2004 Third Quarter Report to Unitholders
for the six and nine months ended September 30, 2004

LETTER TO UNITHOLDERS

The REIT's overall portfolio demonstrated continued RevPAR improvement in the quarter, as our Ontario, Quebec, and Western regions all experienced higher RevPAR than the prior year. The majority of our improvement was concentrated in our Ontario properties, primarily the Greater Toronto Area.

On July 1, 2004, the REIT acquired the 193-room Holiday Inn located in Oshawa, Ontario. InnVest obtained $6.5 million through a credit facility to bring the facility to a total of $61.4 million.

For the quarter, InnVest's revenue per available room ("RevPAR") improved by 10.2% as RevPAR increased from $61.91 last year to $68.24 this year. This was due to posting occupancy of 73.8%, which is 3.9% higher than the quarter in the prior year reflecting stronger demand, along with our average daily rate ("ADR") increasing $5.24 or 6.0% over the same quarter in the prior year.

Continuing with our strategy of investing in our hotels, we deployed approximately $3.0 million for capital asset improvements during the third quarter and committed an additional $2.6 million.

Overall, the REIT continues to improve on a quarterly basis, and we are investing capital in our hotels. We are taking the necessary actions to maximize results in the short term while continuing to execute on our strategy to build value over the longer term through improving our base business as well as adding accretive acquisitions.

FINANCIAL REVIEW

Room revenues for the three months ended September 30, 2004 were $83.3 million, 26.7% higher than the $65.8 million generated for the same period in 2003. The improvement of $17.5 million in room revenue in the third quarter primarily reflects our recent acquisitions which provided $13.5 million in additional revenue. The remaining $4.0 million reflects the increase in room revenue in our original portfolio with the majority of this improvement being achieved through the recovery in our GTA properties.

Hotel expenses for the three months ended September 30, 2004 increased by $15.9 million or 41.6% compared to the previous year. This primarily reflects $12.9 million in expenses incurred in the acquired hotels. A $3.0 million increase relates to our original portfolio, primarily due to the increase in occupancy levels as well as an enhanced guest loyalty program.

Distributable income for the three months ended September 30, 2004 was $25.7 million or $0.563 per unit – basic (diluted – $0.497). This reflects a $4.4 million increase from the distributable income achieved for the three months ended September 30, 2003 of $21.3 million or $0.519 per unit – basic (diluted – $0.481).

At September 30, 2004, InnVest's cash totalled $51.1 million ($33.2 million unrestricted and $17.9 million restricted for replacement of furniture, fixture and equipment and capital improvements) and financial leverage is at 37.1% debt to gross asset value excluding convertible debentures and 50.5% including convertible debentures.

OUTLOOK

The recovery in the Candian hotel industry is continuing, as reflected in the 6.0% improvement in RevPAR experienced by InnVest during the quarter on a same hotel basis. All regions in the original portfolio experienced increased revenues in the third quarter over the prior year. The majority of this improvement was concentrated in our Ontario properties, and most notably, the GTA.

The improving results of the REIT are occurring at a slower pace than we expected. A major factor is that U.S. travel and tourism into Canada has been weak. This is most evident in our Ontario border, Atlantic Canada and Quebec hotels, which typically have strong U.S. tourist demand in the summer months.

Hotel industry expert PKF Consulting is forecasting a RevPAR improvement of approximately 4% in 2005 on a national basis. We agree that the overall Canadian Hotel industry will improve in 2005 and we remain optimistic that our hotels which have been impacted from weaker U.S. tourist demand will continue to experience higher demand. We are pleased with the performance of our recently acquired hotels and will continue to pursue acquisitions that are accretive to the REIT.

Kenneth Gibson
President and Chief Executive Officer
November 11, 2004

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 and nine months ended September 30, 2004, with a comparison to the results of operations of InnVest for the three and nine months ended September 30, 2003.

The following management's discussion and analysis is dated November 4, 2004 and should be read in conjunction with the unaudited consolidated financial statements of the REIT and the notes thereto as at and for the three and nine months ended September 30, 2004 and the audited consolidated financial statements of the REIT and the notes thereto as at and for the year ended December 31, 2003.

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.

THIRD QUARTER HIGHLIGHTS AND RECENT DEVELOPMENTS

- RevPAR growth in the third quarter for the original portfolio of 114 hotels and the 10 acquired hotels was 6.1% and 5.6% respectively above the same period in 2003;
- Distributable income grew to $25.7 million, an increase of $4.4 million over the same quarter of the previous year. Distributable income per unit grew to $0.497 from $0.481 on a diluted basis, which is an increase of 3.3%;
- In July 2004, the REIT acquired the Holiday Inn hotel in Oshawa, Ontario, which was partially financed by a $6.5 million advance in long-term mortgage financing;
- $3.0 million was deployed on capital expenditures. Cash reserves for future capital expenditures are $17.9 million.

DESCRIPTION OF INNVEST REIT

OBJECTIVES OF INNVEST

InnVest's primary objectives remain unchanged: (1) to provide stable and growing cash distributions to Unitholders, and (2) to maximize the long-term value of the REIT by continuing to actively manage the hotel assets and to make selective acquisitions that are expected to be accretive to earnings and cash flow.

OPERATIONS OVERVIEW

InnVest is comprised of: (1) Canada's largest portfolio of hotels, measured by the number of hotels and number of guest rooms, with locations in every province; and (2) a 50% interest in Choice Hotels Canada Inc. ("Choice Canada"), the largest franchisor of hotels in Canada.

Hotel Ownership

Hotels can be categorized by service level and by market positioning. First, there are limited service and full service hotels. Limited service hotels generate a substantial portion of their revenue from guest room rentals, generally providing only limited food and beverage or other ancillary services. They tend to target more price-sensitive customers. Full service hotels typically offer a wider range of services including restaurants, lounges, meeting facilities, and often business centres, fitness centres, and more. As a result, full service hotels have higher fixed costs than limited service properties.

The second categorization reflects the market positioning (price-point) of the property. The most basic hotels (and motels) are in the budget sector. Moving up in price there are the economy, mid-scale without food and beverage ("F&B"), mid-scale with F&B, upscale and luxury categories. The budget, economy and mid-scale without F&B categories combine to form the

limited service category. The REIT's hotels are primarily in the mid-scale without F&B category, and recent acquisitions have added ten hotels in the mid-scale with F&B to InnVest's portfolio growing the number of hotels in the mid-scale with F&B category.

As of November 4, 2004, InnVest owns 124 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 100 hotels flagged with Choice brands (Comfort Inn®, Quality Inn®, Quality Hotel® and Quality Suites®), 13 Travelodge® hotels, 10 Holiday Inn® hotels and one Best Western® hotel. The chart below summarizes InnVest's brand distribution as at September 30, 2004. There has been no change in InnVest's brand distribution to November 4, 2004.

	As at September 30, 2004		
Brands	No. of Hotels	No. of Guest Rooms	% of Guest Rooms
Comfort Inn	84	6,747	50.8%
Travelodge	13	2,118	16.0%
Holiday Inn	10	1,758	13.2%
Quality Hotel	8	1,423	10.7%
Quality Suites/Inn	8	1,096	8.3%
Best Western	1	130	1.0%
	124	13,272	100.0%

A considerable amount of each brand's business is generated through the franchise company's central reservation system. For the nine-month period ended September 30, 2004, for the REIT's Choice branded hotels, which represent the majority of the hotel portfolio, the central reservation system generated 21.5% of the business of Comfort Inns, and 23.8% of the business of Quality Hotels and Suites.

Geographically, the REIT's guest rooms are concentrated in Ontario and Quebec (together representing over 72% of guest rooms as of September 30, 2004) where the majority of Canada's population and business activity is located, with the balance of properties in population centres in the Atlantic and Western provinces. A summary of the geographic distribution by brand as at September 30, 2004 is as follows:

Brand distribution by geographic region
As at September 30, 2004

	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	23.4%	22	1,754	13.3%	16	1,155	8.7%	9	745	5.6%
Travelodge	8	1,041	7.8%	–	–	–	–	–	–	5	1,077	8.1%
Holiday Inn	8	1,410	10.6%	–	–	–	1	196	1.5%	1	152	1.1%
Quality Hotel	4	839	6.3%	2	298	2.2%	1	160	1.2%	1	126	0.9%
Quality Suites/Inn	4	604	4.6%	4	492	3.7%	–	–	–	–	–	–
Best Western	1	130	1.0%	–	–	–	–	–	–	–	–	–
	62	7,117	53.7%	28	2,544	19.2%	18	1,511	11.4%	16	2,100	15.7%

The hotels are typically located near major thoroughfares in urban and suburban areas, near 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.

Franchise Business

InnVest owns 50% of Choice Canada which has franchise agreements with approximately 270 locations open or under development in Canada and more than 23,000 guest rooms. The other 50% is owned by Choice Hotels International Inc. ("Choice International"), which is one of the largest hotel franchise companies in the world. In addition to strong international brand recognition, Choice International has a centralized reservation system, sales and marketing programs, and proprietary property management systems.

Choice Canada earns franchise revenue by charging monthly royalty fees to hotel owners based on a percentage of the revenue generated by the licenced properties and by selling franchises. In 1993 Choice Canada was granted a 99-year licence to franchise all Choice hotel brand names in Canada.

BUSINESS STRATEGY

Operating Strategy

InnVest's operating strategy is to continue to enhance the performance of the hotel portfolio. The manager of the hotel portfolio is Westmont Hospitality Management Canada Limited ("Westmont"), one of the largest privately held owner/operators of hotels in the world. InnVest, through its hotel manager, applies four main operating and strategic principles to maximize efficiencies and internal growth: (1) maximize the performance of each individual hotel; (2) utilize yield management and market strategies to maximize RevPAR; (3) improve operating efficiencies and economies of scale; and (4) continually maintain the quality of the portfolio.

Westmont has approximately seven years and nine months remaining on a 10-year master hotel management agreement to manage InnVest's hotel portfolio and is subject to non-competitive arrangements.

Acquisition Strategy

InnVest will seek to increase cash flow and enhance unit value through selective acquisitions that are expected to be accretive to earnings and cash flow.

In the second quarter of 2004, to further diversify its hotel portfolio and capitalize on a continued strengthening of the hotel market, InnVest expanded its focus on the mid-scale with food and beverage sector through the execution of two transactions. The first transaction was the acquisition of the 196-room Holiday Inn Dartmouth, Nova Scotia, which closed on April 5, 2004. The second transaction was a portfolio acquisition comprised of nine hotels with 1,525 rooms, seven of which are Holiday Inns located in Ontario, one of which is a Holiday Inn located in Calgary, Alberta and one being a Quality Hotel located in Regina, Saskatchewan. This transaction closed in two stages. Eight hotels were acquired on April 7, 2004 and the ninth hotel was acquired on July 1, 2004. This acquisition was funded through the April 2, 2004 issuance of trust units and convertible debentures and through the issuance of long-term debt. Costs related to the issuance of the convertible debentures and long-term debt such as commitment fees, underwriting costs, and legal costs of $3.3 million have been capitalized in deferred financing costs and are being amortized over the term of the applicable debt. The ten hotels that were acquired in the second and third quarters are hereafter referred to as the "acquired hotels".

Based on 2003 actual results and the REIT's expectation of growth in 2004, both acquisitions are expected to be immediately accretive to distributable income. The acquired hotels have been integrated into InnVest seamlessly given that an affiliate of Westmont previously managed the hotels and little change in the management structure has occurred.

Each of the vendors of the acquired hotels is considered a related party of the REIT as defined in its Declaration of Trust. As a result, the Trustees of the REIT established an independent committee comprised of the REIT's Independent Trustees, as defined in the Declaration of Trust, to assess the transaction. The independent committee retained its own legal counsel for the purpose of this assessment.

In compliance with their obligations under the Declaration of Trust, the Independent Trustees retained various independent third party professionals whom they relied upon in their assessment including an appraiser, financial advisor, structural engineer and environmental consultant. Upon completion of their assessment and review of the reports prepared by the independent third party professionals, the Independent Trustees recommended the approval of, and the trustees of the REIT unanimously approved, the acquisitions.

COMPETITIVE STRENGTHS

InnVest has a number of competitive strengths which should enable it to carry out its business and acquisition strategies:

- With Canada's largest hotel portfolio, it plans to continue to leverage its size and scale to achieve operating efficiencies, through centralized purchasing and other functions;
- The strength of its international brands brings name recognition, central reservation systems, marketing and customer loyalty programs and quality standards;
- The 50% ownership interest in Choice Canada brings favourable franchise terms, the benefits of being a franchisor, including the right to participate in the maintenance and enforcement of operating standards across the entire portfolio of hotels in Canada, the approval of any new Choice-branded hotels in Canada and the removal of any defaulting franchisees;
- Westmont's professional management and extensive experience in Canada and international markets enables InnVest to maximize its performance;
- The geographic and customer diversity offset regional and industry sector cyclicality; and
- InnVest has a balanced capital structure, supporting its growth strategy while mitigating risks.

