revenues for the three months ended March 31, 2005 were $51.8 million, 24.1% higher than the $41.7 million generated for the same period in 2004. The improvement of $10.1 million in room revenue in the first quarter primarily reflects the hotels acquired in 2004, which provided $9.8 million in additional room revenue.

Hotel expenses for 2004 increased by $13.9 million or 40.8% compared to 2004, excluding the results of the assets held for sale. This primarily reflects $12.2 million in expenses incurred in the hotels acquired in 2004.

Distributable loss for the three months ended March 31, 2005 was $355 or $0.008 per unit - basic (diluted – $0.008). This reflects a $1.1 million decrease over the distributable income achieved for the same period in the prior year of $779 or $0.019 per unit - basic (diluted - $0.019).

At March 31, 2005, InnVest's cash totaled $12.4 million all of which is restricted for replacement of furniture, fixtures and equipment and capital improvements. Financial leverage is 38.3% debt to gross asset value (defined as total assets before accumulated depreciation less future income tax liability) excluding convertible debentures and 51.7% including convertible debentures.

## OUTLOOK

All regions experienced room rate improvements in the quarter over the prior year, and we expect this trend to continue, given the expected low level of new supply entering the Canadian hotel market this year. This, coupled with expectations of higher hotel room demand, should lead to improved operating results in future quarters. Hotel industry advisors, PKF Consulting, are forecasting a RevPAR improvement of approximately 4% in 2005 on a national basis. InnVest management agrees that the overall Canadian hotel industry will improve in 2005 and remains optimistic that its hotels will benefit from these trends. The REIT expects that its distributable income per unit will be greater than that achieved in 2004.

The hotels acquired in 2004 continue to contribute positively to the results of the REIT, as they have proven to be accretive to unitholders since their acquisition in the second and third quarters of 2004. Also, we expect the recent acquisition of the Oakville Holiday Inn Select to be a positive contributor to the REIT's portfolio. We are continuing to see more Canadian hotel listings and remain optimistic that there will be more acquisition opportunities for InnVest in 2005.

Kenneth Gibson
President and Chief Executive Officer
May 5, 2005

## INTRODUCTION

The following is a discussion of the results of operations and financial condition of InnVest Real Estate Investment Trust ("InnVest" or the "REIT") for the three months ended March 31, 2005, with a comparison to the results of operations of InnVest for the three months ended March 31, 2004.

The following management's discussion and analysis ("MD&A") is dated May 5, 2005 and should be read in conjunction with the audited consolidated financial statements of the REIT and the notes thereto as at and for the year ended December 31, 2004.

The financial statements of InnVest are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are presented in Canadian dollars. Monetary data in tabular form and in the text, unless otherwise indicated, are in thousands of dollars, except for per unit, Average Daily Rate ("ADR"), and Revenue per Available Room ("RevPAR") amounts.

Additional information relating to the REIT, including the REIT's annual information form, can be found at www.sedar.com.

## OVERVIEW OF INNVEST REIT

InnVest holds Canada's largest hotel portfolio with 125 hotels and over 13,000 rooms located in every province of Canada. It also owns a 50% interest in Choice Hotels Canada Inc. ("Choice Canada"), the largest franchisor of hotels in Canada. The hotel portfolio consists of limited service and mid-scale with food and beverage hotel properties operated under several internationally recognized franchise brands such as Comfort Inn, Quality Suites, Quality Hotels, Holiday Inn and Travelodge.



## CANADIAN HOTEL MARKET

### OVERVIEW AND KEY PERFORMANCE DRIVERS

The overview and key performance drivers of the Canadian hotel market remain substantially unchanged from the description provided in the MD&A for the year ended December 31, 2004.

### RECENT INDUSTRY PERFORMANCE

Industry fundamentals declined marginally in the first quarter of 2005 relative to the first quarter of 2004. According to PKF Consulting, advisors to the hotel industry, the Canadian hotel industry experienced a 1.4% decline in occupancy and a 1.1% improvement in ADR. This led to an overall RevPAR decline of 0.3%. Central Canada experienced a decline of 1.4% in RevPAR, and within the province of Ontario, the market was down 0.8% on a RevPAR basis, with the Ottawa and Windsor markets sustaining a 5.6% and 17.3% decline respectively. Atlantic Canada experienced a 5.0% decline in RevPAR, while Western Canada had a 1.7% RevPAR improvement.

## PROFILE OF INNVEST

InnVest owns 125 internationally branded limited service and mid-scale with food and beverage hotels located in every province of Canada (the "hotel portfolio"). The hotel portfolio includes 99 hotels flagged with Choice brands (Comfort Inn®, Quality Inn®, Quality Hotel® and Quality Suites®), 13 Travelodge® hotels, 11 Holiday Inn® hotels, one Best Western® hotel and one independent hotel. The chart below summarizes InnVest's brand distribution at March 31, 2005.

## HOTEL OWNERSHIP

| Brands | No. of Hotels | As at March 31, 2005<br>No. of Guest Rooms | % of Guest Rooms |
|---|---|---|---|
| Comfort Inn | 84 | 6,747 | 50.1% |
| Travelodge | 13 | 2,118 | 15.8% |
| Holiday Inn | 11 | 1,902 | 14.2% |
| Quality Hotel | 7 | 1,201 | 9.0% |
| Quality Suites/Inn | 8 | 1,096 | 8.2% |
| Best Western | 1 | 130 | 1.0% |
| Independent | 1 | 222 | 1.7% |
| | 125 | 13,416 | 100.0% |

A considerable amount of each brand's business is generated through the franchise company's central reservation system. For the quarter ended March 31, 2005, the central reservation system for the REIT's Choice branded hotels generated 20.3% of the business of Comfort Inns and 26.0% of the business of Quality Hotels and Suites/Inns.

Geographically, the REIT's guest rooms are concentrated in Ontario and Quebec, which together represent over 73% of guest rooms as of March 31, 2005. The majority of Canada's population and business activity is located in Ontario and Quebec, with the balance of properties in population centres in the Atlantic and Western provinces. A summary of the geographic distribution by brand as at March 31, 2005 is as follows:

Brand distribution by geographic region

| | Ontario | | | Quebec | | | Atlantic | | | Western | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | No. of Hotels | No. of Guest Rooms | % of Total Guest Rooms | No. of Hotels | No. of Guest Rooms | % of Total Guest Rooms | No. of Hotels | No. of Guest Rooms | % of Total Guest Rooms | No. of Hotels | No. of Guest Rooms | % of Total Guest Rooms |
| Comfort Inn | 37 | 3,093 | 23.0% | 22 | 1,754 | 13.1% | 16 | 1,155 | 8.6% | 9 | 745 | 5.5% |
| Travelodge | 8 | 1,041 | 7.8% | – | – | – | – | – | – | 5 | 1,077 | 8.0% |
| Holiday Inn | 9 | 1,554 | 11.6% | – | – | – | 1 | 196 | 1.5% | 1 | 152 | 1.1% |
| Quality Hotel | 3 | 617 | 4.6% | 2 | 298 | 2.2% | 1 | 160 | 1.2% | 1 | 126 | 0.9% |
| Quality Suites/Inn | 4 | 604 | 4.5% | 4 | 492 | 3.7% | – | – | – | – | – | – |
| Best Western | 1 | 130 | 1.0% | – | – | – | – | – | – | – | – | – |
| Independent | 1 | 222 | 1.7% | – | – | – | – | – | – | – | – | – |
| | 63 | 7,261 | 54.2% | 28 | 2,544 | 19.0% | 18 | 1,511 | 11.3% | 16 | 2,100 | 15.5% |

The REIT's hotels are typically located near major thoroughfares in urban and suburban areas as well as demand generators such as business centres, government and manufacturing facilities, universities, airports and tourist attractions. The hotels have a diverse customer base, including business travelers, leisure travelers, groups, organizations and corporate clients.

Based on customer research, Choice Canada has developed a re-imaging program which is being implemented throughout 2005 for the Comfort Inn brand. The program includes a fresh exterior sign and logo, upgraded bathroom amenities such as curved shower rods and pulsating shower heads, high speed internet access and free continental breakfast. The re-imaging program along with the enhanced customer loyalty programs with the inclusion of Aeroplan® instituted in 2004 will help the REIT's Comfort Inns maintain their competitive advantage and market share premium.

### FRANCHISE BUSINESS, COMPETITIVE STRENGTHS AND DECLARATION OF TRUST

The REIT's Franchise Business, Competitive Strengths and Declaration of Trust remain substantially unchanged from the description provided in the MD&A for the year ended December 31, 2004.

## STRATEGY AND OBJECTIVES

### OBJECTIVES AND OPERATING STRATEGY

The REIT's objectives and operating strategy remain substantially unchanged from the description provided in the MD&A for the year ended December 31, 2004.

### ACQUISITION STRATEGY AND 2005 ACTIVITY

InnVest continues to execute on its strategy of increasing cash flow and enhancing the long-term value of the REIT through selective acquisitions that are expected to be accretive to earnings and cash flow.

On March 31, 2005, the REIT finalized the acquisition of the Oakville Holiday Inn Select and Conference and Banquet Centre for $28.5 million plus transaction costs. The 144-room hotel features a restaurant, lounge, meeting facilities and an indoor swimming pool. It is expected that the acquisition will provide stable accretive cash flow, and provide long-term benefits to unitholders through value appreciation and further diversification. The property is in Oakville, Ontario, where previously, the REIT did not own any hotels. Further, the acquisition increases the number of Holiday Inn® branded hotels from 10 to 11 in the portfolio, and this, along with its participation in the mid-scale with food and beverage segment, should lead to increased diversification by customer segment.

