Royal Commission on Corporate Concentration

Study No. 3

Cadillac Fairview Corporation Limited

A Corporate Background Report

by

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Brown, Baldwin & Nisker Ltd.

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FOREWORD

In April 1975 the Royal Commission on Corporate Concentration was appointed to "inquire into, report upon, and make recommendations concerning:

(a) the nature and role of major concentrations of corporate power in Canada;

(b) the economic and social implications for the public interest of such concentrations; and

(c) whether safeguards exist or may be required to protect the public interest in the presence of such concentrations".

To gather informed opinion, the Commission invited briefs from interested persons and organizations and held hearings across Canada beginning in November 1975. In addition, the Commission organized a number of research projects relevant to its inquiry. One such project resulted in a series of studies, of which this is one, dealing with the growth of large and diversified corporations in Canada. The series was coordinated by Charles B. Loewen of Loewen, Ondaatje, McCutcheon & Co. Ltd., an investment firm in Toronto.

The report on The Cadillac Fairview Corporation Limited which follows is one of twelve studies in the series. It was prepared by Ira Gluskin, who is a security analyst with Brown, Baldwin, Nisker Ltd. Mr. Gluskin, who received his B.Comm. from the University of Toronto, has been engaged in the field of security analysis for the past 12½ years, and specializes in the field of real estate.

The Commission is publishing this and other background studies in the public interest. However, the analyses presented and conclusions reached in each study are those of the author, and do not necessarily reflect the views of the Commission or its staff.

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CHAPTER 1

INTRODUCTION

This study examines in detail The Cadillac Fairview Corporation and its relative position in the Canadian Real Estate Industry.

The Company has assets of over one billion dollars, making it the largest public, and very likely the largest private company. Cadillac Fairview is also a very prominent company because of the magnitude of many of its projects, such as The Pacific Centre in Vancouver, The Toronto-Dominion Centre and Toronto Eaton Centre, as well as its ownership of the new community of Erin Mills, Ont.

The real estate industry has traditionally been conducted by small entities operating with high risks in a competitive atmosphere. Ten years ago there would have been no logical reason to include a large real estate development company in a study of Canadian Corporate Concentration: even the largest companies appeared small in image, and were so in fact.

The situation today is quite different. Public companies headed by The Cadillac Fairview Corporation Limited are large by any conventional standards.

The leading Canadian real estate companies, headed by Cadillac Fairview, Trizec Corporation and Oxford Development,are entering the U.S. real estate market to a significant extent. Most observers believe that the Canadian companies will be successful because of the simple fact that the Canadian companies are much stronger financially and managerially than their U.S. counterparts.

Therefore, it is not surprising that legitimate questions have been asked as to whether the large Canadian companies are overly powerful in Canada. Research for this study indicates conclusively that the public has no reason to fear; the large developers generally conduct their business affairs with high standards, providing more physical amenities to their projects than might otherwise be the case. The key point as far as this study is concerned is that the entire real estate business remains quite fragmented despite the growth of the large companies.

Research showed no evidence of concentration in each major product category; shopping centres, office buildings, industrial buildings, hotels, land development and housing. Subsequently, Cadillac Fairview, which is the largest company and the most prominent, was examined in detail to determine whether the company dominated a product sector in any one particular geographic area. We found that it did not. It was beyond the aim of this study to determine whether any single company does have a monopoly in anything, but there appears no evidence at all that this is true, especially in any major real estate market.

While large development companies have considerable advantages over small companies in undertaking large projects, they apparently have no advantage in small and medium-size projects, and may in fact have some sizeable disadvantages. We also suspect, but cannot document, that large private companies have an advantage over large public companies because the latter take so long to make a decision.

Meanwhile, the advantages of large size are offset by the fact that there are a variety of large companies who compete very strenuously with each other for large projects. For example, Cadillac Fairview, Oxford Development, Trizec Corporation, Campeau Corporation, Olympia and York are all capable of undertaking the same large, mixed-use projects. However, the most competitive force arises from the fact that large projects are invariably created by the need of large space users for more physical space. Typically, the users are large government bodies or large corporations, and in almost all cases are capable of doing the project themselves as evidenced by the large towers owned by either the Canadian chartered banks or by government bodies, the shopping centres owned and developed by department stores, or the factories built and operated by industrial corporations.

The study also discusses in some detail the subject of high prices for land and housing. A wide gulf exists between the arguments of developers and of left-wing critics. The analysis in the study confirms that the developers do not exaggerate their case. The attempt to make the private sector the scapegoat for high housing prices reflects a basic misunderstanding of how the system really works. On the other hand, our study confirms the fact that land development requires large amounts of capital and generates large profits to successful companies.

For the purposes of this study, a theoretical total of the assets invested in the Canadian real estate industry was calculated. This purely hypothetical and academic calculation indicated an asset number of $45 billion. As a basis for comparison the total assets of all the publicly-owned Canadian real estate companies amount to under $7 billion. Although real estate is often described as a secretive, even mysterious endeavour, the quality of available information is unusually high. For one thing, all large assets are easily visible by everyone and their ownership is generally known within the real estate community. Therefore, it is unlikely that private companies aside from such large entities as Olympia and York are capable of throwing our study off-side.

The methodology of gathering information for this study was quite simple. Basic sources of information have been the published data of the public real estate companies themselves. Similarly, in gathering background on the major space users, the published data of public companies such as retailers and financial institutions was utilized. Central Mortgage and Housing Corporation publishes a wealth of information on the Canadian housing industry, while A. E. LePage compiles many interesting real estate statistics, especially on the office building industry in Toronto.

The authors also received complete cooperation from the senior management of Cadillac Fairview. They saw to it that we received a host of documentation on their operations that they ordinarily never release to the financial community. Lastly, we are indebted to Mr. A. E. Diamond, Chairman of the Board and Chief Executive Officer of Cadillac Fairview, for giving us many hours of his valuable time to explain to us some aspects of his company that the documentation left unclear.

CHAPTER 2

HISTORICAL BACKGROUND

The Toronto Eaton Centre prospectus contained this succinct legal definition of the Cadillac Fairview Corporation Limited:

> *Cadillac Fairview is an Ontario corporation resulting from the amalgamation on February 29, 1976, of The Fairview Corporation of Canada Limited and The Cadillac Fairview Corporation Limited, being the corporation which resulted from the amalgamation, on May 31, 1975, of The Fairview Corporation Limited, Cadillac Development Corporation Limited and Canadian Equity & Development Company Limited, and certain subsidiaries thereof.*

Thus the company has only recently celebrated its second birthday. The merger was generally conducted so smoothly and there has been so little corporate bloodletting before or subsequent to the merger, that the general impression in the business community is that the company is considerably older. A proper understanding of the rationale behind the merger depends on an understanding of the three predecessor companies whose histories are examined below.

CADILLAC DEVELOPMENT CORPORATION LIMITED

Cadillac became a public company on December 2, 1968, when McLeod, Young, Weir and Company Limited and Pitfield, McKay, Ross & Company Limited completed a $12 million underwriting of debentures, preferred stock and common shares. The final prospectus disclosed the following corporate history:

> *In 1953 Cadillac Contracting and Development Limited was formed with A. Ephraim Diamond and Joseph Berman both professional engineers as its managing executives .... In 1961 the organization was broadened by the addition of John H. Daniels, an architect and Gerald J. Shear, a chartered accountant .... Prior to 1963 the activities were carried on through a number of companies. In 1963 the decision was made to consolidate the operations of these numerous companies and accordingly Cadillac Development Corporation Limited (the "Holding Company") was incorporated and acquired all of the shares of 23 real estate companies and some of the shares of 18 other real estate companies, in exchange for its common shares. In December, 1963 Traders Group Limited purchased*

debentures of the Holding Company and in 1964 acquired by subscription and purchase in the aggregate 20% of the shares of the Holding Company. On January 1, 1965 the Holding Company and 28 subsidiaries were amalgamated to create the Company in its present form.

NATURE OF THE BUSINESS

The balance sheet in this original prospectus showed that Cadillac had assets at July 31, 1968, of $157 million. A summary of the principal asset breakdowns as well as the liability side is presented in Table 1.

Table 1

The Cadillac Development Corporation Limited
Balance Sheet Summary, July 31, 1968

	Amount ($000's)	Percentage of Total
ASSETS		
Cost of income-producing properties	93,218	
Less: Accumulated depreciation	1,743	
Net income-producing properties	91,475	58.3
Properties under development	36,304	23.1
Housing projects	7,025	4.5
Accounts and mortgages receivable	6,717	4.3
Investment in affiliated companies	14,011	8.9
Other	1,448	0.9
Total Assets	156,980	100.0
LIABILITIES AND SHAREHOLDERS' EQUITY		
Mortgages on Income-producing properties	$ 78,103	49.7
Mortgages and loans on property under development	24,085	15.3
Mortgages on housing projects	5,051	3.2
Secured loans	13,461	8.6
Debentures	6,444	4.1
Bank debt	7,595	4.8
Accounts payable	8,364	5.3
Tenants' security and other deposits	1,081	1.0
Total Liabilities	144,184	92.0
Deferred taxes	939	0.9
Minority interest	176	-
Preferred shares	1,949	1.1
Common shares	5,164	3.2
Retained earnings	4,567	2.8
Total liability and Shareholders' Equity	$ 156,979	100.0

At this point, we are not going to do a detailed financial analysis of Cadillac. Note Five to the Statements noted that the item referred to in Table 1 as "Properties under development" was made up as follows: income-producing properties actually under construction, including land and construction costs - 70%; land, including deposits designated primarily for development as income-producing properties - 30%. Thus, approximately 81.4% of the Corporation's assets were comprised of income properties. Page 3 of the prospectus provided some additional information on this asset structure in unit terms. This information is summarized in Table 2 below along with the related information in dollars and related per unit calculations.

Table 2

The Cadillac Development Corporation Limited
Physical Assets, July 30, 1968

Assets	Number (Units)	Amount ($000's)	Cost per Unit
Completed multiple family residential units	7,472	91,475	$12,325
Multiple family residential units under construction	2,758	25,244	not meaningful
Multiple family residential units for which land is held and now zoned for development	4,979	11,059	2,312

Again, at this stage we are avoiding detailed financial analysis, but the information on the historical cost of apartment construction is interesting. It is commonly thought that to construct today the same type of units that had required $12,325 a unit in 1968 would be more than double the cost.

Also, Cadillac was almost exclusively involved in the ownership of residential income properties as its principal thrust of business. Page 6 of the prospectus was a table of income-producing properties which confirmed that the company's rental portfolio was almost exclusively residential apartments. The $14 million investment was the company's investment in Canadian Equity & Development acquired in 1968. The background to this acquisition will be discussed in the section on Canadian Equity and Development.

Between July 30, 1968, and December 31, 1973, the company's total assets more than doubled to $381.7 million. The tables summarized in Appendix A show the growth of Cadillac over the period from 1964 to 1973. After 1970, Cadillac embarked on an extensive program of diversification into greater housing exposure, office buildings and shopping centres. Nevertheless, apartment units continued to represent over half the total assets as the company completed in the early 1970's the program that had been initiated in the 1960's. Cadillac entered the merger with an equity in approximately 15,000 residential suites, which coincides with the potential total of Table 2. In actual fact, some of the units in the third category became condominiums, but the basic point is that Cadillac continued to be active in apartment development into the early 1970's only because of the momentum of the past. For example, many of Cadillac's land assemblies were acquired with a potential of perhaps four buildings. After the first two buildings were up, including a huge recreational complex, it became reasonable to complete the last two buildings as well, even though the economics had deteriorated. University City in Toronto is an example. That is to say that Cadillac was not prepared to enter into fresh new rental projects although considerable activity was still occurring on these older continuing projects.

CANADIAN EQUITY AND DEVELOPMENT

Canadian Equity and Development (CED) was incorporated in 1953 as the principal Canadian real estate vehicle of Mr. E.P. Taylor. The company was Mr. Taylor's vehicle for developing Don Mills, which was completed in the late 1960's, and for holding Erin Mills, which was assembled in the early 1950's. The company developed some income properties in the 1950's and 1960's, but became basically almost passive by the late 1960's. At one time in the early 1960's, Canadian Equity and Development enjoyed some very good management talent and in theory the company had the opportunity to become a truly major real estate company. It is our understanding that Mr. Taylor was personally reluctant to see the company expand and, consequently, chose to sell control in 1967.

The background to the change in control at CED is as follows. Apparently Mr. Taylor or his representatives contacted Cemp and offered them control of Canadian Equity and Development. Cemp was given approximately two weeks to reach a decision on the project. Cemp at that time was almost completely involved in shopping centres and office buildings, while the greater part of the value of Canadian Equity and Development lay in its land holdings in Mississauga, Ontario. Cemp invited Cadillac Development to be a partner in the purchase of Canadian Equity and Development, and a third partner, Canadian General Investments (CGI), was also brought in. We noted earlier that Traders Group had acquired 20% of Cadillac Development's common stock in 1964. Canadian General Investments at that time controlled Traders Group. Cadillac, prior to going public in 1968, was not a cash-rich company. Cadillac and Cemp did a hurried research job on Canadian Equity and Development, and on March 8, 1968, Mr. Taylor's holdings of 3.8 million shares were acquired at $7.00 per share, all in cash and notes. Subsequently, an offer for 957,204 minority shares was made at $7.00 per share. Over 90% of the outstanding shares was thus acquired by the three partners. The stock was suspended by the Toronto Stock Exchange pending a further distribution of shares. Subsequently, in early 1969 Wood Gundy underwrote an offering of 800,000 shares of CED at $12.00. The sellers were Cadillac (300,000 shares),Fairview (Cemp) (400,000 shares) and CGI (100,000 shares).

Naturally, the principals of Canadian Equity and Development were sensitive to the criticism that they had bought low and sold high. Their response was that they had never expected to obtain as many shares in the initial offer and thus their cash needs had become over extended. Secondly, under the new management the Erin Mills lands had made significant progress toward development. Thirdly, public real estate stocks had become mildly fashionable by mid-1968. It appears that the management of Cemp and Cadillac Fairview was relatively uninformed about the details of public companies. They also mention that at all times they were anxious that Canadian Equity & Development remain a public company.

The change in control of Canadian Equity and Development resulted in significant changes in the management and style of the company. Later in this report we discuss the subtleties of how CED was managed by Cadillac and Fairview. Essentially Cadillac undertook the management of Erin Mills and Fairview managed the income properties of CED. The "green light" for development in Erin Mills was given in 1968 and the first lots were sold to builders in 1970. Today, approximately 10,000 people live in Erin Mills and the proposed 1990 target of 170,000 people is still a possibility. The concept, planning and execution of development to date in Erin Mills have been absolutely first class compared to most suburban properties of this type. The problems and rewards will be discussed in later sections.

THE FAIRVIEW CORPORATION OF CANADA LIMITED

Fairview became publicly owned in July 1972 when Wood Gundy and Dominion Securities completed an underwriting of 1,500,000 common shares at $15.00 per share. The prospectus for this underwriting succinctly summarizes the background of the Company as follows:

> *The Fairview Corporation of Canada Limited, a subsidiary of Cemp Investments Ltd. ("Cemp"), was incorporated with the name Cemp Holdings Ltd. under the laws of Canada by letters patent dated December 9, 1959. By supplementary letters patent dated June 1, 1972, its name and share capital were changed to their present form. The head and principal office of The Fairview Corporation of Canada Limited is Suite 3300, Toronto Dominion Bank Tower, Toronto-Dominion Centre, Toronto, Ontario.*

Cemp Investments was created in the early 1950's as a vehicle for managing the family fortune of Mr. Samuel Bronfman (See Appendix "B"). In 1957 Mr. Bronfman hired a relatively young man named Leo Kolber to be managing director of Cemp. Mr. Kolber made the decision to direct part of Cemp's assets into real estate. The story is told that Mr. Bronfman's only mandate was that Mr. Kolber build quality projects. The company in its early years acted as both a development and investment company with one of its most significant early investments being some of the shopping centre assets of Principal Investments, a leading shopping centre developer of that era, but with financial problems. As recently as 1967 Fairview had gross revenues of only $12 million.

Fairview's fame in the business world really can be attributed to its decision to develop high-quality shopping centres and office buildings in the early 1960's. It is sometimes forgotten that large regional shopping centres with two department stores and an enclosed mall did not really open in Canada until the mid 1960's. Yorkdale in Toronto, which is probably Canada's most famous example, opened in 1964. Fairview Shopping Centre in Pointe Claire, Quebec, opened in 1965. Similarly, although large high rise office buildings are quite common today, the first phase of the Toronto-Dominion Centre, opened in 1967, with its 56 stories and 1.3 million square feet of office space, began a new era in downtown Toronto. By the early 1970's, large regional shopping centres and high-rise towers were commonplace projects, but when they were first contemplated in the early 1960's, there was considerable apprehension about their viability. As an illustration, one would find today similar apprehension about the viability of the Toronto Eaton Centre.

Fairview actually had less than two years as a public company. Right from the beginning, it established an image in the investment community of being the highest quality company in terms of properties, management and financial strength. Mr. Kolber gave a speech to the Montreal Society of Financial Analysts on June 6th, 1973 in which he discussed the company:

> *As many of you know, I started the Fairview Corporation as a one-man operation in 1958 and since then, we have grown to our present size of 500 permanent employees plus many hundred part-time people as well as several thousand construction people who are presently at work on our various projects.*
>
> *I am very pleased to be able to announce the results for our fiscal year ended February 28, 1973. I am particularly pleased because these results are slightly better than our own budgets and those estimates given in several reports by outstanding analysts in the field.*
>
> *Our cash flow for the past fiscal year was $9,647,000 compared to $8,474,000 adjusted for the previous year. Our net income was $3,495,000 before extraordinary items compared to adjusted*

$2,829,000 and $3,707,000 after extraordinary items compared to adjusted $2,348,000.

We have had a very dramatic growth since 1967 and it is interesting to note that our revenues in that period have gone from 12 to 38 million dollars, our cash flows from 2.3 million to 9.6 million, our net income from one million to 3.7 million and our gross assets from 148 million to 269 million.

Mr. Kolber then went on to elaborate on the company's very extensive construction and development program. He also discussed how the company managed its affairs. His self-confident remarks are worth repeating:

We set ourselves very clear priorities at the beginning of each year and we proceed to carry them out in the very best manner possible. Our first priority, of course, is to carry out profitably the work we already have in hand or in process for the immediate future. Secondly, we constantly seek to improve our ability to search out and handle more opportunities, particularly in Canada. Thirdly, we are constantly trying to build enough management depth so that we can undertake the more difficult assignment of expanding outside our country in due course. It stands to reason that because of the size of our cash flow and our ability to finance our projects to a large percentage of their costs that we will have to look to other areas in which to realize our real estate expertise. We are presently having a hard look at Europe and the United States. Our decision to go there, however, will depend completely on whether or not we have sufficient management to send to these areas.

Because of the size of our company and our particular expertise in doing large projects, it therefore follows that it will be quite difficult to maintain dramatic increases in earnings and cash flow each year. For example, a project the size of Eaton Centre might take 3 years to come on stream. However, when it does, its impact can certainly be dramatic. We therefore do not expect repeated annual large increments in growth and earnings but we certainly do expect to maintain a high long-term rate of growth in cash flow and all other significant areas.

I suppose the main reason for Fairview's origin was our basic belief that property and real assets were the best hedges against inflation. There is no doubt that so far we have been proven correct and we have no reason to change our philosophies in this regard. Therefore, our approach to planning, design, operation and financing is not based upon maximizing the early years' cash flow from a property to the detriment of future years' cash flow. Our objective is to maximize the net worth of our assets and to keep them for long-term ownership. Except in the obvious case of housing, it is our policy to rarely, if ever, sell a property.

On the financial side of life, our outlook and posture is probably slightly different from most others in our industry. Unless the project is large in comparison to our total asset base, we do not conceptually relate any financing which may be secured upon that property to the property as an operating asset. We do, however, follow the CIPREC and CICA guidelines with respect to charging of interest on the initial long-term financing. We consider our over-all capital structure which includes every form of debt and equity and try to achieve the best balance of this mix in relation to our present assets and our projected plans. I think it is also important to point out that our accounting practices are amongst the most conservative in the industry. However, we are studying the possibility of capitalizing certain administrative expenses although we believe a thorough study is necessary because there exists the possibility that our industry has not considered some of the timing problems of this practice.

Our pride and joy however is our management team and in the short span of 16 years, we have built up to what I am proud and perhaps immodest enough to say is among the very best on this continent in this industry.

As Chairman of the Board, I am still of course involved in some of the major decision-making processes, but the company is run completely by Neil Wood, our President. Along with Neil and myself, the remaining members of the Executive Committee are Bernie Ghert who is Vice-President, Finance, and Ken Bream, Vice-President, Development.

It is perfectly correct to say that between Neil, Bernie, and Ken, Fairview is motivated, pushed, planned and run on a day-to-day and year-to-year basis.

Along with these gentlemen, we have Bud Rothschild, who is Vice-President in charge of managing all our office buildings across the country; Reg Stapley who is Vice-President in charge of running all our shopping centres across the country; Frank Barrie who is our Vice-President of construction and responsible for seeing that all our projects come in on budget, and Stan Witkin who is Vice-President, Development in charge of shopping centre development. We also have a very full complement of highly-qualified people who make up the balance of our team without whom, I assure you, none of our plans could be realized.

In studying our company, I think one ought to compare the quality of our rentals and their values as compared to those of apartment developers. I am sure it is obvious to you that our cash flows do not necessarily reflect the market values of our rentals because of the nature of our leases. However, as these leases roll over, *we find in most cases that it results in substantial increases in income. A good example is the Toronto-Dominion Centre. In 1966, Toronto-Dominion leased space at $6.00 per sq. ft., some of these leases are currently being renegotiated at $11.00 per sq. ft. Furthermore, because of the nature of our leases, we are, during their terms, protected against increases in operating costs and real estate taxes.*

At the time of this speech, Fairview was in an enviable position. The company's revenues came from high-quality sources. It was protected against cost increases, and its long-term debt was easily carried by the rental stream. The company had demonstrably good management and an excellent relationship with tenants. Future growth would easily be satisfied by the country's apparent insatiable need for new shopping centres and office buildings.

In contrast, other real estate companies were in the position of Cadillac and Canadian Equity having such higher risk factors as the possibility of controls in rental apartments; natural cyclicality of both land and housing; lack of experience in developing either or both shopping centres and office buildings; lack of the financial skills and strength of Fairview.

CONCENTRATION IN CANADIAN REAL ESTATE

Before examining the particulars of the Cadillac Fairview merger, one should place it within the context of the general trend towards rationalization and concentration in the real estate industry. There is little doubt that such a trend does exist in Canada. Indeed the five largest public real estate companies in Canada were assisted in their growth by mergers. Table 3 summarizes this trend.

Table 3

Mergers of Real Estate Companies in the 1970's

Company Resulting from Merger	Total Assets* ($000's)	Components of Merger
Cadillac Fairview	$1,050,000	Formed from merger of Cadillac Development, Fairview Corporation, and Canadian Equity and Development
Trizec	899,714	Acquired Great West International Equities and Cummings Properties in 1970 and 1971
Campeau	481,695	Acquired Canadian Inter-urban Properties in 1970
Oxford	474,800	Acquired Cambridge Leaseholds in 1975
Abbey Glen(1)	387,586	Formed by merger of Western Realty Projects and Great Northern Capital in 1973

* Most recent published total.
(1) Genstar acquired control in 1976.

In our opinion, it was not necessarily an inevitable occurrence. For example, no similar pattern appears to occur in the United States and perhaps the trend may be going in the opposite direction. The most logical factors behind the Canadian trend seems to be as follows:

1. In our opinion, the behaviour of the stock market itself is the principal ingredient. When one reviews the mergers and acquisitions of the five largest companies in Table 3, it should be noted that all of the companies involved were public companies. One finds very little pattern in this industry to the acquisition of private companies by public companies.