CANADIAN HOTEL MARKET OVERVIEW

Thus far in 2004, the Canadian hotel industry, and consequently InnVest, continued to recover from the unusual events, the most significant of which was SARS that occurred in 2003 ("the events of 2003"). According to PKF Consulting, a hotel industry expert, the majority of regional markets have posted gains over the previous year, led by the Greater Toronto Area ("GTA") which has experienced RevPAR gains of 24.8% year-to-date August 2004 versus the prior year. Other markets showing solid RevPAR growth include London (+17.5%), Calgary (+10.3%), Quebec City (+4.7%), and Edmonton (+5.5%) for the same period. As is often the case, while some markets are particularly strong, others are experiencing challenges, such as Windsor where RevPAR has declined 7.3% due to strikes and border crossing slow-downs and Atlantic Canada, where RevPAR is virtually unchanged to last year. InnVest's geographic diversification, however, helps mitigate the risk of fluctuations in regional markets.

One key factor fuelling continued strength in the hotel market is the limited growth anticipated in room supply. According to PKF Consulting, room supply is expected to grow at only 1.2% and 1.0% annually in 2004 and 2005 respectively. As demand returns to more normal levels, the resulting higher occupancies will create the opportunity to increase room rates.

FINANCIAL PERFORMANCE REVIEW

In reviewing the performance of InnVest, a comparison of the results of operations for the three and nine months ended September 30, 2004 is being made to the results of operations for the comparable period in 2003. Hotel operating results on a quarterly basis are unaudited.

Financial Highlights Summary

	Three months ended		Nine months ended	
	Sept. 30, 2004	Sept. 30, 2003	**Sept. 30, 2004**	Sept. 30, 2003
Hotel revenues	**$ 92,995**	$ 70,306	**$ 212,006**	$ 173,929
Hotel expenses	**54,168**	38,258	**136,794**	109,009
Hotel operating income	**38,827**	32,048	**75,212**	64,920
Net income	**$ 22,878**	$ 19,712	**$ 29,705**	$ 24,272
Net income per unit				
– basic	**$ 0.435**	$ 0.431	**$ 0.493**	$ 0.446
– diluted	**$ 0.400**	$ 0.410	**$ 0.492**	$ 0.446
Net income	**$ 22,878**	$ 19,712	**$ 29,705**	$ 24,272
Add / (deduct)				
Depreciation and amortization(1)	**9,312**	7,745	**26,060**	23,004
Future income tax recovery	**(486)**	(1,542)	**(2,102)**	(2,626)
Non-cash executive and trustee compensation	**108**	57	**252**	201
Funds from operations(2)	**$ 31,812**	$ 25,972	**$ 53,915**	$ 44,851
Amortization of fair value debt adjustment	**(125)**	(360)	**(809)**	(1,042)
Amortization of deferred financing and other assets	**493**	365	**1,345**	1,097
Reserve for replacement of furniture, fixtures and equipment and capital improvements ("FF&E Reserve")	**(3,720)**	(2,812)	**(8,480)**	(6,957)
Convertible debentures interest	**(2,743)**	(1,828)	**(7,268)**	(5,484)
Distributable income(2)	**$ 25,717**	$ 21,337	**$ 38,703**	$ 32,465
Distributable income per unit(3)				
– basic	**$ 0.563**	$ 0.519	**$ 0.877**	$ 0.790
– diluted	**$ 0.497**	$ 0.481	**$ 0.849**	$ 0.789
Distributions(4)	**$ 12,854**	$ 11,577	**$ 37,286**	$ 34,686
Distributions – per unit(4)	**$ 0.2813**	$ 0.2813	**$ 0.8438**	$ 0.8438

(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 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 income per unit 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 INDICATORS

The key measures that indicate the performance of the hotel industry and the relative strength of participants in the industry are Occupancy, ADR and RevPAR.

Original 114 Properties

The key performance indicators for the REIT's original hotel portfolio, which excludes the acquired hotels, by geographic region in Canada for the three and nine months ended September 30, 2004 and the comparable periods are as follows:

	Three months ended September 30			Nine months ended September 30		
	2004	2003	Var %	**2004**	2003	Var %
Occupancy						
Ontario	**72.0%**	67.2%	7.1%	**63.5%**	59.8%	6.2%
Quebec	**77.9%**	76.6%	1.7%	**66.7%**	67.8%	(1.6%)
Atlantic	**84.9%**	86.8%	(2.2%)	**67.7%**	68.7%	(1.5%)
Western	**66.2%**	63.9%	3.6%	**57.1%**	55.6%	2.7%
Total	**73.8%**	71.0%	3.9%	**63.4%**	61.9%	2.4%
ADR						
Ontario	**$ 90.60**	$ 88.42	2.5%	**$ 85.75**	$ 85.40	0.4%
Quebec	**$ 92.72**	$ 91.32	1.5%	**$ 87.26**	$ 86.45	0.9%
Atlantic	**$ 94.89**	$ 92.55	2.5%	**$ 83.77**	$ 82.36	1.7%
Western	**$ 71.11**	$ 71.02	0.1%	**$ 68.35**	$ 67.36	1.5%
Total	**$ 88.97**	$ 87.20	2.0%	**$ 83.40**	$ 82.73	0.8%
RevPAR						
Ontario	**$ 65.27**	$ 59.42	9.8%	**$ 54.22**	$ 51.07	6.2%
Quebec	**$ 72.19**	$ 69.95	3.2%	**$ 57.99**	$ 58.61	(1.1%)
Atlantic	**$ 80.58**	$ 80.33	0.3%	**$ 56.50**	$ 56.58	(0.1%)
Western	**$ 47.05**	$ 45.38	3.7%	**$ 38.88**	$ 37.45	3.8%
Total	**$ 65.66**	$ 61.91	6.1%	**$ 52.89**	$ 51.21	3.3%

The original portfolio's room revenue for the three months ended September 30, 2004 were $69.8 million, $4.0 million or 6.1% higher than the $65.8 million generated in the same period in 2003. This increase was due to an increase in occupied rooms of 3.9%, and an increase in ADR of $1.77 (2.0%) for a RevPAR increase of 6.1%. Geographically, all regions experienced higher room revenue relative to the prior year. The overall improvement in room revenue can be primarily attributed to an improvement in our Ontario region hotels, followed by our Quebec, Western and Atlantic region hotels. The main market which contributed positively to our improvement was our Greater Toronto Area ("GTA") hotels (10 hotels, 1,755 rooms) which experienced a 27.2% improvement over the prior year.

Acquired Hotels

The REIT acquired nine hotels in the second quarter of 2004, assuming ownership of one hotel on April 5, 2004 and assuming ownership of the remaining eight hotels on April 7, 2004. The REIT acquired a tenth hotel on July 1, 2004, and as a result, the acquired hotels experienced their first full quarter under InnVest REIT's ownership in the third quarter of 2004. The key performance indicators for the REIT's recently acquired nine Holiday Inns and one Quality Hotel, of which seven hotels are

located in Ontario, two hotels are located in Western Canada, and one hotel is located in Atlantic Canada, for the quarter ended September 30, 2004 and period ended September 30, 2004 (which does not reflect a full nine months) are as follows:

	Three months ended September 30			Period ended September 30		
	2004	2003(1)	Var %	**2004(2)**	2003(1)	Var %
Occupancy	**73.9%**	70.1%	5.4%	**67.7%**	66.6%	1.7%
ADR	**$ 115.76**	$ 115.51	0.2%	**$ 118.58**	$ 113.03	4.9%
RevPAR	**$ 85.53**	$ 81.01	5.6%	**$ 80.22**	$ 75.30	6.5%

(1) The comparable period for the hotels is shown, although the hotels were not owned by the REIT in 2003.

(2) One hotel was acquired on April 5, 2004, eight hotels were acquired on April 7, 2004 and the tenth hotel was acquired on July 1, 2004.

The acquired hotels experienced growth in occupancy levels relative to the prior year of 5.4% in the quarter, which was the main driver behind the RevPAR improvement of 5.6%. For the period from the various acquisition dates to September 30, 2004, growth in ADR of 4.9% was the main driver behind the RevPAR improvement of 6.5%.

REGIONAL OPERATING RESULTS COMPARISON

The following chart shows the regional operating results for the original portfolio of hotels by region along with the acquired properties for the three months ended September 30, 2004 and the three months ended September 30, 2003:

	Ontario		Quebec		Atlantic		Western		Acquired hotels(1)		Total(2)	
	2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
Occupancy	**72.0%**	67.2%	**77.9%**	76.6%	**84.9%**	86.8%	**66.2%**	63.9%	**73.9%**	70.1%	**73.8%**	70.9%
ADR	**$ 90.60**	$ 88.42	**$ 92.72**	$ 91.32	**$ 94.89**	$ 92.55	**$ 71.11**	$ 71.02	**$ 115.76**	$ 115.51	**$ 92.44**	$ 90.83
RevPAR	**$ 65.27**	$ 59.42	**$ 72.19**	$ 69.95	**$ 80.58**	$ 80.33	**$ 47.05**	$ 45.38	**$ 85.53**	$ 81.01	**$ 68.24**	$ 64.38
Room revenues	**$ 35,248**	$ 32,089	**$ 16,895**	$ 16,372	**$ 9,748**	$ 9,718	**$ 7,887**	$ 7,607	**$ 13,542**	$ 12,826	**$ 83,320**	$ 78,612
Total revenues	**$ 38,470**	$ 34,506	**$ 17,832**	$ 17,529	**$ 9,993**	$ 10,005	**$ 8,482**	$ 8,266	**$ 18,218**	$ 17,458	**$ 92,995**	$ 87,764
Hotel operating expenses and management fees	**$ 18,704**	$ 16,238	**$ 8,168**	$ 8,060	**$ 3,870**	$ 3,669	**$ 4,599**	$ 4,360	**$ 11,791**	$ 11,379	**$ 47,132**	$ 43,706
Gross operating profit	**$ 19,766**	$ 18,268	**$ 9,664**	$ 9,469	**$ 6,123**	$ 6,336	**$ 3,883**	$ 3,906	**$ 6,427**	$ 6,079	**$ 45,863**	$ 44,058
GOP margin	**51.4%**	52.9%	**54.2%**	54.0%	**61.3%**	63.3%	**45.8%**	47.3%	**35.3%**	34.8%	**49.3%**	50.2%
Property taxes, rent and insurance	**$ 3,471**	$ 3,501	**$ 1,275**	$ 1,314	**$ 516**	$ 488	**$ 636**	$ 628	**$ 1,138**	$ 1,276	**$ 7,036**	$ 7,207
Hotel operating income	**$ 16,295**	$ 14,767	**$ 8,389**	$ 8,155	**$ 5,607**	$ 5,848	**$ 3,247**	$ 3,278	**$ 5,289**	$ 4,803	**$ 38,827**	$ 36,851
HOI margin	**42.4%**	42.8%	**47.0%**	46.5%	**56.1%**	58.5%	**38.3%**	39.7%	**29.0%**	27.5%	**41.8%**	42.0%

(1) The REIT did not own the acquired hotels for the three months ended September 30, 2003.

(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 2003 will differ from previously reported results.

In the prior year, HOI margin for the original hotel portfolio was 45.6% which is 3.8% points higher than the 41.8% generated in the third quarter of 2004. This is due to the nature of the acquired hotels relative to the original portfolio, as the acquired hotels are mid-scale hotels with food and beverage, whereas the original portfolio is primarily limited service. Mid-scale hotels

typically generate more non-room revenue than limited service hotels, and as a result, generally have lower operating margins. With the inclusion of the acquired hotels in the comparable periods, the HOI margin decreased slightly by 0.2% going from 42.0% in the third quarter of 2003 to 41.8% in third quarter of 2004.

The following chart shows the regional operating results for the original portfolio of hotels by region along with the acquired properties for the nine months ended September 30, 2004 and the nine months ended September 30, 2003:

	Ontario		Quebec		Atlantic		Western		Acquired hotels(1)		Total(2)	
	2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
Occupancy	**63.5%**	59.8%	**66.7%**	67.8%	**67.7%**	68.7%	**57.1%**	55.6%	**67.7%**	66.6%	**63.8%**	62.3%
ADR	**$ 85.75**	$ 85.40	**$ 87.26**	$ 86.45	**$ 83.77**	$ 82.36	**$ 68.35**	$ 67.36	**$ 118.58**	$ 113.03	**$ 86.52**	$ 85.45
RevPAR	**$ 54.22**	$ 51.07	**$ 57.99**	$ 58.61	**$ 56.50**	$ 56.58	**$ 38.88**	$ 37.45	**$ 80.22**	$ 75.30	**$ 55.17**	$ 53.23
Room revenues	**$ 87,208**	$ 81,843	**$ 40,421**	$ 40,704	**$ 20,357**	$ 20,311	**$ 19,411**	$ 18,626	**$ 23,152**	$ 21,731	**$ 190,549**	$183,215
Total revenues	**$ 94,976**	$ 88,932	**$ 42,913**	$ 43,693	**$ 21,032**	$ 21,042	**$ 20,929**	$ 20,262	**$ 32,156**	$ 30,601	**$ 212,006**	$204,530
Hotel operating expenses and management fees	**$ 50,210**	$ 46,844	**$ 22,636**	$ 22,639	**$ 9,987**	$ 9,610	**$ 12,461**	$ 12,177	**$ 21,189**	$ 20,321	**$ 116,483**	$111,591
Gross operating profit	**$ 44,766**	$ 42,088	**$ 20,277**	$ 21,054	**$ 11,045**	$ 11,432	**$ 8,468**	$ 8,085	**$ 10,967**	$ 10,280	**$ 95,523**	$ 92,939
GOP margin	**47.1%**	47.3%	**47.3%**	48.2%	**52.5%**	54.3%	**40.5%**	39.9%	**34.1%**	33.6%	**45.1%**	45.4%
Property taxes, rent and insurance	**$ 10,848**	$ 10,720	**$ 3,846**	$ 3,709	**$ 1,541**	$ 1,464	**$ 1,910**	$ 1,846	**$ 2,166**	$ 2,622	**$ 20,311**	$ 20,361
Hotel operating income	**$ 33,918**	$ 31,368	**$ 16,431**	$ 17,345	**$ 9,504**	$ 9,968	**$ 6,558**	$ 6,239	**$ 8,801**	$ 7,658	**$ 75,212**	$ 72,578
HOI margin	**35.7%**	35.3%	**38.3%**	39.7%	**45.2%**	47.4%	**31.3%**	30.8%	**27.4%**	25.0%	**35.5%**	35.5%

(1) The results of the acquired hotels are shown only for the period owned, which was not for the full nine months ended September 30, 2004. Also, the comparable period 2003 results reflect the same time period included in the 2004 results. The REIT did not own the acquired hotels for any of the nine months ended September 30, 2003.