### DIVESTITURE STRATEGY AND 2005 ACTIVITY

InnVest monitors the operating performance of its assets on an ongoing basis. From time to time, certain assets may be identified that may not support certain primary objectives of the REIT. Such assets may provide unstable or decreasing net operating income levels, which in turn affects the REIT's ability to maintain stable and growing cash distributions to its unitholders. Also, the retention of certain assets may be inconsistent with the REIT's objective of maximizing its long-term asset value. Such a condition may exist where it is believed that further capital investment in certain assets will not provide increases in net operating income sufficient to aid in maintaining or growing cash distribution levels. In addition, certain assets may not contribute to the proposition of long-term value appreciation given both its current and future characteristics and business environment. Overall, when assets are identified that do not support certain primary objectives of the REIT, the REIT will conduct an analysis to decide if the divestiture of such assets is in the best interest of unitholders. Such an analysis will take into consideration the implications for distributable income and overall diversification, market conditions and numerous other factors.

During the first quarter, the REIT identified three hotels that it believes do not support certain primary objectives of the REIT. These three hotel assets are hereafter referred to as "assets held for sale."

Effective March 31, 2005, the REIT has reclassified the three assets held for sale as prescribed by CICA Handbook Section 3475, Disposal of Long-Lived Assets and Discontinued Operations. The recommendations of this section require that disposals of long-lived assets be classified as held for sale, and the results of operations and cash flows associated with the assets disposed and held for sale be reported separately as discontinued operations. Accordingly, the REIT has written down the book value of these hotels by $1.5 million, and no further amortization and depreciation, will be recorded from April 1, 2005 until the date of their final sale by the REIT. The three assets held for sale were acquired by the REIT as part of the original portfolio of 114 hotels. Therefore, when analyzing the operating results of the REIT, any reference to the "original portfolio" will relate to the remaining 111 hotels, as the assets held for sale will no longer constitute part of continuing operations.

## FIRST QUARTER HIGHLIGHTS AND RECENT DEVELOPMENTS

- RevPAR growth in the first quarter for the original portfolio of 111 hotels was 1.6%;
- Distributable loss was $355 in the first quarter, a decrease of $1.1 million from the previous year due primarily to the combined effect of spring break and an earlier than normal Easter, particularly in the province of Ontario, partially offset by improvements in operating results in other regions. Distributable loss per unit on a diluted basis was $0.008 down from distributable income per unit of $0.019 in the first quarter of 2004;
- On March 31, 2005, the REIT acquired the 144-room Oakville Holiday Inn Select and Conference and Banquet Centre for $28.5 million plus transaction costs;
- $5.3 million was invested in the REIT's hotels and was funded from its restricted cash reserves. This represents an increase of $3.9 million over the same quarter in the prior year. Cash reserves for future capital expenditures are $12.4 million at March 31, 2005.

## FINANCIAL PERFORMANCE REVIEW

In reviewing the performance of InnVest, a comparison of the results of operations for the three months ended March 31, 2005 is being made to the results of operations for the comparable period in 2004. Operating results on a quarterly basis are unaudited.

### FINANCIAL HIGHLIGHTS SUMMARY

| Three months ended March 31 | | **2005** | | 2004 |
|---|---|---|---|---|
| Hotel revenues | **$** | **59,964** | $ | 45,168 |
| Hotel expenses | | **47,745** | | 33,895 |
| Hotel operating income | | **12,219** | | 11,273 |
| Net loss before discontinued operations | **$** | **(6,830)** | $ | (4,756) |
| Net loss before discontinued operations per unit | | | | |
| – basic | **$** | **(0.149)** | $ | (0.115) |
| – diluted | **$** | **(0.149)** | $ | (0.115) |
| Net loss from discontinued operations | **$** | **(1,786)** | $ | (92) |
| Net loss from discontinued operations per unit | | | | |
| – basic | **$** | **(0.039)** | $ | (0.002) |
| – diluted | **$** | **(0.039)** | $ | (0.002) |
| Net loss | **$** | **(8,616)** | $ | (4,848) |
| Add / (deduct) | | | | |
| Depreciation and amortization(1) | | **9,499** | | 7,853 |
| Future income tax recovery | | **(1,142)** | | (626) |
| Non-cash executive and trustee compensation | | **90** | | 72 |
| Writedown of assets held for sale | | **1,471** | | – |
| Funds from operations(2) | **$** | **1,302** | $ | 2,451 |
| Amortization of fair value debt adjustment | | **–** | | (342) |
| Amortization of deferred financing and other assets | | **520** | | 375 |
| Reserve for replacement of furniture, fixtures and equipment and capital improvements ("FF&E Reserve") | | **(2,439)** | | (1,860) |
| Convertible debentures accretion | | **262** | | 155 |
| Distributable (loss) income(2) | **$** | **(355)** | $ | 779 |
| Distributable (loss) income per unit(3) | | | | |
| – basic | **$** | **(0.008)** | $ | 0.019 |
| – diluted | **$** | **(0.008)** | $ | 0.019 |
| Distributions(4) | **$** | **12,918** | $ | 11,619 |
| Distributions – per unit(4) | **$** | **0.2813** | $ | 0.2813 |

(1) For purposes of the calculation of funds from operations, amortization of deferred financing and other assets is excluded from depreciation and amortization.

(2) Funds from operations and distributable (loss) income are measures of earnings and cash flow commonly used by industry analysts that are not required under Canadian generally accepted accounting principles, and accordingly, may not be comparable to similar measures used by other organizations.

(3) Distributable (loss) income per unit amounts have been calculated on a basis consistent with that prescribed by Canadian generally accepted accounting principles for calculating earnings per unit.

(4) Distributions and distributions per unit include cash distributions and distributions arising from the Distribution Reinvestment Plan.

## KEY PERFORMANCE MEASURES

The key measures that indicate the performance of the hotel industry and the relative strength of participants in the industry are occupancy, average daily rates ("ADR"), revenue per available room ("RevPAR"), gross operating profit ("GOP"), hotel operating income ("HOI") and funds from operations ("FFO") or distributable income ("DI").

The key performance measures for the REIT's entire portfolio of hotels, excluding the hotels that have been reclassified as assets held for sale, but including the hotels acquired in 2004 (the "acquired hotels") by geographic region in Canada for the three months ended March 31, 2005 and 2004 are as follows:

| Three months ended March 31 | 2005 | 2004(1) | Var % |
|---|---|---|---|
| **Occupancy** | | | |
| Ontario | **53.5%** | 55.7% | (4.0%) |
| Quebec | **55.1%** | 55.6% | (0.9%) |
| Atlantic | **53.8%** | 52.7% | 2.1% |
| Western | **49.3%** | 48.6% | 1.4% |
| Total | **53.2%** | 54.3% | (2.0%) |
| **ADR** | | | |
| Ontario | **$ 91.04** | $ 88.49 | 2.9% |
| Quebec | **$ 84.16** | $ 79.61 | 5.7% |
| Atlantic | **$ 75.12** | $ 72.31 | 3.9% |
| Western | **$ 68.58** | $ 66.89 | 2.5% |
| Total | **$ 84.59** | $ 81.91 | 3.3% |
| **RevPAR** | | | |
| Ontario | **$ 48.70** | $ 49.32 | (1.3%) |
| Quebec | **$ 46.39** | $ 44.28 | 4.8% |
| Atlantic | **$ 40.41** | $ 38.13 | 6.0% |
| Western | **$ 33.84** | $ 32.53 | 4.0% |
| Total | **$ 45.02** | $ 44.47 | 1.2% |

(1) The 10 acquired hotels were not owned by the REIT during the three months ended March 31, 2004, however they are included in the comparable results shown above.

The original portfolio's room revenue for the three months ended March 31, 2005 was $41.9 million, $218 or 0.5% higher than the $41.7 million generated in the same period in 2004. This increase was achieved through an increase in rate of 4.1%, offset by a decline in occupancy of 2.4% due primarily to the combined occurrence of spring break and an earlier than normal Easter, which disrupted normalized business and leisure travel patterns. Geographically, all regions experienced higher room revenue relative to the prior year, with the exception of the Ontario region which partially offset these improvements. In the REIT's Quebec and Atlantic regions, the improvement in room revenue is primarily attributable to successfully increasing room rates by 5.7% and 4.9% respectively. The improvement in the Western region is due both to improvements in occupancy and room rate of 3.2% and 3.6% respectively. The REIT's Ontario region experienced a decline in occupancy, primarily due to occupancy declines in the REIT's Windsor, London, and Ottawa hotels, but this was partially offset by room rate improvement of 3.8%, which led to a RevPAR decline of 1.8%.

## OPERATING RESULTS REVIEW – QUARTER ENDED MARCH 31, 2005

### REGIONAL OPERATING RESULTS COMPARISON

The following chart shows the regional operating results for the original portfolio of hotels by region along with the acquired hotels for the three months ended March 31, 2005 and 2004:

| | Ontario | | Quebec | | Atlantic | | Western | | Acquired hotels(1) | | Total(2) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 |
| Occupancy | **51.5%** | 54.4% | **55.1%** | 55.6% | **53.0%** | 52.3% | **49.1%** | 47.6% | **60.2%** | 59.8% | **53.2%** | 54.3% |
| ADR | **$ 84.70** | $ 81.56 | **$ 84.16** | $ 79.61 | **$ 73.38** | $ 69.96 | **$ 67.59** | $ 65.26 | **$ 105.61** | $ 106.67 | **$ 84.59** | $ 81.91 |
| RevPAR | **$ 43.59** | $ 44.40 | **$ 46.39** | $ 44.28 | **$ 38.93** | $ 36.56 | **$ 33.18** | $ 31.05 | **$ 63.56** | $ 63.81 | **$ 45.02** | $ 44.47 |
| Room revenues | **$ 21,775** | $ 22,424 | **$ 10,621** | $ 10,250 | **$ 4,607** | $ 4,375 | **$ 4,900** | $ 4,636 | $ 9,847 | $ 9,994 | **$ 51,750** | $ 51,679 |
| Total hotel revenues | **$ 24,460** | $ 24,552 | **$ 11,221** | $ 11,005 | **$ 4,787** | $ 4,583 | **$ 5,292** | $ 5,028 | **$ 14,204** | $ 14,402 | **$ 59,964** | $ 59,570 |
| Hotel operating expenses and management fees | **$ 15,656** | $ 14,629 | **$ 7,151** | $ 6,928 | **$ 3,113** | $ 2,901 | **$ 3,521** | $ 3,466 | **$ 11,029** | $ 10,918 | **$ 40,470** | $ 38,842 |
| Gross operating profit | **$ 8,804** | $ 9,923 | **$ 4,070** | $ 4,077 | **$ 1,674** | $ 1,682 | **$ 1,771** | $ 1,562 | **$ 3,175** | $ 3,484 | **$ 19,494** | $ 20,728 |
| GOP margin | **36.0%** | 40.4% | **36.3%** | 37.0% | **35.0%** | 36.7% | **33.5%** | 31.1% | **22.4%** | 24.2% | **32.5%** | 34.8% |
| Property taxes, rent and insurance | **$ 3,653** | $ 3,584 | **$ 1,339** | $ 1,276 | **$ 518** | $ 516 | **$ 605** | $ 595 | **$ 1,160** | $ 1,232 | **$ 7,275** | $ 7,203 |
| Hotel operating income | **$ 5,151** | $ 6,339 | **$ 2,731** | $ 2,801 | **$ 1,156** | $ 1,166 | **$ 1,166** | $ 967 | **$ 2,015** | $ 2,252 | **$ 12,219** | $ 13,525 |
| HOI margin | **21.1%** | 25.8% | **24.3%** | 25.5% | **24.1%** | 25.4% | **22.0%** | 19.2% | **14.2%** | 15.6% | **20.4%** | 22.7% |

(1) The REIT did not own the acquired hotels for the three months ended March 31, 2004.
(2) Total amounts include the results of the acquired hotels in the comparative period as reflected in note (1), therefore the total amounts shown for 2004 will differ from previously reported results.

In the prior year, the HOI margin for the original hotel portfolio was 25.0% or 2.7 points higher than the 22.3% generated in the quarter ended March 31, 2005. This margin compression was the cumulative result of the following factors. Increased expenses related to enhanced customer loyalty programs and extended free continental breakfast programs at numerous hotels and the nature of the acquired hotels relative to the original portfolio, as explained further in the departmental operating profit analysis below resulted in lower HOI margin. These factors also led to a total HOI margin decrease, as it went from 22.7% to 20.4%.

### HOTEL REVENUES

Hotel revenues consist primarily of revenue generated from room occupancy. Non-room revenue includes 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. Departmental expenses are those expenses which are directly related to generating both room revenue and non-room revenue.

## ROOM REVENUES

A geographical comparison of the room revenues variance between the three months ended March 31, 2005 and 2004, excluding the assets held for sale, are as follows:

| | Hotels | Rooms | As a % of total | Room revenue variance | As a % of total | Var % over 2004 |
|---|---|---|---|---|---|---|
| **Original Portfolio** | | | | | | |
| Greater Toronto Area ("GTA") | 9 | 1,533 | 12.0% | $ (104) | (1.0%) | (1.6%) |
| Ontario other | 44 | 4,017 | 31.5% | (545) | (5.4%) | (3.5%) |
| Total Ontario | 53 | 5,550 | 43.5% | (649) | (6.4%) | (2.9%) |
| Quebec | 28 | 2,544 | 19.9% | 371 | 3.7% | 3.6% |
| Atlantic | 17 | 1,315 | 10.3% | 232 | 2.3% | 5.3% |
| Western | 13 | 1,641 | 12.8% | 264 | 2.6% | 5.7% |
| Sub-total | 111 | 11,050 | 86.5% | 218 | 2.2% | 0.5% |
| **Acquired Hotels** | 10 | 1,721 | 13.5% | 9,847 | 97.8% | 100.0% |
| Total | 121 | 12,771 | 100.0% | $ 10,065 | 100.0% | 24.1% |

## OVERALL HOTEL PORTFOLIO

The improvement of $10.1 million in room revenues in the quarter primarily reflects the $9.8 million increase in revenues from the acquired hotels. The remaining $218 improvement stems from increases in room revenue in the REIT's Quebec, Atlantic and Western regions, the aggregate of which was partially offset by a decline in the REIT's Ontario region.

## ACQUIRED HOTELS

The REIT's acquired hotels contributed $9.8 million or 97.8% of the increase in room revenues.

## ONTARIO

InnVest's original portfolio of Ontario hotels experienced a $649 or 2.9% decline in room revenues relative to the prior year. This was primarily attributable to results in the REIT's non-GTA ("Greater Toronto Area") hotels, which experienced a 3.5% decrease from the prior year, primarily due to occupancy declines in the REIT's Windsor, London, and Ottawa hotels.

## QUEBEC

InnVest's portfolio of hotels in Quebec generated a room revenue increase of $371 or 3.6%. While the REIT's Montreal and Quebec city hotels improved modestly, the majority of this improvement was a result of improvements in the REIT's rural Quebec hotels, due to a significant improvement in ADR.

## ATLANTIC

InnVest's original portfolio of Atlantic region hotels experienced a $232 or 5.3% growth over 2004, with room rate increases accounting for the majority of this improvement.

## WESTERN

InnVest's original portfolio of Western hotels experienced an increase of $264 or 5.7% over the prior year. This increase was attributable to occupancy improvements in the REIT's Edmonton, Winnipeg and Swift Current hotels. The Swift Current Comfort Inn has benefited from crew business that will extend throughout 2005.

#### NON-ROOM REVENUES

Non-room revenues for the quarter ended March 31, 2005 account for 13.7% (March 31, 2004 – 7.7%) of total hotel revenues. The mix of room revenues and non-room revenues has changed because the acquired hotels compete in the mid-scale with food and beverage sector and earn a higher proportion of total revenues from non-room revenues.

Non-room revenues increased by $4.7 million, reflecting primarily the non-room revenues generated by the REIT's acquired hotels.

#### DEPARTMENTAL OPERATING PROFIT ANALYSIS

The following chart illustrates the REIT's room and non-room operating profit, excluding the assets held for sale, for the three months ended March 31, 2005 and 2004:

| | Room operations | | Non-room operations | | Total | |
|---|---|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 |
| **Revenues** | | | | | | |
| Original Portfolio | **$ 41,903** | $ 41,685 | **$ 3,857** | $ 3,483 | **$ 45,760** | $ 45,168 |
| Acquired hotels | **9,847** | – | **4,357** | – | **14,204** | – |
| Total | **51,750** | 41,685 | **8,214** | 3,483 | **59,964** | 45,168 |
| **Direct expenses** | | | | | | |
| Original Portfolio | **11,346** | 10,750 | **2,744** | 2,492 | **14,090** | 13,242 |
| Acquired hotels | **2,704** | – | **3,372** | – | **6,076** | – |
| Total | **14,050** | 10,750 | **6,116** | 2,492 | **20,166** | 13,242 |
| **Departmental operating profit** | | | | | | |
| Original Portfolio | **30,557** | 30,935 | **1,113** | 991 | **31,670** | 31,926 |
| Acquired hotels | **7,143** | – | **985** | – | **8,128** | – |
| Total | **37,700** | 30,935 | **2,098** | 991 | **39,798** | 31,926 |
| **Total undistributed expenses** | | | | | **(20,304)** | (14,681) |
| **Gross operating profit** | | | | | **19,494** | 17,245 |
| **Gross operating profit margin** | | | | | **32.5%** | 38.2% |
| **Departmental operating profit margin** | | | | | | |
| Original Portfolio | **72.9%** | 74.2% | **28.8%** | 28.5% | **69.2%** | 70.7% |
| Acquired hotels | **72.5%** | – | **22.6%** | – | **57.2%** | – |
| Total | **72.9%** | 74.2% | **25.5%** | 28.5% | **66.4%** | 70.7% |

Overall departmental operating profit margin decreased 4.3 points. This is due to a 1.3 point decline in room operating profit margin and a 3.0 point decline in non-room operating profit margin.

Rooms operating profit margin on the original portfolio declined slightly by 1.3 points, primarily attributable to increases in expenses partially offset by higher room rates. The increases in expenses related to marketing costs associated with an enhanced customer loyalty program and free continental breakfast programs added to a number of hotels. The rooms operating profit margin of the acquired hotels of 72.5% was consistent with the original portfolio's margin of 72.9%. For the REIT's portfolio, the rooms operating profit margin declined by 1.3 points during the quarter, but the absolute gross operating profit was higher by $2.2 million.

Non-room operating profit margin decreased by 3.0 points from the prior year. This,is primarily due to a lower non-room operating profit margin in the acquired hotels relative to the original portfolio, because they derive a larger percentage of their revenues in food and beverage operations which typically have lower margins than room operations.

#### HOTEL EXPENSES

Hotel expenses for 2005 increased by $13.9 million or 40.9% compared to 2004, excluding the results of the assets held for sale. This primarily reflects $12.3 million in expenses incurred in the acquired hotels. The remaining $1.6 million that relates to the original portfolio represents a 4.9% increase over 2004. In the original portfolio, room expenses increased $596 primarily as a result of the free continental breakfast programs added in a number of hotels. Non-room direct expenses in the original portfolio increased $252 primarily due to increased food and beverage operations due to the addition of a new restaurant in one of the REIT's Sudbury properties. Marketing expense increased $523 or 19.8% in the REIT's original portfolio as a result of enhanced guest loyalty programs. Increases in property taxes of $122 or 2.3% also contributed to the increase in hotel expenses in the original portfolio.

#### HOTEL OPERATING INCOME

HOI for the three months ended March 31, 2005 improved by $946 going to $12.2 million from $11.3 million in 2004. This was a result of higher hotel revenues of $14.8 million along with an overall increase in hotel expenses of $13.9 million, with both being mainly attributable to the acquired hotels.