In theory, this should be considered quite unusual since the mass of companies in real estate are privately owned. The public companies constitute only a very small percentage of aggregate value. What we believe has occurred in this industry is that many companies went public after 1967 in the belief that going public would have some positive benefits. These were seldom realized subsequent to the initial capital raised, however, and instead the public real estate companies have typically sold at significant discounts to their so-called break-up values. It is this large discount and the frustration of the owners with it that have caused so many of them to be prepared to sell. Naturally, this is a subjective comment. But if one visualizes the private company owner content in his valuation of his company's assets and contrasts him with the owner of a large block of a public real estate company, one is struck by the unhappiness of the latter. There is often such a large gap between the market price of the stock and the theoretical break-up value that both buyer and seller have no trouble convincing themselves that a good deal was made. Some commentators continue to believe that real estate companies by their very nature have no business being public in the first place. Regardless of whether it is true or not, and I personally disagree, it is academic at this juncture.

2. The real estate business is in the process of evolving. The day of the entrepreneur making impulsive decisions on a thin equity base is slowly ending. The reason is simply the size and scale of new projects and the delaying effect of anti-development forces throughout Canada. Developments that extend over long periods of years almost by definition require greater financial strength and depth of management.

3. The forces that lead to delays in development have also led to greater specialization within the industry. If a development is going to take ten years and a hundred million dollars, there is a natural tendency to want greater knowledge than is needed for a small, quickly completed development. Specialists in the development of shopping centres, office buildings, mixed-use projects, large scale land development, etc., are all recent phenomena in Canada. It follows from this that it no longer is so easy for a company specializing in one form of real estate to enter another. The easiest way is to obtain the necessary technical expertise via the merger route.

4. As a general rule, the bigger the project, the greater is the need for larger absolute amounts of equity funds. In addition, after 1972 it became more difficult for developers to raise

as high a percentage of project costs from debt sources for the same-size projects. It appears that the inflationary environment of 1973 and 1974 caused construction costs to rise faster than rents. The economics of new projects deteriorated, meaning that developers were obliged to invest more of their own money in each new project. The advantage to a larger, better capitalized company is obvious. Another aspect of finance that deserves mention are the conservative lending practices of Canadian financial institutions. There is an old expression in real estate circles that "developers will build as much as lenders will lend". The U.S. experience is valid testimony to the truth of the statement. We believe that many of the Canadian public companies were prevented from reckless over-expansion and bankruptcy by the fact that the Canadian lenders refused to provide the funds.

5. This study will discuss subsequently the fact that success in large-scale office and shopping centre development relates heavily to the confidence of large space users in the developers. Typically, such users are large corporations who in many instances have come through a period of growth and concentration. Such institutions have a natural desire to deal with other large institutions. It is not surprising that major corporations utilize large law firms, accountancy firms, insurance brokers and advertising agencies. It should not be surprising that they should also wish to deal with large real estate developers if such a choice is available to them.

6. One of the advantages of large size is the ability of companies to undertake larger risks. A company with $100 million of equity can logically undertake projects that a $10 million company cannot.

7. The real estate industry even after the merger trend remains one of the most fragmented of all industries. Thus, to say why the trend has occurred, a philosopher would be on good footing to say, "How come it did not arrive faster?"

This last quotation may appear to conflict with our prior observation on the U.S. real estate market where no clear move towards concentration exists. The reason as we view it is simply an accident of history. There is no underlying logic to why Canada is a leader in such disparate international industries such as liquor or business forms. Similarly, the reasons in real estate in part defy logic. The publicity concerning Cadillac Fairview's attempt to acquire the Irvine Ranch (see Appendix H) is quite interesting. It becomes quite clear that the Cadillac Fairview Corporation of Toronto, Ontario is a strong real estate company in North American terms. Despite the company's failure to acquire Irvine it appears that the company will ultimately be quite successful in the United States. The same type of comment is applicable to other Canadian developers such as Oxford Development. The conclusion is that the strengths of large developers listed above are valid and will be truly relevant when offered in the United States. This statement is admittedly still subjective as "the jury is still out" in terms of the Canadian companies actually developing in the U.S. There is little disagreement, however, about their ability to acquire existing U.S. properties which has been the principal thrust up to now.

THE CADILLAC FAIRVIEW MERGER

PUBLIC REASONS

The information circular of Cadillac pertaining to the merger stated the reasons for the merger as follows:

> *The Managements of Cadillac, CEDC and Fairview Canada consider that to a significant extent future urban development will be oriented toward integrated residential, commercial and retail complexes and that the amalgamated corporation will be well suited to undertake this type of development. The managements are also of the view that the merger will produce a corporation well balanced in its asset mix and with management experienced in most phases of real estate development. The combined financial and management base resulting from the merger will, in the opinion of the managements of Cadillac, CEDC and Fairview Canada, produce a corporation with development and acquisition capabilities substantially greater than their separate capabilities.*
>
> *Since Cadillac and Fairview Canada are major shareholders of CEDC and since certain members of each of their boards of directors are members of the board of directors of CEDC and, in some cases are shareholders of Cadillac and Fairview Canada, the merger will eliminate any problem of serving varying and potentially conflicting interests of the merging corporation.*

OTHER REASONS

There is no reason to believe that the managements were insincere in what they stated above. However, it appears that they left out some of the more human and subjective aspects of the merger. Let us explore the reasons for the merger from each company's point of view.

Canadian Equity and Development

It must be recalled that Canadian Equity and Development was a unique public company. Of its outstanding shares 71% were owned by

Cadillac and Fairview in total, and only 29% by the minority shareholders. The company's headquarters were located in Cadillac's offices and the senior management were in reality closely identified with Cadillac. The development and management of Erin Mills was formally managed by Cadillac on a fee basis. The shopping centres of Canadian Equity and Development were being managed by Fairview on a fee basis, and the single apartment project of Canadian Equity and Development was managed by Cadillac on a fee basis. Meanwhile, in Erin Mills both Cadillac and Fairview were buyers of lots. Canadian Equity and Development had eight directors, of which three were officers of Cadillac and three were officers of Fairview. The remaining two outside directors were also directors of Cadillac.

Obviously, there was potential for conflict and it is a testimony to the integrity of the two senior companies that there were so few complaints from outsiders. Meanwhile, a potential tax problem was being created in that Canadian Equity and Development was in the process of recording higher sales and profits from Erin Mills and in the process depleting its tax deferrals. Its existing rental portfolio was also quite mature. Typically, in the case of land-based companies such as Canadian Equity and Development, when the prospects of paying cash income taxes become immediate, the typical step is to develop new income properties. Here the conflicts between the two partners would obviously become severe as the logical question would be, "Why would an opportunistic rental situation be given to Canadian Equity and Development and not to its senior shareholders?" Meanwhile, to repeat a point made earlier, Canadian Equity and Development did not have its own management team capable of undertaking large-scale income property developments.

As an illustration of the magnitude of sums involved, Canadian Equity and Development in 1972 generated net profits of $3.7 million including land sales of $13.9 million. Land sales in fiscal 1976 for Cadillac Fairview, which are almost exclusively Erin Mills, rose to $24 million. If Canadian Equity and Development had remained a public company, net profits would have been around $6 million according to our calculations. The deferral of $6 million in annual income taxes is not a small matter. Lastly, both land sales and profits from Erin Mills were likely to climb in the future aggravating the problem of tax deferrals. Knowledgeable outside observers, aware of the fact that developers go to great lengths to defer taxes, believe that the Canadian Equity situation was at the heart of the decision to amalgamate all three companies. However, this point of view ignores the fact that one of the two parents could simply have acquired full control from the other and the public. Management of Cadillac Fairview insists that the CED situation was not the pricipal reason for the amalgamation.

Clearly, the concept of the merger was a happy solution for Canadian Equity and Development.

Cadillac Development Corporation Limited

There is a variety of reasons to explain why the management of Cadillac might have been prompted to enter the merger. The most cynical one is that management was afraid of the consequences of Ontario rent controls. As far back as 1972, the prospect of rent controls was under intense public discussion. Although Cadillac had made great strides to diversify the company, its most basic asset was its interest in 14,541 residential rental suites, all located in the province of Ontario. The management of Cadillac had understood the trends in the business quite clearly. They had literally halted "new" apartment suites by 1971 and were aggressively diversifying the company. Their reason was that rentals had failed to keep up with the rising cost levels of construction, interest and operating costs. As vacancies tightened in 1972, management was aware that rents would begin to rise sharply. It would be naive to suggest that they were not afraid of rent controls, a public topic of discussion in 1973. It is our understanding that Fairview understood these risks quite clearly and the disadvantages of rent controls were openly discussed and calculated in the pre-merger discussions.

Another logical reason for the merger, and perhaps one that flows naturally from the fear of rent controls, was the share ownership structure of Cadillac. Four key directors of Cadillac Development directly held approximately five million (about 53%) of the outstanding shares of the Company. For three of these men their shares represented the bulk of their net worth. It is not unusual in such instances for men to seek diversification in their estates, especially as they are entering the latter phases of their business careers.

Another reason for the merger was likely the problems common to Cadillac and to other growing public real estate companies in obtaining solid, professional management. The concept of large public companies with capable professional management is still in its embryonic stage in Canada. Cadillac had succeeded in obtaining a reputation for good management and the company's record speaks for itself. However, within the real estate community, the company had an enviable reputation for having four talented entrepreneurs as principals but not necessarily for having developed a superior middle and senior management team behind them. In addition, the company's principal field of expertise had been in the construction and management of high-rise residential apartments in Toronto. The geographic and product diversification that was underway by mid-1973 had not necessarily turned out successfully. It might be added that neither had the opposite occurred. Historically Cadillac's approach when entering new endeavours was to utilize joint ventures. Cadillac would ally itself with a supposedly proven practitioner in the field. This had been done in residential housing, office buildings and shopping centres. The shopping centre joint venture was terminated in 1972 and the company's management was reorganized.

The 1972 annual report only serves to highlight some facets of the company's lack of experience in certain key areas. Table 4 is taken from the 1972 annual report of Cadillac. We note the following:

Table 4

The Cadillac Development Corporation Limited
Officers, December 31, 1972

Division	Name	Title
Corporate	A.E. Diamond, P.Eng.	President
	Martin Seaton, C.A.	Secretary
	D.N. Smyth, C.A.	Treasurer
Commercial Group	J.N. Daniels, MRAIC	Executive Vice-President
	Martin Seaton, C.A.	Senior Vice-President
	Harold Fealdman P.Eng.	Vice-President
	Thomas Hammond	Vice-President
	A.C. Morgan	Vice-President
	W.D. Hulme, M.Arch	Assistant Vice-President
New Communities Group	G.J. Shear, C.A.	Executive Vice-President
	Gerald Sheff, MRAIC	Assistant Vice-President
Residential Group	Joseph Berman, P.Eng.	Executive Vice-President
	N.R. Stone, MRAIC	Executive Vice-President
	Kenneth Brocklehurst	Vice-President
	W.G. Hilton	Vice-President
	M.A. Shear	Vice-President
	R.L. Strom	Vice-President
	Geoffrey Jacobs	Assistant Vice-President
	Steven Shaffer	Assistant Vice-President
	Joseph Wolf	Assistant Vice-President
	George Sharp, C.A.	Controller

1. In early 1973, the company was obliged to go outside to obtain a Vice-President of Finance.

2. Mr. Daniels, although one of the leading real estate entrepreneurs in Canada, was not experienced in the commercial field.

3. Mr. Martin Seaton, Senior Vice-President, Commercial Group, was actually in charge of the Shopping Centre Division. Mr. Seaton prior to 1972 had been the company's senior financial officer and thus was obviously new to the position.

4. The company's office building program was being run by Messrs. Joseph Fruchter and William Kagan who owned 20% of Cadillac Commercial Properties, and therefore do not appear on the chart. There are natural limitations to such a method of operation.

It is also worth noting that Cadillac's Board of Directors in 1972 consisted of 14 men, only five of whom represented management. Within the real estate group, this is a low representation from management and underscores our thesis that Cadillac was "heavy on top".

Fairview Corporation of Canada

The reasons for Fairview's decision to merge seem the most difficult to comprehend. On the surface, they had the least reason as they had a very attractive portfolio, many new projects in the works, an excellent financial picture and the reputation for having the best management team in the business. The company prior to the merger had moved tenuously into the residential area and was not achieving great results, but this was not a big investment.

Perhaps the logical way to understand the merger is to think about it from the point of view of Cemp Investments. Cemp, under the presidency of Leo Kolber, had a very long term point of view, and, when viewed from this perspective, the merger becomes a takeover by Fairview of Cadillac. In the long run, the Cadillac executives will retire and presumably dispose of much of their stock, while Cemp can take a point of view that goes on for generations.

Meanwhile, the Cadillac management brought a new spirit of entrepreneurship to Fairview. A common criticism of Fairview has been that, considering its natural advantages, the company was not aggressive enough. It is true that Fairview was a leader in the shopping centre field, but in no way can it be accused of dominating it. At the time of the merger, Fairview was operating 16 shopping centres. By comparison, Cambridge Leaseholds was in the process of establishing only a slightly smaller portfolio from a tiny base. Fairview operated on very high standards and appeared to be interested in doing only the most prestigious projects. It would appear that Mr. Kolber of Cemp recognized this limitation in his staff, and from this point of view the merger makes a lot of sense. The Fairview professional style could be put to work on the Cadillac asset base, and the Cadillac entrepreneurial drive would be an added plus as the company expanded its base.

We have alluded more than once to the successful side of Fairview and the various positive factors that the company possessed. From the vantage point of 1976, however, we can see that the management of Fairview were also mere mortals. Earlier, we quoted extensively from a speech of Mr. Kolber's given in June 1973. At that time, he discussed ten new projects "which are in various states of planning and hopefully will commence some time in the future". Three years later, none of the ten developments appear to be any closer to inception than they did at the time. There are a variety of reasons for the delays, all of them legitimate and symbolic of the nature of the industry. The only purpose in presenting this retrospective view is to demonstrate that even with their technical expertise and sophistication, the management of Fairview could not overcome the damage of planning delays, inflation and over-building. We have no idea if the view from hindsight entered into the merger decision.

DETAILS OF THE MERGER

The Cadillac-Fairview merger was really a two-step affair, with the first crucial one being taken on May 30, 1974, and the second on February 29, 1976. For purposes of this study, the highly legalistic and complex reasoning behind the two stages are irrelevant. The important facets of the merger are as follows:

1. Prior to the merger, all three companies were publicly owned and traded.

2. The merger was accomplished strictly on a share exchange basis. Each share of Cadillac received one share of the new company while each share of Fairview received 1.4 shares and each share of Canadian Equity and Development received 1.2 shares.

3. Prior to the merger, Canadian Equity and Development had 4,881,605 outstanding shares, of which Cadillac owned 2,001,441 or 41.0%, and Fairview 1,458,104 shares or 29.9%. These shares were cancelled in the merger.

The pro-forma common share capitalization may be seen in Table 5.

Table 5

Cadillac Fairview Corporation Limited
Pro-Forma Common Share Capitalization

	Previously Outstanding Shares	Ratio of New Company	Number of New Shares	Percentage
Cadillac	9,550,305	1.0	9,550,305	39.4
Fairview	9,269,629	1.4	12,976,068	53.6
CED	1,422,060	1.2	1,706,472	7.0
Total			24,232,845	100.0

The Fairview shareholders received 53.6% of the outstanding shares of the new company, and it is logical to infer that they came out of the deal the best. Cadillac actually had an absolutely higher level of cash flow and net profits than Fairview so it is again clear that the latter was well served by the merger.

The basis for valuing the three separate companies was never disclosed. There was no public controversy at the time of the comparative Cadillac and Fairview exchange ratios, although there was some dissension about Canadian Equity and Development. The CED information circular stated the following:

> *CEDC Corporate Action*
>
> *All the present directors of CEDC are also directors of either Cadillac or Fairview Canada and some of them or their associates are shareholders in one or more of these companies and as such could be subject to possible conflicts of interest. Accordingly, at the time when the merger proposals were first discussed by the board of CEDC, it was decided to retain independent legal advice concerning the negotiations leading to the proposed merger. For this purpose, Blake, Cassels & Graydon of Toronto were engaged as special counsel.*
>
> *At the recommendation of such counsel to obtain independent advice on the merger, the board of directors of CEDC retained Richardson Securities of Canada. Richardsons were requested to give an opinion regarding the desirability, from the point of view of the minority shareholders of CEDC, of CEDC amalgamating with Cadillac and Fairview Canada and on the appropriateness of the ratio of shares of First Cadillac Fairview to be received for the CEDC shares.*

The situation at Canadian Equity and Development was made especially tricky by the fact that the company had no independent directors. The following is extracted from page 8 of the information circular.

> *When the board of CEDC met to consider the Merger Agreement providing for the ultimate merger of CEDC, Cadillac and Fairview Canada, the board decided, on the advice of counsel, that it would not be proper for the board itself to authorize the execution of the Merger Agreement, but rather that the Merger Agreement should be submitted to the shareholders of CEDC for their consideration at a general meeting called for that purpose. In referring the Merger Agreement to the shareholders, which Agreement provides for a ratio of 1.2 common shares of First Cadillac Fairview for each common share of CEDC, the board took into account the information available to it, including the opinion of Richardson Securities of Canada....*

The shareholders are being asked at the meeting to consider and if thought fit to approve the Merger Agreement and to authorize CEDC to enter into it. In order to effect the First Amalgamation, it was necessary for the directors, by resolution, to approve and authorize the execution of the Amalgamation Agreement prior to confirmation by the shareholders even though the directors have an interest in the Amalgamation Agreement for the reasons noted above. Accordingly, at a meeting held on May 2nd, 1974, the directors passed a resolution approving the Amalgamation Agreement and authorizing its execution. The Business Corporations Act (Ontario) requires that this resolution be confirmed by at least two-thirds of the votes cast at the meeting in order to be effective. The Business Corporations Act also provides in effect that if agreements such as the Merger Agreement or the Amalgamation Agreement are confirmed by the shareholders as aforesaid, a director who has made adequate disclosure of his interest in the agreements and is acting honestly and in good faith, will not be accountable for any profit or gain realized from any such agreements by reason only of his holding the office of director and the agreements, if in the best interest of the corporation at the time they were entered into, are not by reasons only of the director's interest therein voidable.

It will be noted that the Amalgamation Agreement required two-thirds approval of the shareholders. Since the two principals held 71% of the total, it was quite apparent that the motion would be carried. However, the two parents never stated unequivocally that they would vote their shares, so there was a tenuous case for minority shareholders to block the merger. There was a single, vocal, minority shareholder who felt the shares were not getting full weight, but he got no support from the institutional shareholders who owned a big percentage of the minority holdings. These institutions had "grumbled" a little about the price of the deal in the first instance and may be partially responsible for the change in the exchange rate from 1.12 to 1.2 shares. In our opinion, the reason there was so little dissension with the merger relates to the market action of the shares. Cadillac common shares, which are the logical bench mark since they were exchanged one-for-one, were generally much stronger throughout the merger negotiations than either before or after the deal. The Canadian Equity and Development shares traded at over $20 in the spring of 1974 compared to the low teens prior to the announcement of the merger.

TAX CONSEQUENCES OF MERGER

It was mentioned earlier that Canadian Equity and Development was entering into a period when it was likely going to have to pay cash income taxes. One of the benefits of the merger was to allow the rental deferrals of the other two companies to shield these land profits. This tax advantage was certainly an important but probably not the crucial factor in the equation that lead to the merger.

Once the decision to merge the three companies was made, we believe that the share exchange program, as opposed to the use of cash or debt securities by one of the parties, was heavily influenced by the tax laws. The company exercised great imagination in coming up with the corporate steps that resulted in a two-stage merger. Certainly, it was the tax consequences of the transaction that were crucial in the decision to go this tortuous route. In summary, the tax laws did not in themselves initiate this merger, but they were a vital factor in the actual methods of merger employed.

WHY THE MERGER HAS WORKED

There are "horror stories" in the real estate world as in other industries of mergers not working out because of disagreements among the respective managements. We have not attempted to answer the question of whether or not the new company is more successful than the summation of the previous three companies. This is a hypothetical question that cannot be documented. For our purposes we are able to find many examples where real estate mergers have occurred and the results have been chaotic in terms of management changes shortly afterwards. This was the situation in three of the major real estate mergers discussed in Table 3 on page 15. From an outside point of view this particular merger seems to be quite effective. All the evidence indicates that it has in fact worked smoothly, with a minimum loss of people. There are occasional rumors within the real estate community that some members of management are seeking new opportunities elsewhere, but this appears to be just normal executive behaviour.

It is not surprising that the merger has worked out so well. The principal reasons are that the respective senior managements have known each other for many years, have worked together in many instances and generally have mutual respect both personally and professionally. This combination of ingredients is quite rare and cannot serve as a model for future mergers in the industry.

The relationship of Cadillac and Cemp dates back to 1960 when Cemp Investments acquired a one-third interest in Cadillac. This little known association did not work out and was terminated in 1961. Cadillac subsequently acted as an independent contractor for Fairview in the Point Claire Shopping Centre near Montreal, completed in 1965. From 1967 onward, Fairview and Cadillac met regularly in the management of Canadian Equity and Development. The two companies acted as joint venture partners in the development of Hillcrest Mall in Richmond Hill, as well as office building projects in Ottawa and Toronto. It seems probable that the companies also negotiated on other deals that never materialized.

Thus the companies knew each other quite well prior to the merger, and presumably knew "where the bodies were buried". In addition, the merger negotiations went on for approximately eight months giving time to iron out many of the details of how the new company would run. An organizational and managerial structure was announced prior to the merger's being finalized, and, to the best of our knowledge, it is intact today.

The merger has also worked because the two management teams tend to approach real estate itself in a similar manner. Both sides are in agreement that the essence of the company should be high quality, well located, with income property real estate financed by long term debt securities. In addition, as explained below, the structure of the new company permitted many of the key members of management to continue to operate in their area of specialization.

Lastly, the success of the merger owes much to the character and personality of Mr. A.E. Diamond, Chairman and Chief Executive Officer of Cadillac Fairview. Mr. Diamond occupies a leading position in the real estate community in Canada today. Some of it is owing to his position, but a great deal of his influence rests on high personal character and the respect he has gathered in the industry over the last 23 years. The real estate industry is one that is renowned for its spawning of "sharp operators". Mr. Diamond, on the other hand, is the classical "people person". He is an executive who engenders respect from his associates and employees and we believe that this characteristic has been crucial at Cadillac Fairview.

HISTORICAL GROWTH OF CADILLAC FAIRVIEW

There is no single official table recording the historical pro forma record of Cadillac Fairview. The annual report of Cadillac Fairview maintains that "because of the differences in accounting policies of the predecessor companies, it is not feasible to provide accurate comparisons on a pro forma basis". In preparation for the merger, Cadillac sent to its shareholders a 175 page document which also lacks historical statements. The reasons are as suggested above plus the fact that there were a variety of transactions among the three companies. While management seems intellectually correct,judicious estimates could have allowed for some admittedly imperfect but approximate tabulations which we have done below. Cadillac Fairview has prepared a five year consolidated statement of income on a pro forma basis which may appear in the fiscal 1977 annual report of the company. This document only examines net income over the five years and the results were not dissimilar from our calculations below.