(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 2003 will differ from previously reported results.

In the prior year, HOI margin for the original hotel portfolio was 37.3% which is 1.8% points higher than the 35.5% generated in the nine months ended September 30, 2004. This is due to the nature of the acquired hotels relative to the original portfolio, as described previously. With the inclusion of the acquired hotels in the comparable periods, the HOI margin remained unchanged at 35.5%.

HOTEL REVENUES

Three months ended September 30, 2004

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

Room Revenues

A geographical comparison of the room revenue variance between the three months ended September 30, 2004 and the three months ended September 30, 2003 is as follows:

	Hotels	Rooms	As a % of total	Room revenue variance	As a % of total	Var % over 2003
Original Portfolio						
Greater Toronto Area ("GTA")	10	1,755	13.2%	$ 2,359	13.4%	27.2%
Ontario other	45	4,115	31.0%	800	4.6%	3.4%
Total Ontario	55	5,870	44.2%	3,159	18.0%	9.8%
Quebec	28	2,544	19.2%	523	3.0%	3.2%
Atlantic	17	1,315	9.9%	30	0.2%	0.3%
Western	14	1,822	13.7%	280	1.6%	3.7%
Sub-total	114	11,551	87.0%	3,992	22.8%	6.1%
Acquired Hotels	10	1,721	13.0%	13,542	77.2%	100.0%
Total	124	13,272	100.0%	$ 17,534	100.0%	26.7%

Acquired hotels

Our acquired hotels contributed $13.5 million or 77.2% of the increase in room revenues.

Ontario

Geographically, for the three months ended September 30, 2004, InnVest's original portfolio of Ontario hotels, which accounts for 44.2% of the InnVest portfolio, contributed 18.0% of the increase in room revenues. The GTA alone, which accounts for only 13.2% of the InnVest portfolio, contributed 13.4% or $2,359 of the overall increase as room revenues increased by 27.2%. This reflects a recovery in revenues in the GTA which suffered significant negative effects in demand due to the events of 2003. As for the remainder of Ontario, increases in room revenues throughout the province were partially offset by a decline in certain regional markets. Our Oshawa hotels improved significantly, showing growth in room revenues of $435 or 17.3% as a result of increased business activity in this region, and our North Bay hotels improved $176 or 12.0% due to a general return of business and leisure activity to normalized levels. Partially offsetting these improvements were declines in our Windsor hotels of $218 or 12.6% due to a reduction in U.S. tourist traffic, and our London hotels of $223 or 14.0% due to new supply and general reductions in market demand.

Quebec

The increase of $523 or 3.2% in Quebec was attributable to increases in our Montreal, Quebec City, and rural Quebec hotels, as all three regions showed improvement over the prior year. Our Quebec hotels are experiencing improvement over the prior year due to a gradual return of U.S. tourist traffic into the region.

Atlantic

InnVest's original portfolio of Atlantic region hotels showed some growth, as room revenues improved 0.3%. This result has been achieved despite new competition in this region, poor weather conditions, and a lack of U.S. tourists.

Western

InnVest's original portfolio of Western region hotels experienced an increase of 3.7% over the prior year. This increase was primarily attributable to improvement in our Edmonton hotels due to an increase in energy related business activity in the quarter over the prior year.

Overall Hotel Portfolio

The improvement of $17.5 million in room revenues in the third quarter primarily reflects our recent acquisitions which provided $13.5 million in additional revenues. The remaining $4.0 million reflects the increase in room revenues in our original portfolio with the majority of this improvement being achieved through the recovery in our Ontario properties, more specifically our GTA properties.

Non-Room Revenues

Non-room revenues for the three months ended September 30, 2004 account for 10.4% (2003 – 6.4%) of total hotel revenues. The mix of room revenues and non-room revenues has changed from the prior year as a result of including the acquired hotels which compete in the mid-scale with food and beverage sector and earn a higher proportion of total revenues from non-room revenues. It is estimated that on an annualized basis non-room revenues will account for approximately 12% of total hotel revenues.

Non-room revenues increased $5.2 million primarily reflecting $4.7 million in non-room revenues generated by the REIT's acquired hotels, a large portion of which is food and beverage revenues.

Nine months ended September 30, 2004

Room Revenues

A geographical comparison of the room revenue variance between the nine months ended September 30, 2004 and the nine months ended September 30, 2003 is as follows:

	Hotels	Rooms	As a % of total	Room revenue variance	As a % of total	Var % over 2003
Original Portfolio						
Greater Toronto Area ("GTA")	10	1,755	13.2%	$ 4,564	15.7%	20.1%
Ontario other	45	4,115	31.0%	801	2.8%	1.4%
Total Ontario	55	5,870	44.2%	5,365	18.5%	6.6%
Quebec	28	2,544	19.2%	(283)	(1.0%)	(0.7%)
Atlantic	17	1,315	9.9%	46	0.1%	0.2%
Western	14	1,822	13.7%	785	2.7%	4.2%
Sub-total	114	11,551	87.0%	5,913	20.3%	3.7%
Acquired Hotels(1)	10	1,721	13.0%	23,152	79.7%	100.0%
Total(1)	124	13,272	100.0%	$ 29,065	100.0%	18.0%

(1) The results of the acquired hotels do not reflect a full period as they were acquired during the second and third quarters of 2004.

Acquired hotels

Our acquired hotels contributed $23.2 million or 79.7% of the increase in room revenues.

Ontario

Geographically, for the nine months ended September 30, 2004, InnVest's original portfolio of Ontario hotels, which accounts for 44.2% of the InnVest portfolio, contributed 18.5% of the increase in room revenues. The GTA alone, which accounts for only 13.2% of the InnVest portfolio, contributed 15.7% or $4.6 million of the overall increase as room revenues increased by 20.1%. This reflects primarily a recovery in the third quarter in revenue in the GTA which experienced significant negative effects in demand due to the events of 2003. As for the remainder of Ontario, increases in room revenues throughout the province were offset by a decline in our Windsor hotels of $543 or 10.9% due to a reduction in U.S. tourist travel, and by a decline of $344 or 3.6% in our Ottawa hotels due to a freeze in government spending which occurred in the earlier part of the year.

Quebec

The decrease of $283 in Quebec was attributable primarily to hotels located in Montreal, which decreased $1.1 million or 4.3% over the prior year. This reflects declines in the Montreal corporate sector, as well as a decrease in U.S. tourism business. The performance of our Montreal hotels was offset by improvement in our Quebec City hotels of $294 or 4.4% and other Quebec hotels of $536 or 5.0%.

Atlantic

InnVest's original portfolio of Atlantic region hotels experienced 0.1% growth over the prior year, reflecting market stability in this segment for the year as a whole.

Western

InnVest's original portfolio of Western region hotels experienced an increase of 4.2% over the prior year. This increase was attributable to improvement in both our Edmonton and Calgary hotels in the period, which experienced a 5.3% improvement due to increased energy activity.

Overall Hotel Portfolio

The improvement of $29.1 million in room revenues in the period primarily reflects the increased revenues from our acquired hotels of $23.2 million. The remaining $5.9 million reflects the increase in room revenues in our original portfolio, and the majority of this improvement was achieved through an improvement in our Ontario hotels of $5.4 million, more specifically our GTA hotels which improved $4.6 million. This result combined with the improvement in our Western and Atlantic hotels of $785 and $46 respectively, along with a decline of $283 in our Quebec hotels result in the REIT's overall improvement.

Non-Room Revenues

Non-room revenues for the nine months ended September 30, 2004 account for 10.1% (2003 – 7.2%) of total hotel revenues. The mix of room revenues and non-room revenues has changed from the prior year as a result of the acquired hotels which 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 $9.0 million, reflecting primarily the non-room revenues generated by the REIT's recently acquired hotels.

DEPARTMENTAL OPERATING PROFIT ANALYSIS

Three months ended September 30, 2004

The following chart illustrates the REIT's room and non-room based operating profit for the three months ended September 30, 2004 and for the three months ended September 30, 2003:

	Room operations		Non-room operations		Total	
	2004	2003	**2004**	2003	**2004**	2003
Revenues						
Original Portfolio	**$ 69,778**	$ 65,786	**$ 4,999**	$ 4,520	**$ 74,777**	$ 70,306
Acquired hotels(1)	**13,542**	–	**4,676**	–	**18,218**	–
Total	**83,320**	65,786	**9,675**	4,520	**92,995**	70,306
Direct expenses						
Original Portfolio	**14,800**	13,380	**3,621**	3,363	**18,421**	16,743
Acquired hotels(1)	**3,031**	–	**3,658**	–	**6,689**	–
Total	**17,831**	13,380	**7,279**	3,363	**25,110**	16,743
Departmental operating profit						
Original Portfolio	**54,978**	52,406	**1,378**	1,157	**56,356**	53,563
Acquired hotels(1)	**10,511**	–	**1,018**	–	**11,529**	–
Total	**$ 65,489**	$ 52,406	**$ 2,396**	$ 1,157	**67,885**	53,563
Total undistributed expenses					**(22,022)**	(15,584)
Gross operating profit					**$ 45,863**	$ 37,979
Gross operating profit margin					**49.3%**	54.0%
Departmental operating profit margin						
Original Portfolio	**78.8%**	79.7%	**27.6%**	25.6%	**75.4%**	76.2%
Acquired hotels(1)	**77.6%**	–	**21.8%**	–	**63.3%**	–
Total	**78.6%**	79.7%	**24.8%**	25.6%	**73.0%**	76.2%

(1) The acquired hotels were acquired by the REIT during 2004 and are not included in the results of the REIT in 2003.

Departmental room operating profit margin on the original portfolio declined slightly by 0.9% points. This is primarily attributable to higher occupancy growth of 2.8% points relative to ADR growth of 2.0%. The operating profit margin of the acquired hotels was only 1.2% points less than the original portfolio's, and in the aggregate, the REIT's operating profit margin declined by 1.1% points during the quarter relative to the prior year, but the gross operating profit dollars were higher.

Departmental non-room operating profit margin declined by a modest 0.8% points from the prior year. This is a result of a 2.0% point improvement in the original portfolio, offset by the lower operating margin generated by the acquired hotels relative to the original portfolio. This is due to the nature of the acquired hotels relative to the original portfolio, as the acquired hotels are mid-scale hotels with food and beverage, whereas the original portfolio is limited service. Mid-scale hotels typically generate lower non-room operating profit margins than limited service hotels, but higher cash flows on a per room basis.

Overall gross operating profit margin decreased 4.7% points. This is due to the nature of the acquired hotels relative to the nature of the original portfolio of hotels, as discussed previously.

Nine months ended September 30, 2004

The following chart illustrates the REIT's room and non-room operating profit for the nine months ended September 30, 2004 and for the nine months ended September 30, 2003:

	Room operations		Non-room operations		Total	
	2004	2003	**2004**	2003	**2004**	2003
Revenues						
Original Portfolio	**$ 167,397**	$ 161,484	**$ 12,453**	$ 12,445	**$ 179,850**	$ 173,929
Acquired hotels(1)	**23,152**	–	**9,004**	–	**32,156**	–
Total	**190,549**	161,484	**21,457**	12,445	**212,006**	173,929
Direct expenses						
Original Portfolio	**38,809**	36,624	**8,811**	9,080	**47,620**	45,704
Acquired hotels(1)	**5,367**	–	**6,688**	–	**12,055**	–
Total	**44,176**	36,624	**15,499**	9,080	**59,675**	45,704
Departmental operating profit						
Original Portfolio	**128,588**	124,860	**3,642**	3,365	**132,230**	128,225
Acquired hotels(1)	**17,785**	–	**2,316**	–	**20,101**	–
Total	**$ 146,373**	$ 124,860	**$ 5,958**	$ 3,365	**152,331**	128,225
Total undistributed expenses					**(56,808)**	(45,566)
Gross operating profit					**$ 95,523**	$ 82,659
Gross operating profit margin					**45.1%**	47.5%
Departmental operating profit margin						
Original Portfolio	**76.8%**	77.3%	**29.2%**	27.0%	**73.5%**	73.7%
Acquired hotels(1)	**76.8%**	–	**25.7%**	–	**62.5%**	–
Total	**76.8%**	77.3%	**27.8%**	27.0%	**71.9%**	73.7%

(1) The acquired hotels were acquired by the REIT during 2004 and are not included in the results of the REIT in 2003.

Room operating profit margin on the original portfolio declined slightly by 0.5% points. This is primarily attributable to higher occupancy growth of 1.5% points relative to ADR growth of 0.8%. The operating profit margin of the acquired hotels was consistent with the original portfolio's at 76.8%, and in the aggregate, the REIT's operating profit margin declined by 0.5% points during the nine months relative to the same period in the prior year, but the gross operating profit dollars were higher.