A geographical comparison of the HOI variance between the three months ended March 31, 2005 and 2004 is as follows:

| | Hotels | Rooms | As a % of total | | HOI variance | As a % of total | Var % over 2004 |
|---|---|---|---|---|---|---|---|
| **Original Portfolio** | | | | | | | |
| Greater Toronto Area ("GTA") | 9 | 1,533 | 12.0% | $ | (309) | (32.7%) | (21.4%) |
| Ontario other | 44 | 4,017 | 31.5% | | (879) | (92.9%) | (18.0%) |
| Total Ontario | 53 | 5,550 | 43.5% | | (1,188) | (125.6%) | (18.7%) |
| Quebec | 28 | 2,544 | 19.9% | | (70) | (7.4%) | (2.5%) |
| Atlantic | 17 | 1,315 | 10.3% | | (10) | (1.1%) | (0.9%) |
| Western | 13 | 1,641 | 12.8% | | 199 | 21.1% | 20.6% |
| Sub-total | 111 | 11,050 | 86.5% | | (1,069) | (113.0%) | (9.5%) |
| **Acquired Hotels** | 10 | 1,721 | 13.5% | | 2,015 | 213.0% | 100.0% |
| Total | 121 | 12,771 | 100.0% | $ | 946 | 100.0% | 8.4% |

The increase of $2.0 million in HOI arising from the acquired hotels was partially offset by an HOI decline in the REIT's original portfolio of $1.1 million. The majority of the HOI decline in the REIT's original portfolio was experienced in the REIT's Ontario hotels, primarily as a result of declines in room operating profit and increased marketing costs. This decline in room operating profit was primarily attributable to decreases in room revenues. The remainder of the original portfolio experienced similar cost pressures, but were not as adversely affected given their improvement in room operating profit, driven by increases in room revenues.

#### 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 three months ended March 31, 2005 was $19.9 million, $3.6 million or 21.9% more than the same period in 2004. The main contributors to this change were a $1.8 million increase in depreciation and amortization, a $1.1 million increase in interest on mortgages, and a $931 increase in convertible debentures interest and accretion, all three mainly related to the acquired hotels.

#### INCOME TAXES

Current income tax expense for three months ended March 31, 2005 was $262, a decrease of $43 over 2004. Further, InnVest experienced a $516 increase in the future income tax recovery over the prior year. Future income tax expense is recorded as a result of temporary differences between the measurement of income for tax and accounting purposes for the REIT's corporate subsidiaries. The largest temporary difference is the result of differences between depreciation for accounting purposes and the amount claimed as capital cost allowance for income tax purposes. Temporary differences are recorded at the substantively enacted corporate tax rates at which these differences are expected to reverse.

In 2004, the REIT reported that 46% of the distributions made during that year were not taxable to unitholders. For calendar 2005, the REIT estimates that over 40% of the distributions made to Unitholders will not be taxable to Unitholders.

### NET LOSS

InnVest's net loss in the three months ended March 31, 2005 was $8.6 million compared to $4.8 million in the prior year.

InnVest's net loss before discontinued operations was $6.8 million or $0.149 per unit – basic (diluted – $0.149), compared with net loss in the prior year of $4.8 million or $0.115 per unit – basic (diluted – $0.115). The increase of $2.0 million in net loss before discontinued operations is represented by a $946 improvement in HOI, offset by the $3.6 million increase in other expenses and the $559 decrease in tax expenses relating to continuing operations.

InnVest's net loss from discontinued operations, relating to the assets held for sale, was $1.8 million or $0.039 per unit – basic (diluted – $0.039), compared with a net loss from discontinued operations in the prior year of $92 or $0.002 per unit – basic (diluted – $0.002). The increase of $1.7 million in net loss from discontinued operations is attributable to the $1.5 million write down and a $223 increased loss from discontinued operations.

### FUNDS FROM OPERATIONS

Funds from operations ("FFO") is not a measure defined under GAAP, but is widely used by the real estate industry. The Real Property Association of Canada generally defines FFO as net income adjusted for extraordinary items, gains or losses on the sale of assets, or provisions for impairment against property values, capital items and depreciation and amortization relating to capital items. FFO should not be considered as a substitute for net income or funds from operating activities determined in accordance with GAAP as an indicator of performance. The REIT's method of calculating FFO may be different from that reported by other organizations. The REIT currently calculates FFO by using net income and adjusting it by adding:

i) Depreciation and amortization expense (excluding amortization of deferred financing and other assets expense);

ii) Or deducting, future income tax expense (recovery);

iii) Non-cash executive and trustee compensation expense.

FFO is a meaningful measure of operating performance for investors. It assumes that the value of real estate investments does not necessarily decrease on a systematic basis over time, which is an assumption inherent in GAAP, and it adjusts for items included in GAAP net income that do not necessarily provide the best indicator of operating performance (such as gains or losses on the sale of, and provisions for impairment against, hotel properties).

FFO for the three months ended March 31, 2005 was $1.3 million, $1.2 million lower than the $2.5 million achieved for the same period in 2004. The increased net loss is partially offset by the adding back of increased depreciation and amortization of $1.6 million.

### DISTRIBUTABLE INCOME

Distributable income is not a measure defined under GAAP, however it is commonly used in the real estate investment trust industry to measure performance.

Distributable income is intended to approximate cash earnings and is defined in the REIT's Declaration of Trust to mean, net income of the REIT and its consolidated subsidiaries as reported in its consolidated financial statements in accordance with GAAP adjusted by:

i) Adding depreciation and amortization, amortization of fair value debt adjustments and future income tax expenses;

ii) Excluding any gains or losses on the disposition of any real property and any future income tax benefits;

iii) Deducting the amount calculated for the reserve for replacement of furniture, fixtures and equipment and capital improvements ("FF&E reserves"); and

iv) Any other adjustment determined by a majority of the Trustees of the REIT in their discretion.

The calculation of distributable income and the amounts of each adjustment from net income are disclosed in the notes to the financial statements. Distributable income is one measure used by industry analysts in the determination of the Trust's per unit value, the ability of the Trust to fund distributions and investment returns for current or potential investors. As outlined in the Declaration of Trust, the REIT is required to distribute monthly to unitholders not less than one-twelfth of 80% of the distributable income of the Trust on an annualized basis based on estimated distributable income of the Trust for the calendar year. Distributable income is not only used by management and the Board of Trustees to determine the level of distributions to unitholders, it also serves as an important measure for investors in their evaluation of the performance of management.

In addition, when evaluating acquisition opportunities, the current level of distributable income and the expected distributable income to be generated through each acquisition are reviewed by management in determining whether a proposed acquisition will cause an increase in distributable income per unit. Therefore, distributable income is an important measure for management as a guideline by which operating and financial decisions are made and is an integral part of the investment decision for investors and potential investors.

Distributable loss for the three months ended March 31, 2005 was $355 or $0.008 per unit – basic (diluted – $0.008). This reflects a $1.1 million decrease over the distributable income achieved for the same period in the prior year of $779 or $0.019 per unit – basic (diluted – $0.019). This decrease is primarily due to the variance in net loss before depreciation and increases in convertible debentures interest and in the reserve for replacement of FF&E.

## CHANGES IN FINANCIAL CONDITION

The following discussion evaluates the cash flow results of InnVest from operating, investing and financing activities for the quarter ended March 31, 2005.

*Operating Activities*

Funds generated from operating activities decreased slightly by $262 to $6.5 million for the three months ended March 31, 2005 from $6.8 million in the same period of the prior year. The decrease is mainly attributable to higher hotel operating income being offset by increases in interest on mortgages and convertible debentures interest.

*Financing Activities*

Funds from financing activities generated $843 for the quarter compared to a $3.2 million deficit for the same period in 2004. The majority of this change relates to:

- A reduction in the net of advances and repayment of long-term debt of $6.3 million;
- An increase in cash distributions of $1.1 million; and
- A decrease in the amount drawn on the operating line of $1.6 million.

*Investing Activities*

Investing activities used cash of $29.9 million during the three months ended March 31, 2005 compared to $7.2 million in the same period of the prior year. This increase was mainly the result of the acquisition of the Oakville Holiday Inn Select which used cash of $29.2 million, less $5.8 million in costs associated with second quarter 2004 acquisition incurred in the first quarter of 2004. Capital expenditures in the period amounted to $5.3 or $3.9 million more than the first quarter of 2004. The balance of the increase is related to a decrease of $4.6 million in cash restricted for future furniture, fixtures and equipment and capital expenditures.

As part of the regular refurbishment program, InnVest sets aside 4% of revenue for the replacement of furniture, fixture and equipment and capital improvements ("FF&E reserve") shown as restricted cash in the financial statements. The FF&E reserve is managed over the longer term to maintain the hotel properties to ensure they remain competitive in their markets.

In the three months ended March 31, 2005 and 2004, InnVest spent $5.3 million and $1.4 million respectively on capital items. The REIT intends to complete a significant amount of its property refurbishments when demand for lodging is weaker. This allows management to displace a minimal amount of business from rooms out of service for refurbishment.

## LIQUIDITY AND CAPITAL RESOURCES

### LIQUIDITY

The following chart summarizes InnVest's future contractual obligations as at March 31, 2005:

| | Remainder of 2005 | 2006 | 2007 | 2008 | 2009 | 2010 and thereafter | Total |
|---|---|---|---|---|---|---|---|
| **As at March 31, 2005** | | | | | | | |
| Mortgages payable | $ 5,081 | $ 139,060 | $ 4,752 | $ 153,032 | $ 1,599 | $ 53,646 | $ 357,170 |
| Capital lease obligation | 70 | 87 | 93 | 100 | 113 | 1,692 | 2,155 |
| Operating equipment leases | 389 | 500 | 393 | 290 | 257 | 222 | 2,051 |
| Long-term land leases | 1,157 | 1,485 | 1,316 | 1,320 | 1,340 | 75,095 | 81,713 |
| Convertible debentures | – | – | 73,324 | – | – | 57,500 | 130,824 |
| | $ 6,697 | $ 141,132 | $ 79,878 | $ 154,742 | $ 3,309 | $ 188,155 | $ 573,913 |

The next material refinancing to occur will be in 2006 when $139.1 million of long-term debt with a weighted average interest rate of 6.9% matures. At that time, InnVest will seek refinancing of the debt. InnVest will follow the same strategy in 2008, when $153.0 million of long-term debt with a weighted average interest rate of 7.2% matures.