GROWTH IN ASSETS

We took the reported Cadillac asset figures at each year-end and substracted the equity investment in Canadian Equity and Development. We

Table 6

Total Assets
Historical Growth of Assets
(000's)

	December 1967	December 1968	December 1969	December 1970	December 1971	December 1972	December 1973	February 1974	February 1975	February 1976
Cadillac Development as reported	130,414	171,420	197,814	227,485	272,195	332,064	381,653	387,073		
Less: Investment in Canadian Equity Development	-	13,778	11,890	14,093	14,562	16,655	18,035	18,124		
Adjusted Cadillac Development	130,414	157,642	187,924	213,392	257,633	315,409	363,618	368,949		
	October 1967	October 1968	October 1969	October 1970	October 1971	October 1972	October 1973	February 1974	February 1975	February 1976
Canadian Equity and Dev.	33,800	34,449	38,702	41,923	56,992	72,834	85,461	85,801		
	February 1968	February 1969	February 1970	February 1971	February 1972	February 1973	February 1974	February 1974	February 1975	February 1976
Fairview as reported	150,000*	183,000*	204,941	214,656	242,732	269,487	333,623	333,623		
Less: Investment in Canadian Equity and Development	-	-	-	-	16,731	17,445	18,563	18,563		
Adjusted Fairview	150,000*	182,000*	204,941	214,656	226,001	252,042	315,060	315,060		
Pro forma consolidated (our calculations)	314,214	374,091	431,567	469,971	540,626	640,285	764,139	769,810		
Pro forma reported								782,886	921,175	1,050,000
Percentage Change over previous year		19.1	15.4	8.9	15.0	18.4	19.3		17.7	14.0

took the reported Canadian Equity Development figures at October 31 of the same year. We took Fairview as reported from February 1972 and estimated its assets for the prior five years from data in the 1972 prospectus. We substracted Fairview's equity in Canadian Equity and Development only after 1971 as prior to that year the actual owner of the shares was Cemp. The Fairview figures were added to the other two and the results are summarized in Table 6.

We calculate that assets on a pro forma basis have grown from $314 million at December 1967 to the current $1.05 billion, or by 234%. When compared to the other public companies, this growth is not out of line. Growth over the past two years has been under the industry average.

GROWTH IN NET INCOME AND CASH FLOW

We took the same approach to obtain the historical growth figures in net income and cash flow. We acknowledge that the error factor is larger in these two sets of calculations than in total assets. In any one year, the figure for net income and cash flow could be quite wrong by general accounting standards. However, the trend is quite indicative and valid (see Table 7).

Table 7

Historical Growth of Cash Flow and Net Income, 1967-76
($000's)

			Percentage % Change Over Prior Year	
Year	Cash Flow	Net Income	Cash Flow	Net Income
1967	7,656	2,862	-	-
1968	9,196	3,567	20.1	24.6
1969	12,217	4,876	32.9	36.7
1970	13,650	5,866	11.7	20.3
1971	18,623	6,287	36.4	7.2
1972	21,668	8,530	16.4	13.6
1973	30,842	12,244	42.3	43.5
February				
1974	30,500	12,300	-	-
1975	34,442	13,045	12.9	6.1
1976	40,827	16,489	18.5	26.4

COMPARISON WITH CIPREC RESULTS

The Canadian Institute of Public Real Estate Companies (CIPREC) publishes an annual report each year that includes a Combined Statistical Profile of its General and Associate Members. It will be noted later in the discussion on CIPREC that part of its weakness is that it does not represent all of the public companies. Our Table contains statistics on 35 public companies with total assets of \$6.7 billion dollars. Thirteen of these companies with total assets of \$1.4 billion or 21% of the total do not belong to CIPREC. However, CIPREC does have as members three public companies with total assets of \$94 million that we do not include in our tabulations. In addition, CIPREC has as Associate Members six companies who are either private or divisions of diversified public companies: these six companies have total assets of approximately 650 million dollars by our calculations. Thus, we calculate that the CIPREC totals represent about \$6.0 billion dollars today or approximately 90% of our industry sample. In Table 8 we compare our Cadillac Fairview figures to the CIPREC totals.

Although there are statistical weaknesses in the preparation of the Cadillac Fairview numbers and the industry data, it is safe, however, to conclude that Cadillac Fairview does not appear to be growing faster than the industry in terms of assets. We also note that some of the fastest growing companies in terms of net income, i.e. Nu-West and Carma, do not belong to CIPREC.

Table 8

CIPREC AND CADILLAC FAIRVIEW
COMPARATIVE ASSETS, 1969-75
($000's)

Year End	CIPREC	Cadillac Fairview	Cadillac Fairview (%)
1969	2,200,000	432,000	19.6
1970	2,480,000	470,000	19.0
1971	2,650,000	541,000	20.4
1972	3,180,000	640,000	20.1
1973	3,950,000	764,000	19.3
1974	5,310,000	921,000	17.3
1975	5,885,000	1,045,000	17.8
Comparative Cash Flow:			
1969	49,000	12,217	24.9
1970	83,000	13,650	16.4
1971	89,000	18,623	20.9
1972	122,000	21,668	17.8
1973	172,000	30,842	17.9
1974	197,000	34,442	17.5
1975	177,000	40,827	23.1
Net Income:			
1969	23,000	4,876	21.2
1970	36,000	5,866	16.3
1971	40,000	6,287	15.7
1972	54,000	8,530	15.8
1973	75,000	12,224	16.3
1974	84,000	13,045	15.5
1975	74,000	16,489	22.3

FINANCIAL DESCRIPTION

Cadillac Fairview reported total assets at February 29, 1976, of $1.05 billion. The key balance sheets numbers are itemized below. We have included a comparison with fiscal 1975 as well.

Table 9

The Cadillac Fairview Corporation Limited
Balance Sheet Breakdown, 1975 and 1976
(Year end February 28)

Year ended February 28	1975	1976 ($000's)	As percentage of total 1975	As percentage of total 1976
Income producing properties	553,719	590,338	60.1	56.5
Income producing properties under construction	73,131	117,312	7.9	11.2
Land held for and under development	165,320	180,410	17.9	17.3
Housing projects under construction and for sale	59.653	66,109	6.5	6.3
Accounts receivable	49,288	61,623	5.4	5.9
Other	20,064	29,365	2.2	2.8
Total	921,175	1,045,157	100.0	100.0

Accounting practices of Cadillac Fairview and the industry will be discussed later. At this point, the key accounting item to note is that the assets of Cadillac Fairview in almost all cases include its percentage share of the assets and liabilities of projects not 100% owned by the Corporation. As an illustration, Cadillac Fairview owns approximately 60% of the Toronto Eaton Centre now under construction. Table 10 appeared in a recent prospectus.

Table 10

The Cadillac Fairview Corporation Limited
Owner's Assets and Liabilities pertaining to Toronto Eaton Centre -
As at February 29, 1976
(after giving effect to the issue of the Series C Bonds)
(unaudited)

	Cadillac Fairview	Eaton Properties	Terbert	Total
		($ 000's)		
ASSETS :				
Land (at cost)	$21,861	$ 7,411	$ 7,781	$ 37,053
Construction in progress	40,454	13,713	14,399	68,566
Deferred expenses	1,354	459	436	2,249
Project fund	20,055	6,798	7,138	33,991
Other assets (including accounts receivable and pre-paid construction costs)	1,208	410	476	2,094
	$84,932	$28,791	$30,230	$143,953
LIABILITIES ;				
First mortgage bonds :				
Series A	$41,300	$14,000	$14,700	$ 70,000
Series B	14,750	5,000	5,250	25,000
Series C	11,800	4,000	4,200	20,000
Mortgage payable	531	180	189	900
Bank loans	8,273	2,805	2,945	14,023
Accounts payable and accrued liabilities	8,278	2,806	2,946	14,030
	$84,932	$28,791	$30,230	$143,953

As of February 29, 1976, the project had total assets of almost $144 million. Cadillac Fairview's portion as segregated on the table was $84.9 million, which represents 59% of the total. Thus the balance sheet of Cadillac Fairview at February 28, 1976 will reflect the $84.9 million total only. It will be subdivided on a line for line basis into five components consistent with Cadillac Fairview's balance sheet format illustrated in Table 9.

Cadillac Fairview employs this line by line presentation in all of its major assets, including such projects as the Pacific Centre in Vancouver where the company owns only 33-1/3%. This particular accounting presentation for assets is now common in the real estate industry. One alternative approach for joint ventures is to include only the equity investment. This practice is widely used by the non-real estate joint venture partners such as banks and department stores. The other approach is to fully consolidate the assets and subtract the minority interest. Table 11 summarizes the physical assets of the company.

Table 11

The Cadillac Fairview Corporation Limited
Physical Assets, 1975 and 1976
(Year end February 28)

	1975	1976
Shopping Centres		
Number of shopping centres	33	34
Sq. ft. rentable space incl. non-owned lands	11,250,000	11,795,000
Sq. ft. of rentable space excluding non-owned lands	9,375,000	9,897,000
Equity of CFV in above space	6,967,000	7,367,000
Office Buildings		
Number of office buildings	15	17
Sq. ft. rentable space managed by CFV	7,314,000	8,197,000
Equity of CFV in above space	4,463,000	4,787,000
Total office buildings under construction	8	11
Total sq. ft. involved	4,676,000	5,649,000
Equity of CFV in above projects	2,675,000	3,822,000

Table 11
Continued

	1975	1976
Residential Units - Rentals		
Number of residental units managed by CFV	16,128	16,739
Equity of CFV in above units	14,388	14,997
Apartments under construction	603	0
Residental Units - Sales		
Units for sale or under construction	4,133	4,950
Equity of CFV in above space	3,405	4,157
Number of projects involved	23	28
Industrial Space		
Sq. Ft. industrial space owned by CFV	951,000	1,071,000
Number of projects	3	6
Number of projects under construction	0	3
Sq. ft. of above projects	0	200,000
Acres of land in Erin Mills	6,496	5,960

All of the above data are published by the company. Detailed summaries of all the properties are also published by the company and will be discussed in greater detail in subsequent chapters. Some of the implications and definitions of the terms used in the tables already cited will be explained here.

In many cases, a shopping centre developer will not own all of the land on which the project sits or all of the project itself. To cite an example, Georgian Mall in Barrie has 201,000 square feet of leasable space. However, this includes 93,000 square feet owned by Simpsons-Sears. Thus, for purposes of presentation in the table above, the 201,000 square foot figure would appear under "Square footage of rentable space including non-owned land". But, the entry under "Square footage of rentable space excluding non-owned land" (by Georgian Mall) would be 108,000 square feet, which is 201,000 less 93,000. In this particular case, Cadillac Fairview owns 100% of the project so that their equity in Georgian Mall remains at 108,000 square feet. However, in many cases they own less than 100% of a project, such as Fairview Mall in Toronto. The project has 570,000 square feet and it is owned by three partners. Cadillac Fairview's share is 50%: so their equity in Fairview Mall is 285,000 square feet.

The presentation for office buildings is slightly more complex. "Net rentable area" for our definition includes office space, retail space and parking space as well. The first two are quite common in the industry's jargon, but not necessarily the latter. In addition, under the category "Office buildings under construction", it is common to describe a new phase of an existing building as an additional project. The same principle applies to land held for development. Thus the Pacific Centre appears under completed projects as being one project with 1,315,000 square feet of rentable space. Cadillac Fairview owns one-third, hence their equity is stated as 438,000 square feet. Meanwhile, there was a total of 1,130,000 square feet under construction, which is listed as another project. Finally, a building of another 500,000 square feet is listed under "Land held for development".

It is to be expected that the company has considerably more land under its control than they publicly discuss. For example, land assemblies in major cities can be quite secretive affairs extending over a number of years. In addition, the company may control a site and this may not be public information. However, if the future of the site is not known whether for zoning or market reasons,this is another type of project not separately classified. For example,the Toronto Dominion Centre is believed to own a site for a fourth tower. Its existence is not separately noted, nor is the land for the Toronto Eaton Centre that fronts on Bay Street and is intended for development in the early 1980's. The company is also a major land developer primarily for its own building operations. This operation is conducted in a very low profile manner in comparison to the land development activities of Erin Mills.

Cadillac Fairview is also in the early stages of an ambitious expansion program into the United States. Subsequent to the year-end, the company purchased over $80 million of U.S. industrial properties. None of this U.S. exposure, with the exception of some housing units in Florida, is reflected in Tables 9 and 11.

We also find that the residential units presentation is misleading in that the company is really only producing 1,000 to 1,500 units in actuality and that the expression of units for sale or under construction includes future inventories of land.

BREAKDOWN OF GROSS REVENUES

Cadillac Fairview in its financial reports breaks down its gross revenues into four principal categories. Gross revenues for fiscal 1975 and 1976 are shown in Table 12.

Table 12

The Cadillac Fairview Corporation Limited
Gross Revenue Breakdown, 1975 and 1976
(Year end February 28)

	Actual 1975	1976	Percentage Change	As Percentage of Total 1975	As Percentage of Total 1976
	($000's)	($000's)			
Gross rentals	104,824	122,898	17	65	61
House sales	33,516	46,130	38	21	23
Land sales	18,640	26,763	44	12	34
Other income	4,093	4,605	13	2	2
Total	161,073	200,396	24	100	100

The accounting treatment of gross revenues for joint ventures is consistent with the balance sheet practices noted above. If a given project has $10 million of gross rentals and the company owns half the project, then $5 million of gross rentals would be included as part of gross revenues. Typically, the partner would be a financial institution and/or a large retailer. In such instances, Cadillac Fairview would develop the project and manage it after it was constructed for a fee. This fee income on the portion not owned by Cadillac Fairview would be included in "Other Income".

INCOME AND CASH FLOW

The consolidated statement of income and sources of cash flow for Cadillac Fairview in fiscal 1975 and 1976 is summarized in Table 13.

Table 13

The Cadillac Fairview Corporation Limited
Consolidated Statement of Income and Sources of Cash Flow,
1975 and 1976
(Year end February 28)
($000's)

	1975	1976
Gross rental income	104,824	122,898
Property operating expenses	44,152	54,261
Interest (as allocated)	30,996	34,409
Depreciation	6,588	7,508
Gross profits from rentals	23,088	26,720
Housing sales	33,516	46,130
Direct costs	28,911	41,416
Gross profits from housing	4,605	4,714
Land sales	18,640	26,763
Direct costs	12,071	15,361
Gross profits from land	6,569	11,402
Other income	4,093	4,605
Total gross profits	38,355	47,441
Other interest expense	3,468	4,385
General and administrative expenses	6,593	8,827
Pre-tax profits	28,294	34,229
Income taxes	15,250	17,740
Net income	13,044	16,489
Cash Flow Summary		
Net income	13,044	16,489
Deferred income taxes	14,810	16,830
Depreciation	6,588	7,500
Cash Flow	34,442	40,827
Property operating expenses as percentage of gross rentals	42.1	44.2
Interest expenses as allocated to gross rentals as percentage of gross rentals	29.6	28.6
Gross margin - houses	13.9	10.2
Gross margin - land	35.2	42.6

Cadillac Fairview in its 1976 annual report revised its format for presenting interest expense. The company now allocates interest into that portion attributed to the rental account which was $34.4 million in fiscal 1976, and a smaller portion of $3.1 million not allocated. Formerly the company just gave one all-inclusive interest number. The presentation now utilized is similar to the manner in which Cadillac and Canadian Equity presented their accounts as opposed to that of Fairview. The company makes no effort to allocate general and administrative expenses between divisions.

Table 14

Contributions to Gross Profits

	1975 ($000's)	1976 ($000's)	% Change
Rentals	23,088	26,720	16
Housing	4,605	4,714	2
Land	6,569	11,402	74
Other	4,093	4,605	13
Total	38,355	47,441	21
As a % of Gross Profits			
Rentals	60	56	
Housing	12	10	
Land	17	24	
Other	11	10	
Total	100	100	

CONTRIBUTION OF RENTS TO CASH FLOW

We know the following about the rental portfolio: gross rents; direct operating expenses; interest allocation; depreciation allocation. The only piece of information missing is the portion of general and administrative expenses to be allocated to rentals. It is our understanding of Cadillac Fairview's accounting system that the majority of expenses normally associated with property management are charged directly into property operating expenses. In addition, most of the costs of new development projects are capitalized in accordance with normal practice in this industry. We suspect that the reason the company does not make the allocation itself is because it is so subjective. For purposes of this particular calculation, we have suggested that 60% of total G & A be applied to rentals. This 60% number is purely subjective and is roughly based on the relationship of rental assets to total assets and the fact that much of the cost of new rental projects are capitalized. This allows us to compute Table 15.

Table 15

The Cadillac Fairview Corporation Limited
Contribution to Cash Flow by Rents, 1975 and 1976
(Year end February 28)

	1975	1976	Change
	($000's)		%
Rental operating profit	23,088	26,720	15.7
Add: Depreciation	6,588	7,508	14.0
	29,676	34,228	15.3
Less: 60% of G & A	3,956	5,296	33.9
Estimated cash flow from rents	25,720	28,932	12.5
Reported cash flow	34,442	40,827	18.5
Percent from rentals	74.7%	70.9%	

The company maintains that the major parts of G & A is really attributable to the costs of new developments. Some of this cost has already been capitalized (i.e., approximately 5 million in fiscal 1976) while the majority of it is expensed. They argue that it does not belong to the rental pool since those profits would all remain at that level if the properties were to be sold and theoretically managed by a trust company for a fee. However, in comparing Cadillac Fairview to other specialized income property companies, we would tend to allocate close to 100% of the G & A of the latter group of companies to income properties.

INCOME PORTFOLIO

We understand from management that the income portfolio was broken down in terms of assets, as shown in Table 16.

Table 16

The Cadillac Fairview Corporation Limited
Breakdown of Income Portfolio, 1975 and 1976
(After Accumulated Depreciation)

Company Group*	Feb. 28 1975	Feb. 29 1976	Change	As percentage of total 1975	As percentage of total 1976
	($000's)		(%)		
Urban Development	164,362	180,561	9.9	29.7	30.6
Shopping Centres	172,622	185,475	7.5	31.1	31.4
Residential	205,581	212,420	3.3	37.1	36.0
Industrial	10,302	11,183	8.6	1.9	1.9
Other	852	699	(18.0)	0.2	0.1
Total	553,719	590,388	6.6	100.0	100.0

* Cadillac Fairview is formally structured into five operating groups: Corporate Development; New Communities; Residential; Shopping Centres; Urban Development. We shall later examine these groups in some detail.

BREAKDOWN OF GROSS RENTALS

Cadillac Fairview has never published its breakdown of gross rental income although Fairview in its annual report for the fiscal year to February 28, 1973, did so. The management of Cadillac Fairview has seen our estimates and agreed that they are reasonable.

Table 17

The Cadillac Fairview Corporation Limited
Breakdown of Gross Rental Income, 1975 and 1976
(Year end February 28)

Fiscal Year to February 28th	1975	1976	Percentage Change	As Percentage of Total	
				1975	1976
	($000's)	($000's)			
Office buildings	29,400	33,500	13.9	28.0	27.2
Shopping centres	35,000	43,500	24.3	33.4	35.4
Apartments	39,300	44,700	13.4	37.5	36.3
Industrial	1,000	1,100	10.0	1.0	0.9
Other	124	200	61.3	0.1	0.2
Total	104,824	123,000	17.2	100.0	100.0

Cadillac Fairview does not employ the term "office buildings", but rather the expression "urban developments". Many of the company's major projects in this sector, such as the Toronto-Dominion Centre and Pacific Centre, contain substantial retail space in addition to the office space. The income from this retail space as well as the associated parking space is included under office buildings.

There is also some inconsistency within the real estate industry about accounting for recharges from tenants. Typically in new regional shopping centres, the leases are net leases. The following quote from a recent Oxford Development prospectus states that:

> *Leases in regional centres provide that direct operating expenses of the centre will be borne by the tenants of a pro rata basis. In addition these leases provide that the tenant will pay their proportional share of all property taxes or property taxes in excess of a specified base amount. In these centres the operating expenses borne by Oxford include such items as structural maintenance, the cost of maintaining an office on the premises and Oxford's annual contribution to merchant associations.**

The accounting problem stems from the fact that some companies net out the recharges while others include them in both gross revenues and operating expenses. Table 18 demonstrates the two approaches.

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* Oxford Development prospectus.

Table 18

The Cadillac Fairview Corporation Limited
Comparison of Accounting Approaches
($000's)

	Netting Out Approach	All Inclusive Approach
Basic rents	1,000,000	1,000,000
Overage rents	100,000	100,000
Recharges such as common area maintenance and real estate taxes	0	300,000
Reported gross revenues	1,100,000	1,400,000
Operating expenses actually absorbed by developer	100,000	100,000
Recharges	0	300,000
Reported operating expenses	100,000	400,000
Reported operating profits before interest expense	1,000,000	1,000,000

There is no difference on the profit and loss statement or cash flow statements between the two approaches. However, Cadillac Fairview appears to employ the method of including expenses in both revenues and expenses in all activities except the industrial side. Cambridge Leaseholds Limited in contrast used the net approach while it was a public company as does Oxford today in both shopping centres and parts of office buildings. The gross shopping centre rents for Cadillac Fairview would thus be lower on new centres if the same accounting had been applied as that of Cambridge. Similarly, the operating expense ratio for Cadillac Fairview turns out to be higher. This accounting differential is only relevant for newer centres using net leases. Accounting practices are more consistent on old centres. Although real estate accounting is still a bit of an "art form", the widespread use of footnotes tends to make the analyst's life easy. Unfortunately, to the best of our knowledge, there have never been any references to this accounting problem for net leases. We have tried to summarize the complex problem but in actual fact the details are more esoteric, especially in such areas as accounting for gross leases in regional centres.

OPERATING PROFITS OF INCOME PORTFOLIOS

The company does not publicly disclose its operating performances by segments. However, it is possible to arrive at sophisticated guesses from the following:

1. Cadillac Development's rental performance was predominantly obtained from residential apartments, giving us a good idea of the trend in margins in this area.

2. In its annual report for the fiscal year to February 28, 1973, Fairview broke its gross rentals into office buildings and shopping centres and, in addition, disclosed operating profits within the two categories.

3. Canadian Equity and Development's income portfolio was heavily weighted in favour of shopping centres.

The Tables 19 and 20 are our rough breakdowns of the company's profitability before allocation of interest.

Table 19

The Cadillac Fairview Corporation Limited
Breakdown of Rental Profits, 1975
(Year end February 28)
($000's)

	Office	Shopping	Residential	Industrial	Other	Total
Gross rents	29,400	35,000	39,300	1,000	124	104,824
Operating expense	13,500	12,200	18,352	100	-	44,152
Percentage	45.9%	34.9%	46.7%	10.0%	-	42.1%
Operating profit	15,900	22,800	20,948	900	124	60,672
Percentage	54.1%	64.2%	53.3%	90.0%	100.0%	57.9%
As a Percentage of Total						
Gross rents	28.0%	33.4%	37.5%	1.0%	0.1%	100.0%
Operating profit	26.2%	37.6%	34.5%	1.5%	0.2%	100.0%

Table 20

The Cadillac Fairview Corporation Limited
Breakdown of Rental Profits, 1976
(Year end February 29)
($000's)

	Office	Shopping	Resi-dential	Indus-trial	Other	Total
Gross rents	33,400	43,500	44,700	1,100	198	122,898
Operating expense	16,061	16,400	21,700	100	-	54,261
Percentage	48.1%	37.7%	48.6%	9.1%	-	44.2%
Operating profit	17,339	27,100	23,000	1,000	198	68,637
Percentage	51.9%	62.3%	51.4%	90.9%	100.0%	55.8%
As a Percentage of Total						
Gross rents	27.2	35.4	36.3	0.9	0.2	100.0
Operating profits	25.3	39.5	33.5	1.5	0.2	100.0

ALLOCATION OF INTEREST EXPENSE

Theoretically it should not be difficult to allocate the corporation's interest expense by product. We have already subdivided the income portfolio by net asset investment, gross rentals and operating profits. The majority of the individual income properties are financed by an individual mortgage or mortgage bond. The analytical problem is that some of the company's debt is general corporate debt, such as bank loans and debentures, and the attribution of this interest is not easy. For example, an older income property might have originally cost $10 million and been financed by an $8 million mortgage which today has a balance of $5 million. The property might have an economic value today of $15 million and in actuality the unmortgaged portion of $10 million ($15 million less $5 million) is the effective security for the corporate debt. It is for these reasons that the corporation finds it difficult to allocate interest expense internally, let alone externally. Up to now, we have broken the portfolio down by gross rents, total assets and operating profits. We have made the arbitrary assumption that interest expense is broken down in the same manner as total assets, as shown in Table 21.