Non-room operating profit margin improved by 0.8% points from the prior year. This is a result of a 2.2% point improvement in the original portfolio, partially offset by a lower operating profit margin generated by the acquired hotels relative to the original portfolio. The 2.2% point improvement in the original portfolio is primarily due to improved food and beverage operations, which experienced a 7.1% operating profit margin in the current year, compared to a 3.0% operating profit margin in the prior year. The lower operating profit margin in the acquired hotels is due to their mid-scale nature relative to the limited service nature of the original portfolio, as explained previously.

Overall gross operating profit margin decreased 2.4% points. This is due to the nature of the acquired hotels relative to the nature of the original portfolio of hotels, as discussed previously.

HOTEL EXPENSES

Three months ended September 30, 2004

Hotel expenses for the three months ended September 30, 2004 increased by $15.9 million or 41.6% compared to the previous year. This primarily reflects $12.9 million in expenses incurred in the acquired hotels. Of the total increase, $3.0 million relates to our original portfolio, and this represents a 7.8% increase over the prior year. In the original portfolio, room expenses increased $1.4 million as a result of increases in occupancy over the prior year of 2.9% which led to higher payroll costs. Administrative and general expense increased $277, generally as the result of the increase in occupancy. Marketing expense increased $598 primarily due to enhanced guest loyalty programs.

Nine months ended September 30, 2004

Hotel expenses for the nine months ended September 30, 2004 increased by $27.8 million or 25.5% compared to the previous year. This primarily reflects $23.4 million in expenses incurred in the acquired hotels. Of the total increase, $4.4 million relates to our original portfolio, and this represents a 4.0% increase over the prior year. In the original portfolio, room expenses increased $2.7 million as a result of increases in occupancy over the prior year of 2.6% which led to higher payroll costs. Increased room expense also resulted from the installation of a new front desk computer software system at all of our Choice branded hotels. Property taxes increased $594 or 3.5%. Marketing expense increased $1.2 million or 10.6% as a result of enhanced guest loyalty programs. Lastly, administrative and general expense increased $667, generally as the result of the increase in occupancy.

HOTEL OPERATING INCOME

Three months ended September 30, 2004

Hotel operating income ("HOI") for the three months ended September 30, 2004 increased by $6.8 million growing to $38.8 million from $32.0 million achieved in the third quarter of 2003. This was a result of higher hotel revenue of $22.7 million, along with an increase in hotel expenses of $15.9 million both of which are mainly attributable to the acquired hotels.

A geographical comparison of the hotel operating income variance between the three months ended September 30, 2004 and the three months ended September 30, 2003 is as follows:

	Hotels	Rooms	As a % of total	HOI variance	As a % of total	Var % over 2003
Original Portfolio						
Greater Toronto Area ("GTA")	10	1,755	13.2%	$ 1,419	20.9%	47.4%
Ontario other	45	4,115	31.0%	109	1.6%	0.9%
Total Ontario	55	5,870	44.2%	1,528	22.5%	10.3%
Quebec	28	2,544	19.2%	234	3.5%	2.9%
Atlantic	17	1,315	9.9%	(241)	(3.6%)	(4.1%)
Western	14	1,822	13.7%	(31)	(0.4%)	(0.9%)
Sub-total	114	11,551	87.0%	1,490	22.0%	4.6%
Acquired Hotels(1)	10	1,721	13.0%	5,289	78.0%	100.0%
Total(1)	124	13,272	100.0%	$ 6,779	100.0%	21.2%

(1) The results of the acquired hotels reflect the complete quarter ended September 30, 2004.

The majority of the improvement in HOI is attributable to the acquired hotels which generated $5.3 million or 78.0% of the REIT's HOI improvement. The remaining $1.5 million or 22.0% of HOI improvement relates to the original hotel portfolio. The majority of the improvement was experienced in the GTA with a $1.4 million or 47.4% improvement over the prior year, primarily reflecting a recovery from the negative effects of SARS. InnVest's Quebec hotels experienced a $234 or 2.9% improvement in HOI from the prior year, primarily due to room revenue improvements in the quarter which were discussed previously. Our Atlantic and Western properties experienced a $241 or 4.1% and $31 or 0.9% decline respectively in HOI from the prior year, as expenses were slightly higher than the improvements in room revenue.

Nine months ended September 30, 2004

Hotel operating income ("HOI") for the nine months ended September 30, 2004 improved by $10.3 million, growing from $64.9 million in the prior year to $75.2 million. This was a result of higher hotel revenue of $38.1 million, along with an overall increase in hotel expenses of $27.8 million.

A geographical comparison of the hotel operating income variance between the nine months ended September 30, 2004 and the nine months ended September 30, 2003 is as follows:

	Hotels	Rooms	As a % of total	HOI variance	As a % of total	Var % over 2003
Original Portfolio						
Greater Toronto Area ("GTA")	10	1,755	13.2%	$ 2,755	26.8%	45.7%
Ontario other	45	4,115	31.0%	(205)	(2.0%)	(0.8%)
Total Ontario	55	5,870	44.2%	2,550	24.8%	8.1%
Quebec	28	2,544	19.2%	(914)	(8.9%)	(5.3%)
Atlantic	17	1,315	9.9%	(464)	(4.5%)	(4.7%)
Western	14	1,822	13.7%	319	3.1%	5.1%
Sub-hotel	114	11,551	87.0%	1,491	14.5%	2.3%
Acquired Hotels(1)	10	1,721	13.0%	8,801	85.5%	100.0%
Total (1)	124	13,272	100.0%	$ 10,292	100.0%	15.9%

(1) The results of the acquired hotels do not reflect a full period as they were acquired during the second and third quarters of 2004.

Strong gains were made in HOI in our GTA properties along with modest gains in our Western hotels due to improving room revenue as outlined previously. These results were offset by declines in our Quebec hotels, other-Ontario hotels and Atlantic hotels of the original portfolio. Our Windsor and Ottawa hotels experienced a combined decline of $1,153 for the nine months ended September 30, 2004. The results in these two markets were partially offset by improvements in the remainder of our other-Ontario properties. The decline in our Quebec hotels primarily reflects a decrease in HOI of $1.0 million in our Montreal hotels.

OTHER INCOME AND EXPENSES

Three months ended September 30, 2004

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 third quarter was $16.3 million, an increase of $2.4 million or 17.3% over the same period in 2003. The main contributors to this change were increased interest on mortgages and depreciation and amortization of $849 and $1.7 million respectively reflecting our recent acquisitions. Corporate and administrative expenses increased $173 due to higher trustee compensation and additional staffing expenses.

Nine months ended September 30, 2004

The net amount of other income and expenses for the nine months ended September 30, 2004 was $47.1 million, which was $4.5 million or 10.5% more than the same period in 2003. The main contributors to this change was $3.3 million and $1.0 million in increased depreciation and amortization and interest on mortgages respectively, mainly attributable to the acquired hotels. Also, there was a $532 increase in corporate and administrative expense for reasons noted previously.

INCOME TAXES

Three months ended September 30, 2004

Current income tax expense for the three months ended September 30, 2004 was $112, an increase of $146 from the previous year. This increase is attributable to a lower benefit recognized from the expected tax loss generated in corporate subsidiaries of the REIT in the current period being carried back to the prior periods versus the benefit recognized in the same period of the previous 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 lesser 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. InnVest experienced a $1.1 million future income tax recovery decrease over the prior period, as the result of a recovery recorded in the same period of the prior year which was related to anticipated 2003 income tax losses in a subsidiary of the REIT.

For calendar 2003, the REIT reported that 52.5% of the distributions made in 2003 were not taxable to the Unitholders. The REIT estimates that the non-taxable portion of the distributions to the Unitholders for 2004 will be approximately 40%.

Nine months ended September 30, 2004

Current income tax expense for the nine months ended September 30, 2004 was $460, down from $600 in 2003 because of the tax loss benefit previously discussed. Further, InnVest experienced a $524 future income tax recovery decrease for the period, as the result of a recovery recorded in the same period of the prior year which was related to anticipated 2003 income tax losses in a subsidiary of the REIT.

NET INCOME

Three months ended September 30, 2004

InnVest's net income for the three months ended September 30, 2004 was $22.9 million or $0.435 per unit – basic (diluted – $0.400), compared with net income for the three months ended September 30, 2003 of $19.7 million or $0.431 per unit – basic (diluted – $0.410). The variance of $3.2 million is a result of higher HOI of $6.8 million partially offset by an increase in other expenses of $2.4 million, the current income tax benefit as a result of the recognition of carrying tax losses back to prior periods of $393, net of a decrease in the future income tax recovery of $1.1 million.

Nine months ended September 30, 2004

InnVest's net income for the nine months ended September 30, 2004 was $29.7 million or $0.493 per unit – basic (diluted – $0.492), compared with net income for the nine months ended September 30, 2003 of $24.3 million or $0.446 per unit – basic (diluted – $0.446). The variance of $5.4 million is primarily a result of an increase in HOI of $10.3 million partially offset by an increase in other expenses of $4.5 million, net of a decrease in the future income tax recovery.

FUNDS FROM OPERATIONS

Funds from operations ("FFO") is not a measure defined under GAAP, however it is commonly used by the real estate industry. The Canadian Institute of Public and Private Real Estate Companies generally defines FFO as net income adjusted for extraordinary items, gains or losses on the sale of, or provisions for impairment against, capital items and depreciation and amortization relating to capital items. FFO should not be considered as a substitute to 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 utilizing net income and adjusting it by:

i) adding back depreciation and amortization expense (excluding amortization of deferred financing and other assets expense);

ii) adding back (or deducting) future income tax expense (recovery);

iii) adding back 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 lead to a result which is 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 September 30, 2004 was $31.8 million, which is $5.8 million higher than the $26.0 million in the prior year. FFO for the nine months ended September 30, 2004 was $53.9 million, which is $9.0 million higher than the $44.9 million in the prior year. These increases in FFO are primarily a result of the increase in net income discussed previously.

DISTRIBUTABLE INCOME

Distributable income is not a measure defined under Canadian generally accepted accounting principles, however it is commonly used in the Real Estate Investment Trust industry to measure performance and relative performance within the industry.

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

i) adding back 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 the interest on convertible debentures that is not included in the computation of net income;

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 Note 9 to the financial statements. Distributable income is one measure used by industry analysts in the determination of the Trust's per unit value and the ability of the Trust to fund distributions, and therefore investment returns, for current or potential investors. As outlined in the Declaration of Trust, the REIT is required to distribute 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 not only serves management and the Board of Trustees in determining the level of distributions for unitholders, but it also serves as an important measure for investors in their evaluation of the performance of management.

In addition, in evaluating acquisition opportunities, the current level of distributable income and the expected distributable income to be generated through an acquisition is 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 it is the guideline by which operational and financial decisions are made, and it serves as an integral part of the investment decision for investors and potential investors.

Three months ended September 30, 2004

Distributable income for the three months ended September 30, 2004 was $25.7 million or $0.563 per unit – basic (diluted – $0.497). This reflects a $4.4 million increase over the distributable income achieved for the three months ended September 30, 2003 of $21.3 million or $0.519 per unit – basic (diluted – $0.481). The improvement is primarily due to the increase in net income before future income taxes, as higher depreciation and amortization of $1.7 million which is added back to arrive at distributable income was offset by higher FF&E reserves and convertible debentures interest of $908 and $915 respectively.

Nine months ended September 30, 2004

Distributable income for the nine months ended September 30, 2004 was $38.7 million or $0.877 per unit – basic (diluted – $0.849). This reflects a $6.2 million increase over the distributable income achieved for the nine months ended September 30, 2003 of $32.5 million or $0.790 per unit – basic (diluted - $0.789). The improvement is primarily due to the increase in net income, as higher depreciation and amortization of $3.3 million which is added back to arrive at distributable income was offset by higher FF&E reserves and convertible debentures interest of $1.5 million and $1.8 respectively.

CHANGES IN FINANCIAL CONDITION

The following discussion evaluates the cash flow results of InnVest from operational, investing, and financing activities for the three and nine months ended September 30, 2004.

Operating Activities

Three months ended September 30, 2004

Funds generated from operating activities were $32.8 million for the three months ended September 30, 2004, an increase of $9.9 million compared to $22.9 million for the three months ended September 30, 2003. The increase is mainly attributable to higher net income before depreciation and amortization of $4.9 million, and a positive variance in changes in non-cash working capital of $3.7 million as summarized below:

	Three months ended September 30		
	2004	2003	Variance
Accounts receivable	**$ (3,210)**	$ (1,563)	$ (1,647)
Prepaid expenses and other assets	**(1,229)**	(200)	(1,029)
Accounts payable	**5,070**	(1,314)	6,384
	$ 631	$ (3,077)	$ 3,708

The $1.6 million decrease in non-cash working capital arising from accounts receivable is primarily due to higher revenues in the quarter relative to the prior year, along with the assumption of accounts receivable arising from the acquired hotels. The $1.0 million decrease in non-cash working capital from prepaid expense and other assets is due to a prepayment of insurance for the REIT's properties and directors' and officers' insurance, which was paid in full during the quarter for the period through to the end of June 2005, whereas in the past the REIT paid such expenses on a monthly basis. Lastly, the $6.4 million improvement in non-cash working capital arising from accounts payable is due to the increase of accounts payable for the acquired hotels, additional accruals for convertible debentures interest due to the issuance of the Series A convertible debentures during the year, changes in the timing of interest payments, and a general increase in business activity over the prior year.