The long-term land leases require minimum annual average lease payments as outlined above and expire between the years 2023 and 2088. There are also future rental charges that are determined as a percentage of revenue that are not included in the amounts reflected above.

The following chart illustrates the REIT's generation of distributable income relative to cash distributions paid to unitholders.

| | **Three months ended March 31, 2005** | **Previous 12 months ended March 31, 2005** | Year ended December 31, 2004 | Year ended December 31, 2003 | Period ended(1) December 31, 2002 | **Cumulative since inception to March 31, 2005** |
|---|---|---|---|---|---|---|
| Distributable (loss) income | **$ (355)** | **$ 43,135** | $ 44,269 | $ 39,455 | $ 25,263 | **$ 108,632** |
| Distributions | **12,918** | **51,463** | 50,164 | 46,280 | 20,000 | **129,362** |
| Distributable income in excess (deficit) of distributions | **(13,273)** | **(8,328)** | (5,895) | (6,825) | 5,263 | **(20,730)** |
| Non-cash distributions made through the distribution reinvestment plan ("DRIP") | **848** | **3,345** | 3,168 | 1,367 | – | **5,383** |
| Distributable income in excess (deficit) of cash distributions | **$ (12,425)** | **$ (4,983)** | $ (2,727) | $ (5,458) | $ 5,263 | **$ (15,347)** |
| Payout ratios: | | | | | | |
| Total distributions | | **119.3%** | 113.3% | 117.3% | 79.2% | **119.1%** |
| Cash distributions (total distributions minus DRIP) | | **111.6%** | 106.2% | 113.8% | 79.2% | **114.1%** |

(1) For the period from July 26, 2002 to December 31, 2002.

The payout ratio of the REIT is best evaluated on an annualized basis over a 12-month period due to the seasonal nature of the hotel industry. The REIT's payout ratio was 119.3% for the twelve months ended March 31, 2005, or 111.6% on a cash basis. On a cumulative basis from the inception of the REIT on July 26, 2002, the payout ratio has been 119.1% or 114.1% on a cash basis. Liquidity to fund distributions is generated from cash flow from hotel operations, the 50% interest in Choice Canada, cash on hand, bank operating lines available and by the ability to finance certain unencumbered or under-leveraged assets. It is anticipated that the payout ratio for the year ending December 31, 2005 will show improvement over the percentage experienced in 2004.

Distributions to unitholders are approved by the REIT's Board of Trustees. In exercising their discretion to approve the level of distributions, the Trustees use internal forecasts prepared by management and other financial information to determine if sufficient cash flow will be available to fund distributions. Such financial information is subject to continual change due to the nature of the Canadian hotel industry, which is difficult to predict even in the short-term. This is due to the following factors:

1. Its exposure to the overall cyclical effects of the Canadian business environment;
2. The seasonal nature of the REIT's business;
3. The REIT's geographical diversity. InnVest's hotels are located in numerous regions throughout Canada each with its own unique characteristics;
4. Changing customer sentiment toward brands which the REIT's hotel properties use;
5. Changes in customer segmentation due to changing social, economic and political conditions; and
6. Numerous other macroeconomic, social and geopolitical factors which are beyond the control of the REIT.

All of these factors can have a material effect on the REIT's revenue and cost structure. An example is the significant impact of SARS on the Canadian hotel industry in 2003. As a result of the REIT's exposure to numerous factors which are beyond its control, it is difficult for management of the REIT to make predictions concerning distribution levels for future quarters and, as a result, management asserts that it would not be prudent to provide investors or potential investors with forward-looking information regarding distribution levels.

The REIT is structured to segregate the ownership and operations of the hotel properties. The bricks and mortar are owned directly by the REIT and underlying corporate subsidiaries. The operations of the hotels and ownership of the chattels are held through partnership subsidiaries. The inter-entity relationships between the operations and ownership structures are governed by leasing and inter-entity debt agreements, the terms of which are at commercial rates considered acceptable for income tax purposes. The structure allows for the efficient access to cash generated through the operations of the hotels, and flow through of income and tax deductions to the REIT's unitholders.

### CAPITAL RESOURCES

The REIT's cash position at March 31, 2005 was $12.4 million all of which is restricted under the REIT's trust indenture for the replacement of furniture, fixtures, and equipment and for capital improvements. The REIT used $29.2 million of a combination of cash and $8.3 million of its operating line to purchase the Holiday Inn Oakville on March 31, 2005.

InnVest sets aside 4% of total hotel revenue for the purpose of the replacement of furniture, fixtures and equipment and for capital improvements. Capital expenditures committed and yet to be incurred at March 31, 2005 were $4.1 million. The current expectation is that capital spending in 2005 will be in the range of $18 – $20 million.

The following chart shows the changes in the restricted cash balance for the three months ended March 31, 2005 along with the comparable period:

| Three months ended March 31 | | 2005 | | 2004 |
|---|---|---|---|---|
| Opening balance | $ | **17,024** | $ | 13,381 |
| 4% of revenues | | **2,439** | | 1,860 |
| Transferred to operating cash | | **(1,754)** | | (515) |
| Capital expenditures | | **(5,265)** | | (1,367) |
| Closing balance | $ | **12,444** | $ | 13,359 |

The REIT intends to replace the amount of restricted cash transferred to operating cash in the quarter through the financing of unencumbered hotels or from the available capacity on its operating line. InnVest is restricted from exceeding certain financial leverage amounts pursuant to the Declaration of Trust. The REIT is permitted to hold indebtedness (calculated in accordance with GAAP but excluding non-interest bearing indebtedness, trade accounts payable, and any future income tax liability), excluding convertible debentures, up to a level of 50% of gross book value (gross book value is the total book value of assets per the REIT's balance sheet, plus the amount of accumulated depreciation and amortization, less any future income tax liabilities). Further, the REIT is permitted to hold indebtedness and convertible debentures up to a level of 60% of gross asset value. As at March 31, 2005, the REIT's leverage excluding and including convertible debentures was 38.3% and 51.7% respectively.

The REIT also had unused operating loan availability of $16.7 million at March 31, 2005 and five hotel properties that remain unencumbered that the REIT estimates could generate at least $20 million in mortgage proceeds. The REIT also has an unused acquisition facility of $40 million available to acquire hotel properties and an unused loan facility of $24 million available to fund 50% of capital expenditures incurred.

During the three months ended March 31, 2005, the REIT distributed $12.9 million or $0.2813 per unit, of which $848 was distributed in units as part of the Distribution Reinvestment Plan ("DRIP") at the rate of $0.09375 per unit per month, with an additional 3% premium attached to the unit distribution. A regular monthly distribution of $0.09375 per unit for the month of March 2005 was paid in April 2005. A distribution at the same rate for April 2005 was declared and will be payable on May 16, 2005.

The REIT has a $100 million mortgage loan facility with its main mortgage lender which is available to repay mortgage debts as they mature. Mortgage debts with a weighted average interest rate of 7.9% maturing through to the end of 2005 total $38.4 million. The remaining availability of this facility is $39.1 million. Consequently, the REIT has minimal refinancing risk until 2006.

InnVest expects to make cash distributions to its unitholders, based on cash flow to be generated from operations after non-cash distributions satisfied through the distribution reinvestment plan ("DRIP"), and its borrowing capacity. Future growth is expected to be funded from borrowing capacity and through the issuance of trust units.

## ISSUED TRUST UNITS

As at March 31, 2005 a total of 45,996,591 units of the REIT were outstanding. There is only one class of trust units, with each unit eligible for one vote. For the quarter ended March 31, 2005 and subsequent, units of the REIT were issued as follows:

| | Units | Amount |
|---|---|---|
| **Balance at December 31, 2004** | 45,815,071 | $ 438,657 |
| Units issued under DRIP | 72,359 | 848 |
| Units issued under trustee compensation plan | 2,561 | 46 |
| Units issued upon conversion of debentures | 106,600 | 1,146 |
| **Balance at March 31, 2005** | 45,996,591 | $ 440,697 |
| Activity subsequent to March 31, 2005 | | |
| Units issued under DRIP | 24,460 | 279 |
| Units issued under trustee compensation plan | 2,716 | 30 |
| **Balance at May 5, 2005** | 46,023,767 | $ 441,006 |

There are a total of $73.3 million in outstanding convertible unsecured subordinated debentures at March 31, 2005 from the initial series of debentures ("9.75% Debentures") issued July 26, 2002. These debentures are convertible into trust units at a strike price of $10.75, bear interest at 9.75% per annum payable semi-annually in arrears on June 30 and December 30 in each year and are due June 30, 2007. The total remaining trust units to be issued upon conversion of the 9.75% Debentures is 6,820,837.

On and after July 1, 2005, the 9.75% Debentures will be redeemable at the option of the REIT, in whole or in part from time to time, at a redemption price equal to the principal amount thereof plus accrued and unpaid interest, provided that the volume-weighted average trading price of the Units on the TSX for the 20 consecutive trading days ending five trading days prior to the date on which the notice of redemption is given exceeds 115% of the conversion price.