Table 21

The Cadillac Fairview Corporation Limited
Breakdown of Rental Portfolio, February 29, 1976

	Gross Rents	Assets	Operating Profits	Interest Expense
Offices	27.2%	30.6%	25.1%	30.6%
Shopping centres	35.4	31.4	39.6	31.4
Residential	36.3	36.0	33.6	36.0
Industrial	0.9	1.9	1.5	1.9
Other	0.2	0.1	0.2	0.1
Total	100.0	100.0	100.0	100.0

This data provides the basis for Tables 22 and 23 which give a breakdown of the company's profits from rents after interest.

Table 22

The Cadillac Fairview Corporation Limited
Breakdown of Rental Profits, 1975
After Interest Allocation
(Year end February 28)

	Office	Shop-ping	Resi-dential	Indus-trial	Other	Total
			($000's)			
Operating profit	15,900	22,800	20,948	900	124	60,672
Less interest expense	9,485	9,733	11,159	589	30	30,996
Profits before G & A	6,415	13,067	9,789	311	94	29,676
As a percentage of gross rents						
Operating profits	541	64.2	53.3	90.0	100.0	57.9
Interest	32.3	27.4	28.4	58.9	24.2	29.6
Profits before G & A	21.8	36.8	24.9	31.1	75.8	28.3
Profits before G & A percentage of total	21.6	44.0	33.0	1.0	0.4	100.0

Table 23

The Cadillac Fairview Corporation Limited
Breakdown of Rental Profits, 1976
After Interest Allocation
(Year end February 28)

	Office	Shopping	Residential	Industrial	Other	Total
Operating Profit	17,339	27,100	23,000	1,000	198	68,637
less Interest Expense	10,529	10,804	12,387	638	51	34,409
Profit before G & A	6,810	16,296	10,613	362	147	34,228
As a percentage of gross rents						
Operating profits	51.9	62.3	51.4	90.9	100.0	55.8
Interest	31.5	24.8	27.7	58.0	25.8	28.0
Profits before G & A	20.4	37.5	23.7	32.9	74.2	27.8
Profits before G & A as percentage of total	19.9	47.6	31.0	1.1	0.4	100.0

ALLOCATION OF GENERAL AND ADMINISTRATIVE EXPENSES

Calculations on Table 15 (page 40) suggested that it would be appropriate to assume that 60% of the general and administrative expenses of the company be applied against the rental account. In assessing how that 60% might be subdivided by the company's various rental activities we have arbitrarily assumed that it is apportioned as percentage in the same manner as gross rentals. Thus office rentals in fiscal 1976 contributed 27.2% to gross rentals. We assume that 27.2% of general and administrative expenses also belong to gross rentals. The following table summarizes the data.

Table 24

Breakdown of Rental Profits, 1975 and 1976
After Allocation of G & A
(Year end February 28)

	1975	1976
Gross Rentals total percentage	104,824	122,898
Profits before G & A	29,676	34,228
less 60% of G & A	3,956	5,296
Profits after G & A	25,720	28,932
Allocated into		
Offices	5,307	5,369
Shopping	11,746	14,421
Residential	8,305	8,691
Industrial	272	314
Other	90	137
Total	25,720	28,932

ACCOUNTING AND DISCLOSURE POLICIES

The company reports to its shareholders in a manner that appears to be a blend of the separate practices of the three predecessor companies. Cadillac and Fairview were both lending members of the Canadian Institute of Public Real Estate Companies. We do not personally believe that CIPREC is a very powerful organization. We do note that CIPREC has enjoyed considerable success in getting its members to adopt consistent accounting policies. The notes to Cadillac Fairview's Consolidated Financial Statements state that, "The Company's accounting policies and its standards of financial disclosure are in accordance with the recommendations of that Institute in all material respects".

Fairview's accounting practices were among the most conservative of the public companies. For example, Fairview did not capitalize any of the administrative expenses incurred in developing new income properties. By comparison, Cadillac followed "the policy of also capitalizing that portion of administrative overhead considered applicable as part of the cost of income properties under construction and that portion of interest or general borrowings considered applicable as part of the cost of both income-producing properties under construction and lands under development".

It does not take a great deal of imagination to realize that considerable subjectivity would enter into the calculations of these amounts. The expression that accounting is an art form remains very true in real estate accounting. It is our impression that the practices of Cadillac Fairview are not as conservative as that of the former Fairview, but also not as "liberal" as the Cadillac practices might have permitted.

In terms of disclosure, Cadillac Fairview supplies a considerable amount of useful information about its affairs. It is our opinion that the public real estate industry is a leader among Canadian industries in the policies of full disclosure. In our text, we will discuss the department store industry on several occasions. The annual reports of most of the leading retailers are scanty in their disclosure policies when compared to the real estate companies. Cadillac Fairview provides above average disclosure but is not the leader in the industry. We suspect that the reasons are the highly political status of rent controls and land development. Such an attitude is understandable, as it is easy to see industry critics taking certain figures out of context.

MANAGEMENT

An up-to-date management chart of Cadillac Fairview is reproduced in Table 25.

Table 25

The Cadillac Fairview Corporation Limited
Officers, 1976

Group	Name	Title
Corporate	A.E. Diamond	Chairman of the Board and Chief Executive Officer
	E. Leo Kolber	Vice-Chairman
	Neil R. Wood	President
	Bernard I. Ghert	Executive Vice-President and Chief Financial Officer
	Peter McNichol	Vice-President, Finance, and Senior Controller
	Rene Baby	Vice-President, Finance, and Treasurer
	Wayne R. Smith	Secretary
	Raymond W. Quirk	Vice-President, Administration
	Albert J. Ellman	Vice-President, Information Systems
	Donald E. Fox	Vice-President, Financial Planning
	Crandell E. Murray	Vice-President and Corporate Controller

Table 25
Continued

Group	Name	Title
Corporate Development Group	John H. Daniels	Executive Vice-President
	Martin Seaton	Senior Vice-President
New Communities Group	G. J. Shear	Executive Vice-President
	Gerald Sheff	Senior Vice-President
	J.D. Ellison	Vice-President
	Michael Warren	Vice-President and Group Controller
Residential Group	Joseph Berman*	Executive Vice-President
	Norman R. Stone	Executive Vice-President
	Kenneth Brocklehurst	Vice-President
	William G. Hilton	Vice-President
	Geoffrey Jacobs	Vice-President
	Steven Shaffer	Vice-President
	George Sharp	Vice-President and Group Controller
	M.A. Shear	Vice-President
	Robert L. Strom	Vice-President
	Sebastian Valente	Vice-President
	Joseph Wolf	Vice-President
Shopping Centres Group	Stanley H. Witkin	Senior Vice-President
	Joseph Flamer	Vice-President
	George A. Lawtey	Vice-President and Group Controller
	Reginald G. Stapley	Vice-President
Urban Development Group	Kenneth G. Bream	Executive Vice-President
	Gerald R. Coyle	Vice-President
	Joseph Fruchter	Vice-President
	William D. Hulme	Vice-President
	William Kagan	Vice-President
	Patrick J. Kelly	Vice-President
	Marvin J. Rothschild	Vice-President
	David N. Smyth	Vice-President and Group Controller
Commercial Design and Construction Divisions	Harold Fealdman	Vice-President
	Frank E. Barrie	Vice-President
	Donald McMaster	Vice-President
	Allen C. Morgan	Vice-President

* Mr. Berman announced his resignation as an Officer effective November 1, 1976.

It lists 44 people: 23 came from Cadillac or Canadian Equity; 18 came from Fairview; and 3 came from outside. According to the annual report of Fairview for the fiscal year ended February 28, 1974, there were eleven senior officers. Only one is not now with Cadillac Fairview. Cadillac's annual report for 1972 showed twenty senior officers, and all but one are still with Cadillac Fairview. Cadillac Fairview has twelve executives who hold a senior vice-president or higher rank. Seven of them come from Cadillac and five from Fairview. The origins of the directors will be described in the next section.

The management of Cadillac Fairview on the surface appears to have been a marriage of equals. Earlier we inferred that the merger made sense from the point of view of Cemp if one assumed it was a takeover of Cadillac and qualified those remarks by pointing out this could be concluded only if one takes a long-term perspective. The easiest contradiction of the hypothesis is that Mr. Diamond is the Chief Executive Officer in fact as well as in title. We do not believe that it is possible to conclude that one side is more powerful than the other. For example, the commercial development program is headed up by former Fairview people and this is a significant aspect of the company, outweighing the housing, apartment and land sides which are led by Cadillac representatives. However, the thrust of the U.S. expansion effort, which will likely be very significant in the future, is a Cadillac area at this moment except for shopping centres. Finance, a big area, is the prerogative of Fairview. The general conclusion is that Fairview is more important but this is offset by Mr. Diamond's strong role. An interesting illustration of the synthesis of management at Cadillac Fairview over the two years is the aborted acquisition by Cadillac Fairview of control of Abbey Glen Property Corporation. It is our understanding of the situation that initially the two spearheads of the deal within Cadillac Fairview were from both sides. Similarly, the task force set up to analyse and study Abbey Glen came from both sides. It is our contention that over a period of time the two former management groups will tend to coalesce and that a decade from now the expression "Cadillac" or Fairview man" will no longer be relevant.

DIRECTORS

The original Board of Directors of Cadillac Fairview is shown in Table 26. It consisted of men who may be viewed as representing the following sources: 5 were former officers of Cadillac; 4 were former officers of Fairview; 5 were clear nominees of Cemp and former directors of Fairview; 4 were clear nominees of Cadillac and former directors of Cadillac.

The 1976 Board of Directors resembles the original one except for the following changes: Mr. Rupert Carleton and Mr. Ross Willmott have been replaced by Mr. Richard Thomson, President of Toronto Dominion Bank and Mr. Martin Seaton, Senior Vice-President, Corporate Development, a long standing Cadillac Fairview employee. Considering Fairview's long and current close relationship with the Toronto Dominion Bank, it is safe to assume that the nominees have been evenly split.

This pattern of nine nominees from each side is not a coincidence. The Shareholders' Agreement for the merger set up this arrangement for five years as noted below.

The Shareholders Agreements

The principal shareholders and certain senior officers of Cadillac have entered into an agreement with Fairview Canada and a further agreement with Cemp Investments Ltd. ("Cemp"), as the principal shareholder of Fairview Canada, and certain senior officers of Fairview Ontario and Fairview Canada. These agreements (the "Shareholders Agreements") have been entered into with a view to the orderly and effective carrying on of the business of First Cadillac Fairview during the Interim Period and of Second Cadillac Fairview thereafter.

The Shareholders Agreements provide, subject to certain conditions, that the parties will vote their shares of First Cadillac Fairview or Second Cadillac Fairview, as the case may be, for a period of five years following the First Amalgamation for the election as directors of First Cadillac Fairview during the Interim Period and of Second Cadillac Fairview thereafter of (a) nine nominees of the principal shareholders of Cadillac, and (b) nine nominees of Fairview Canada during the Interim Period and of Cemp thereafter. The Shareholders Agreements further provide, subject to certain conditions, that the parties will vote their shares of First Cadillac Fairview or Second Cadillac Fairview, as the case may be, to cause the election as directors of Messrs. J. Berman, J.H. Daniels, A.E. Diamond, G.J. Shear and N.R. Stone (who are to be five of the nine nominees of the principal shareholders of Cadillac). Cemp has agreed that Messrs. N.R. Wood, B.I. Ghert and K.G. Bream will be three of the nine nominees of Cemp. The parties have also covenanted to cause a nominee of North American Life Assurance Company to be elected as a director so long as it holds any of the debentures issued to it by Cadillac. For as long as the principal shareholders of Cadillac are entitled to have nine nominees elected as directors, the North American Life Assurance Company nominee will be one of the nominees of the principal shareholders of Cadillac.

In the Shareholders Agreements the parties acknowledge that in their opinion the transactions set out in the Merger Agreement are in the best interests of the shareholders of Cadillac, CEDC and Fairview Canada and covenant to vote as shareholders of Cadillac, CEDC, Fairview Ontario and Fairview Canada and, during the Interim Period, of First Cadillac Fairview, respectively, and otherwise to act so as to implement the Merger Agreement. In the Shareholders

Agreements the parties confirm, to extent permitted by law, their intention that a dividend policy be established for First Cadillac Fairview and Second Cadillac Fairview. Reference is made to "Dividend Policy" on page 38 for details of the proposed dividend policy.

Cemp has agreed, subject to certain conditions, that it will not vote its shares of Fairview Canada other than as contemplated in the Merger Agreement, so as to permit any sale, transfer or other dealing with shares, securities or indebtedness of First Cadillac Fairview held by Fairview Canada or to allow Fairview Canada to make any application for supplementary letters patent without the consent of the majority of those of Messrs. J. Berman, J.H. Daniels, A.E. Diamond, G.J. Shear and N.R. Stone who are then directors of First Cadillac Fairview.

Certain of the parties of the Shareholders Agreements have entered into an agreement providing that in the event of any intended sale of shares of Fairview Canada, First Cadillac Fairview or Second Cadillac Fairview held by them, such shares will first be offered to the other parties.

Table 26

The Cadillac Fairview Corporation Limited
Original Board of Directors

Name	Principal Occupation	Firm
Joseph Berman	Executive Vice-President	Cadillac
Kenneth G. Bream	Vice-President, Development	Fairview Ontario
Charles R. Bronfman	Executive Vice-President	Distillers Corp. - Seagrams Limited
Rupert B. Carleton	Vice-President and General Counsel	Cemp
John H. Daniels	Executive Vice-President	Cadillac
A.E. Diamond	President	Cadillac
Nathan Gesser	Vice-President, Finance	Cemp
Bernard I. Ghert	Vice-President, Finance	Fairview Ontario
Edwin A. Goodman	Partner	Goodman & Goodman
Thomas H. Inglis	Executive Officer	North American Life Assurance Company
E. Leo Kolber	President	Cemp
John H. Moore	(Chairman (President	John Labatt Limited Brascan Limited

Table 26
Continued

Name	Principal Occupation	Firm
Ivan E. Phillips	Partner	Phillips & Vineberg
Gerald Joseph Shear	(President	CEDC
	(Executive Vice-President	Cadillac
Norman R. Stone	Executive Vice-President	Cadillac
Phillip F. Vineberg	Partner	Phillips & Vineberg
Ross M. Willmott	Company Director	
Neil R. Wood	President	Fairview Ontario

The Executive Committee

Nine of the directors sit on the Executive Committee. Three are former Cadillac officers, four are former Fairview officers and two are outside directors representing each side. The Executive Committee is currently the same as 1975, except that Mr. Shear has replaced Mr. Berman. Each is a former Cadillac officer.

It is probable that the same comments that applied to the management compatibility also apply to the Board of Directors. There does not seem to be any likelihood that decisions are factionalized. The great majority of decisions taken by the Board of Directors seem to have been agreed upon by senior management.

CHAPTER 3

DETERMINING THE SIZE OF THE MARKET

A considerable amount of attention has been given to the size of Cadillac Fairview, which has been seen as "big" because it has assets of a "billion" dollars, still a large sum even in an inflationary age. In addition the real estate industry generally has many critics of the apparent growth to large size of a few companies.

On the other hand, to the best of our knowledge, there has never been any emphasis placed on attempting to determine the actual aggregate size of the Canadian real estate market. There are probably two main reasons for this. The first is that "the aggregate value of total real estate" is a largely meaningless figure since it is made up of a variety of non-comparable components, e.g., shopping centres in Calgary, office buildings in Halifax - a fact which should be remembered when discussing the total assets of Cadillac Fairview, which comprise similar non-comparable items. Secondly, as will be seen, an accurate figure is impossible to obtain.

Nevertheless, since any rational discussion of the size of Cadillac Fairview, and of the degree of concentration that it represents, must take place in context, it becomes necessary to relate the company to the industry as a whole. We have, therefore, in this chapter attempted to arrive at an approximate figure for aggregate value by looking at the various components of the industry -- public companies, other large real estate companies, apartment owners, etc. -- establishing approximate value figures for these, and combining them. This figure is then related to Cadillac Fairview's assets.

Finally, since what is also of interest to the Royal Commission on Corporate Concentration is the degree of power and/or influence exercised, this study examines the three major industry associations, assessing both their influence and the position of Cadillac Fairview within them.

CALCULATIONS OF THE SIZE OF THE INDUSTRY

RESEARCH PROBLEMS

Before presenting our detailed calculations, we should identify some of the major research problems.

To begin with, many large holders of real estate are very secretive and have done their best to conceal their existence. For example, by using a different name of each holding, they make it next to impossible for an outsider to determine their common ownership. In addition, many large holdings are held by foreigners of all descriptions. Last in this category, the great majority of non-real estate large companies in Canada also own large real estate. Whether such holdings belong in this study is a subject itself for a Ph.D. thesis. We could argue both sides. For example, Chrysler leases a large warehouse in Erin Mills. One day it may want to acquire another. The alternative to the land holdings of a private developer are its own lands. For instance, Ford Motor has just announced a major expansion in Oakville on lands it already owns. We believe that this extra land of Ford's would have deserved to be included in a tabulation of the size of the Canadian real estate industry. In actual fact we have not included "Ford type" land in our calculation. Similarly, we have not included all the properties owned by government bodies, which in aggregate amounts to hundreds of millions of square feet.

The academic problems suggested above are simple when one begins to contemplate the number of smaller participants in real estate. There are literally thousands of "mini-developers" in this country, many of whom are active in real estate as a sideline. However, their impact on the greater real estate market is often underplayed.

For example, we would argue that while the bigger projects are now the exclusive domain of the bigger companies, the "little guys" have an undeniable effect on the total market. The existence of many smaller suppliers of residential shelter has an effect on the big apartment owners. Naturally, many renters would prefer a new high-rise project with amenities such as saunas and pools, high speed elevators and doormen. However, if the rent demanded by the latter landlords gets too far above the level being charged by small, bland projects, the results are vacancies in the bigger buildings. This is not an academic point since for many years Toronto residential rents rose only slightly. The reason was that there were too many apartments.

This type of competition prevails throughout all real estate. One cannot look at retailing and calculate just the amount of square feet of large shopping centres. The strip locations, neighborhood plazas, and inner city street locations are all real competition to the "big guys". While it is clear that the the "big guys" have a natural advantage in providing retail space, it would be folly to dismiss the small participants.

The same type of exercise can be conducted and the same conclusions drawn in all phases of real estate, in land development, housing, industrial real estate, offices, etc. The thousands of smaller competitors in aggregate in total dollars constitute more of the industry than all of the major companies combined. At the same time, accurate figures for this participation do not exist. It is for this reason that we stated earlier that an aggregate value for the industry was impossible to obtain. Admittedly our assumptions are arbitrary in some cases and our error factor is potentially large. We have attempted in all cases to be conservative in our calculations and thus arrive at a minimum figure for the size of the industry. We rejected the management consultant's approach of producing low, high and mid-point estimates on the grounds that our data base is truly non-documentable and we do not want to portray it as more than this.

PUBLIC COMPANIES

Table 27 summarizes some key statistics on 35 public companies. In total, these companies have total assets of $6.7 billion. It is our basic contention that this $6.7 billion plus another $2 billion that we can easily identify is just "the tip of the iceberg".

Extent of Double Counting

Nu-West - Included in Nu-West's reported assets of $187.1 million at December 31/75 is its investment in Carma Developers Ltd. of $10.7 million. Adjusted total assets of Nu-West would be $176.4 million. Nu-West's reported net income and cash flow also include the company's equity in the earnings of Carma of $3.3 million. Adjusted net income of Nu-West would be $10.6 million and cash flow $13.4 million.

Deltan - Deltan owns indirectly 52% of the shares of Y & R Properties Ltd. and 74% of Imperial General Properties Ltd. The results of these two companies are consolidated. We calculate that Deltan's total assets would be $230.2 million excluding the investment in these two companies.

OTHER LARGE REAL ESTATE COMPANIES

1. Olympia and York

Olympia and York appears to be the leading private real estate company in Canada. The only source of primary information known to us are two prospectuses issued in connection with the debt financing of First Canadian Bank Tower. The bonds are guaranteed by the Bank of Montreal and therefore information on Olympia and York is restricted. It would appear from the available information that the company could have total assets of between $750 million and $1.0 billion today.

2. Marathon Realty Company Limited

Marathon is a wholly-owned subsidiary of CP Limited. The 1975 annual report of CP indicates that Marathon had total gross revenues of $59.6 million, total assets of $275 million and net income as defined of $7.7 million.

Table 27

Comparative Public Real Estate Data, 1976
($000's)

	Year End	Total Assets	Total Gross Revenues	Gross Cash Flow	Net Income	Common Share-holders' Equity	Common Equity Average for Year	Cash Flow as % of Average Common Equity	Net Income as % of Average Common Equity
Cadillac Fairview	Feb 29/76	1,045,157	200,396	40,827	16,489	135,836	126,301	32.3	13.1
Trizec [3]	Oct 31/75	899,714	170,327	17,814	3,234	115,844	112,935	14.5	2.9
Campeau [3]	Dec 31/75	481,695	139,696	16,467	7,568	46,734	43,037	39.3	16.3
Oxford Developments	Mar 31/76 [7]	474,800	45,911	10,327	3,033	41,869	35,365	29.2	8.6
Deltan	Dec 31/75	390,495	67,772	9,466	1,970	20,205	20,254	46.6	9.7
Abbey Glen	Mar 31/76 [3]	387,586	107,747	16,387	8,276	75,511	72,808	22.5	11.4
Bramalea	Jan 31/76	279,143	66,339	9,812	3,540	26,193	27,089	36.2	13.1
S. B. McLaughlin	Dec 31/75	256,402	61,091	9,141	3,930	33,228	31,088	29.4	12.6
Daon Developments [2]	Oct 31/75	209,963	102,939	12,921	6,694	19,319	16,152	80.0	41.4
Nu-West [3]	Dec 31/75	187,143	143,399	13,329	13,953	36,509	30,155	44.2	46.3
M.E.P.C. [3] (1)	Sep 30/75	179,505	23,647	5,560	3,245	32,325	31,237	17.4	9.9
Cmnwlth Hol. Inns [3]	Oct 31/75	160,361	120,695	8,522	413	21,290	21,265	38.2	-
Block Brothers	Jan 31/76	146,767	41,631 [5]	9,077	5,712	24,303	22,796	39.8	25.1
Markborough	Oct 31/75	142,104	26,516	6,793	4,283	38,424	36,283	18.7	11.8
Orlando	Dec 31/75	120,230	28,766	5,029	2,248	12,680	11,948	42.1	18.8
Revenue Properties	Dec 31/75	104,476	21,479	1,827	580	20,510	20,185	9.1	2.9
Carma	Dec 31/75	103,523	39,487 [6]	11,594	7,266	23,282	18,977	61.1	38.3
Allarco Developments	Dec 31/75	101,356	12,999	4,134	3,307	17,417	15,763	26.5	21.0
Consolidated Bldg.	Feb 28/76	100,583	32,281	2,682	2,372	17,802	17,094	15.7	13.9
Y & R Properties	Dec 31/75	98,149	22,698	4,301	1,584	21,436	20,324	21.2	7.8
Alliance Bldg.	Dec 31/75	97,706	34,202	2,922	695	10,319	8,567	34.1	8.1
Sifton Props.	Dec 31/75	94,354	28,847	5,278	2,072	9,240	8,448	62.5	24.5
Richard Costain	Dec 31/75	92,618	38,337	4,931	3,192	13,143	11,815	41.7	27.0
Headway	Aug 31/75	81,889	34,654 [4]	2,330	1,134	10,813	10,247	22.7	11.1
Four Seasons Hotels	Dec 31/75	67,123	31,168	3,447	1,505	15,801	15,349	20.9	8.2
Monarch Investments	Dec 31/75	63,923	26,964	2,747	2,812	17,025	15,725	17.5	17.9
Imperial General	Oct 31/75	62,126	6,337	2,061	758	11,240	10,861	19.0	7.0
Halifax Devel.	Dec 31/75	48,149	8,154	1,033	256	8,543	8,458	12.2	3.0
Melcor	Dec 31/75	46,931	37,313	4,450	3,494	9,990	8,249	53.4	42.4
Skyline Hotels	Dec 31/75	42,469	32,782	308	(667)	5,247	5,581	5.5	neg
Major Holdings	Dec 31/75	34,681	12,167	4,494	1,538	5,373	4,722	94.7	32.1
Corporate Properties	Dec 31/75	24,385	13,269	814	112	3,268	3,212	25.3	3.4
Sobey Leased Props.	Jan 31/76	19,406	2,089	650	305	3,171	3,037	21.4	10.0
Abacus Cities	Dec 31/75	16,658	17,215	2,876	1,526	3,529	2,635	109.5	57.9
Douglas Leaseholds	Dec 31/75	13,508	1,373	340	145	5,429	4,612	7.4	3.1
		6,675,078	1,800,960	254,746	126,070	904,453	852,917	29.9	14.8

Notes

1. MEPC's total assets at October 31, 1976 were $186.8 million.
2. Includes investment in Carma.
3. Returns are after subtraction of preferred dividends.
4. Excludes non-real estate related sales of $30.4 million.
5. Excludes gross revenues from brokerage, and mortgage portfolio of $48 million.
6. Excludes non-real estate revenues of $50 million.
7. Includes investment in Y & R and Imperial General.