Nine months ended September 30, 2004

Funds generated from operating activities were $55.1 million for the nine months ended September 30, 2004, an increase of $18.3 million compared to $36.8 million for the nine months ended September 30, 2003. The increase is mainly attributable to higher net income before depreciation and amortization of $8.7 million, and a positive variance in changes in non-cash working capital of $8.7 million as summarized below:

	Nine months ended September 30		
	2004	2003	Variance
Accounts receivable	**$ (4,497)**	$ (3,147)	$ (1,350)
Prepaid expenses and other assets	**(5,163)**	(2,499)	(2,664)
Accounts payable	**10,251**	(2,449)	12,700
	$ 591	$ (8,095)	$ 8,686

The $1.4 million decrease in non-cash working capital arising from accounts receivable is primarily due to higher revenues in the period relative to the prior year, along with the assumption of accounts receivable arising from the acquired hotels. The $2.7 million decrease in non-cash working capital from prepaid expenses and other assets is due to a prepayment of insurance as described previously, along with prepayment of property taxes on the REIT's properties for future periods. The $12.7 million improvement in non-cash working capital arising from accounts payable is due to the reasons stated above, net of the payment of acquisition related liabilities in the prior period.

Financing Activities

<u>Three months ended September 30, 2004</u>

Funds used in financing activities were $9.8 million for the three months ended September 30, 2004 compared to $14.1 million for the three months ended September 30, 2003. Proceeds from long-term debt amounted to $6.5 million through the financing of the Holiday Inn Oshawa, Ontario. Cash distributions and convertible debentures interest were higher than the same period in the prior year by $1.0 million and $915 respectively as the result of the Trust unit issue and convertible debentures issue in April 2004.

<u>Nine months ended September 30, 2004</u>

Funds from financing activities generated $110.2 million for the nine months ended September 30, 2004 compared to a $47.1 million deficit for the nine months ended September 30, 2003. The majority of this change relates to the issuance of trust units of $45.3 million net of issuance costs, the issuance of convertible debentures of $54.9 million net of issuance costs, new mortgage proceeds of $61.4 million, net of an increase in cash distributions and convertible debentures interest of $586 and $1.8 million respectively and a temporary $4.1 million repayment of mortgages payable that is available to be drawn upon when funds are required. The increase in cash distributions of $586 is comprised of $2.2 million of distributions on the newly issued trust units, net of a $1.6 million increase in distributions made under the distribution reinvestment plan, which was not in effect until the middle of the second quarter of 2003.

On April 2, 2004, InnVest closed an equity and convertible debentures issue pursuant to a final short form prospectus dated March 23, 2004. InnVest used the funds raised, along with long-term mortgage financing secured in part to purchase the acquired hotels as follows:

	Closed April, 2004	Closed July, 2004	Total
Funds from financing activities			
Trust units, net of commissions and costs	$ 45,281	$ –	$ 45,281
Convertible debentures, net of commissions and costs	54,944	–	54,944
Long-term debt mortgage financing	54,875	6,500	61,375
Capital lease obligation assumed	2,052	–	2,052
	$ 157,152	$ 6,500	$ 163,652
Less purchase price and related costs	$ 116,817	$ 14,231	$ 131,048
Excess cash	$ 40,335	$ (7,731)	$ 32,604

InnVest intends to deploy the excess cash raised to make selected acquisitions that will be accretive to earnings and cash flow.

CONVERTIBLE DEBENTURES

On April 2, 2004, the REIT raised a total amount of $57.5 million in convertible debentures, which bear interest at an annual rate of 6.25% payable semi-annually in arrears on April 15th and October 15th in each year commencing October 15, 2004. The debentures have a term of seven years and are convertible into units of the REIT at a conversion price of $12.50 per unit.

MORTGAGE FINANCING

The REIT secured two pools of mortgage financing with each pool secured by five of the acquired hotels. The first pool is $31.1 million, which was fully funded in April 2004. The mortgages bear interest at an annual rate of 6.65% compounded semi-annually and are repayable in blended monthly payments of interest and principal amortized over 21.4 years during their 10-year term. The second pool is $30.3 million, of which $23.8 million was advanced in April 2004, and the remaining $6.5 million was advanced in July 2004. The first advance of the second pool bears interest at an annual rate of 6.60% compounded semi-annually and is repayable in blended monthly payments of interest and principal amortized over 25 years during the 10-year term. The second advance in July 2004 bears interest at a rate of 6.78%, with all other terms being identical.

Investing Activities

Three months ended September 30, 2004

Funds from investing activities generated a deficit of $18.0 million for the three months ended September 30, 2004 compared to a $2.8 million deficit for the three months ended September 30, 2003. This decrease was mainly the result of $14.0 million being used to acquire the Holiday Inn Oshawa, Ontario which closed in July 2004 and a $1.6 million increase in capital expenditures in the quarter, along with a lower net increase in the FF&E reserve of $743.

As part of the regular refurbishment program, InnVest sets aside 4% of revenue for the 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 in order to ensure that they remain competitive in their markets. For the three months ended September 30, 2004 and 2003 a total amount of $3.0 million and $1.4 million respectively was spent on capital items. The FF&E reserve balance at September 30, 2004 was $17.9 million, an increase of $743 over the period.

Nine months ended September 30, 2004

Funds from investing activities generated a deficit of $136.1 million for the nine months ended September 30, 2004 compared to a $7.0 million deficit for the nine months ended September 30, 2003. This decrease was mainly the result of $121.4 million in hotel acquisitions which closed in April and July 2004 and a $4.4 million increase in capital expenditures in the period, along with a $3.2 million increase in the FF&E reserve.

For the nine months ended September 30, 2004 and 2003 a total amount of $10.1 million and $5.7 million respectively was spent on capital items. The REIT intends to follow a program of completing a significant amount of its property refurbishments when there is less hotel demand, as it is management's objective to displace a minimal amount of business from rooms being out of service for refurbishment.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

The following chart summarizes InnVest's future contractual obligations as at September 30, 2004:

	Balance of 2004	2005	2006	2007	2008	2009 and thereafter	Total
As at September 30, 2004							
Mortgages payable	$ 1,911	$ 6,950	$ 139,303	$ 4,835	$ 154,275	$ 55,272	$ 362,546
Capital lease obligation	153	87	94	101	113	1,504	2,052
Operating equipment leases	174	550	502	393	290	479	2,388
Long-term land leases	384	1,542	1,489	1,324	1,332	68,638	74,709
Convertible debentures	–	–	–	74,470	–	57,500	131,970
	$ 2,622	$ 9,129	$ 141,388	$ 81,123	$ 156,010	$ 183,393	$ 573,665

The next material refinancing to occur will be in 2006 when $139.3 million of long-term debt matures. At that time, InnVest will seek refinancing of the debt. InnVest will follow the same strategy in 2008, when $154.3 million of long-term debt matures.

The long-term land leases require minimum annual average lease payments as outlined above, 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 the cash distributions it has been paying out to unitholders for the three and nine months ended September 30, 2004, along with the trailing twelve months ended September 30, 2004:

	Three months ended September 30, 2004	Nine months ended September 30, 2004	Twelve months ended September 30, 2004
Distributable Income	$ 25,717	$ 38,703	$ 45,693
Distributions	12,854	37,286	48,880
Distributable income in excess (deficit) of distributions	12,863	1,417	(3,187)
Non-cash distributions made through the distribution reinvestment plan ("DRIP")	855	2,303	2,961
Distributable income in excess (deficit) of cash distributions	$ 13,718	$ 3,720	$ (226)
Payout ratios:			
Total distributions	50.0%	96.3%	107.0%
Cash distributions (total distributions minus DRIP)	46.7%	90.4%	100.5%

The payout ratio of the REIT is best evaluated on an annualized basis over a twelve month period due to the seasonal nature of the hotel industry. As is shown, the payout ratio of the REIT has been 107.0% over the trailing twelve month period, or 100.5% on a cash basis. Liquidity to fund distributions is generated from cash flow from hotel operations, the 50% interest in Choice Canada, bank operating lines available, by the ability to finance certain unencumbered or under-leveraged assets, and cash on hand.

Distributions to unitholders are approved on a monthly basis by the REIT's board of trustees. In exercising their discretion to approve the level of distributions, the Trustees utilize 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. This is due to the following factors:

i) its exposure to the overall cyclical effects of the Canadian business environment;

ii) the seasonal nature of our business,

iii) our geographical diversity, as our hotels are located in numerous regions throughout Canada, with each region having their own unique characteristics,

iv) changing customer sentiment in regards to brands which the REIT's hotel properties utilize;

v) changes in customer segmentation due to changing social, economic and political conditions,

vi) and 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. A recent example was evidenced by the outbreak of SARS in 2003 which had a material negative impact on the Canadian hotel industry. As a result of the REIT's exposure to numerous factors which are beyond its control, it is difficult for the 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 in a manner 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 September 30, 2004 was $51.1 million of which $17.9 million is restricted under the REIT's trust indenture for the purpose of the replacement of furniture, fixtures, and equipment and for capital improvements. The REIT's intention is to use its unrestricted cash in excess of working capital requirements for acquisitions.

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 September 30, 2004 were $2.6 million. Our current expectation is that capital spending in 2005 will exceed 2004 levels.

The following chart shows the changes in the restricted cash balance for the three and nine months ended September 30, 2004 along with their comparable periods:

	Three months ended September 30		Nine months ended September 30	
	2004	2003	**2004**	2003
Opening balance	**$ 17,221**	$ 11,961	**$ 13,381**	$ 12,075
4% of revenues	**3,720**	2,812	**8,480**	6,957
Transferred from operating cash	**–**	3	**–**	3
Initial reserve – acquired hotels	**–**	–	**6,100**	–
Capital expenditures	**(3,034)**	(1,386)	**(10,054)**	(5,645)
Closing balance	**$ 17,907**	$ 13,390	**$ 17,907**	$ 13,390

The REIT had unused operating loan availability of $25 million at September 30, 2004 and four hotel properties that remain unencumbered that the REIT estimates could generate at least $6.5 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 September 30, 2004, the REIT distributed $12.9 million or $0.2813 per unit, of which $855 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, bringing the total distributions for the nine months ended September 30, 2004 to $37.3 million or $0.8438 per unit, of which $2.3 million was distributed in units as part of the DRIP. A regular monthly distribution of $0.09375 per unit for the month of September 2004 was paid in October 2004 and the distribution of $0.09375 per unit for the month of October 2004 was declared and will be payable on November 15, 2004.

Mortgage debts with a weighted average interest rate of 7.8% maturing through to the end of 2005 total $44.9 million. The REIT has a $100 million mortgage loan facility with its main mortgage lender which is available to repay these mortgage debts as they mature. The remaining availability of this facility is $47.2 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 current cash position. Future growth is expected to be funded from cash on hand and borrowing capacity and through the issuance of trust units.

Issued Trust Units

As at September 30, 2004 a total of 45,731,710 units of the REIT were outstanding. There is only one class of trust units, with each unit eligible for one vote. During the first two quarters of 2004 units were issued under the trustee compensation plan, the DRIP and through the conversion of convertible debentures as follows:

	Units	Amount
Balance at December 31, 2003	41,247,862	$ 389,310
First quarter activity		
Units issued under trustee compensation plan	4,678	53
Units issued under DRIP	60,484	671
Units issued upon conversion of debentures	46,511	505
Balance at March 31, 2004	41,359,535	$ 390,539
Second quarter activity		
Units issued under prospectus dated March 23, 2004	4,187,000	45,281
Units issued under trustee compensation plan	2,900	30
Units issued under DRIP	75,870	777
Units issued upon conversion of debentures	2,790	30
Balance at June 30, 2004	45,628,095	$ 436,657
Third quarter activity		
Units issued under trustee compensation plan	2,709	30
Units issued under DRIP	80,333	855
Units issued under executive compensation plan	20,573	220
Balance at September 30, 2004	45,731,710	$ 437,762
Activity subsequent to September 30, 2004		
Units issued under trustee compensation plan	2,699	30
Units issued under DRIP	27,572	298
Balance at November 4, 2004	45,761,981	$ 438,090

There are a total of $74.5 million in outstanding convertible unsecured subordinated debentures at September 30, 2004 from the initial series of 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 30th and December 30th in each year and are due June 30, 2007. The total remaining trust units to be issued upon conversion for this series of debentures is 6,927,442.

On April 2, 2004 the REIT issued $57.5 million of convertible unsecured subordinated debentures ("Series A 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 15th and October 15th in each year, commencing October 15, 2004 and are due April 15, 2011. The total trust units to be issued upon conversion of the Series A Debentures are 4,600,000.