Provided that there is not a then current event of default, the REIT will have the option to satisfy its obligation to pay all or a portion of the principal amount of the 9.75% Debentures due at maturity or upon redemption by issuing that number of Units equal to the aggregate principal amount of the 9.75% Debentures maturing or to be redeemed divided by 95% of the volume-weighted average trading price of the Units on the TSX for the 20 consecutive trading days ending five trading days prior to the date of redemption or maturity, as applicable.

On April 2, 2004 the REIT issued $57.5 million of convertible unsecured subordinated debentures ("6.25% Debentures"). These debentures are convertible into trust units at a strike price of $12.50, bear interest at 6.25% per annum payable semi-annually on April 15 and October 15 of each year and are due April 15, 2011. The total trust units to be issued upon conversion of the 6.25% Debentures are 4,600,000.

## RISKS AND UNCERTAINTIES

The REIT's risks and uncertainties remain substantially unchanged from the description provided in the MD&A for the year ended December 31, 2004.

## ACCOUNTING POLICIES

### RELATED PARTY TRANSACTIONS

*Franchise Business*

The REIT's related party transactions between itself and its franchise business remain substantially unchanged from the description provided in the MD&A for the year ended December 31, 2004. Royalty payments paid to Choice Canada by the REIT on a net basis for the three months ended March 31, 2005 totaled $131.

*Management Company*

The REIT's related party transactions between itself and its hotel manager remain substantially unchanged from the description provided in the MD&A for the year ended December 31, 2004. Total management fees paid to the hotel manager for the three months ended March 31, 2005 were $2.1 million. No management incentive fees were paid in the three months ended March 31, 2005.

### HEDGING TRANSACTIONS

The REIT's hedging transactions remain substantially unchanged from the description provided in the MD&A for the year ended December 31, 2004.

*Critical Accounting Estimates*

The REIT's critical accounting estimates remain substantially unchanged from the description provided in the MD&A for the year ended December 31, 2004.

### CHANGE IN ACCOUNTING POLICY

*Liabilities and equity presentation*

Effective January 1, 2005, InnVest adopted new guidance as set out by the CICA as it pertains to financial instruments. This new standard requires certain financial instruments that may be settled in cash or by an issuer's own equity instrument, at the issuer's discretion, by a variable number of the issuer's own equity instruments to be presented as liabilities. The adoption of this new standard has resulted in the liability component of the REIT's convertible debentures being reclassified from equity to liabilities and interest on the convertible debentures being deducted in the calculation of net income or loss. The new standard did not have any effect on net income or loss per unit as the interest expense on the convertible debentures was deducted from earnings for the purpose of the per unit calculations.

## OUTLOOK

The first three months of the calendar year typically generate lower than average operating levels given the seasonal nature of the Canadian hotel industry. This along with lower than normal occupancy levels, due to the combined effect of spring break and Easter in March rather than April, gave rise to a distributable loss in the quarter. However, the declines in the REIT's Ontario region were partially offset by improvements in other provinces. As a result, the REIT continues to benefit from owning a diverse portfolio of hotels where declines in certain operational sectors are offset by improvements in others.

All regions experienced room rate improvements in the quarter over the prior year, and we expect this trend to continue, given the expected low level of new supply entering the Canadian hotel market this year. This, coupled with expectations of higher hotel room demand, should lead to improved operating results in future quarters. Hotel industry advisors, PKF Consulting, are forecasting a RevPAR improvement of approximately 4% in 2005 on a national basis. InnVest management agrees that the overall Canadian hotel industry will improve in 2005 and remains optimistic that its hotels will benefit from these trends. With these trends, the REIT expects that its distributable income per unit will be greater than that achieved in 2004.

The acquired hotels continue to contribute positively to the results of the REIT, as they have proven to be accretive to unitholders since their acquisition in the second and third quarters of 2004. Also, we expect the recent acquisition of the Oakville Holiday Inn Select to make a positive contribution to the REIT's portfolio. We are continuing to see more Canadian hotel listings and remain optimistic that there will be more acquisition opportunities for InnVest in 2005.

### FORWARD–LOOKING INFORMATION

The preceding management's discussion and analysis contains forward looking or outlook information with respect to InnVest. Because forward-looking information addresses future events and conditions, it involves risk and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking information. These risks and uncertainties are discussed earlier in management's discussion and analysis, as well as the REIT's annual information form.

InnVest disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required to do so by applicable securities laws.

| (in thousands of dollars) (unaudited) | **March 31, 2005** | December 31, 2004 |
|---|---|---|
| | | Restated (Notes 2 and 14) |
| **ASSETS** | | |
| Current Assets | | |
| Cash | **$ –** | $ 22,637 |
| Accounts receivable | **8,568** | 9,314 |
| Prepaid expenses and other assets | **7,606** | 6,248 |
| Current assets held for sale *(Note 14)* | **214** | 238 |
| | **16,388** | 38,437 |
| Restricted cash | **12,444** | 17,024 |
| Hotel properties *(Note 4)* | **949,800** | 924,454 |
| Licence contracts (accumulated amortization $3,532 – December 31, 2004 – $3,203) | **22,788** | 23,117 |
| Deferred financing and other assets *(Note 5)* | **7,053** | 7,359 |
| Long-term assets held for sale *(Note 14)* | **9,529** | 11,073 |
| | **$ 1,018,002** | $ 1,021,464 |
| **LIABILITIES** | | |
| Current Liabilities | | |
| Bank indebtedness *(Note 6)* | **$ 8,300** | $ – |
| Accounts payable and accrued liabilities | **29,014** | 24,138 |
| Distributions payable | **4,312** | 4,295 |
| Current portion of long-term debt *(Note 7)* | **7,154** | 6,949 |
| Current liabilites held for sale *(Note 14)* | **406** | 314 |
| | **49,186** | 35,696 |
| Long-term debt *(Note 7)* | **352,171** | 347,638 |
| Convertible debentures *(Note 8)* | **126,980** | 127,821 |
| Future income tax liability | **134,973** | 136,115 |
| Long-term liabilities held for sale *(Note 14)* | **5,532** | 5,556 |
| | **668,842** | 652,826 |
| **UNITHOLDERS' EQUITY** | **349,160** | 368,638 |
| | **$ 1,018,002** | $ 1,021,464 |

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

| (in thousands of dollars, except per unit amounts) (unaudited) | **Three Months Ended March 31, 2005** | Three Months Ended March 31, 2004 |
|---|---|---|
| | | Restated (Notes 2 and 14) |
| Hotel revenues | **$ 59,964** | $ 45,168 |
| Hotel expenses | | |
| Operating expenses *(Note 12)* | **38,446** | 26,399 |
| Property taxes, rent and insurance | **7,275** | 5,971 |
| Management fees *(Note 12)* | **2,024** | 1,525 |
| | **47,745** | 33,895 |
| Hotel operating income | **12,219** | 11,273 |
| Other (income) and expenses | | |
| Interest on mortgages | **6,343** | 5,233 |
| Convertible debentures interest and accretion | **2,911** | 1,980 |
| Corporate and administrative *(Note 12)* | **934** | 924 |
| Capital tax | **441** | 490 |
| Franchise business income | **(428)** | (308) |
| Other income | **(120)** | (29) |
| Depreciation and amortization | **9,848** | 8,060 |
| | **19,929** | 16,350 |
| Loss before income tax expense (recovery) | **(7,710)** | (5,077) |
| Income tax expense (recovery) | | |
| Current | **262** | 305 |
| Future | **(1,142)** | (626) |
| | **(880)** | (321) |
| Net loss before discontinued operations | **(6,830)** | (4,756) |
| Write down of assets held for sale *(Note 14)* | **(1,471)** | – |
| Loss from discontinued operations *(Note 14)* | **(315)** | (92) |
| | **(1,786)** | (92) |
| Net loss | **$ (8,616)** | $ (4,848) |
| Net loss before discontinued operations, per unit *(Note 10)* | | |
| Basic and diluted | **$ (0.149)** | $ (0.115) |
| Net loss from discontinued operations, per unit *(Note 10)* | | |
| Basic and diluted | **$ (0.039)** | $ (0.002) |

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

| (in thousands of dollars) (unaudited) | Units in $ | Net Income | Distributions | Executive Compen-sation | Holders' Conversion Option | Total |
|---|---|---|---|---|---|---|
| Balance December 31, 2003 *(Restated, Note 2)* | $ 389,310 | $ 20,138 | $ (66,280) | $ 72 | $ 2,850 | $ 346,090 |
| CHANGES DURING THE PERIOD | | | | | | |
| Net loss | – | (4,848) | – | – | – | (4,848) |
| Unit distributions | – | – | (11,619) | – | – | (11,619) |
| Distribution reinvestment plan units issued *(Note 9)* | 671 | – | – | – | – | 671 |
| Conversion of debentures | 505 | – | – | – | (20) | 485 |
| Executive and trustee compensation *(Note 9)* | 53 | – | – | 42 | – | 95 |
| Balance March 31, 2004 *(Restated, Note 2)* | $ 390,539 | $ 15,290 | $ (77,899) | $ 114 | $ 2,830 | $ 330,874 |
| Balance December 31, 2004 *(Restated, Note 2)* | **$ 438,657** | **$ 40,494** | **$(116,444)** | **$ 226** | **$ 5,705** | **$ 368,638** |
| CHANGES DURING THE PERIOD | | | | | | |
| Net loss | **–** | **(8,616)** | **–** | **–** | **–** | **(8,616)** |
| Unit distributions | **–** | **–** | **(12,918)** | **–** | **–** | **(12,918)** |
| Distribution reinvestment plan units issued *(Note 9)* | **848** | **–** | **–** | **–** | **–** | **848** |
| Conversion of debentures | **1,146** | **–** | **–** | **–** | **(44)** | **1,102** |
| Executive and trustee compensation *(Note 9)* | **46** | **–** | **–** | **60** | **–** | **106** |
| **Balance March 31, 2005** | **$ 440,697** | **$ 31,878** | **$(129,362)** | **$ 286** | **$ 5,661** | **$ 349,160** |