3. Genstar Limited

Genstar, through its wholly-owned subsidiaries, BACM Development Corporation, Engineered Homes Limited and Keith Construction Company Limited, is a major factor in Western Canadian land development and housing. The company does supply detailed figures for its overall real estate activities, which encompass a small operation in California as well. In total, gross revenues from real estate were $160.3 million in 1975 on total assets of approximately $200 million. Genstar acquired control of Abbey Glen Property Corporation in 1976.

MAJOR TORONTO APARTMENT OWNERS

Cadillac Development rose to prominence as a result of its strong position in the Toronto apartment market. The company finished 1964 with 2,084 units and by the end of 1971 had 11,740 units. During this period of time, three privately owned Toronto companies also achieved growth of this magnitude. They are Belmont Construction, Greenwin Construction, and The Meridian Group.

We understand from reliable sources that today these three companies own a total of 25,000 suites. Assuming an average cost per unit of $15,000, this suggests total assets for the three companies in apartment units alone of $375 million. The three companies keep a low profile and it is difficult to determine the extent of their non-apartment real estate holdings. On balance, they did not choose to go the route of Cadillac and aggressively diversify their operations. Based on projects that we are aware of, and some speculation, we would guess that the non-apartment assets of the three companies might amount to $100 million. Thus our estimate of total assets for the three companies is $475 million, or $158 million each.

OTHER MAJOR DEVELOPERS

Table 27 shows that 35 leading companies had total assets of over $6.7 billion, or an average of $209 million. However, this sample is influenced considerably by the biggest companies. For instance, the largest ten companies averaged $462 million in assets compared to $47 million for the bottom ten. We maintain that in Canada, the ten largest companies would rank very high if the data was available for a listing that included both public and private companies. On the other hand, the bottom ten public companies averaging $47 million apiece are not that big. We believe that there are literally scores of private companies in Canada with assets of this magnitude or greater.

Other owners of large amounts of real estate are the leading financial institutions and major retailers. This group has real estate assets in the low billions. It is our contention that even after one adds up all the easily determined owners of large real estate, it is still, as said before, "the tip of the iceberg".

OFFICE BUILDINGS

Subsequently in this report Cadillac Fairview's position in the Toronto office market will be discussed in some detail (see page 80) Our bench mark figure is that Toronto contains currently over 50 million square feet of rentable office space. Let us make the theoretical judgement that this one city contains one-third of the office space in all of Canada. This is apparently a very high figure, but by exaggerating, it will help to make the point. Canada, therefore, would have total office space of 150 million square feet. Let us assume that the average historical cost of putting up this space was $25.00 per square foot. The value of office buildings alone would be $3.75 billion. We elaborate on this 150 million square foot number in our subsequent section on Cadillac Fairview's share of the market.

$3.75 billion dollars may or may not seem like a lot depending on the perspective. It appears that our totals are very low compared to the actual ones. Many observers believe that the total holdings of the federal government alone would exceed this amount.

SHOPPING CENTRES AND RETAILING

Similarly, we mention in the section on shopping centres (page 91) that Statistics Canada claimed that Canada had 89 million square feet of shopping centre space at the end of 1973. However, our figures suggest that this estimate is low by a factor of over one-third. These shopping centre figures include only minor representations from either downtown or conventional retailing on street locations. Surely it would be agreed that such locations would more than rival the quantity of shopping centres, but by how much we do not know. We do have some hard numbers on department stores. George Hartman of Brown, Baldwin, Nisker Limited published in June 1975 a major study entitled The Canadian Department Store Directory. In this study, he catalogues the department store space in almost every location in Canada. His figures state that at the end of 1975 Canada possessed 71,829,521 square feet of department store capacity.

Naturally, there is bound to be considerable overlapping between the total shopping centre figures, which we believe is currently around 135 million square feet, and the department store totals. It would appear that the biggest portion of the department store capacity would be in shopping centres, despite the existence of such million square foot facilities as downtown Eaton's and Simpsons in Toronto.

Assume that 60% of the department store capacity is in shopping centres. This comes to 43 million square feet. Assume again that roughly a third of the shopping centre capacity is composed of department stores. (This figure varies considerably from centre to centre as discount-based centres have a very high percentage of their space leased to the department store while many centres have no department store at all. Large regional centres tend to have roughly half their space given over to the department stores). We estimate that the department stores might have 43 million square feet in shopping centres and with our assumption of one-third, this suggests total shopping centre capacity of 132 million square feet. We also know that total retail sales in Canada are approximately $50 billion. A small percentage of these come from mail order and the like, but the mass of them must surely originate in hard, physical retail locations. Let us assume that $40 billion comes from such assets. We know that in retailing, sales of $100 per square foot was traditionally considered as more than satisfactory in almost all places except groceries. Inflation has caused $100 to be unsatisfactory in some new expensive rent projects, but considering the entire spectrum of retailing across Canada, it is still a satisfactory working number in our opinion. Employing this as a guidepost we estimate that Canada has over 400 million square feet of retailing space. We stated above our contention that retailing space is probably largely located in areas other than shopping centres. Thus the 400 million square foot number is not surprising. Admittedly,there is no particular validity or invalidity in stating that the total market for supplies of retail space is so all-inclusive. For the sake of conservatism, we have cut our estimate down to 300 million square feet. On the other hand, our sales figure of $100 per square foot is high, and a lower figure would cause the space figures to increase correspondingly.

Let us place a very conservative value of $20 per square foot on these 300 million square feet of real estate. This suggests total assets of $6 billion.

RESIDENTIAL RENTAL APARTMENTS

Later in this report the size of the apartment market in Toronto will be discussed. Data from the Central Mortgage and Housing Corporation states that this city possessed 246,550 units in dwelling structures with more than six units. The total number for all Canada is 1,081,970 units. If it is assumed that each unit had a historical cost of $10,000 per unit, again a low value, this suggests an aggregate valuation of $10.8 billion.

RECONCILIATION TO DATE

Our conclusions as to the minimum asset figures for three major segments of real estate are shown in Table 28.

The magnitude of these sums is considerable. However, there are still five important categories to consider: current housing inventories; land for future development, primarily housing; industrial locations; land for future commercial development; and hotels. We acknowledge that our attempt to value the assets in these five areas is an even more esoteric process than it was in the first three.

Table 28

Estimated Minimum Assets of Three Major Segments of the Real Estate Market in Canada, 1975 ($Billions)

Type of Asset	Estimated Value
Office space	$ 3.8
Retailing space	6.0
Rental apartments	10.8
TOTAL	$20.6

RESIDENTIAL LAND FOR FUTURE DEVELOPMENT

The federal government's target of one million housing starts over the next four years is a good bench mark. If each of these units had a total book investment today of $5,000, the aggregate investment in land would be $5 billion. We calculate in Table 106 (page 180) that twenty public companies held residential land for future development worth $748.8 million in 1975. These same companies also held land under current development worth $270.7 million for a combined investment of $1.02 billion. We calculate that the public companies supplied either the land or the housing for less than 16% of the 1975 production of homes. The $5 billion figure mentioned above suggests that the public companies own 20% of the land in the country for future development. This seems high, and confirms that our estimate of $5 billion for the aggregate land held for future residential development is low.

LAND HELD FOR COMMERCIAL DEVELOPMENT

This is truly an unknown item. We suspect that the number of dollars invested in this area would run into the multi-billions. However, a goodly portion of it would be currently occupied by existing structures that were otherwise tabulated. For the sake of conservatism, we shall leave it out of our calculations.

INDUSTRIAL SPACE

This is the most fragmented of all real estate endeavours. Orlando Corporation of Toronto is considered to be Canada's largest industrial developer and landlord; it owns approximately 4.7 million square feet of rental space. We estimate that Canada's inventory of industrial space is approximately 400 million square feet. Assuming the rate of $10 per square foot, the total value is $4 billion.

This $4 billion figure is quite a conservative estimate, as the statistics on industrial building permits show (Table 29).

Table 29

Industrial Building Permits, 1960 - 75

Period	Location	Amount ($millions)
1960 - 1971	Metropolitan Toronto	$ 841.7
1972 - 1975	Metropolitan Toronto	837.6
1960 - 1971	Metropolitan Montreal	499.9
1972 - 1975	Metropolitan Montreal	532.7
1972 - 1975	Sum of Metropolitan Vancouver, Ottawa, Calgary, Quebec City and Edmonton	356.3
	Total of Above	$3,068.2

If the total value of these properties comes to $3.1 billion, then the total Canadian figure, including all the facilities in Toronto and Montreal built before 1960, probably exceeds $4 billion.

HOTELS

Hotels should definitely be considered as part of the Canadian real estate industry. For example, Trizec Corporation Limited, Campeau Corporation, Bramalea Limited, Abbey Glen Property Corporation, Oxford Development Group Ltd., S.B. McLaughlin Associates, Markborough Properties Limited, Orlando Corporation Ltd., Consolidated Building Corporation and Monarch Investments Ltd. all have some involvement in hotels. The situation most developers prefer is to own the hotel facilities and lease the facility to a professional operator who will pay a rent greater than the costs to the developer of ownership. Cadillac Fairview has an equity in only one hotel-related project today, and this is the method of ownership. Regardless of whether the developer operates the hotel himself, or whether the hotel is managed or leased by a professional operator, the asset value of the property is part of our calculation. While there is a superabundance of statistics concerning the operating breakdowns of different types of hotel units, as well as occupancy rates by city per month, the simple number that we need of total number of rooms in the country is not calculated. However, both of the two recognized leading consultants to the industry, Laventhol and Horwath and Campbell Sharp, have agreed with us that a low estimate for all of Canada would be 150,000 hotel rooms. They also agree that $15,000 per room would be a low estimate. These two figures suggest an industry with assets in excess of $2.25 billion.

HOUSING INVENTORIES

In the discussion of land held for development, we attempted to distinguish between housing under construction and land held for future development. We know that the current federal target of 250,000 housing units is apparently being met. We know that many units are sold before construction has even started; on the other hand, many projects do not sell until close to completion. Let us assume that the privately owned industry in Canada sells 170,000 units at $30,000 each for an aggregate sales value of $5.1 billion. If inventories represented half of sales, the book value of the industry would be in excess of $2.5 billion.

In Table 106 on page 180, we also compute the value of housing inventories of the leading public building companies as $449.6 million. These same companies had total housing sales of $471.4 million, indicating a sales inventory ratio of one to one. Since some lands that were destined for sales to other builders are included in the asset value, the sales to inventory ratio is actually higher than one to one. However, it is far below the ratio employed in our $2.5 billion calculation.

TOTAL ASSETS

Our calculations of the aggregate value of Canadian real estate assets are summarized in Table 30.

We have attempted to make it quite clear that we do not want to have to defend the accuracy of this $34.3 billion number. We have attempted only to place it in perspective with the published asset numbers of Cadillac Fairview and the other public companies. Our aim has been to arrive at a single number that was reasonable and conservative for discussion purposes. Our conclusion as stated above, is that the public and leading companies are just the tip of the iceberg in the real estate industry since the public companies with total assets of $6.7 billion represent less than 20% of the industry. Cadillac Fairview itself accounts for approximately 3% of the industry's assets. Neither the company itself nor the whole group of public companies appears to us to be very dominant.

Table 30

Estimated Minimum Assets of the
Canadian Real Estate Industry
at Book Value, 1975
($billions)

Type of Asset	Estimated Value
Office space	$ 3.8
Retailing space	6.0
Rental apartments	10.8
Land for residential development	5.0
Housing inventories	2.5
Land for commercial use	-
Industrial space	4.0
Hotels	2.2
	$34.3

THE INFLUENCE OF CADILLAC FAIRVIEW

Despite the evidence of our statistical tabulations, Cadillac Fairview does appear to be a dominant factor in the industry. We attribute this powerful image to the following circumstances:

1. The company is publicly owned.

2. The projects are well known and often prestigious.

3. The company has been in the news a lot in recent years.

4. The industry is fragmented and lacks a single trade association representing all of it.

5. This last situation has led to an apparent leadership vacuum which the company, by virtue of its high profile, has been deemed to fill.

6. Mr. A.E. Diamond, Chairman of Cadillac Fairview, has, more than any other single individual, earned the respect of the industry.

Let us examine the three industry associations considered to be the most important in the industry.

THE HOUSING AND URBAN DEVELOPMENT ASSOCIATION OF CANADA (HUDAC)

HUDAC began in 1945 and today has over 6,000 members. Probably about half are builders, while the remainder are associated with the industry in a peripheral capacity. Such members are suppliers of building products, sub-contractors, representatives of public utilities and financial institutions. HUDAC has 72 chapters spread across all 10 provinces. It is geared towards representing the interest of the smaller Canadian house builders. It is a genuine grass-roots organization; the builders in each locality across Canada elect representatives to serve them on provincial and national grounds. HUDAC works closely with the government to formulate a national warranty program for new homes in Canada. HUDAC appeared to lobby the most persistently in Ottawa for special treatment of the real estate industry under the Anti-Inflation Board. HUDAC speaks with an authority representing a lot of members, but since they are mainly smaller house-builders, HUDAC is able to speak out only on this one front.

THE URBAN DEVELOPMENT INSTITUTE (UDI)

UDI Ontario is theoretically the forum for the large land developers in Ontario, there is a loose affiliation with UDI Canada, but it is our impression that only the Ontario body is a strong force. UDI Ontario had approximately 300 members in 1975. Each member must represent a company.

UDI was started in 1957 as an organization of land developers. The original land developer members were in the forefront of the building boom that transformed Toronto into a city of high-rise structures from the mid-1950's to the present time. Thus it was inevitable that the apartment industry in its organized form would join UDI. Similarly, since the process of land development requires such specialists as consultants, engineers and architects, these people were invited to join UDI as Associate Members. The membership was not extended beyond this circle.

UDI provides a forum for developers to air their common fears. Typical issues are: development levies within municipalities, provisions for servicing (especially trunk services), negotiations with the province and federal governments on new housing programs, on such items as the Planning Acts, Parkway Belts, Ontario Land Corporation, etc. It does not take much imagination to see that there is no shortage of issues. UDI Ontario also includes an apartment group which represents the interests of most large apartment owners in the province. The campaign against rent controls in Ontario was fought primarily by this particular group. Its weaknesses are that it is only a provincial group; and it represents only two aspects of real estate: land development and apartments. UDI has made a token effort to draw shopping centre developers into its midst but with only marginal success. It makes no pretense of representing office or industrial developers. Many of the land developers who constitute UDI's membership are also house-builders. However, as we noted earlier, HUDAC is their natural representative.

UDI is active in four Canadian provinces in addition to Ontario: British Columbia, Alberta, Manitoba and Nova Scotia. The federal institute of UDI is operated from the Ontario offices.

THE CANADIAN INSTITUTE OF PUBLIC REAL ESTATE COMPANIES (CIPREC)

CIPREC was formed in 1970 with lofty aspirations. We quote from CIPREC's 1975 annual report:

> *The Canadian Institute of Public Real Estate Companies was established to represent the unique position of publicly-owned real estate development companies and as a forum for the establishment and maintenance of codes of conduct and standards appropriate to this major industry.*
>
> *The Institute draws its general membership from companies whose shares are publicly traded on recognized Canadian securities markets and which, as principals, are primarily involved in real estate development and investment with a view to establishing a sound investment status for the industry. Member corporations are involved in land development and planning, and construction of real properties for all residential, commercial and industrial requirements. Public real estate companies which do not qualify under the regulations as a general member, or companies which are the real estate subsidiaries of public companies are eligible for associate membership. Affiliate membership is open to qualified trust and life insurance companies and real estate investment trusts, which for their own account or as fiscal agents have substantial involvement in real estate investment and development.*

CIPREC appears to be the least powerful of the three bodies named. One reason is that not all of the public companies agreed to join CIPREC (notable examples are such western companies as Nu-West, Carma and Melcor). Secondly, the exclusion from membership of private companies, which do play a major role in real estate, weakens CIPREC's position. There are very few important issues that can be settled without the mutual participation of public and private companies.

Generally CIPREC cannot exert much influence because it has so few members. The 1975 membership is listed in Table 31.

RELATIVE INFLUENCE OF THE INDUSTRY ASSOCIATIONS

In preparation for this study we spoke to a staff member of one of the three groups. We asked him to rank the three in terms of "influence and power". His response was that "it was like trying to compare a car, a truck and a bus". Each have different aspirations and mandates. It is easy to comprehend once one grasps the magnitude and diversity of the

Table 31

CIPREC Membership, 1975

Members

Abbey Glen Property Corporation, Toronto
Alliance Building Corporation, Toronto
Bramalea Consolidated Developments, Toronto
Cadillac Fairview Corporation, Toronto
Campeau Corporation, Ottawa
Consolidated Building Corporation, Toronto
Richard Costain (Canada) Ltd., Toronto
Daon Development Corporation, Vancouver
Douglas Leaseholds Limited, Toronto
Grosvenor International Holdings, Vancouver
Halifax Developments, Halifax
Headway Corporation, Thunder Bay
MEPC Canadian Properties, Toronto
Markborough Properties, Toronto
S.B. McLaughlin Associates, Mississauga
Orlando Corporation, Mississauga
Oxford Development Group, Edmonton
Revenue Properties, Toronto
Sifton Properties, London
Trizec Corporation, Montreal
Webb & Knapp (Canada) Limited, Vancouver
Y & R Properties, Toronto

Associate Members

Canadian Freehold Properties, Vancouver
Centennial Properties, Halifax
Clayton Developments, Halifax
Corporate Properties, Toronto
Four Seasons Hotels, Toronto
Great National Land & Investment Corp., Nanaimo
Ivanhoe Corporation, Montreal
Marathon Realty, Toronto
Victoria Wood Development Corp., Toronto

Affiliate Member

The Royal Trust Company, Montreal

industry why no one particular group can claim to represent it. The interests of western Canadian house-builders are not typically even distantly related to eastern Canadian shopping centre developers. Even within a small geographic area, there is no common concern. Developers with land to the east of Metropolitan Toronto can easily have diametrically opposed thoughts to those of developers with land to the west of Toronto.

Many members of the real estate industry complain vocally about this state of affairs where no one group can claim to represent all of them. They contrast this situation to such industries as steel, banking or pulp and paper where one industry trade group claims to represent the industry.

There are other members of the industry who believe that the fragmented nature of the industry can work to their advantage. For example, when an issue arises that calls for negotiation with the federal government, all three groups, in addition to minor groups and individual companies, feel free to make representations to Ottawa. Thus the force of all these representations is greater than if only one group were to represent the industry.

THE POSITION OF CADILLAC FAIRVIEW

Cadillac Fairview fits into all three trade groups quite easily. Mr. A.E. Diamond is the past-president of CIPREC. Since the company is a major land-owner and house-builder in Ontario, it is also active in both UDI and HUDAC. However, as we have suggested earlier, CIPREC is the weakest of the three organizations. Cadillac Fairview has the capability of dominating the organization but in practice does not. It is our observation that the company takes an active but not dominating role in UDI. In 1975, for example, Mr. Joseph Berman, at that time Executive Vice-President of Cadillac Fairview, served as a director and spoke at numerous functions of the group. The 1975 UDI annual report reveals that various members of the Cadillac Fairview management were active in many committees, especially in the struggle against rent controls. In contrast, the company seems to be a relatively minor participant in HUDAC, a fact which is consistent with that group's efforts to represent the interests of the smaller builders.

We have stated earlier that Cadillac Fairview still has the reputation of being the industry leader. We believe this must be attributed to the high regard of most industry participants for Mr. A.E. Diamond. We said earlier in the report that we credited his human skills very highly in determining the reasons for the success of Cadillac Development and the smooth transition of the merger. It is our contention that these same human skills have come to the attention of his competition in real estate. If you assume that on certain issues, the industry is anxious to speak with one voice, whether privately or publicly, Mr. Diamond becomes the logical choice. He is Chairman of the largest and most prestigious company and he has earned the respect of his competitors over many years. Our thesis would be that if Mr. Diamond were to retire tomorrow, the industry would not have a natural successor. Certainly the new Chief Executive Officer of Cadillac Fairview would not automatically inherit the position. We would contrast this situation to that of many other industries where the leader of the trade association is rotated from the Chief Executive Officer of one company to another on a preordained basis.

CHAPTER 4

THE URBAN DEVELOPMENT GROUP

The Cadillac Fairview Corporation Limited is formally divided into the following groups: Corporate Development, New Communities, Residential, Shopping Centres, and Urban Development. In the next five chapters we shall analyse the performance of each of these groups and relate it to its appropriate market and the economics of that market. We begin with the Urban Development Group.

A major thrust of this group is the building and Managing of large scale multi-use redevelopments such as the Toronto-Dominion Centre and the Toronto Eaton Centre in Toronto, and the Pacific Centre in Vancouver. (The Company has a 50%, 60% and 33.3% interest in these projects respectively.) Although these integrated projects often include space for retail, hotel, parking and other related uses, our focus is on their primary function, the provision of office space.

PERFORMANCE

The performance of the Urban Development Group is analysed in Tables 32-35. Their profile suggests average gross rents of $7.22 per square foot and cash flow before principal repayments of $5.4 million, or $1.15 per square foot. The company includes in its square footage totals the aggregate amounts for parking, exerting an upwards bias on rents and a downwards bias by retail space.

There are few yardsticks to measure these totals against. Different companies have different types of buildings where standards differ quite radically. This is obviously true even within Cadillac Fairview's portfolio, as the Toronto-Dominion Centre commands rents much higher than some of the older buildings listed in the portfolio. Cadillac Fairview's cash flow from rents would seem to be in line with those of all of its competitors except Y & R Properties, which is a specialist in Toronto office space and has a greater percentage of older properties. Other leading public companies with big office building portfolios are Trizec Corporation, Oxford Developments and Campeau Corporation. Some statistical comparison of these five companies is presented in Appendix D.

Table 32

The Cadillac Fairview Corporation Limited
Office Buildings: Gross Rents, 1975 and 1976
(Year end February 28)

Gross Rents	1975	1976	Change	As Percentage of Total	
				1975	1976
	($000's)		(%)		
Office buildings	29,400	33,400	13.6	28.0	27.2
Total gross rents	104,824	122,898	17.2	100.0	100.0

Source: Tables 19 and 20, pages 44 and 45.

Table 33

The Cadillac Fairview Corporation Limited
Office Buildings: Rental Profits, 1975 and 1976
(Year end February 28)

	1975	1976
	($000's)	
Gross office rents	29,400	33,400
Less: operating expenses*	13,500	16,061
Rental profit - offices	15,900	17,339
Total rental profits	60,672	68,637
Percentage contributed by offices	26.2%	27.2%

*Assumption: operating expenses for rentals calculated as 45.9% in 1975 and 48.1% in 1976, (see Tables 19 and 20).