HISTORICAL QUARTERLY AND ANNUAL OPERATING RESULTS COMPARISON

InnVest has audited results for the year ended December 31, 2003 and the period from July 26, 2002 to December 31, 2002. The following is therefore a year-over-year comparison of hotel operating results for the quarters of 2003 and 2002 using unaudited results for each quarter:

	Quarter ended			Year ended	Quarter ended				Period ended	Quarter ended
	Sept. 30 2004	June 30 2004	March 31 2004	Dec. 31 2003	Dec. 31 2003	Sept. 30 2003	June 30 2003	March 31 2003	Dec. 31 2002	Dec. 31 2002
Occupancy	**73.8%**	63.8%	53.0%	60.3%	55.4%	71.0%	61.0%	53.6%	66.1%	57.2%
Average daily rates	**$ 92.44**	$ 85.32	$ 77.13	$ 81.77	$ 78.70	$ 87.20	$ 81.67	$ 77.79	$ 83.14	$ 78.55
Revenue per available room	**$ 68.24**	$ 54.39	$ 40.86	$ 49.28	$ 43.57	$ 61.91	$ 49.82	$ 41.69	$ 54.94	$ 44.93
Room revenues	**$ 83,320**	$ 64,283	$ 42,946	$ 207,784	$ 46,300	$ 65,786	$ 52,363	$ 43,335	$ 101,354	$ 47,742
Total revenues	**$ 92,995**	$ 72,498	$ 46,513	$ 224,216	$ 50,287	$ 70,306	$ 56,318	$ 47,305	$ 109,230	$ 51,956
Hotel operating expenses and management fees	**$ 47,132**	$ 40,430	$ 28,921	$ 120,444	$ 29,174	$ 32,327	$ 29,537	$ 29,406	$ 55,075	$ 29,507
Gross operating profit	**$ 45,863**	$ 32,068	$ 17,592	$ 103,772	$ 21,113	$ 37,979	$ 26,781	$ 17,899	$ 54,155	$ 22,449
Gross operating profit margin	**49.3%**	44.2%	37.8%	46.3%	42.0%	54.0%	47.6%	37.8%	49.6%	43.2%
Property taxes, rent and insurance	**$ 7,036**	$ 7,142	$ 6,133	$ 23,562	$ 5,823	$ 5,931	$ 5,865	$ 5,943	$ 9,626	$ 5,545
Hotel operating income	**$ 38,827**	$ 24,926	$ 11,459	$ 80,210	$ 15,290	$ 32,048	$ 20,916	$ 11,956	$ 44,529	$ 16,904
Hotel operating income margin	**41.8%**	34.4%	24.6%	35.8%	30.4%	45.6%	37.1%	25.3%	40.8%	32.5%
Net income (loss)	**$ 22,878**	$ 9,695	$ (2,868)	$ 10,858	$ (13,414)	$ 19,712	$ 6,914	$ (2,354)	$ 20,387	$ 2,672
Net income (loss) per unit										
– basic	**$ 0.435**	$ 0.148	$ (0.117)	$ 0.071	$ (0.374)	$ 0.431	$ 0.120	$ (0.106)	$ 0.419	$ 0.021
– diluted	**$ 0.400**	$ 0.148	$ (0.117)	$ 0.071	$ (0.374)	$ 0.410	$ 0.120	$ (0.106)	$ 0.419	$ 0.021
Distributable income	**$ 25,717**	$ 12,207	$ 779	$ 39,455	$ 6,990	$ 21,337	$ 10,019	$ 1,109	$ 25,263	$ 5,916
Distributions paid	**$ 12,854**	$ 12,813	$ 11,619	$ 46,280	$ 11,594	$ 11,577	$ 11,556	$ 11,553	$ 20,000	$ 11,553
Distributable income per unit										
– basic	**$ 0.563**	$ 0.269	$ 0.019	$ 0.959	$ 0.170	$ 0.519	$ 0.244	$ 0.027	$ 0.615	$ 0.144
– diluted	**$ 0.497**	$ 0.262	$ 0.019	$ 0.959	$ 0.170	$ 0.481	$ 0.244	$ 0.027	$ 0.592	$ 0.144
Trust units outstanding	**45,731,710**	45,628,095	41,359,535	41,247,862	41,247,862	41,179,554	41,096,747	41,082,720	41,075,910	41,075,910
Weighted average of trust units outstanding	**45,683,379**	45,445,996	41,292,952	41,130,961	41,214,890	41,140,075	41,087,537	41,079,756	41,075,910	41,075,910
Total assets	**$1,047,475**	$1,030,037	$ 883,783	$ 887,054	$ 887,054	$ 904,148	$ 901,686	$ 912,501	$ 932,912	$ 932,912
Total long-term debt	**$ 364,598**	$ 360,021	$ 309,009	$ 303,883	$ 310,926	$ 312,896	$ 314,236	$ 317,223	$ 310,486	$ 319,462

(1) The REIT began operations on July 26, 2002, therefore the net income, distributable income and the related per units amounts for the September 2002 quarter reflect the results for the period from July 26, 2002 to September 30, 2002 and are not available for the June 2002 quarter. Hotel operating revenue, expenses and income reflect operations for the June and September 2002 quarters have been adjusted to reflect the current management fee structure.

InnVest's operations are seasonal and as such its results are not consistent throughout the year. Revenue 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. The results from operations vary materially from quarter to quarter because of the seasonal nature of the revenue stream and the fact that certain costs such as property taxes, insurance, interest, depreciation and amortization, corporate and administrative are fixed or virtually fixed. The effects of the significant negative events of 2003 are clearly evident when comparing 2003 quarters to the same periods in 2002.

The quarterly negative RevPAR variances on a year-over-year basis have continued to improve after the second quarter of 2003, as illustrated in the chart below:

Quarters Ended	% RevPAR change from prior year
September 30, 2004(1)	**6.0%**
June 30, 2004(1)	4.9%
March 31, 2004	-2.0%
December 31, 2003	-3.0%
September 30, 2003	-11.4%
June 30, 2003	-12.1%

(1) % RevPAR change compares the original portfolio plus the acquired hotels on a same hotel basis.

RISKS AND UNCERTAINTIES

The REIT is subject to the normal operating risks consistent with hotel ownership, including the risks described below. The REIT has risk management processes in place, and additionally mitigates business risks through restrictions, limitations and policies placed upon it by its trust indenture as outlined below.

Real Estate Investment Risks

One of the factors contributing to the REIT's income and its ability to make distributions to its Unitholders is its ability to operate the hotel portfolio in a manner that maintains or increases revenue and that generates sufficient hotel operating income.

Hotel Industry Risks

The REIT is subject to the operating risks inherent in the Canadian hotel industry, including:

- Cyclical downturns arising form changes in economic conditions;
- Competition from other hotels;
- Seasonal fluctuations in hotel operating income produced throughout the year;
- Changes in wages, prices, energy costs and construction and maintenance costs that may result from inflation, government regulation, changes in interest rates or currency fluctuations;
- Changes in the level of business, commercial and tourism travel;
- Increase in the supply of accommodations in local markets may adversely affect the results of operations; and
- Availability and pricing of financing for operating or capital requirements.

The REIT mitigates these risks by having a geographically diverse portfolio of hotels, which were acquired at below replacement costs, many of which are in markets with significant barriers to entry. The REIT maintains a $25 million operating line to ensure that the seasonal fluctuation in the generation of cash flow will not affect its ability to operate in the normal course of business.

The REIT also has significant buying power and negotiates favourable national contracts on a regular basis for operating supplies and renovation materials required, and hedges energy costs where deemed appropriate. The REIT's strategy is to maintain customers across several segments, including corporate, government, leisure, local, crew, sports and other groups, and not rely overly on any one segment.

The REIT is required to maintain, by its Trust Indenture, a conservative leverage of 50% or less of its gross asset value (which is defined as total assets before accumulated depreciation less future income tax liability). The vast majority of the REIT's mortgage debt is subject to fixed interest rates, which significantly reduces its exposure to changes in interest rates. The REIT also has the ability to fix interest rates at any time for debts currently subject to floating interest rates, and is in process of developing a longer term interest rate hedging program in order to minimize the interest rate risk on maturing debts.

Trust Indenture

InnVest is governed by its Trust indenture which is intended to mitigate risks by virtue of the restrictions, limitations and policies for financial and operational management. The following is a list of the restrictions, limitations, and policies:

- Eligible investments restricted primarily to hotels in Canada;
- A prohibition against investing in raw land for development and engaging in the development and construction of new real property;
- Individual property mortgages, or mortgages on a pool of properties, cannot exceed 75% of their respective values;
- A limitation on debt of 50% of gross asset value, before convertible debentures. The REIT's leverage at September 30, 2004 was 37.1%;
- A limitation on debt of 60% of gross asset value, including convertible debentures. The REIT's leverage, including convertible debentures, at September 30, 2004 was 50.5%;
- Units cannot be issued from treasury unless the trustees consider it not to be dilutive to ensuing annual distributions of distributable income to existing Unitholders;
- A requirement to pay distributions of not less than 80% of the annual distributable income, equally on a monthly basis;
- Related party transactions require the approval of two-thirds of the independent trustees, and any transfers of real property between related parties requires an independent appraisal; and
- Any material change to the Master Hotel Management Agreement requires two-thirds approval of the independent trustees.

FINANCIAL ACCOUNTING CONSIDERATIONS

RELATED PARTY TRANSACTIONS

Franchise Business

InnVest owns 50% of Choice Canada. The other 50% is owned by Choice Hotels International, which is one of the largest hotel franchise companies in the world. Choice Canada earns franchise revenue by charging monthly royalty fees to hotel owners based on a percentage of the licenced hotels' revenue and by selling franchises. Under the terms of the joint venture agreement between Choice International and a subsidiary of the REIT, InnVest pays a below market royalty fee for its hotels that are franchised under the Choice hotel brands. This arrangement will remain in place for the duration of the joint venture until 2092. Royalty payments paid to Choice Canada by the REIT on a net basis for the three and nine months ended September 30, 2004 totaled $131 and $412 respectively.

Management Company

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. Westmont is controlled by a minority Unitholder of the REIT. The Agreements have an initial term of 10 years with two successive five-year renewal terms, subject to the consent of Westmont and approval by the REIT. The Agreements will expire July 25, 2012. The Agreements are subject to non-competition arrangements. The Agreements provide for the payment of an annual management fee to Westmont in an amount equal to 3.375% of gross hotel revenue 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 earned in the three and nine months ended September 30, 2004.

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.

HEDGING TRANSACTIONS

InnVest's Ontario hotel properties have established fixed contracts with Ontario Power Generation for the provision of hydro electricity. The purpose of these contracts is to reduce the exposure InnVest has to hydro prices in the province of Ontario. The energy contracts set the price of electricity at 52.45 cents/MWh for quantities contracted for. The contracts were established on April 26, 2002 and have a length of 3 years. In the first year of the contract, 100% of the expected usage was contracted for at the fixed price. In the second and third year of the contract, the quantity contracted for at fixed prices declines to 75% and 50% of the expected usage respectively. InnVest pays market rates for the amount of electricity it consumes that are not contracted for at fixed prices. InnVest accounts for this hedge by recording the contracted price of electricity in its accounts for quantities up to the minimum contracted amounts. Electricity usage above this amount is recorded at the market rate. If this arrangement was terminated, the REIT would be subject to the market fluctuations in electricity prices for its Ontario hotels for its entire electricity consumption as opposed to the non-hedged portion.

CRITICAL ACCOUNTING ESTIMATES

A description of the REIT's significant accounting policies is summarized in Note 1 to the consolidated financial statements. Generally accepted accounting principles require management to make estimates and assumptions concerning 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 revenue and expenses during the reporting period. Management uses its judgment and knowledge from past experience as a basis for estimates and other assumptions required in the preparation of the financial statements. Management's estimates and assumptions are evaluated and updated on a regular basis. The actual results for the REIT may materially differ, if management were to use different estimates and assumptions. The following accounting estimates are what management considers to be the most critical in the preparation of the REIT's consolidated financial statements.

Hotel properties

Hotel properties, consisting of land, buildings and furniture, fixtures and equipment, represent the vast majority of the REIT's assets. Depreciable assets within hotel properties again represent the vast majority of the assets of the REIT and the depreciation method and estimates of useful life selected could have a material impact on the REIT's operating results. InnVest depreciates these assets using the straight-line method over their estimated economic or useful lives, which are estimated at 40 years for buildings, up to seven years for building renovations, up to seven years for furniture and fixtures and 10 years for paving.

Allocation of purchase price for acquired hotels

The REIT has accounted for the acquired hotels using the purchase method of accounting. Accordingly, management undertook a process of identifying all tangible and intangible assets acquired and has made a preliminary allocation based on their relative fair value. 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.

Valuation of hotel properties

Generally accepted accounting principles require that long-lived assets be written down to fair value at such time that it is determined that they have been permanently impaired. In order to determine if any of the hotel properties have been permanently impaired, future cash flows are forecasted for each hotel using its most recent performance and expected trends in each specific market, such as new or expected new hotel supply, local and macroeconomic conditions. Then the undiscounted cash flows are aggregated and compared to the net book value of each hotel. An impairment in value will be recorded if the aggregate undiscounted cash flows are less than the net book value for a specific hotel. Each hotel in the portfolio is currently generating and is forecasted to continue to generate positive operating cash flow sufficient to conclude that no impairment of value exists at the present time.

Income taxes

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. The book value of the assets of the REIT's subsidiaries are approximately $404.8 million higher than their respective tax values. Income taxes will be payable if assets that contribute to this difference are sold at amounts higher than their tax base. The REIT has recorded a future income tax liability of $138.1 million related to these temporary differences, which will reverse over time.

Fair value of debt instruments

Long-term debt that was assumed on the acquisition of hotel properties was recorded at its fair value on the date of acquisition, July 26, 2002. The fair value was determined by discounting expected payments on the debts at interest rates being offered to the REIT for debt of the same remaining maturities. In determining interest rates offered to the REIT, management uses the government of Canada bench mark bond yields for the appropriate time period, then adds the expected spread currently being offered to it by various lenders. The difference between the fair value and the face value of the long-term debt was estimated at $2.7 million, was recorded as an increase to long-term debt and has been amortized over approximately two years from the acquisition date through a reduction to interest expense at a rate of approximately $342 per quarter. During the third quarter of 2004, the reduction to interest expense was $125, and the unamortized balance has now been fully amortized.