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

| (in thousands of dollars) (unaudited) | **Three Months Ended March 31, 2005** | Three Months Ended March 31, 2004 |
|---|---|---|
| | | Restated (Notes 2 and 14) |
| **OPERATING ACTIVITIES** | | |
| Net loss from continuing operations | **$ (6,830)** | $ (4,756) |
| Add (deduct) items not affecting operations | | |
| Depreciation and amortization | **9,328** | 7,689 |
| Amortization of deferred financing and other assets | **520** | 375 |
| Future income tax recovery | **(1,142)** | (626) |
| Non-cash executive and trustee compensation | **106** | 72 |
| Convertible debentures accretion | **262** | 155 |
| Amortization of fair value debt adjustment | **–** | (342) |
| Changes in non-cash working capital | **4,281** | 4,220 |
| | **6,525** | 6,787 |
| **FINANCING ACTIVITIES** | | |
| Repayment of long-term debt | **(1,964)** | (7,654) |
| Proceeds from long-term debt | **6,702** | 6,100 |
| Unit distributions | **(12,053)** | (10,941) |
| Increase in bank indebtedness | **8,300** | 9,927 |
| Changes in non-cash working capital related to financing activities | **(17)** | (289) |
| Deferred financing | **(125)** | (307) |
| | **843** | (3,164) |
| **INVESTING ACTIVITIES** | | |
| Capital expenditures on hotel properties | **(5,265)** | (1,367) |
| Acquisition of hotel properties and related costs *(Note 3)* | **(29,194)** | (5,826) |
| Changes in restricted cash | **4,580** | 22 |
| | **(29,879)** | (7,171) |
| Decrease in cash from continuing operations during the period | **(22,511)** | (3,548) |
| Decrease in cash from discontinued operations *(Note 14)* | **(126)** | (109) |
| Cash, beginning of period | **22,637** | 3,958 |
| Cash, end of period | **$ –** | $ 301 |

| | | |
|---|---|---|
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | **$ 6,382** | $ 5,826 |
| Cash paid for income taxes (including capital tax) | **$ 725** | $ 651 |

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

March 31, 2005 (all dollar amounts are in thousands, except unit and per unit amounts) (unaudited)

## 1. BASIS OF PRESENTATION

InnVest Real Estate Investment Trust ("InnVest" or the "REIT") is an unincorporated open-ended real estate investment trust governed by the laws of Ontario. The REIT began operations on July 26, 2002. As at March 31, 2005 the REIT owns 125 Canadian hotels with 13,416 guest rooms operated under international brands and has a 50% interest in Choice Hotels Canada Inc. ("CHC").

The accompanying unaudited interim consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The accounting principles used in these financial statements are consistent with those used in the annual consolidated financial statements, except for the change in accounting policy described in Note 2. These financial statements do not include all the information and disclosure required by GAAP for annual financial statements, and should be read in conjunction with the annual consolidated financial statements.

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 tends to be lower at that time of the year.

## 2. CHANGE IN ACCOUNTING POLICY

### LIABILITIES AND EQUITY PRESENTATION

Effective for periods beginning on or after November 1, 2004, the CICA has issued new guidance with respect to accounting for financial instruments. This new standard requires certain financial instruments that may be settled in cash or by an issuer's own equity instrument, at the issuer's discretion, by a variable number of the issuer's own equity instruments to be presented as liabilities. The REIT has adopted this new standard as of January 1, 2005 and therefore the liability component of the REIT's convertible debentures has been reclassified from equity to liabilities and the interest on the debentures is now deducted in the calculation of net loss. The REIT has accounted for the change retroactively with a restatement of the comparative period. This new standard did not have any effect on net loss per unit.

## 3. ASSET ACQUISITIONS

On March 31, 2005, the REIT purchased the Holiday Inn Select Oakville.

The net assets acquired are as follows:

| | | |
|---|---|---|
| Cash | $ | 4 |
| Current assets | | 91 |
| Hotel properties | | 29,194 |
| | | 29,289 |
| Current liabilities | | (95) |
| | $ | 29,194 |
| The consideration paid consists of the following: | | |
| Cash | $ | 29,194 |

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

## 4. HOTEL PROPERTIES

| | Cost | Accumulated Depreciation | March 31, 2005 Net Book Value | December 31, 2004 Net Book Value |
|---|---|---|---|---|
| | | | | Restated (Note 14) |
| Land | **$ 80,526** | **$ –** | **$ 80,526** | $ 72,091 |
| Buildings | **875,175** | **53,490** | **821,685** | 805,883 |
| Furniture, fixtures and equipment | **77,247** | **29,658** | **47,589** | 46,480 |
| | **$ 1,032,948** | **$ 83,148** | **$ 949,800** | $ 924,454 |

## 5. DEFERRED FINANCING AND OTHER ASSETS

| | Cost | Accumulated Amortization | March 31, 2005 Net Book Value | December 31, 2004 Net Book Value |
|---|---|---|---|---|
| | | | | Restated (Note 14) |
| Deferred financing | **$ 10,648** | **$ 4,373** | **$ 6,275** | $ 6,725 |
| Other assets | **854** | **76** | **778** | 634 |
| | **$ 11,502** | **$ 4,449** | **$ 7,053** | $ 7,359 |

## 6. BANK INDEBTEDNESS

The REIT has a $25 million operating loan facility that bears interest at Canadian bank prime plus 0,5%, is secured by nine hotel properties and is payable on demand. As at March 31, 2005, the REIT had drawn $8,300 on this facility.

## 7. LONG-TERM DEBT

| | March 31, 2005 | Dec. 31, 2004 |
|---|---|---|
| Mortgages payable | **$ 357,170** | $ 352,439 |
| Deferred land lease obligation | **161** | 154 |
| Capital lease obligation | **1,994** | 1,994 |
| | **$ 359,325** | $ 354,587 |
| Less current portion | **7,154** | 6,949 |
| Total long-term debt | **$ 352,171** | $ 347,638 |

Substantially all of the REIT's assets have been pledged as security under various debt agreements. At March 31, 2005, long-term debt had a weighted average interest rate of 7.1% (December 31, 2004 – 7.2%). The long-term debt is repayable in average monthly payments of principal and interest totalling $2,780 (December 31, 2004 – $2,730) per month, and matures at various dates from July 1, 2005 to October 1, 2017.

The deferred land lease obligation is the difference between the long-term land lease expense using the straight-line method and actual lease payments made.

Scheduled repayment of long-term debt is as follows:

| | |
|---|---|
| 2005 (remainder of the year) | $ 5,151 |
| 2006 | 139,147 |
| 2007 | 4,845 |
| 2008 | 153,132 |
| 2009 | 1,712 |
| 2010 and thereafter | 55,338 |
| | $ 359,325 |

The current portion of long-term debt on the balance sheet is based on the year ended March 31, 2006, whereas the repayment schedule above reflects the fiscal year.

The estimated fair value of the REIT's long-term debt at March 31, 2005 was approximately $365,817 (December 31, 2004 – $362,277). 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 $59,733 (December 31, 2004 – $53,401) of mortgages payable, which are subject to floating interest rates. Interest expense will increase by $597 for every 1% increase in the base Bankers' Acceptance rate.

The REIT has a $100,000 mortgage loan facility with its main mortgage lender of which $39,098 is available to refinance mortgage debts held by its various other lenders, as they mature.

## 8. CONVERTIBLE DEBENTURES





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

| | Issue Date | Maturity Date | Interest Rate | Original Face Amount | Converted to Trust Units | Face Amount Outstanding | Holder Conversion Options | Accretion | **March 31, 2005** | December 31, 2004 |
|---|---|---|---|---|---|---|---|---|---|---|
| Initial Debentures(a) | July 26, 2002 | June 30, 2007 | 9.75% | $ 75,000 | $ 1,676 | $ 73,324 | $ 2,850 | $ 1,470 | **$ 71,944** | $ 72,888 |
| Series A Debentures (b) | April 2, 2004 | April 15, 2011 | 6.25% | 57,500 | – | 57,500 | 2,875 | 411 | **55,036** | 54,933 |
| | | | | $ 132,500 | $ 1,676 | $ 130,824 | $ 5,725 | $ 1,881 | **$ 126,980** | $ 127,821 |

## 9. UNITHOLDERS' EQUITY

The REIT is authorized to issue an unlimited number of units, each of which represents an equal undivided beneficial interest in any distributions from the REIT. All units are of the same class with equal rights and privileges.

| | Units | Amount |
|---|---|---|
| Balance at December 31, 2003 | 41,247,862 | $ 389,310 |
| Units issued under distribution reinvestment plan | 60,484 | 671 |
| Units issued on conversion of debentures | 46,511 | 505 |
| Units issued under trustee compensation plan | 4,678 | 53 |
| Balance at March 31, 2004 | 41,359,535 | $ 390,539 |
| Balance at December 31, 2004 | **45,815,071** | **$ 438,657** |
| Units issued under distribution reinvestment plan | **72,359** | **848** |
| Units issued on conversion of debentures | **106,600** | **1,146** |
| Units issued under trustee compensation plan | **2,561** | **46** |
| Balance at March 31, 2005 | **45,996,591** | **$ 440,697** |

### TRUSTEE COMPENSATION PLAN

The members of the Board of Trustees receive 50% of their annual retainer in units (based on the then current market price of the units). The REIT has set aside 100,000 units in reserve for this purpose. During the three months ended March 31, 2005, 2,561 units were issued (March 31, 2004 – 4,678 units) under the Trustee Compensation Plan.