Table 34

The Cadillac Fairview Corporation Limited
Office Buildings: Cash Flow, 1975 and 1976
(Year end February 28)

	1975	($000's)	1976
Gross rentals - offices	29,400		33,400
Less: operating expenses	13,500		16,061
Rental profits	15,900		17,339
Less: interest and G & A	10,593		11,970
Contribution to cash flow	5,307		5,369
Reported cash flow - total company	34,442		40,827
Percentage from office rentals	15.4%		13.2%

See Tables 23 and 24, pages 47 and 48.

Table 35

The Cadillac Fairview Corporation Limited
Office Buildings: Operating Performance on a Square
Footage Basis, 1976
(Year end February 29)

	Total ($000's)	Per Average Square Foot*
Gross rents	33,400	$7.22
Operating expenses	16,061	3,47
Interest and G & A	11,970	2.59
Cash flow	5,369	$1.16

*Based on average aggregate figure of 4,625,000 square feet (see Table 11, page 34).

Table 36

The Cadillac Fairview Corporation Limited
Portfolio of The Urban Development Group

COMPLETED	YEAR OPENED	APPROXIMATE NET RENTABLE AREA (000 sq.ft.) OFFICE	RETAIL	PARKING	TOTAL	EXTENT OF COMPANY'S INTEREST Percentage	(000 sq. ft.)
MONTREAL							
Dominion Square Building	1929[1]	228	52	120	400	100	400
2100 Papineau	1957	40	--	5	45	100	45
1440 St. Catherine St. West	1968	204	7	84	295	75	221
OTTAWA							
400 Cumberland Street	1973	168	9	24	201	88.8	179
Carling Square 1	1974	60	--	--	60	40	24
TORONTO							
500 University Avenue	1960	115	--	45[3]	160	100	160
130 Bloor Street West[4]	1961	151	18	140[3]	309	100	309
Toronto-Dominion Centre[5]	1967/69/74	2,827	164	344	3,335	50	1,668
181 Bloor Street West	1970	134	20	--	144	80	115
77 Bloor Street West	1971	346	24	50	420	90	378
5 Fairview Mall Drive[7]	1972	81	--	--	81	100	81
245 Fairview Mall Drive[7]	1975	99	--	--	99	100	99
60 Bloor Street West	1973	227	29	--	256	60	154
1200 Sheppard Avenue East (Head Office)	1973	130	--	20	150	100	150
111 Avenue Road	1974	117	9	20	146	64	93
1155 Leslie Street[8]	1962	20	--	--	20	100	20
VANCOUVER							
Pacific Centre[6]	1971/73/75	687	695	694	2,076	33 1/3	691
		5,634	1,017	1,546	8,197		4,787
UNDER CONSTRUCTION							
EDMONTON							
108th Street		144	12	68	224	70	157
HULL							
Place du Centre[6]		726	172	176	1,074	100	1,074
MONTREAL							
Laval Office Building		109	--	--	109	51	55

OTTAWA						
Kent Square (Phase I)	205	5	56	266	80	213
Carling Square II	92	--	40	132	40	53
Meriline Court (Phase 1-2 Buildings)	228	--	--	228	50	114
TORONTO						
1210 Sheppard Avenue East	187	--	150	337	80	270
1075 Bay Street	210	11	107	328	80	262
Toronto Eaton Centre (Phase 1A)	500	1,193	487	2,180	60	1,308
VANCOUVER						
Pacific Centre[6]	--	--	--	360[9]	33 1/3	120
WINNIPEG						
Rupertsland Square	211	30	170	411	50	206
	2,612	1,423	1,254	5,649		3,832
LANDS HELD FOR DEVELOPMENT						
OTTAWA						
Kent Square (Phase II & III)	471	15	131	617	80	494
Meriline Court (Phase II-2 Buildings)	228	--	--	228	50	114
Slater & Metcalfe Streets	153	--	30	183	50	91
TORONTO						
Bay & Charles Streets	565	--	229	794	88.8	706
1220 Sheppard Avenue East	175	--	97	272	80	219
Toronto Eaton (Centre Phase 1B)	611	289	125	1,025	60	615
VANCOUVER						
Pacific Centre[6]	500	--	--	500	33 1/3	167
	2,703	304	612	3,619		2,405

1) Acquired in 1967.
2) Acquired in 1972.
3) Includes a free standing parking building.
4) Leasehold interest.
5) A portion on leased land.
6) On leased land.
7) A third party may acquire a 50% leasehold interest in the building at cost.
8) Acquired in 1976.
9) A 400 Room Hotel.

FREE AND CLEAR RETURNS

One of the best measures of performance in real estate is the profitability of a project before interest expense. The industry jargon refers to it as the free and clear return. An outsider would view it as a return on capital. Table 37 looks at office buildings on a free and clear basis both absolutely and on a per square foot basis. Please note that we have looked at the gross investment in office buildings, whereas earlier we had utilized the net assets. The difference is the extent of depreciation taken for shareholder purposes.

Table 37

The Cadillac Fairview Corporation Limited
Office Buildings: Free and Clear Returns, 1975 and 1976
(Year end February 28)

	1975 ($000's)	1976 ($000's)	Feb. 1976 Operating net rental per sq.ft.
Gross rentals	29,400	33,400	$7.22
Less: operating expenses	13,500	16,061	3.47
Free and clear returns	15,900	17,339	3.75
Gross investment	172,904	190,611	
Average for year		181,758	
Free and clear returns as a percentage of average gross investment		9.5%	9.5%

The return of 9.5% shown in Table 37 would not be considered very attractive today, since longterm interest rates are in the 11% area. However, it must not be forgotten that the company also developed properties when interest rates were much lower. Thus, a property that yields a free and clear return of 8% may be perfectly satisfactory to a developer if long-term interest rates are at 6%, as they were in the mid-1960's.

CASH FLOW AS A PERCENTAGE OF TOTAL ASSETS

In comparing the performance of different real estate companies no single ratio seems of crucial significance. For example, there are easily explained structural reasons why operating profit margins, or return on equity, or free and clear returns on investment are not valid measurements by themselves. The best single statistic that we have been able to find for comparing income property companies is cash flow as a percentage of total investment in income properties. In Chapter 3 we compared Cadillac Fairview to other public real estate companies on this basis. In Table 38 we compare office buildings to the corporate total. It is easily seen that other parts of the company's activities generate superior returns. This point of view is elaborated below.

Table 38

The Cadillac Fairview Corporation Limited
Office Buildings: Cash Flow as a Percentage
of Total Investment in Rental Properties, 1976
(Year end February 29)

	Total Portfolio		Office Buildings
		($000's)	
Total investment in rental properties at year-end	637,557		190,611
Average for year	615,718		181,758
Cash flow	28,932		5,369
As percentage of total investment	4.7%		3.0%

CADILLAC FAIRVIEW - SHARE OF OFFICE BUILDING MARKET

Cadillac Fairview is currently managing 8.2 million square feet of office space spread across Canada. In earlier discussions on the dimensions of the total Canadian office market, we suggested that the total Canadian market was probably around 150 million square feet of space. This number was obtained by the simplified method of taking Toronto's 50 million square feet (see below) and assuming that the city accounted for one-third of all the office space in Canada. Some statistics on other large Canadian cities tend to endorse this statement (Table 39). Cadillac Fairview, therefore, appears to represent approximately 5.5% of the market in total, and 3.2% if examined only from the viewpoint of the company's equity in its various projects.

There can be little doubt that Cadillac Fairview is a factor only in Toronto. Since the company has 11 of its 17 office properties in Toronto, we do not believe that the company's market share in Montreal, Ottawa or Vancouver need be investigated. The situation does not really change when one looks at the properties under construction or lands held for development. Edmonton and Winnipeg will be entirely new markets, while in Ottawa, the projects completed and under construction that the company is managing total only 896,000 square feet (Table 40).

Table 39

Office Space in Major Canadian Cities, 1976

City	Amount of Space ('000 sq. ft)
Toronto	50,000
Montreal	23,000
Vancouver	20,000
Ottawa/Hull	25,000
Calgary	15,000
Edmonton	8,000
Winnipeg	5,000
Halifax	2,000
Sub-total	148,000

Source: A.E. LePage, Oxford Development Group, Y & R Properties, Campeau Corporation

Table 40

The Cadillac Fairview Corporation Limited
Office Buildings: Position in Ottawa, 1976

	Number of Projects	Total* Square Feet
Completed	2	270,000
Under Construction	3	626,000
Lands held for Development		1,028,000
Total		1,924,000

*Total space managed; not just company's equity.

We need not remind many taxpayers about the proliferation of Ottawa office buildings. Completed and under construction of less than 900,000 square feet is less than the size of one new modern project. The same comment applies to land held for development (1,028,000 square feet).

CADILLAC FAIRVIEW IN TORONTO

It seems somewhat macabre to be investigating Cadillac Fairview's dominance of the Toronto office market when the business itself currently appears to be in such anemic shape. Vacancy rates in Toronto are too high for the industry's taste, and even optimists predict that two years or more will be needed to absorb the extra space. The outlook looks quite positive thereafter, as current additions are quite modest by historical standards.

In Table 41, we examine Cadillac Fairview's position in Toronto. For purposes of this table, we have excluded retail and parking space. In this instance, the large extent of retail space of the Toronto Eaton Centre would have been misleading.

Table 41

The Cadillac Fairview Corporation Limited
Office Buildings: Position in Toronto, 1976

Office Space*	Number of Projects	Total** Square Feet
Completed	11	4,247,000
Under construction	3	297,000
Land held for development	3	1,351,000
Total	17	6,895,000

*Excluding retail and parking space.
**Total space managed; not just company's equity.

THE TORONTO MARKET

The acknowledged expert on the Toronto office building market is A.E. LePage Ltd. This firm publishes detailed statistics on the market, which include a breakdown of Toronto into 12 areas for detailed analysis. There are some who question LePage's statistics because the company is a major factor in leasing new space. We suspect that in the worst case. LePage adjusts its statistics mildly to attempt to give a more positive tone to the market. However, since the current base of space is over 50 million square feet, we doubt whether any small errors will affect our conclusions.

According to the Real Estate Market Survey, Toronto, 1976, Metropolitan Toronto had 461 buildings aggregating 50,272,061 square feet at the end of 1975. Cadillac Fairview's current total was 4,247,000 square feet in 11 projects (Table 41). Thus Cadillac Fairview constitutes 8.5% of the market.

It might be argued that the aggregate Metropolitan Toronto statistics are not particularly relevant because one landlord could have a virtual monopoly in one part of the city while space goes begging in another area. Fortunately, as we have stated, LePage provides some very good statistics. Tables 42 and 43 are taken from their, "Scope and Method of 1975 Office Space Market Survey".

Table 42

Statistical Summary as at December 31, 1975 (Compared with 1974)
All Classes of Buildings - Metropolitan Toronto - By Districts

(Square footages expressed in thousands)

	Number of Buildings		Total Space		Total as % of All Space in Metro		Vacant Space		% of Total Space Vacant		Net Increase in Supply		Increase in Occupied Space		Demand Factor	
	1975	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975	1974
Downtown Core	92	93	16,325	14,812	32.5	32.8	1,519	835	9.3	5.6	1,516	416	832	440	6.0	3.3
Downtown East	2	2	119	119	.2	.3	-	-	-	-	-	-	-	-	-	-
Downtown South	8	8	790	790	1.6	1.7	13	58	1.7	7.4			45	68	6.1	10.2
Downtown West	9	9	513	513	1.0	1.1	10	9	2.0	1.9	-	-	-	2	-	-
Downtown North	31	31	3,580	3,593	7.1	7.9	92	98	2.6	2.7	(13)	188	(9)	128	-	3.8
University	33	31	5,360	4,181	10.7	9.3	421	251	7.8	6.0	1,199	391	1,029	402	28.2	11.4
DOWNTOWN AREA	175	174	28,710	24,008	53.1	53.1	2,056	1,249	7.7	5.2	2,702*	993	1,895	1,040	8.3	4.8
Bloor-Davenport	65	64	6,895	6,787	13.7	15.0	963	1,295	14.0	19.1	107	1,709	440	754	8.0	15.9
St. Clair	20	19	2,339	2,092	4.6	4.6	63	35	2.7	1.7	247	36	219	42	10.6	2.1
Davisville-Eglinton	45	44	3,503	3,054	7.0	6.8	408	201	11.7	6.6	450	49	242	297	8.5	11.8
MIDTOWN AREA	130	127	12,737	11,933	25.3	26.4	1,434	1,531	11.3	12.8	804	1,794	901	1,123	8.7	12.1
Metro North	95	88	6,905	5,825	13.8	12.9	833	194	12.1	3.3	1,080	197	440	278	7.8	5.2
Metro East	27	24	2,288	1,988	4.6	4.4	285	135	12.5	6.8	300	338	150	274	8.1	17.4
Metro West	34	32	1,635	1,458	3.2	3.2	185	133	11.3	9.1	176	104	125	107	9.4	8.8
SUBURBAN AREA	156	142	10,825	9,289	21.6	20.5	1,303	462	12.0	5.0	1,558	639	715	659	8.1	8.1
All Metropolitan Toronto	461	443	50,272	45,210	100.0	100.0	4,793	3,242	9.5	7.2	5,082	3,428	3,511	2,822	8.4	7.2

Source: A.E.LePage Scope and Method of 1975 Office Space Market Survey.

Statistical Summary as at December 31, 1975 (compared with 1974) Table 43
(Square Footages Expressed in Thousands)
All Classes of Buildings — Metro Toronto — By District

District Code	District	Bldg Class	No. of Bldgs	Sq. Ft. Areas Total	Non/Comp	Competitive	Vacant	% age of Vacant to Total Space 1975	1974	% of Comp to Total Space 1975
A	Downtown Core	A	30	11,301,617	3,515,463	7,786,154	1,123,803	9.9	6.3	68.9
		B	33	2,893,560	890,865	2,002,695	326,693	11.3	4.6	69.2
		C	29	2,133,269	804,460	1,328,809	68,543	3.2	3.8	62.3
		ALL	92	16,328,446	5,210,788	11,117,658	1,519,039	9.3	5.6	68.1
B	Downtown East	A								
		B	1	87,558	87,558					
		C	1	31,200		31,200				100.0
		ALL	2	118,758	87,558	31,200				26.3
C	Downtown South	A	3	539,350	243,650	295,700	13,148	2.4	10.8	54.8
		B	1	52,992	52,992					
		C	4	197,493	190,749	6,744				3.4
		ALL	8	789,835	487,391	302,444	13,148	1.7	7.4	38.3
D	Downtown West	A	1	73,971	73,971					
		B	2	182,000	128,000	54,000				29.7
		C	6	257,372	201,672	55,700	10,350	4.0	3.7	21.6
		ALL	9	513,343	403,643	109,700	10,350	2.0	1.9	21.4
E	Downtown North	A	13	1,971,841	1,670,723	301,118	56,215	2.9	4.0	15.3
		B	12	1,414,312	1,004,870	409,442	35,702	2.5	1.3	28.9
		C	6	193,671	189,971	3,700				1.9
		ALL	31	3,579,824	2,865,564	714,260	91,917	2.6	2.7	20.0
F	University	A	19	4,302,834	2,408,022	1,894,812	373,394	8.7	7.4	44.0
		B	10	949,767	448,457	501,310	48,017	5.1	2.3	52.8
		C	4	127,186	99,186	28,000				22.0
		ALL	33	5,379,787	2,955,665	2,424,122	421,411	7.8	6.0	45.1
	Downtown Districts Sub-Total	A	66	18,189,613	7,911,829	10,277,784	1,586,560	8.6	6.4	56.5
		B	59	5,580,189	2,612,743	2,967,447	410,412	7.4	3.1	53.2
		C	30	2,940,191	1,486,038	1,454,153	78,893	2.7	3.1	49.5
		ALL	175	26,709,993	12,010,609	14,699,384	2,055,865	7.7	5.2	55.0
G	Bloor-Davenport	A	32	5,484,239	2,509,991	2,974,248	847,013	15.4	21.2	54.2
		B	12	727,686	294,199	433,487	94,729	13.0	13.9	59.6
		C	21	682,602	195,279	487,323	21,043	3.1	7.6	71.4
		ALL	65	6,894,527	2,999,469	3,895,058	962,785	14.0	19.0	56.5
H	St. Clair	A	15	1,914,604	1,066,353	848,251	43,168	2.3	2.1	44.3
		B	4	396,201	348,201	48,000	19,408	4.9		12.1
		C	1	28,350	25,883	2,467				8.7
		ALL	20	2,339,155	1,440,437	898,718	62,576	2.7	1.7	38.4
I	Davisville/Eglinton	A	25	2,794,027	791,253	2,002,774	379,509	13.6	6.0	71.7
		B	10	483,873	89,840	394,033	20,779	4.3	10.1	81.4
		C	10	225,468	51,447	174,021	7,950	3.5	4.1	77.2
		ALL	45	3,503,368	932,540	2,570,828	408,238	11.7	6.6	73.4
	Midtown Districts Sub-Total	A	72	10,192,870	4,367,597	5,825,273	1,269,690	12.4	14.1	57.2
		B	26	1,607,760	732,240	875,520	134,916	8.4	9.4	54.5
		C	32	936,420	272,609	663,811	28,993	3.1	6.6	70.9
		ALL	130	12,737,050	5,372,446	7,364,604	1,433,599	11.3	12.8	57.8
J	Metro North	A	54	4,972,854	2,360,547	2,612,307	743,853	15.0	1.1	52.5
		B	38	1,849,237	884,259	964,978	89,563	4.8	8.3	52.2
		C	3	82,700		82,700				100.0
		ALL	95	6,904,791	3,244,806	3,659,985	833,416	12.1	3.3	53.0
K	Metro East	A	21	2,050,120	845,756	1,204,364	284,067	13.9	7.7	58.7
		B	6	235,483	205,483	30,000	1,352	.6		12.7
		C								
		ALL	27	2,285,603	1,051,239	1,234,364	285,419	12.5	6.8	54.0
L	Metro West	A	18	1,087,623	510,345	577,278	106,905	9.8	4.6	53.1
		B	10	407,031	91,331	315,700	60,099	14.8	1.9	77.6
		C	6	139,970	46,945	93,025	17,790	12.7	5.6	66.5
		ALL	34	1,634,624	648,621	986,003	184,794	11.3	9.1	60.3
	Suburban Districts Sub-Total	A	93	8,110,597	3,716,648	4,393,949	1,134,825	14.0	3.7	54.2
		B	54	2,491,751	1,181,073	1,310,678	151,014	6.1	9.3	52.6
		C	9	222,670	46,945	175,725	17,790	8.0	5.5	78.9
		ALL	156	10,825,018	4,944,666	5,880,352	1,303,629	12.0	5.0	54.3
	Metro Toronto Total	A	231	36,493,080	15,996,074	20,497,006	3,971,075	10.9	8.0	56.2
		B	139	9,679,700	4,526,055	5,153,645	696,342	7.2	6.2	53.2
		C	91	4,099,281	1,805,592	2,293,689	125,676	3.1	4.0	56.0
		ALL	461	50,272,061	22,327,721	27,944,340	4,793,093	9.5	7.2	55.6

Source: A.E. LePage Scope and Method of 1975 Office Space Market Survey

Let us first note the differences between "A", "B" and "C" classifications. LePage employs highly subjective definitions:

> *Office space which competes for the same tenant in the market is grouped into a classification -- "A", "B", "C". These classifications roughly parallel quality and price levels, but character of tenancy, landlord reputation, location and other factors are also reflected. Thus they are basically competitive market classifications.*

It would be our strong impression that all 11 of Cadillac Fairview's present Toronto office buildings are "A" buildings.

LePage also employs the concept of competitive versus non-competitive space. They maintain that since 22.3 million of Toronto's 50.3 million square feet was occupied by office builders, owners or long-term tenants, this is non-competitive space. We disagree with this distinction, partly because it makes analysis much more difficult but also because it is misleading. For example, Ontario Hydro is a tenant of Cadillac Fairview on Bloor Street under a long-term lease. Because Hydro has a new office building, it is trying to sublet the space and, in effect, its old space is competing with new buildings. If LePage is statistically showing this as non-competitive space, this would be highly illusionary. Comparing Cadillac Fairview's Toronto portfolio with LePage's statistics for "A" buildings, we find the following: Cadillac enjoys 11.6% of the Class "A" market in Toronto, but a surprisingly high 25.0% of the downtown core market (Table 44). This reflects the immensity of the Toronto-Dominion Centre with its three towers. However, it is this particular market which is in the midst of witnessing the biggest increase in capacity. For example, LePage in its statistics for capacity has included for 1975 only 1,650,000 square feet of First Canadian Place. Another 550,000 square feet is now ready for occupancy. Meanwhile, the new Royal Bank building will add more than 1.5 million square feet in 1977. These two buildings alone should add a minimum of 2.1 million square feet to the core. Thus, by 1977, the core will have a minimum total of 13,401,617 square feet. Cadillac Fairview's position at 2,827,000 square feet is remaining constant, so that their percentage will fall from 25.0 to 21.1.

THE ECONOMICS OF OFFICE BUILDINGS

There is no such thing, in our opinion, as a typical office building. A new office building in suburbia is quite different from a downtown complex in an inner city. Also, costs have risen enormously. For instance, the first two phases of the Toronto-Dominion Centre cost approximately $150 million. Today, they would cost over $225 million, minimum.

Table 44

Office Buildings: Comparison of Cadillac Fairview to Total Toronto Market, 1976

District Code	No. of "A" Buildings	Total Sq.Ft.	Cadillac Fairview Number of Buildings	Cadillac Fairview Total Sq.Ft.	Cadillac Fairview Per Cent CFV
Downtown Core	30	11,301,617	1	2,827,000	25.0
Other Downtown	36	6,887,996	1	115,000	1.7
Mid-town	72	10,192,870	5	975,000	9.6
Suburban	93	8,110,597	4	330,000	4.1
Total	231	36,493,080	11	4,247,000	11.6

A HYPOTHETICAL OFFICE BUILDING

For the sake of presenting the case, let us work through some simple numbers.

Building Costs

Let us assume that land costs are $100 per square foot in the core of our hypothetical city. Assume that a developer acquires 100,000 square feet for $10 million. Also assume that the area is zoned for 10 times coverage. This means that the developer can build physically 10 times the land space. This suggests a building with 1,000,000 square feet of total space. Assume that there is no need to put in parking space and that 10% of the final space is devoted to retail use. Obviously stairs, walls and elevators take up a good part of the space; so the developer is left with 750,000 square feet of net rentable office space and 100,000 square feet of retail space. Assume that the physical costs of building are $50 per gross square foot. Thus the building costs would be $50 million, and, with the addition of $10 million for land, total costs would come to $60 million.

Gross Rents

If we postulate that the new building is one of the new prestigious areas in town, the rental levels might be $13 per square foot for the office space and $16 for the retail space. Total potential gross rents are shown in Table 45.

Operating Expenses

We have attempted to suggest that in reality there is no such thing as a typical office building with a typical operating statement. Expense factors in buildings with large floor areas can be quite different from those in buildings with small floor areas. Similarly, property taxes can vary by large amounts from one locality to another. For the purposes of this particular exercise, we have estimated that operating expenses including property taxes would represent 48% of gross rents. This produces a figure of $5,175,000, or $6.09 per rentable square foot.

Table 45

Hypothetical Office Building
Total Potential Gross Rents, 1976

Description	No. of Rentable Sq.Ft.	Rental Rate	Gross Revenue
Offices	750,000	$13.00	$ 9,750,000
Retail	100,000	16.00	1,600,000
Total	850,000		11,350,000
Vacancy factor at 5%			567,500
Gross Revenues			$10,782,500

Free and Clear Return

Gross rents less operating expenses before financing equals the free and clear return. In the example given above, the free and clear return would be $5,606,400. Stated as a percentage of the total cost of $60 million, this works out to 9.3%. This ratio is inadequate and would not ordinarily justify going ahead with the project. Generally speaking, in order for a new project to have attractive economics, the free and clear return must be higher than the level of interest rates. If interest rates are 11%, then most developers would be shooting for 13%. In our example, the return of 9.3% would not even cover the interest costs at a low level of borrowing. It is worth stating that we have assumed an occupancy rate of 95% in projecting the potential returns.