CHANGES IN ACCOUNTING POLICIES

Impairment of value of hotel properties

Effective January 1, 2004, InnVest adopted the new CICA standard with respect to accounting for the impairment of long-lived assets and it has been applied prospectively. The new requirement is that long-lived assets be reviewed by management for impairment whenever any events or changes in circumstances exist that would indicate that the carrying amount of an asset may not be recoverable over time. The adoption of this new standard did not have an impact on InnVest's results from operations or financial position.

Disposal of long-lived assets and discontinued operations

At the beginning of 2004 the REIT also adopted the new CICA standard with respect to the disposal of long-lived assets and discontinued operations, whereby provided certain criteria are met, long-term assets and related assets and liabilities expected to be disposed of by management will be classified as held for sale. The adoption of this new standard did not have an impact on InnVest's results from operations or financial position.

Hedging relationships

Effective January 1, 2004, InnVest adopted the new CICA standard with respect to accounting for hedging transactions. The new standard specifies the requirements that must be in place in regards to a hedge transaction in order for the transaction to be accounted for as a hedge. The adoption of this new standard did not have an impact on InnVest's results from operations or financial position.

PENDING CHANGES IN ACCOUNTING POLICIES

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 adoption of this new standard will have the effect that the REIT's convertible debentures will have to be reclassified from equity to liabilities and that interest on the debentures will be deducted in the calculation of net income or loss. The new standard will not have any effect on net income or loss per unit as the interest expense on the convertible debentures is currently deducted from earnings for the purpose of the per unit calculations.

OUTLOOK

The recovery in the Candian hotel industry is continuing, as reflected in the 6.0% improvement in RevPAR experienced by InnVest during the quarter on a same hotel basis. All regions in the original portfolio experienced increased revenues in the third quarter over the prior year. The majority of this improvement was concentrated in our Ontario properties, and most notably, the GTA.

The improving results of the REIT are occurring at a slower pace than we expected. A major factor is that U.S. travel and tourism into Canada has been weak. This is most evident in our Ontario border, Atlantic Canada and Quebec hotels, which typically have strong U.S. tourist demand in the summer months.

Hotel industry expert PKF Consulting is forecasting a RevPAR improvement of approximately 4% in 2005 on a national basis. We agree that the overall Canadian Hotel industry will improve in 2005 and we remain optimistic that our hotels which have been impacted from weaker U.S. tourist demand will continue to experience higher demand. We are pleased with the performance of our recently acquired hotels and will continue to pursue acquisitions that are accretive to the REIT.

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)	**September 30, 2004**	December 31, 2003
	(Unaudited)	
ASSETS		
Current Assets		
Cash	**$ 33,198**	$ 3,958
Accounts receivable	**13,584**	7,827
Prepaid expenses and other assets	**9,956**	3,747
	56,738	15,532
Restricted cash	**17,907**	13,381
Hotel properties *(Note 3)*	**941,788**	828,262
Licence contracts		
(accumulated amortization $2,874 – December 31, 2003 – $1,887)	**23,446**	24,433
Deferred financing and other assets *(Note 4)*	**7,596**	5,446
	$ 1,047,475	$ 887,054
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	**$ 30,439**	$ 17,197
Distributions payable	**4,287**	3,867
Acquisition related liabilities	**682**	759
Current portion of long-term debt *(Note 5)*	**7,395**	7,043
	42,803	28,866
Long-term debt *(Note 5)*	**357,203**	303,883
Future income tax liability	**138,084**	135,441
	538,090	468,190
EQUITY		
Unitholders' equity	**376,123**	343,240
Convertible debentures *(Note 7)*	**133,262**	75,624
	509,385	418,864
	$ 1,047,475	$ 887,054

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

Consolidated Statements of Net Income

(in thousands of dollars, except per unit amounts) (Unaudited)	**Three months ended Sept. 30, 2004**	Three months ended Sept. 30, 2003	**Nine months ended Sept. 30, 2004**	Nine months ended Sept. 30, 2003
Hotel revenues	**$ 92,995**	$ 70,306	**$ 212,006**	$ 173,929
Hotel expenses				
Operating expenses	**43,993**	29,954	**109,327**	85,400
Property taxes, rent and insurance	**7,036**	5,931	**20,311**	17,739
Management fees	**3,139**	2,373	**7,156**	5,870
	54,168	38,258	**136,794**	109,009
Hotel operating income	**38,827**	32,048	**75,212**	64,920
Other (income) and expenses				
Interest on mortgages	**6,429**	5,580	**17,775**	16,769
Corporate and administrative	**945**	772	**2,814**	2,282
Capital tax	**344**	495	**1,324**	1,485
Franchise business income	**(1,105)**	(1,015)	**(1,930)**	(1,814)
Other income	**(95)**	(30)	**(239)**	(149)
Depreciation and amortization	**9,805**	8,110	**27,405**	24,101
	16,323	13,912	**47,149**	42,674
Income before income tax expense (recovery)	**22,504**	18,136	**28,063**	22,246
Income tax expense (recovery)				
Current	**112**	(34)	**460**	600
Future	**(486)**	(1,542)	**(2,102)**	(2,626)
	(374)	(1,576)	**(1,642)**	(2,026)
Net income	**$ 22,878**	$ 19,712	**$ 29,705**	$ 24,272
Net income per unit – basic *(Note 8)*	**$ 0.435**	$ 0.431	**$ 0.493**	$ 0.446
Net income per unit – diluted *(Note 8)*	**$ 0.400**	$ 0.410	**$ 0.492**	$ 0.446

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

Consolidated Statements of Unitholders' Equity

(in thousands of dollars) (unaudited)	Units in $	Net Income	Distributions	Executive Compensation	Convertible Debentures Interest and Accretion	Total
Balance December 31, 2002	$ 387,744	$ 20,387	$ (20,000)	$ 72	$ (3,170)	$ 385,033
CHANGES DURING THE PERIOD						
Net income	–	24,272	–	–	–	24,272
Unit distributions	–	–	(34,686)	–	–	(34,686)
Distribution reinvestment plan units issued *(Note 6)*	709	–	–	–	–	709
Costs incurred regarding the distribution reinvestment plan *(Note 6)*	(19)	–	–	–	–	(19)
Vested executive compensation	168	–	–	(168)	–	–
Executive and trustee compensation *(Note 6)*	60	–	–	126	–	186
Convertible debentures interest and accretion	–	–	–	–	(5,952)	(5,952)
Balance September 30, 2003	$ 388,662	$ 44,659	$ (54,686)	$ 30	$ (9,122)	$ 369,543
Balance December 31, 2003	$ 389,310	$ 31,245	$ (66,280)	$ 72	$ (11,107)	$ 343,240
CHANGES DURING THE PERIOD						
Net income	–	29,705	–	–	–	29,705
Unit distributions	–	–	(37,286)	–	–	(37,286)
Issue of new units	47,522	–	–	–	–	47,522
Costs incurred regarding issue of new units	(2,241)	–	–	–	–	(2,241)
Distribution reinvestment plan units issued *(Note 6)*	2,303	–	–	–	–	2,303
Conversion of debentures	535	–	–	–	–	535
Vested executive compensation	220	–	–	(220)	–	–
Executive and trustee compensation *(Note 6)*	113	–	–	168	–	281
Convertible debentures interest and accretion	–	–	–	–	(7,936)	(7,936)
Balance September 30, 2004	$ 437,762	$ 60,950	$ (103,566)	$ 20	$ (19,043)	$ 376,123

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

Consolidated Statements of Cash Flows

(in thousands of dollars) (Unaudited)	**Three months ended Sept. 30, 2004**	Three months ended Sept. 30, 2003	**Nine months ended Sept. 30, 2004**	Nine months ended Sept. 30, 2003
OPERATING ACTIVITIES				
Net income	**$ 22,878**	$ 19,712	**$ 29,705**	$ 24,272
Add (deduct) items not affecting operations				
Depreciation and amortization	**9,312**	7,745	**26,060**	23,004
Amortization of deferred financing and other assets	**493**	365	**1,345**	1,097
Future income tax recovery	**(486)**	(1,542)	**(2,102)**	(2,626)
Non-cash executive and trustee compensation	**114**	57	**281**	201
Amortization of fair value debt adjustment	**(125)**	(360)	**(809)**	(1,042)
Changes in non-cash working capital	**631**	(3,077)	**591**	(8,095)
	32,817	22,900	**55,071**	36,811
FINANCING ACTIVITIES				
Repayment of long-term debt	**(1,760)**	(20,748)	**(42,344)**	(25,292)
Proceeds from long-term debt	**6,462**	19,768	**94,773**	19,768
Issue of trust units, net of issue costs	**–**	–	**45,281**	–
Issue of convertible debentures	**–**	–	**57,500**	–
Costs incurred regarding the distribution reinvestment plan	**–**	–	**–**	(19)
Unit distributions	**(11,990)**	(10,991)	**(34,563)**	(33,977)
Changes in non-cash working capital related to financing activities	**(88)**	(292)	**(296)**	(2,116)
Deferred financing	**366**	–	**(2,855)**	–
Convertible debentures interest	**(2,743)**	(1,828)	**(7,268)**	(5,484)
	(9,753)	(14,091)	**110,228**	(47,120)
INVESTING ACTIVITIES				
Capital expenditures on hotel properties	**(3,034)**	(1,386)	**(10,054)**	(5,645)
Other assets	**(273)**	–	**(639)**	–
Changes in non-cash working capital related to investing activities	**(11)**	–	**593**	–
Acquisition of hotel properties *(Note 2)*	**(14,008)**	–	**(121,433)**	–
Changes in restricted cash	**(686)**	(1,429)	**(4,526)**	(1,315)
	(18,012)	(2,815)	**(136,059)**	(6,960)
Increase (decrease) in cash during the period	**5,052**	5,994	**29,240**	(17,269)
Cash, beginning of period	**28,146**	3,467	**3,958**	26,730
Cash, end of period	**$ 33,198**	$ 9,461	**$ 33,198**	$ 9,461
Supplemental disclosure of cash flow information:				
Cash paid for interest	**$ 6,299**	$ 6,016	**$ 18,221**	$ 17,994
Cash paid for income taxes (including capital tax)	**$ 1,005**	$ 439	**$ 2,307**	$ 2,488

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

September 30, 2004 (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 was established pursuant to a declaration of trust dated January 1, 2002. On July 25, 2002, the REIT raised $300,000 (before issue costs) by issuing units on the Toronto Stock Exchange. These proceeds together with the issue of additional units and convertible debentures were utilized to acquire a portfolio of 114 Canadian hotels with 11,551 guest rooms operated under international brands.

In the nine-month period ended September 30, 2004, InnVest acquired ten hotels with 1,721 guest rooms through the execution of two transactions. The first transaction was the acquisition of the 196-room Holiday Inn Dartmouth, Nova Scotia, which closed on April 5, 2004. The second transaction was a portfolio acquisition that was comprised of nine hotels with 1,525 rooms, seven of which are Holiday Inns located in Ontario, one of which is a Holiday Inn located in Calgary, Alberta and one being a Quality Hotel located in Regina, Saskatchewan. This transaction closed in two stages. Eight hotels were acquired on April 7, 2004 and the ninth hotel was acquired on July 1, 2004. This acquisition was funded through the April 2, 2004 issuance of trust units and convertible debentures and through the issuance of long-term debt.

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 changes in accounting policies noted below. 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.

CHANGES IN ACCOUNTING POLICIES

Impairment of long-lived assets

Effective January 1, 2004, the REIT adopted the new CICA standard with respect to accounting for the impairment of long-lived assets, which has been applied on a prospective basis. This new standard requires that long-lived assets be reviewed by management on a regular basis for impairment to determine if any events or changes in circumstances exist that would indicate that the carrying amount of an asset may not be recoverable over time. If it is determined that the net recoverable amount of a hotel property is less than its carrying value, the hotel property is written down to its fair value. Net recoverable amount represents the undiscounted estimated future cash flow expected to be received from the hotel property. The adoption of this new standard did not have an impact on the REIT's results from operations or financial position.

Hedging relationships

Effective January 1, 2004, InnVest adopted the new CICA guideline with respect to accounting for hedging relationships. The guideline increases the documentation and monitoring required for hedging strategies to be eligible for hedge accounting treatment. The REIT currently has a fixed price contract in place which hedges the cash flows related to utility costs on certain of its properties. The REIT had the appropriate documentation in place for this hedge at the inception of the hedge and throughout the three and nine-month period ended September 30, 2004. The adoption of this new standard did not have an impact on the REIT's results from operations or financial position.

2. ASSET ACQUISITIONS

On April 5, 2004, the REIT purchased the Holiday Inn Dartmouth, Nova Scotia, and on April 7, 2004 the REIT purchased eight hotels, of which six are Holiday Inn hotels located in Ontario, one Holiday Inn hotel located in Alberta and one Quality Hotel located in Saskatchewan. On July 1, 2004 the REIT purchased the Holiday Inn Oshawa, Ontario (the "Acquired Hotels").

Each of the vendors of the acquired hotels is considered a related party of the REIT as defined in the Declaration of Trust of the REIT. As a result, the Trustees of the REIT established an independent committee comprised of the REIT's Independent Trustees as defined in the Declaration of Trust to assess the transaction.