### 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.

The following table summarizes the status of the executive compensation plan at March 31, 2005:

| | Unvested Executive units | Units Accumulated from Distributions | Total Units |
|---|---|---|---|
| July 18, 2002 – granted | 49,500 | 11,529 | 61,029 |
| January 1, 2003 – granted | 17,846 | 4,949 | 22,795 |
| January 1, 2004 – granted | 10,218 | 1,362 | 11,580 |
| January 1, 2005 – granted | 13,118 | 308 | 13,426 |
| July 26, 2003 – units vested | (16,500) | (1,983) | (18,483) |
| July 26, 2004 – units vested | (16,500) | (4,073) | (20,573) |
| | 57,682 | 12,092 | 69,774 |

On March 2, 2005 the Board of Trustees approved the granting of 13,118 units effective as of January 1, 2005. These units vest equally on the third and fourth anniversary of the effective date of grant.

### DISTRIBUTION REINVESTMENT PLAN ("DRIP")

The REIT has a DRIP whereby eligible Canadian unitholders may elect to have their distributions of income from the REIT automatically reinvested in additional units. Unitholders who so elect will receive a further bonus distribution of units equal in value to 3% of each distribution that was reinvested.

## 10. PER UNIT INFORMATION

Net loss per unit calculations are based on the following:

| | | Three Months Ended March 31, 2005 | Weighted Average Units | | Three Months Ended March 31, 2004 | Weighted Average Units |
|---|---|---|---|---|---|---|
| Net loss before discontinued operations – basic | **$** | **(6,830)** | **45,907,766** | $ | (4,756) | 41,292,952 |
| Dilutive effect of executive compensation plan | | **–** | **68,989** | | – | 14,116 |
| Net loss before discontinued operations – diluted | **$** | **(6,830)** | **45,976,755** | $ | (4,756) | 41,307,068 |

| | | Three Months Ended March 31, 2005 | Weighted Average Units | | Three Months Ended March 31, 2004 | Weighted Average Units |
|---|---|---|---|---|---|---|
| Net loss from discontinued operations | **$** | **(1,786)** | **45,907,766** | $ | (92) | 41,292,952 |
| Dilutive effect of executive compensation plan | | **–** | **68,989** | | – | 14,116 |
| Net loss from discontinued operations – diluted | **$** | **(1,786)** | **45,976,755** | $ | (92) | 41,307,068 |

Distributable income per unit calculations are based on the following (Note 11):

| | | Three Months Ended March 31, 2005 | Weighted Average Units | | Three Months Ended March 31, 2004 | Weighted Average Units |
|---|---|---|---|---|---|---|
| Distributable (loss) income – basic | **$** | **(355)** | **45,907,766** | $ | 779 | 41,292,952 |
| Dilutive effect of executive compensation plan | | **–** | **68,989** | | – | 14,116 |
| Distributable (loss) income – diluted | **$** | **(355)** | **45,976,755** | $ | 779 | 41,307,068 |

The impact of the convertible debentures has been excluded from the diluted calculations because the impact of this conversion would not be dilutive.

## 11. DISTRIBUTABLE INCOME

Distributions to unitholders are computed based on distributable income as defined by the Declaration of Trust.

Distributable (loss) 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 issuers. Distributable income per unit has been calculated on a basis consistent with that prescribed by Canadian generally accepted accounting principles for calculating earnings per unit.

Distributable income means net income in accordance with Canadian generally accepted accounting principles, subject to certain adjustments as set out in the Declaration of Trust, including adding back depreciation and amortization, amortization of fair value debt adjustment and future income tax (recovery) expense, excluding any gains or losses on the disposition of real property and future income taxes, deducting the amount calculated, at 4% of hotel revenues, for the reserve for the replacement of furniture, fixtures and equipment and capital improvements, and the accretion on convertible debentures that is included in the computation of net income, and making any other adjustments determined by the trustees of the REIT in their discretion.

| | | Three Months Ended March 31, 2005 | | Three Months Ended March 31, 2004 |
|---|---|---|---|---|
| Net loss | $ | **(8,616)** | $ | (4,848) |
| Add (deduct) | | | | |
| Depreciation and amortization | | **10,019** | | 8,228 |
| Amortization of fair value debt adjustment | | **–** | | (342) |
| Future income tax recovery | | **(1,142)** | | (626) |
| Reserve for replacement of furniture, fixtures and equipment and capital improvements | | **(2,439)** | | (1,860) |
| Writedown of assets held for sale | | **1,471** | | – |
| Non-cash executive and trustee compensation | | **90** | | 72 |
| Convertible debentures accretion | | **262** | | 155 |
| | | **8,261** | | 5,627 |
| Distributable (loss) income | | **(355)** | | 779 |
| Distributions in excess of distributable (loss) income | | **(13,273)** | | (10,840) |
| Distributions | $ | **12,918** | $ | 11,619 |
| Distributable (loss) income per unit – basic | $ | **(0.008)** | $ | 0.019 |
| – diluted | $ | **(0.008)** | $ | 0.019 |

## 12. MANAGEMENT AGREEMENTS

On July 26, 2002, the REIT entered into a Management Agreement for hotel management and accounting services and an Administrative Services Agreement ("the Agreements") with Westmont Hospitality Management Canada Limited.

The Agreements have an initial term of 10 years with two successive five-year renewal terms, subject to the consent of Westmont and approved by the REIT. The Agreements will expire July 25, 2012. The Agreements provide for the payment of an annual management fee to Westmont in an amount equal to 3.375% of gross revenues during the term of the Agreements, including renewal periods. In addition, Westmont may receive an annual incentive fee if the REIT achieves distributable income in excess of $1.25 per unit. No management incentive fees were paid during the period. Accounting fees are calculated based on a fixed charge per room which increases by the Consumer Price index change annually.

In addition to the base management fee and incentive fee, Westmont is entitled to reasonable fees based on a percentage of the cost of purchasing certain goods and supplies and certain construction costs and capital expenditures, fees for accounting services, reasonable out-of-pocket costs and expenses, (other than general and administrative expenses or overhead costs except as otherwise provided in the Administrative Services Agreement) and project management and general contractor service fees related to hotel renovations managed by Westmont.

During the three months ended March 31, 2005 and 2004, the fees charged to the REIT pursuant to the Agreements were as follows:

| | **Three Months Ended March 31, 2005** | Three Months Ended March 31, 2004 |
|---|---|---|
| Management fees | **$ 2,058** | $ 1,570 |
| Accounting services (included in hotel operating expenses) | **517** | 438 |
| Administrative services (included in corporate and administrative services) | **126** | 124 |
| Project management and general contactor services (capitalized in hotel properties) | **176** | 87 |
| | **$ 2,877** | $ 2,219 |

In addition, salaries of REIT employees paid by Westmont and reimbursed by the REIT, were $90 (March 31, 2004 – $36). Included in accounts payable and accrued liabilities are amounts outstanding at March 31, 2005 totalling $984 (December 31, 2004 – $863).

## 13. SEGMENTED FINANCIAL INFORMATION

The REIT operates hotel properties throughout Canada. Information related to these properties by geographic segment is presented below. The REIT primarily evaluates operating performance based on hotel operating income. All key financing, investing and capital allocation decisions are centrally managed.

| | Western | Ontario | Quebec | Atlantic | Total |
|---|---|---|---|---|---|
| Three months ended March 31, 2005 | | | | | |
| Hotel revenues | **$ 6,507** | **$ 36,095** | **$ 11,221** | **$ 6,141** | **$ 59,964** |
| Hotel expenses | **5,256** | **28,948** | **8,490** | **5,051** | **47,745** |
| Hotel operating income | **$ 1,251** | **$ 7,147** | **$ 2,731** | **$ 1,090** | **$ 12,219** |
| Three months ended March 31, 2004 | | | | | |
| Hotel revenues | $ 5,028 | $ 24,552 | $ 11,005 | $ 4,583 | $ 45,168 |
| Hotel expenses | 4,061 | 18,213 | 8,204 | 3,417 | 33,895 |
| Hotel operating income | $ 967 | $ 6,339 | $ 2,801 | $ 1,166 | $ 11,273 |
| Capital expenditures | | | | | |
| Three months ended March 31, 2005 | **$ 505** | **$ 3,697** | **$ 457** | **$ 606** | **$ 5,265** |
| Three months ended March 31, 2004 | $ 133 | $ 707 | $ 294 | $ 233 | $ 1,367 |
| Hotel properties | | | | | |
| March 31, 2005 | **$ 76,675** | **$ 580,903** | **$ 183,811** | **$ 108,411** | **$ 949,800** |
| December 31, 2004 | $ 77,266 | $ 553,216 | $ 185,155 | $ 108,817 | $ 924,454 |

## 14. ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

On March 31, 2005, the REIT reclassified three hotel properties to assets held for sale. The long-term debt for these assets is with the REIT's main mortgage lender and can be repaid at any time without penalty. Mortgage debt of $3,101 matures on July 26, 2006 and $2,431 matures on July 26, 2008.

The discontinued operations for the three months ended March 31, 2005 and 2004 are as follows:

| | **Three Months Ended March 31, 2005** | Three Months Ended March 31, 2004 |
|---|---|---|
| Hotel revenues | **$ 1,020** | $ 1,345 |
| Hotel expenses | | |
| Operating expenses | **864** | 952 |
| Property taxes, rent and insurance | **159** | 162 |
| Management fees | **34** | 45 |
| | **1,057** | 1,159 |
| Hotel operating income | **(37)** | 186 |
| Interest on mortgages | **107** | 110 |
| Depreciation and amortization | **171** | 168 |
| | **278** | 278 |
| Loss from discontinued operations | **(315)** | (92) |
| Writedown of assets held for sale | **(1,471)** | – |
| Net loss from discontinued operations | **$ (1,786)** | $ (92) |

## 15. COMPARATIVE INFORMATION

Certain prior period amounts have been restated to conform to the current presentation.

## CORPORATE OFFICE

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## REGISTRAR AND TRANSFER AGENT

Inquiries regarding change of address, registered holdings, transfers and duplicate mailings should be directed to the following:

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## STOCK EXCHANGE LISTING

The Toronto Stock Exchange
Trading Symbol: INN.UN

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