Financing

Most income projects carry debt burdens of from 80% to 105%. If in the example used above, the developer borrowed 80% at 11%, the annual interest costs would be $5,280,000, and the project would make $326,400 annually before principal repayments. After principal repayments of $530,000, the net cash flow loss annually would be $204,000.

Even assuming debt financing of only half, the project would produce annual interest charges of $3.3 million. If we assume annual principal repayments of another $300,000, the total carrying charges would be $3.6 million annually. Net cash flow would be $2,006,000 on an equity investment of $30 million or 6.7%. Gross cash flow as a percentage of total assets would be 3.8%.

THE LOGIC OF SUCH PROJECTS

Projects with such economics are going ahead in Canada, albeit very few of them. The rationale in many cases from the developer's point of view would be that the current level of rents on the new project is very low compared to "what they should be". Another reason for the construction of large projects with seemingly undesirable economics is the desire for major corporations to occupy prestige space, preferably with their name on the building. In terms of the financial resources of large operations, head office rents are typically quite insignificant. This factor combined with the self-satisfaction derived from a prominent showplace office tower proves to be very important in the office market.

The reason rents are so low is that there is a surplus of space. Let us assume that the developer is correct in his observation and that five years from now, office rentals are at $16 per square foot. Let us assume that there was a good percentage of five-year leases in the portfolio, say a third. Also assume that five years after, retail space is going for $20 per square foot and that half of the space is eligible for releasing. The new economics are shown in Table 46. The project would still not be economical unless one was willing to look 10 years ahead. This may help to explain why so few projects are underway.

ECONOMICS OF AN OLDER PROJECT

Let us look at a project of this magnitude undertaken in the late 1960's and the returns it might be generating today. Consider a project similar to the example discussed above, assuming land costs in the 1966-68 period were half what they are today and that building costs were 20% lower. We have repeated several times in this study the elementary fact in real estate that there is no such entity as the typical project. This fact deserves extra emphasis when one is dealing with projects of the dimension of Tables 46 and 47. There is a dramatic difference in the rate of return of projects that are apparently similar but had longterm financing at different dates. Consider the fact that a large project may have a time frame of 10 years between the inception of the idea and final leasing. There is considerable flexibility as to when the long-term financing is arranged. One can finance well before construction commences or wait until it is a finished project. The ramification of such decisions are very significant considering the violent swings in interest rates that were common in the late 1960's and early 1970's.

Our purpose in presenting a hypothetical table is simply to provide the reader with a basic idea as to the profitability of large projects, and to demonstrate the changes caused by inflation. This is not meant as a case study for the simple reason that the economics of one building would not provide great insight into another for the reasons discussed above.

Table 46

Economics of Hypothetical Office Project - Five Years Later

$000's	80% financing	50% financing
Gross Revenues:		
Offices - 750,000 total		
500,000 sq ft at $13.00	6,500	6,500
250,000 sq ft at $16.00	4,000	4,000
Gross revenues - Offices	10,500	10,500
Retail - 100,000 total		
50,000 sq ft at $16.00	800	800
50,000 sq.ft at $20.00	1,000	1,000
Gross revenues - Retail	1,800	1,800
Sub-total	12,300	12,300
Less: 5% vacancy rate	615	615
Gross revenues	11,685	11,685
Operating expenses at 48%	5,609	5,609
Free and clear return	6,076	6,076
Interest and Principal	5,810	3,600
Net cash flow	266	2,476
Original equity	12,000	30,000
Return on equity	2.7%	8.3%
Free and Clear as % of Cost	10.1%	10.1%
Gross Cash Flow as % of Cost	1.3%	4.6%

Table 47 presents the economics of such a project: the project that originally yielded 4.2% now yields 16.8%. This is the type of situation all developers look for.

In addition to the current yields, many developers or investors are interested in the capital appreciation potential of such projects. It is self-evident that replacement costs for new buildings have risen sharply over the years.

The profit and cash flow returns do not rise at the same rate because of the lag time of leases. Each developer has his own preference as to the desirable mix of leases. The lender looks to longer leases from high-quality tenants, while the developer may wish to balance this with

Table 47

Economics of Hypothetical Project
Undertaken in Late 1960's

	Original Economics 1966-68	Same Project Current Economics
No. of sq.ft. of land	100,000	100,000
Cost per sq. ft. of land	$ 50	$ 50
Total cost of land	$ 5,000,000	$ 5,000,000
Density of building	10 times	10 times
Total building area in sq ft	1,000,000	1,000,000
Net rentable space in sq ft		
- offices	750,000	750,000
- retail	100,000	100,000
Cost per sq ft gross	$ 40	$ 40
Cost of building	$40,000,000	$40,000,000
Gross rental rates on average		
- offices	$ 6	$ 9
- retail	$ 9	$ 13
Gross rentals		
- offices	$ 4,500,000	$ 6,750,000
- retail	900,000	1,300,000
Sub-total	$ 5,400,000	$ 8,050,000
Less: 5% vacancy	270,000	403,000
Gross rentals	$ 5,130,000	$ 7,647,000
Operating expenses at 48%	2,462,000	3,670,560
Free and clear return	$ 2,668,000	$ 3,976,440
Percent of cost	6.7%	9.9%
Original percent of debt	80%	80%
Amount of debt - current	$32,000,000	$30,000,000
Interest rate	6.5%	6.5%
Annual interest + principal	$ 2,300,000	2,300,000
Net cash flow	$ 338,000	$ 1,676,400
Original equity	$ 8,000,000	$ 8,000,000
Current equity	--	$10,000,000
Return on equity	4.2%	16.8%
Gross Cash Flow as % of Assets	1.5%	5.0%

shorter-term leases. In our example, we used the same operating expense factor in both 1968 and 1975, for the following reasons. In most leases the tenant is responsible for all of the expense increase. Therefore, for any one tenant, gross rents and operating expenses will tend to rise by the same amount in each year. Thus,the apparent effect is to cause an increase in the operating expense ratio. On the other hand, as leases roll over, the new rent tends to be higher than the sum of the old basic rent plus the increase in expenses. Thus the operating expense ratio might tend to stay the same or to fall. We have compromised and kept the margin the same.

BARRIERS TO ENTRY

In Chapter 5, we conclude that it is much more difficult to gain entry into the regional shopping centre market than the office building market and that is why the shopping centre returns are higher. The only limitation to entering this latter market is availability of land and access to money. It is quite common for small- and medium-size office buildings to be undertaken without key tenants. It is rare in larger projects, although the amount of unleased space in new giant projects can be much more than in many medium buildings. All in all, we find the consumer well served by this market as the choices for accommodation in most cities are broad.

It also appears that large landlords have very little headstart over new participants in new facilities. One might think that a landlord with a large portfolio and a national leasing team might achieve results superior to those of a smaller operator. We do not find this to be the case. Real estate leasing agents such as the LePage organization mentioned above or Knowlton Realty in western Canada are the real forces in the leasing of space. Certainly, it can be proven that a poorly conceived or badly located project of Cadillac Fairview will lag in occupancy behind a well-executed project of a smaller competitor.

One of the common complaints in the industry concerns the supposed power of the large chartered banks. They are alleged to be quite forceful in convincing their customers of the merits of their own particular project. We find this to be primarily a case of "sour grapes", and the extent of unleased space in the two new bank projects in Toronto tends to confirm our theory.

CONCLUSION

The evidence is overwhelming that the office building market is very competitive. In Appendix D we have attempted to calculate office building results for the leading five public companies. The overall returns are quite similar to those of Cadillac Fairview, which as we have suggested, are not very lucrative.

An outsider might question our calculations on rates of return and argue that we are too conservative as developers are not foolish. We contend that the opposite is the case. Toronto, with one-third of the country's office capacity, is already over-built. However, the City of Toronto introduced a height restriction by-law about two years ago that has prevented many projects from getting started. Without this restriction we believe that the Toronto scenario would be quite reminiscent of New York. That great city suffered from such an abundance of overbuilding that vacancy rates reached levels not seen since the 1930's; the result is that many developers are now bankrupt.

CHAPTER 5

THE SHOPPING CENTRES GROUP

PERFORMANCE

The performance of the Shopping Centres Group is analysed in Tables 48 - 53. Our calculations indicate that, however measured, the shopping centre portfolio of Cadillac Fairview is dramatically more profitable than the comparative office building portfolio. For instance, cash flow per square foot is almost double (compare Tables 35 and 51), while the free and clear return is 13.4% (Table 52) as compared with 9.5% (Table 37) and cash flow as a percentage of total investment is 7.2% (Table 53) as compared with 3.0% (Table 38). It should be noted as well that there is no reason to believe that the two kinds of property have radically different ages or debt structures.

Indeed, Cadillac Fairview's performance in this area parallels that of other leading real estate companies who also seem to find shopping centres more profitable than office buildings. Although many real estate experts have always known about the high inherent profitability of shopping centres, it is surprising to see such a marked difference between the two areas, since one would expect in real estate as in other industries capital to be attracted to the sources of highest returns. The reason this has not occurred in shopping centres as much as in other forms of real estate is actually quite simple to understand, and may be contrasted to the situation in office buildings.

Even when a developer has the technical capability to construct a large office building or shopping centre, in order to obtain any sort of financing, he must obtain a high-quality key tenant or tenants for part of the building. In shopping centres, the key tenants are department stores. The number of potential office tenants in Canada with a high credit rating would be in the hundreds or possibly the thousands, but the number of key department store tenants in all of Canada is from three to ten, depending on your point of view. These department stores are aware of their bargaining strength and use it to the maximum. As a result, there is a natural rationing process in shopping centres since the shortage of key tenants prohibits unlimited growth. By comparison, it becomes considerably easier to generate over-building in office buildings as a result of the accessible entry. This tends to happen quite often in all types of office buildings from the least to the most prestigious.

Although one may have read in the press about over-building in shopping centres, it is basically an exaggeration and vastly different in Canada than in the United States. Certainly, if there is a proliferation of shopping centres, it is in the small strip centres. These can be built on a speculative basis because of their small cost requirements.

TABLE 48

THE CADILLAC FAIRVIEW CORPORATION LIMITED

PORTFOLIO OF THE SHOPPING CENTRES GROUP, MAY 1976

	Year Opened	Company's Interest (%)	Size of Site (acres)	Total Leasable Area (sq.ft.)	Area of Non-Owned Buildings (sq.ft.)	No. of Stores & Services	Parking Spaces
BARRIE, ONTARIO							
Georgian Mall	1973	100	22	201,000	93,000	42	1100
CALGARY, ALBERTA							
North Hill Shopping Centre	1958	100	32	510,000	208,000	95	2400
EDMONTON, ALBERTA							
Bonnie Doon Shopping Centre	1959	100	31	415,000	-	90	2500
GIFFARD, QUEBEC							
Les Galeries Ste. Anne	1973	70	18	228,000	-	25	1150
HAMILTON, ONTARIO							
The Centre Mall	1955	100	66	678,000	335,000	74	3800
Eastgate Square	1973	70	41	525,000	-	107	3000
Gage Square	1974	70	7	67,000	-	4	500
KITCHENER, ONTARIO							
Fairview Park Mall	1966	100	52.8	727,000	337,000	92	3678
LEVIS, QUEBEC							
Les Galeries Chagnon	1974	70	42	536,000	126,000	63	2400
MISSISSAUGA, ONTARIO							
Milway Shopping Centre	1976	100	4.5	45,000	-	11	226
Rockwood Mall	1974	42	24	291,000	-	37	1400
MONTREAL, QUEBEC							
Domaine Shopping Centre	1959	100	13	235,000	25,000	60	900
Maisonneuve Shopping Centre	1959	100	9	139,000	-	30	550
Greenfield Park Shopping Centre	1961	50	26	375,000	17,000	45	2100
Fairview Pointe Claire	1965	50	74	628,000	-	79	3900
Les Galeries D'Anjou	1968	50	74	937,000	-	145	5300
Le Carrefour Laval	1974	51	74	870,000	123,000	128	4500

TABLE 48 (continued)

	Year Opened	Company's Interest (%)	Size of Site (acres)	Total Leasable Area (sq.ft.)	Area of Non-Owned Buildings (sq.ft.)	No. of Stores & Services	Parking Spaces
OTTAWA, ONTARIO							
Montreal Square	1973	70	5	58,000	-	12	300
Vista Centre	1973	100	6.5	70,000	-	20	430
REGINA, SASKATCHEWAN							
Southland Mall	1975	50	28	255,000	-	35	1400
RICHMOND HILL, ONTARIO							
Hillcrest Mall	1974	100	46	566,000	-	85	3000
ST. CATHERINES, ONTARIO							
Fairview Mall	1960	100	24	261,000	67,000	30	1600
SAINT JOHN, N.B.							
Fairview Plaza	1960	100	15	192,000	99,000	18	500
THUNDER BAY, ONTARIO							
Thunder Bay Mall	1972	70	16	140,000	-	22	900
TORONTO, ONTARIO							
York Mills Shopping Centre	1953	100	6	51,000	-	17	250
Don Mills Shopping Centre	1955	100	33	411,000	52,000	86	2400
Parkway Plaza	1958	100	19	280,000	-	65	1200
Cedarbrae Plaza	1960	100	30	403,000	114,000	77	2300
Parkwoods Village Shopping Centre	1960	100	6	73,000	39,000	20	250
The Towne Mall	1967	100	1	71,000	-	14	150
Don Valley Plaza	1970	50	5	90,000	-	18	600
Fairview Mall	1970	50	47	570,000	-	113	3300
University City	1974	100	4	44,000	-	13	200
WINNIPEG, MANITOBA							
Polo Park Shopping Centre	1959	100	60	848,000	263,000	83	4600
			961.8	11,795,000	1,898,000		

Table 49

The Cadillac Fairview Corporation Limited
Shopping Centres: Gross Rents, 1975 and 1976
(Year end February 28)

	1975	1976	Change	As percentage of Total 1975	As percentage of Total 1976
	($000's)		%		
Shopping centres	35,000	43,500	24.3	33.4	35.4
Total gross rents	104,824	122,898	17.2	100.0	100.0

Source: Tables 19 and 20, pages 44 and 45.

Table 50

The Cadillac Fairview Corporation Limited
Shopping Centres: Cash Flow, 1975 and 1976
(Year end February 28)

	1975	1976
	($000's)	
Gross rentals - shopping centres	35,000	43,500
Less: operating expenses*	12,200	16,400
Rental profits	22,800	27,100
Less: interest** and G & A	11,054	12,679
Contribution to cash flow	11,746	14,421
Reported cash flow - total company	34,442	40,827
Percentage from shopping centres	34.1%	35.3%

*Assumption: 34.9% in 1975 and 37.7% in 1976 (see Tables 19 and 20)

**Assumption: see Table 24, page 48.

Table 51

The Cadillac Fairview Corporation Limited
Shopping Centres: Operating Performance On
A Square Footage Basis, 1976
(Year end February 28)

	Total ($000's)	Per Average Square Foot*
Gross rents	43,500	$6.07
Operating expenses	16,400	2.29
Interest and allocated G & A	12,679	1.77
Cash flow	14,421	$2.01

* Based on an average aggregate figure of 7,167,000 square feet (see Table 11, page 34).

Table 52

The Cadillac Fairview Corporation Limited
Shopping Centres: Free and Clear Returns, 1975 and 1976
(Year end February 28)

	1975 ($000's)	1976 ($000's)	Feb. 1976 Operating Net Rental Per Sq.Ft.
Gross rentals	35,000	43,500	$6.07
Less: operating expense	12,200	16,400	2.29
Free and clear returns	22,800	27,100	3.78
Gross investment	193,366	209,735	
Average for year		201,551	28.12
Free and clear returns as a percentage of average gross investment		13.4%	13.4%

Table 53

The Cadillac Fairview Corporation Limited
Shopping Centres: Cash Flow as a
Percentage of Total Investment in
Rental Properties, February 29, 1976
($000's)

	Total Portfolio	Shopping Centres
Total investment at year end	637,557	209,735
Average for year	615,718	201,551
Cash flow	28,932	14,421
As a percentage of total investment	4.7%	7.2%

CONCENTRATION IN SHOPPING CENTRES

CADILLAC FAIRVIEW AND REGIONAL SHOPPING CENTRES

One of the purposes of this study is to ascertain whether Cadillac Fairview or any one company can hold a position of dominance in any phase of real estate, and if so, what the effects on society would be. We contend that if such a situation were to exist anywhere in real estate, it would surely turn up in regional centres, since two characteristics for monopoly profits are superficially available: barrier to entry, and high profit margins. Our research found that although Cadillac Fairview does have a natural head start, it is faced with an abundance of economic problems designed to protect the public. The following section is devoted to documenting and explaining the company's position within the industry. It is unfortunate that the data does not exist in the same succinct manner as is available for the Toronto office market. However, there is more than enough data available from which to draw conclusions.

The department store industry in Canada is quite strong (see Table 54).

Table 54

Department Stores in Canada
Percentage of Retail Sales, 1965 - 1975

$000,000's	(1) Total Retail Sales	(2) Total ex Motor Vehicles	Department Store Sales	Department Store Sales As a percent of (1)	(2)
1965	21,155	16,980	2,010	9.5	11.8
1966	22,686	18,348	2,144	9.4	11.7
1967	24,155	19,722	2,384	8.9	10.9
1968	25,711	20,997	2,384	9.3	10.5
1969	27,401	22,605	2,669	9.7	11.8
1970	28,034	23,777	2,852	10.2	11.9
1971	30,646	25,383	3,184	10.4	12.5
1972	33,929	28,266	3,696	10.9	13.1
1973	38,239	31,470	4,313	11.3	13.7
1974	43,829	35,854	5,064	11.6	14.1
1975	50,778	40,998	5,785	11.4	14.1

Source: Canada, Statistics Canada

The traditional department stores, e.g., Eaton's and Simpsons, were a little slow in the early 1960's in realising the potential of the suburban market. There was a natural fear that outward expansion would hurt their traditional downtown markets. Meanwhile, the discount or promotional department stores, such as Woolco and K-Mart, undertook a massive expansion program across Canada. Ultimately, the senior chains began to expand rapidly as well. It appears that within the department store group, the leading companies have generally kept up to the times and have retained their consumer franchises. While there are major differences between the experiences of Simpsons-Sears and Eaton's, nevertheless, the major stores are eminently viable. We contrast the situation with the United States, where W. T. Grant, a national chain with sales in 1973 of over $3 billion, has gone bankrupt. Its Canadian subsidiary, Zeller's, while suffering a little from competition, is not a candidate for such a condition, in our opinion. In the United States, many other regional and national chains, especially discounters, have suffered similar plights. There are many stories of empty shopping centres financed by exuberant Real Estate Investment Trusts (REIT's) in the early 1970's. In Canada, however, the casualty list remains quite small.

We focus primarily on the department stores because they are the keys to success of regional shopping centres. The developer who can secure one, two, three, or even four department stores as lead tenants almost certainly can lease out the rest of a centre at high rentals to both national chains and independents. There is almost universal acceptance among smaller retailers of the theory that the department stores are well-equipped to research the viability of new sites. The logic of the smaller tenants is, "if it is good enough for Sears, it is good enough for me! " The department stores are not unaware of the fact that they are the magnets drawing traffic to the centre. The department stores demand and quite often obtain significant equity positions in the centre; in some, they conceive, develop, lease, manage and own the entire centre. Without exception, they pay lower rents than everybody else, with the rent approximating the effective cost to the developer of the space.

Almost all Canadian developers prefer Simpsons-Sears Limited as their key anchor tenants. Eaton's of Canada Limited, Simpsons, Limited and the Hudson's Bay Company or its affiliate, G. W. Robinsons Limited, are next in line, depending on the market, with Woodward Stores Limited being the lone regional magnet in western Canada. The discounters, although they dislike the expression, are lead by Woolco (F.W. Woolworth Co. Ltd.) and K-Mart (S.S. Kresge Co. Ltd.), with Zeller's Limited, Miracle Mart (a division of Steinberg's Limited) and Towers (part of the Oshawa Group Limited) in the running as well. These ten chains constitute the industry.

SHOPPING CENTRE DATA

In attempting to assess the shopping centre market and Cadillac Fairview's place in it, we found the problems of definitions and data collection nearly insurmountable.

Statistics Canada had collected some primary data on the industry but their definitions of different types of centres are so arbitrary as to preclude the data from having any validity. The leading companies do have more flexible definitions but the subjective element in analysing the data is so high as to make the data meaningless.

There seems little doubt that Cadillac Fairview is not a significant factor in Canadian total retailing. Sales of all tenants in all of the company's locations are less than $1.5 billion or a small percentage of the national total. The theoretical question to be answered is whether the company has a dominant position in the ownership of larger centres as defined,and whether these types of centres by their very nature have an unusually high percentage of the retailing business in Canada.

The hypothesis looks plausible on the surface. Regional shopping centres do attract traffic from long distances; if certain developers and large department stores worked closely together, it could put the smaller retailers at a major disadvantage. The problem with the theory is that it ignores the competitive environment we live in. There are very few secrets in the shopping centre industry. All of the major developers and retailers belong to an organization called the International Council of Shopping Centres, which has regular meetings and conventions to discuss common problems. One of its members is Mr. Irwin Adelson, President, Westcliffe Developments of Montreal. Mr. Adelson's firm has completed seven centres with over two million square feet of space in the past three years, which would make him one of the most significant shopping centre developers in the country. Outside of a small group of people in the industry, he is virtually unknown. An Ontario company called Multi-Malls has constructed a host of medium-size centres throughout Ontario and Quebec. The financial performance of these centres is not available but the existence of the projects is a matter of record. Both of these unknown companies have surpassed such industry leaders as Cadillac Fairview, Trizec, Bramalea, Campeau, Orlando, and so on. Only Cambridge, now Oxford, has kept pace and it might be noted that Cambridge was a relatively small company six years ago.

It should be quite clear to most observers that almost anybody can and has built a small shopping centre. As one becomes involved with larger centres, the necessity for technical skills becomes increasingly imperative.

The trust of large space users in the developer is most crucial for shopping centres because there are so few of them. However, the public is protected by the fact that the large department store chains have never concentrated their business with any developer. It is true that the department store companies may have a favorite developer, but almost inevitably the 'favouritism' only gives marginal assistance to the developer. Performance is crucial and the department store must see results before the developer is entrusted with a "favour again". However, to emphasize the point, there are probably over ten shopping centre developers seeking the association with the department stores and with the proper credentials. The competition is quite fierce and conducted openly and is one of the principal topics of discussion at these I.C.S.C. meetings discussed above.

The above narrative is academic in our opinion for the simple reason that the department stores have reduced their expansion program down to a trickle. It is self-evident that a shopping centre developer with a "close relationship" to Eaton's and Simpsons has no competitive advantage in a period when these two giants are concentrating on their existing stores and not contemplating new sites.

Admittedly, these remarks show just one end of the spectrum. However, optimists in the industry are only slightly more positive.

It is important to distinguish between regional shopping centres and all others. The non-regional business is quite viable and almost by definition much more competitive. At this point, we will explain why analysis and data collection are difficult.

As stated above, Statistics Canada has made some efforts at documentation. They define a shopping centre as follows:

> *A group of stores which are planned, developed and designed as a unit, containing a minimum of five retail establishments (or four retail establishments and a restaurant) in operation during any part of the current year. The centre must have a minimum of 20,000 square feet of usuable parking area adjacent to it, and the parking facilities must be free of charge to customers. For shopping centres with paved parking areas of 20,000 - 50,000 square feet, the ratio of parking area of gross floor area must be 1.5 to one or better. The merchandising development must contain either a grocery and combination store (i.e., a grocery store with sales of fresh meat accounting for 20.0% to 40.0% of total sales), a department store, or a chain variety store. While a shopping centre is usually designed as a single project, all establishments do not necessarily have to be leased from a single (private or collective) ownership.*
>
> *A retail establishment may own the building and the land on which it is situated and still be fully integrated with the centre. A shopping centre usually bears a name, and, as a rule, matters of common interest to the tenants, such as children's playgrounds, community activities, parking, etc. originate from one authority.**

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* Canada, Statistics Canada, <u>Shopping Centres in Canada, 1973</u> (Ottawa, 1975) page 5.