The net assets acquired are as follows:

Cash	$ 1,095
Current assets	2,306
Hotel properties	128,546
	131,947
Future income tax liability	(4,745)
Assumption of existing capital lease	(2,052)
Current liabilities	(2,622)
	$ 122,528

The consideration paid consists of the following:	
Cash	$ 117,097
Payment of land transfer tax and other acquisition costs	5,431
	$ 122,528

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.

3. HOTEL PROPERTIES

	Cost	Accumulated Depreciation	Sept. 30, 2004 Net Book Value	Dec. 31, 2003 Net Book Value
Land	**$ 70,813**	**$ –**	**$ 70,813**	$ 58,801
Buildings	**864,384**	**43,018**	**821,366**	728,748
Furniture and equipment	**73,603**	**23,994**	**49,609**	40,713
	$ 1,008,800	**$ 67,012**	**$ 941,788**	$ 828,262

4. DEFERRED FINANCING AND OTHER ASSETS

	Cost	Accumulated Depreciation	Sept. 30, 2004 Net Book Value	Dec. 31, 2003 Net Book Value
Deferred financing	**$ 10,594**	**$ 3,410**	**$ 7,184**	$ 5,217
Other assets	**456**	**44**	**412**	229
	$ 11,050	**$ 3,454**	**$ 7,596**	$ 5,446

5. LONG-TERM DEBT

	Sept. 30, 2004	Dec. 31, 2003
Mortgages payable	**$ 362,546**	$ 310,926
Capital lease obligation	**2,052**	–
	364,598	310,926
Less: current portion	**7,395**	7,043
Total long-term debt	**$ 357,203**	$ 303,883

Substantially all of the REIT's assets have been pledged as security under various debt agreements. At September 30, 2004, long-term debt had a weighted average interest rate of 7.1% (December 31, 2003 – 7.4%). The long-term debt is repayable in blended monthly payments of principal and interest totalling $2,784 (December 31, 2003 – $2,528) per month, and matures at various dates from January 1, 2005 to October 1, 2017.

Scheduled repayment of long-term debt is as follows:

2004 (remainder of the year)	$ 2,064
2005	7,037
2006	139,397
2007	4,936
2008	154,388
Thereafter	56,776
	$ 364,598

The current portion of long-term debt on the balance sheet is based on the twelve months ended September 30, 2005, whereas the repayment schedule above reflects the fiscal year.

The estimated fair value of the REIT's long-term debt at September 30, 2004 was approximately $368,414 (December 31, 2003 – $314,604). 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 $52,254 (December 31, 2003 – $39,191) of mortgages payable, which are subject to floating interest rates. Interest expense will increase by $523 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 $47,226 is available to refinance mortgage debts held by its various other lenders, as they mature.

6. 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, 2002	41,075,910	$ 387,744
Units issued under distribution reinvestment plan	78,351	709
Costs incurred regarding the distribution reinvestment plan	–	(19)
Units issued under executive compensation plan	18,483	168
Units issued under trustee compensation plan	6,810	60
Balance at September 30, 2003	**41,179,554**	**$ 388,662**
Balance at December 31, 2003	41,247,862	$ 389,310
Units issued under public offering (net)	4,187,000	45,281
Units issued under distribution reinvestment plan	216,687	2,303
Units issued on conversion of debentures	49,301	535
Units issued under executive compensation plan	20,573	220
Units issued under trustee compensation plan	10,287	113
Balance at September 30, 2004	**45,731,710**	**$ 437,762**

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 nine months ended September 30, 2004, there were 10,287 units (September 30, 2003 – 6,810 units) issued 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.

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. On July 17, 2004, 16,500 of the originally granted units along with 4,073 units accumulated from distributions vested.

Effective as of January 1, 2003, the Board of Trustees approved the granting of 17,846 units to the senior executives for services rendered. The units granted on January 1, 2003 vest equally on the third and fourth anniversary of the effective date of grant.

The following table summarizes the status of the executive compensation plan at September 30, 2004:

Date	Unvested Executive Units	Units Accumulated from Distributions	Total Units
July 17, 2002 – granted	49,500	10,490	59,990
January 1, 2003 – granted	17,846	3,871	21,717
July 17, 2003 – units vested	(16,500)	(1,983)	(18,483)
July 17, 2003 – units vested	(16,500)	(4,073)	(20,573)
	34,346	8,305	42,651

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.

7. CONVERTIBLE DEBENTURES

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

	Issue Date	Maturity Date	Interest Rate	Face Amount	Converted to Trust Units	Amount Outstanding	Accretion	Total
Initial Debentures (a)	July 26, 2002	June 30, 2007	9.75%	$ 75,000	$ 530	$ 74,470	$ 1,087	$ 75,557
Series A Debentures (b)	April 2, 2004	April 15, 2011	6.25%	57,500	–	57,500	205	57,705
				$132,500	$ 530	$131,970	$1,292	$133,262

(a) Initial Debentures

The Initial Debentures bear interest at the rate of 9.75% per annum payable semi-annually in arrears and mature on June 30, 2007. Each $1 principal amount of the initial debentures is convertible at the option of the holder into 93.0233 units (representing a conversion price of $10.75 per unit). These 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 these 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. During the nine months ended September 30, 2004, 49,301 units were issued for debentures at a conversion price of $10.75 per unit.

In accordance with GAAP, the holder conversion option was valued separately from the convertible debentures at $2,850, being the estimated fair market value of the option on the date the security was issued. The debenture discount equal to the value of the option is being accreted to Unitholders' Equity over the term of the initial debentures. During the nine months ended September 30, 2004, $5 was reclassified for the accretion attributable to the converted debentures.

(b) Series A Debentures

On April 2, 2004, the REIT raised a total amount of $57,500 in convertible debentures, which bear interest at an annual rate of 6.25% payable semi-annually in arrears on April 15 and October 15 in each year, commencing October 15, 2004. These convertible debentures have a term of seven years and each $1 principal amount are convertible at the option of the holder, into 80 units (representing the

conversion price of $12.50 per unit). The holder conversion option was valued separately from the convertible debentures at $2,875. The holder conversion option is being accreted to Unitholders' Equity over the term of the Series A debentures.

The convertible debentures balances have 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.

8. PER UNIT INFORMATION

Net income per unit calculations are based on the following:

		Three months ended Sept. 30, 2004		Three months ended Sept. 30, 2003
		Weighted Average Units		Weighted Average Units
Net income	**$ 22,878**	**45,683,379**	$ 19,712	41,140,075
Convertible debentures interest and accretion	**(3,002)**	**–**	(1,984)	–
Net income - basic	**19,876**	**45,683,379**	17,728	41,140,075
Convertible debentures interest and accretion	**3,002**	**11,527,442**	1,984	6,976,744
Dilutive effect of executive compensation plan	**–**	**48,331**	–	8,095
Net income - diluted	**$ 22,878**	**57,259,152**	$ 19,712	48,124,914

		Nine months ended Sept. 30, 2004		Nine months ended Sept. 30, 2003
		Weighted Average Units		Weighted Average Units
Net income	**$ 29,704**	**44,146,333**	$ 24,272	41,102,677
Convertible debentures interest and accretion	**(7,936)**	**–**	(5,952)	–
Net income - basic	**21,768**	**44,146,333**	18,320	41,102,677
Dilutive effect of executive compensation plan	**–**	**56,345**	–	8,095
Net income - diluted	**$ 21,768**	**44,202,678**	$ 18,320	41,110,772

Distributable income per unit calculations are based on the following *(Note 9)*:

		Three months ended Sept. 30, 2004		Three months ended Sept. 30, 2003
		Weighted Average Units		Weighted Average Units
Distributable income - basic	**$ 25,717**	**45,683,379**	$ 21,337	41,140,075
Convertible debentures interest	**2,743**	**11,527,442**	1,828	6,976,744
Dilutive effect of executive compensation plan	**–**	**48,331**	–	8,095
Distributable income - diluted	**$ 28,460**	**57,259,152**	$ 23,165	48,124,914

8. PER UNIT INFORMATION (CONTINUED)

Distributable income per unit calculations are based on the following:

		Nine months ended Sept. 30, 2004		Nine months ended Sept. 30, 2003
		Weighted Average Units		Weighted Average Units
Distributable Income - basic	**$ 38,703**	**44,146,333**	$ 32,465	41,102,677
Convertible debentures interest	**7,268**	**9,966,128**	5,484	6,976,744
Dilutive effect of executive compensation plan	**–**	**56,345**	–	8,095
Distributable income - diluted	**$ 45,971**	**54,168,806**	$ 37,949	48,087,516

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

9. DISTRIBUTABLE INCOME

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

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, 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 interest on convertible debentures that is not 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 Sept. 30, 2004	Three months ended Sept. 30, 2003	**Nine months ended Sept. 30, 2004**	Nine months ended Sept. 30, 2003
Net income	**$ 22,878**	$ 19,712	**$ 29,705**	$ 24,272
Add (deduct)				
Depreciation and amortization	**9,805**	8,110	**27,405**	24,101
Amortization of fair value debt adjustment	**(125)**	(360)	**(809)**	(1,042)
Future income taxes	**(486)**	(1,542)	**(2,102)**	(2,626)
Reserve for replacement of furniture, fixtures and equipment and capital improvements	**(3,720)**	(2,812)	**(8,480)**	(6,957)
Non-cash executive and trustee compensation	**108**	57	**252**	201
Convertible debentures interest	**(2,743)**	(1,828)	**(7,268)**	(5,484)
	2,839	1,625	**8,998**	8,193
Distributable income	**25,717**	21,337	**38,703**	32,465
Distributable income in excess (deficit) of distributions	**12,863**	9,760	**1,417**	(2,221)
Distributions	**$ 12,854**	$ 11,577	**$ 37,286**	$ 34,686
Distributable income per unit – basic	**$ 0.563**	$ 0.519	**$ 0.877**	$ 0.790
– diluted	**$ 0.497**	$ 0.481	**$ 0.849**	$ 0.789

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 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.

10. 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 ("Westmont"). Westmont is controlled by a minority unitholder of the REIT.

The Agreements have an initial term of 10 years with two successive five-year renewal terms, subject to the consent of Westmont and approval 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 in the period.

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 and nine months ended September 30, 2004 and 2003, the fees charged to the REIT pursuant to the Agreements were as follows:

	Three months ended Sept. 30, 2004	Three months ended Sept. 30, 2003	**Nine months ended Sept. 30, 2004**	Nine months ended Sept. 30, 2003
Management fees	**$ 3,139**	$ 2,373	**$ 7,156**	$ 5,870
Accounting services (included in hotel operating expenses)	**503**	427	**1,418**	1,281
Administration services (included in corporate and administrative services)	**109**	127	**372**	408
Project management and general contractor services (capitalized in hotel properties)	**123**	24	**344**	160
	$ 3,874	$ 2,951	**$ 9,290**	$ 7,719

In addition, salaries of REIT employees paid by Westmont and reimbursed by the REIT, were $131 (September 30, 2003 – $194). Included in accounts payable and accrued liabilities are amounts outstanding at September 30, 2004 totalling $1,201 (December 31, 2003 - $670).

11. 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 September 30, 2004					
Hotel revenues	**$ 10,134**	**$ 52,642**	**$ 17,832**	**$ 12,387**	**$ 92,995**
Hotel expenses	**6,471**	**32,217**	**9,443**	**6,037**	**54,168**
Hotel operating income	**$ 3,663**	**$ 20,425**	**$ 8,389**	**$ 6,350**	**$ 38,827**
Three months ended September 30, 2003					
Hotel revenues	$ 8,266	$ 34,506	$ 17,529	$ 10,005	$ 70,306
Hotel expenses	4,988	19,739	9,374	4,157	38,258
Hotel operating income	$ 3,278	$ 14,767	$ 8,155	$ 5,848	$ 32,048
Nine months ended September 30, 2004					
Hotel revenues	**$ 24,037**	**$ 119,669**	**$ 42,913**	**$ 25,387**	**$ 212,006**
Hotel expenses	**16,705**	**78,852**	**26,482**	**14,755**	**136,794**
Hotel operating income	**$ 7,332**	**$ 40,817**	**$ 16,431**	**$ 10,632**	**$ 75,212**
Nine months ended September 30, 2003					
Hotel revenues	$ 20,262	$ 88,932	$ 43,693	$ 21,042	$ 173,929
Hotel expenses	14,023	57,564	26,348	11,074	109,009
Hotel operating income	$ 6,239	$ 31,368	$ 17,345	$ 9,968	$ 64,920
Capital expenditures					
Three months ended					
September 30, 2004	**$ 309**	**$ 2,052**	**$ 344**	**$ 329**	**$ 3,034**
Three months ended					
September 30, 2003	$ 94	$ 746	$ 390	$ 156	$ 1,386
Nine months ended					
September 30, 2004	**$ 1,114**	**$ 5,519**	**$ 1,626**	**$ 1,795**	**$ 10,054**
Nine months ended					
September 30, 2003	$ 581	$ 3,644	$ 1,144	$ 276	$ 5,645
Hotel properties					
September 30, 2004	**$ 74,700**	**$ 568,171**	**$ 186,571**	**$ 112,346**	**$ 941,788**
December 31, 2003	$ 65,538	$ 471,764	$ 190,184	$ 100,776	$ 828,262

12. COMPARATIVE INFORMATION

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

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