They also divide them into three size classifications:

Type A: 5 to 15 outlets;
Type B: 16 to 30 outlets;
Type C: Over 30 outlets.

Subsequently we use and discuss the expression, "regional shopping centre". This definition, as we shall see, has some subjective elements. Statistics Canada leaves no room for prejudice in its size breakdowns. Theoretically, all regional centres should belong to Type C, since without exception the genuine regionals all have more than 30 stores. Unfortunately, all Type C centres are not regionals as many neighbourhood or community centres in Canada also fit the definition. It is conceivable that a Type C centre could have as a lead tenant a supermarket of 20,000 square feet and 30 other tenants averaging 2,000 square feet each, and thus a total of only 80,000 square feet. In actual practice, this seldom turns out to be the case, but there are enough exceptions to make us skeptical of the Statistics Canada approach. We have summarized their data below with some comparisons to Cadillac Fairview.

Statistics Canada tells us that at the end of 1973, there were 664 centres in Canada allocated as follows:

Type A - 417
Type B - 146
Type C - 101

664

Tables 55 and 56 compare Cadillac Fairview and the industry as defined by Statistics Canada.

In the following set of tables we attempt to contrast the Statistics Canada data with that publicly available or supplied to us by Cadillac Fairview.

Table 55

Shopping Centres: Statistics Canada Data Only

	Total	Type A	Type B	Type C
Total number of centres	664	417	146	101
Sales ($000,000's)	7,077	2,078	1,638	3,291
Percentage of total sales	100.0	30.0	23.0	47.0
Sales per square foot	$78	$79	$64	$88
Millions of square feet	89,351	26,447	25,603	37,302
Average per centre ('000)	135	64	175	364

As a matter of interest to the reader, it probably is somewhat surprising that the A centres appear to generate higher sales per square foot numbers than the B centres and are in fact not too far behind the supposedly more powerful C centres. The logical explanation is that in the smaller centres, the food supermarket will typically be a dominant tenant and supermarkets generate considerably higher sales per square foot results than almost every other type of retailer.

Table 56

Shopping Centres: Cadillac Fairview
Contrasted to Industry as
at 1973 Pro-forma

	Industry	Cadillac Fairview	Per Cent Cadillac Fairview %
Number of Centres			
Total	664	26	5.8
A	417	2	0.5
B	146	10	6.8
C	101	14	13.9
Total Size in GLA			
Total	89,351	8,621	9.6
A	26,446	129	0.5
B	25,603	1,420	5.5
C	37,302	7,072	19.6
Average Size of Centres			
Total	134,565	331,577*	146.2
A	63,422	64,500*	101.7
B	175,363	142,000*	81.0
C	364,327	505,143*	139.7
Sales per Square Foot			
Total	$78.42	$102.33	130.5

* Total centre, not just Cadillac Fairview's equity. The aggregate square footage number employed in the above table is slightly different to the data publicly disclosed in the annual report that we use elsewhere in this report. The detailed numbers given to us exclude premises that do not report retail sales, such as banks and small offices.

We have not found one retailer or shopping centre developer who relies on the Statistics Canada data. We agree, as our research indicated, that at the end of 1973 there were about 150 centres in Canada fitting the definition of Type C centres, compared to the 101 that Statistics Canada was able to locate. Thus Cadillac Fairview, instead of managing 14% of the number of centres by units, manages only 9%. Presumably, Cadillac Fairview would no longer manage 20% of the total space either: the correct figure is probably closer to 11%.

Rigid Definition of a Regional Shopping Centre

We spent a considerable amount of time attempting to gain an accurate definition of a regional centre. The Oxford Development Group has recently completed an underwriting of convertible preferred shares. The prospectus for this issue states the following:

> *Regional shopping centres which attract shoppers from a wide area are enclosed and are characterized by their large size, their large number of tenants and their broad range of merchandise types and services, including at least one full line department store.**

We agree with this definition, but will note below the many subjective elements that come into play.

For purposes of this particular study, we believe the key phrase is "which attract shoppers from a wide area". In theory, a regional shopping centre has the power to change the nature of consumer spending quite dramatically. If one developer had a strong grip on the market and was prone to exclude, for example, local merchants in favour of chains, the effect on the economy would be significant. It is for this reason that we have attempted to nail down the definition. The Oxford definition stated above leaves open the following questions:

1. What is the definition of "large"?
2. How many is a "large number of tenants"?
3. What size department store constitutes "full line"?

We have found that this exercise in semantics is quite complicated. There is no shortage of experts in the field or reference documents with firm definitions. The source of the confusion lies in the need to distinguish between regionals in major markets and smaller markets. For example, the Oxford prospectus distinguishes between their 11 regional centres and the 12 community centres. The prospectus states that Quinte Mall in Belleville, with 234,000 square feet, is a regional. Most experts would accept this as a fact. However, a 234,000 square foot centre would be too small in a major city like Toronto. In a major market, one would probably need a stricter definition. For example,

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* Oxford Development Group Ltd., Cumulative Redeemable Convertible First Preference Shares Series A, Edmonton, May 1976, page 9.

many experts would state that in a major market area, a regional centre must consist of two department stores, one of which must be a full line department store in excess of 100,000 square feet, and the total centre must be at least 300,000 square feet. The definition in a smaller market can be much more vague. The department store can be a so-called discount store, such as Woolco, at over 60,000 square feet, and the centre itself can be as small as 200,000 square feet.

Oxford's definition of a regional centre appears to ensure success: if the centre stands up to all the criteria, then it is sure to be well rewarded by heavy patronage. But, the problem with the definition is that it makes no allowance for centres that may have seen better days. Theoretically a centre could aim at being a regional and miss because of location or selection of major tenants. We know of no "sure-fire" way of determining which are the successful centres in Canada. Generally speaking, all centres anchored by Sears are genuine regionals, while those anchored by Sayvette or Zeller's or Towers are not.

Another subjective approach is to examine the character of the specialty retailers who have located there. For example, Reitman's can or will locate a store in every centre in Canada beyond a minimum size. On the other hand, some ladies' retailers such as Dalmy's,Pennington's or Fairweathers are more selective in their choice of sites. These latter retailers are more concerned about being in major regional centres. Similarly, any centre of a minimum size is capable of carrying a jewellery store. However, when one sees two or more in a centre, that is an interesting sign, especially if the same retailer operates them both. Naturally, this approach of looking at centres from the viewpoint of the specialty tenants has its limitations. Often retailers make mistakes in site selection or are unable to negotiate satisfactory deals with the developers.

We are unable to draw from our subjective data any conclusions materially different from our earlier impressions. Cadillac Fairview and Oxford are the leading landlords for the specialty tenants but still do not account together for more than 20% of the locations of Dalmy's, Pennington's or Dylex, to name three prominent users.

HISTORICAL DATA

Table 57 refers to 29 shopping centre projects whereas our Table 48 indicates that Cadillac Fairview was involved in 34 projects. The difference is as follows:

1. Millway Shopping Centre opened in calendar 1976;

2. The Towne Mall is actually part of an apartment complex;

3. Cadillac Fairview owns 42% of Rockwood Mall, and 50% of Greenfield Park and Don Valley Plaza but does not actually

Table 57

The Cadillac Fairview Corporation Limited
Shopping Centre Statistics, 1961 - 75

Year	Number of Projects	Total Sales $000's	Total Sq.Ft.	Sales Sq.Ft.	% Increase Sales	% Increase Sq. Ft.	% Increase Sales/Sq.Ft.
1961	10	120,159	2,789	43.08			
1962	10	136,831	2,955	46.30	13.9	5.6	7.8
1963	10	154,673	3,116	49.64	13.0	5.4	7.2
1964	10	162,820	2,939	54.47	5.3	(4.1)	9.7
1965	11	197,200	3,627	54.38	21.1	21.3	(0.2)
1966	14	249,950	3,880	64.42	26.7	6.9	18.5
1967	14	269,101	4,010	67.01	7.7	3.5	4.0
1968	14	339,106	5,112	66.14	25.6	27.3	(1.3)
1969	14	394,409	5,159	76.45	16.6	0.9	15.6
1970	14	452,727	5,666	79.90	14.8	9.8	4.5
1971	14	502,526	5,678	88.50	11.0	0.2	10.8
1972	14	553,780	5,731	96.63	10.2	0.9	9.2
1973	19	645,107	6,304	102.33	16.5	10.0	5.9
1974	27	932,866	8,881	105.04	44.6	40.9	2.6
1975	29	1,139,507	9,711	117.24	22.0	9.3	11.6

Table 58
The Cadillac Fairview Corporation Limited
Shopping Centre Sales Compared to Total Industry, 1961 - 75

	Total Retail Sales	Total ex Motor Vehicles	Deartment Store Sales	Total CFV Sales	Cadillac Fairview As a percentage of (1)	(2)	(3)
	$ Million	$ Million	$000's	$000's			
1965	21,155	16,980	2,010	197	0.9	1.2	9.8
1966	22,686	18,348	2,144	250	1.1	1.4	11.7
1967	24,155	19,722	2,158	269	1.1	1.4	12.5
1968	25,711	20,997	2,384	338	1.3	1.6	14.2
1969	27,401	22,605	2,669	394	1.4	1.7	14.8
1970	28,034	23,777	2,852	453	1.6	1.9	15.9
1971	30,646	25,383	3,184	503	1.6	2.0	15.8
1972	33,929	29,266	3,969	554	1.6	2.0	15.0
1973	38,239	31,470	4,212	645	1.7	2.0	14.9
1974	43,829	35,854	5,064	933	2.1	2.6	18.4
1975	50,778	40,998	5,785	1,139	2.2	2.8	19.7

manage any of the three. The five projects not listed have a total of 872,000 square feet of rentable space, or less than 9% of the portfolio that is calculated. It might be noted that the 9.7 million square feet of rentable space listed in Table 57 and the 872,000 square feet above add up to 10.6 million square feet, whereas the company's actual leasable area is shown as 11.8 million. The difference of 1.2 million is accounted for by the fact that the internal sales statistics are based on tenants' calculation of sales per square foot results. For example, tenants such as banks, finance companies, brokerage firms, etc. do not compute such figures. In addition, many of the centres also contain small amounts of office space.

The most relevant statistic concerns the company's centres that account for less than 3% of total retail sales excluding motor vehicles. The growth of Cadillac Fairview since 1965 has tended to parallel the total growth of Woolco and Simpsons-Sears. We doubt whether these two retailers can be accused of dominating the retail market and the same comment is applicable to Cadillac Fairview. Even when Cadillac Fairview's retail statistics in selected markets are examined, the original conclusion remains valid since the company's major markets, Toronto and Montreal, are also the two biggest markets in all of Canada.

ECONOMICS OF REGIONAL SHOPPING CENTRES

Although there is no such thing as a typical centre any more than there is a typical office building or a typical hotel, we shall attempt to discuss the economics of a hypothetical centre to be developed today on the outskirts of a major suburban area.

LAND

Naturally, considerably more land is needed for a shopping centre than for an office building because of the need for parking. Some centres in particularly advantageous locations are able to use two levels of retail space and decked parking, and thus use smaller amounts of space. In this particular situation, let us assume that 50 acres are required at $80,000 an acre for a total cost of $4 million. This is actually a low amount today and includes the possibility that the company has owned the land for some time.

BUILDING COSTS

Inflation in building costs has been very serious. In this particular case, we assume an average construction cost of $40 per net rentable square foot. Let us also assume that the centre contains

500,000 square feet of total retail space or gross leasable area (GLA). This would include all of the following:

Land
Land improvements - on-site and off-site services, on-grade parking and parking decks
Major tenants' buildings (mixed maximum cost)
Other buildings (basic construction plus finished mall areas)
Allowances for finishing of other tenants' stores
Estimated costs of tenants' non-removable improvements
Professional fees (architects, engineers, legal, etc.)
Leasing and financing fees, other development expenses
Interest on interim financing

Total costs would be $20 million for the construction, and $24 million including land. There is a variety of definitional problems in such an exercise. For example, some developers might state that land improvements mentioned above are really part of land; thus the breakdown of construction and land costs were different.

RENTALS

There are major differences in the rentals paid by different tenants. Let us make a realistic assumption that our centre of 500,000 square feet has plans for three department stores of 100,000 square feet each. Traditionally in this industry, the department stores have paid what is described in the vernacular of the trade as "cost". The average cost of the total space is $24 million divided by 500,000 square feet or $48 per square foot. Let us assume that the only yearly cost of the centre is financing and that this works out to $5 per square foot, the approximate rent that the department stores would pay. This is quite a high rent level by historical standards and developers would be very fortunate to obtain it from department stores. High rent levels constitute one of the principal reasons for the industry's current slowdown in expansion. In actuality, the department stores would be willing to pay this level only if they received an equity participation in the deal. The majority of larger regional shopping centres, in fact, do have department stores as partial equity owners. However, for this set of calculations, let us assume that the developer is able to maintain 100% control.

The non-department stores occupy 200,000 square feet, an area commonly referred to as mall space. Rents in this case are generally based on "market" as opposed to cost. In other words, if the general level of effective rents in nearby centres is $8.00 per square foot, this is the approximate level that the developer can expect to obtain. The actual rents will, of course, depend on the location, the appearance of the department stores, the economic climate, and so on. The national retail chains, such as Dylex, Reitman's, Dalmy's and Kofflers, have a bargaining strength superior to the local merchants because of their track records and higher credit rating. On the other hand, the developer will want as many locals as possible so that the centre will not look like every other big centre. In addition, as mentioned above, the local merchants will pay more in rentals. Let us assume that the average rental per square foot for the mall space is $8.00. Gross rentals for the centre would be $3.1 million (Table 59).

Table 59

Hypothetical Shopping Centre Gross Rentals

Gross Rentals for the Centre

Description	No. of Sq. Ft.	Rental Per Sq. Ft.	Gross Rentals
Department stores	300,000	$5.00	$1,500,000
Mall tenants	200,000	8.00	1,600,000
Total centre	500,000	$6.20	$3,100,000

OPERATING EXPENSES

To developers one of the most attractive features of shopping centre ownership is the very low level of operating expenses. Earlier we discussed the two methods of accounting for tenant re-charges. Regardless of the method of accounting, the effective situation is that the developer has nominal out-of-pocket operating expenses. In our hypothetical centre, the costs of insurance, miscellaneous, and contributions to the Merchants' Association could amount to $100,000. The effective cash charges for operating the centre could easily be a million dollars, but the provisions of net leases today would require that those costs be absorbed by the tenants.

The proof of our statement on operating expenses can be seen by examining the historical financial statements of Cambridge Leaseholds. Until acquired by Oxford in 1975, this company was exclusively an owner/operator of shopping centres. In five years, this company was able to double gross rentals of over $11 million from $5.2 million while operating expenses only rose from $1 million to $1.4 million.

FREE AND CLEAR RETURNS

These are summarized in Table 60.

Table 60

Hypothetical Shopping Centre
Free and Clear Returns

	Amount ($000's)	Per Sq. Ft.
Total cost	24,000	$48.00
Gross revenues	3,100	6.20
Less: Operating expenses	100	0.20
Free and clear return	3,000	$ 6.00
As percent of total cost	12.5%	12.5%

Financing

The financing of such a centre would be relatively simple. Often it could be obtained prior to final leasing of the mall space. The lenders would first look at the fact that $1.5 million, or 48% of total gross rentals would be coming from major department store tenants. Secondly, they would have the confidence obtained from experience that, if the centre has as anchors three department store tenants, then the remainder of the space will be relatively simple to lease. To the developer, it becomes of primary importance that he obtain high rentals from the mall tenants because that is the profit in the whole exercise. To the lender, on the other hand, it would not be a disaster even if only $6.00 were obtained from the mall tenants, rather than $8.00.

The lenders would look at the $3 million figure (Table 59),which is sometimes also referred to as operating surplus, and capitalize it. This means that they assume that the economic value of the centre is an amount at which the $3 million may reflect a satisfactory return. Thus, if properties such as this one would be yielding 11%, then a property with this free and clear return of $3 million is worth $27.3 million. A purchaser who bought the property for $27.3 million would end up with a yield of 11%. Obviously, this 11% is a conservative number because many investors would be prepared to accept a much lower yield.

Let us assume that the lenders wish to lend only 80% of the economic value, $21.8 million, and that the developer can obtain a mortgage of $22 million with an interest rate of 11%. Annual interest charges would be $2.42 million and principal repayments might be another $250 thousand annually for total payments of $2.67 million annually. The return on equity could be 16.5% (Table 61).

Table 61

Hypothetical Shopping Centre
Return on Equity

	Amount ($000's)	Per Sq.Ft.
Free and clear return	3,000	$6.00
Principal + interest	2,670	5.34
Net cash flow	330	$0.66
Original equity	2,000	$4.00
Return on equity	16.5%	16.5%

There is considerable flexibility to the developer's methods of financing such projects. Some developers prefer 100% financing, while others are quite conservative. Table 62 illustrates two methods of financing our hypothetical centre.

Table 62

Hypothetical Shopping Centre
Alternatives in Financing Shopping Centre

	100% Financing ($000's)	80% Financing
Original cost of centre	24,000	24,000
Free and clear return	3,000	3,000
Mortgage	24,000	19,200
Interest at 11% + principal	2,900	2,300
Net cash flow	100	700
Original equity	0	4,800
Return on equity	infinite	14.6%

OVERAGES OR PERCENTAGE RENTALS

As has been stated on several occasions in this report, shopping centres are the most attractive form of real estate investment. One of their many appealing features is the overage or percentage rental clause. Just about all of the mall tenants and some of the department store tenants have lease provisions where the rent is the greater of a fixed amount or a percentage of sales. Let us look at the case of one of the typical retail tenants in our example who is paying a base rental of $8.00 per square foot. We assume that the operator also agreed to pay the higher of the base rental or 5% of sales. In year one, the tenant achieves sales per square foot of $100.00; since 5% of this amount is $5.00 per square foot, the effective rent continues to be $8.00 per square foot. But let us assume that the centre is a success and that inflation continues. It would not be surprising to see the tenant's sales grow by 20% annually for five years and subsequently by 10% annually. Table 63 demonstrates what can happen to percentage rents.

Table 63

Effect of Overage Clause

Year	Total Sales	Minimum Rents	5% of Sales	Percentage Rents	Total Rents	Per* Sq. Ft.
One	$500,000	$40,000	25,000	--	$40,000	8.00
Two	600,000	40,000	30,000	--	40,000	8.00
Three	720,000	40,000	36,000	--	40,000	8.00
Four	864,000	40,000	43,200	$3,200	43,200	8.64
Five	1,036,800	40,000	51,840	11,840	51,840	10.37
Six	1,139,600	40,000	56,980	16,980	56,980	11.40
Seven	1,253,560	40,000	62,678	22,678	62,678	12.54
Eight	1,378,916	40,000	68,946	29,946	68,946	13.79
Nine	1,516,808	40,000	75,840	35,840	75,846	15.17
Ten	1,668,488	40,000	83,424	43,432	83,424	16.68

Table 64 examines the situation of our hypothetical developer in years five and ten, assuming that all of the mall tenants have similar experiences and that the department stores either pay no overages or have not reached the "hurdle amount".

Historically, situations like these have occurred in regional centres, as our centre-by-centre analysis of Cadillac Fairview confirms. Admittedly, the centre must be highly successful in real terms in addition to a high level of inflation.

Whereas the tenants do not find any joy in inflation because costs can often outpace dollar sales, the landlord's costs are fixed and overage rents are based solely on reported dollar sales.

Table 64

Hypothetical Shopping Centre
Financial Situation Years Five and Ten*

	Amount		Per Square Foot	
	Year 5	Year 10	Year 5	Year 10
	($000's)			
Gross rentals from department stores	1,500	1,500	$5.00	$5.00
Minimum gross rentals from mall tenants	1,600	1,600	8.00	8.00
Overages mall tenants	474	1,736	2.37	8.68
Total gross revenues	3,574	4,836	7.15	9.67
Operating expenses	100	100	0.20	0.20
Free and clear return	3,474	4,736	6.95	9.47
% of Original $24,000,000 investment	17.4%	19.7%	17.4%	19.7%
Original debt	22,000	22,000	44.00	44.00
Original equity	2,000	2,000	4.00	4.00
Current debt	20,000	16,000	40.00	32.00
Current equity	4,000	8,000	8.00	16.00
Annual financing costs	2,670	2,670	5.34	5.34
Net cash flow	804	2,066	1.61	4.13
Return on current equity	20.1%	25.8%	20.1%	25.8%
Return on original equity	40.2%	103.3%	40.2%	103.2%
Gross Cash flow as % of original $24,000,000	5.3%	23.9%	5.3%	23.9%

* Assumption overage clause operating for mall tenants.

CONCLUSION

BARRIERS TO ENTRY

It is clear that the shopping centre business is highly profitable. In ordinary circumstances, all sorts of competition would tend to enter it. However, there are two major barriers to entry.

One reason that the construction of shopping centres slowed down is not that the developers are unwilling to build them but that the department stores are unwilling to commit themselves. In many other aspects of real estate, developers build speculative space, even in large projects. In shopping centres there are so few lead tenants it is ludicrous to speculate: if one obtains the lead tenants, the financing and the mall tenants will follow; without the lead tenants, construction is impossible.

The other important factor is the negotiation process through the regulatory bodies. Today it is not possible to pick out a good site and begin to excavate immediately. There are many steps involved in obtaining the necessary zoning clearances. It is our interpretation of the modern shopping centre business that there are very few secrets about the expansion plans of the major retailers; e.g., Sears would like a new store in the east of Toronto and in Cornwall, while Eaton's is interested in new facilities at Kingston and South Ottawa. Several developers will acquire or option lands in these areas and begin the regulatory process. The winner from the regulatory side will almost automatically become the winner with the department stores, and according to our scenario, the winner with the rest of the tenants. The development process in shopping centres can take many years and a certain degree of luck is involved when projects suddenly materialize.

POWER OF CADILLAC FAIRVIEW IN SHOPPING CENTRES

As we have seen, Cadillac Fairview is the leading company in shopping centres and is highly profitable. Nevertheless, Cadillac Fairview is still a relatively small factor in both total retailing (8%) and regional shopping centres, (11%).

We shall argue later that it is the major tenants who have power. Certainly, Cadillac Fairview and three or four others have a head start over everybody else in establishing new centres, but our interpretation of actual bargaining is that the department stores take a pragmatic approach to expansion. They would prefer to use a developer of their choice, but if another developer has a preferable location, "c'est la vie".

We do not believe that the developers can be accused of having power over the national specialty chains. This group of companies including Dylex, Pennington's, Peoples Jewellers, Reitman's, Kinney Shoes, Dalmy's, Elks, Jack Fraser, Birks, Coles, and so on, has a basic corporate strategy, the plan of locating in new regional centres. Naturally, they tend to be large tenants of Cadillac Fairview, Oxford, and so on. However, we can find very few examples of developers 'coercing' or forcing such tenants into their locations. Among the national specialities none is in all of the "good centres". The usual reasons developer and retailer were unable to reach agreement are technical such as amount of rent or exact location in centre.

We have also heard suggestions that shopping centre developers may be prejudiced against the "independent merchant". This seems improbable for the simple reason that the independent is more likely to pay higher rentals and overage percentages to the developers. What has actually occurred is that the costs of entering new regional shopping centres have escalated sharply in recent years. In addition to the basic rentals, the costs of construction for the store and operating expenses have risen sharply. The natural specialty chains have been in a better position than the smaller local merchants to absorb these costs.

Generally speaking, there were more candidates to enter a new centre than available positions and, as a result, the chains have tended to increase their market share. The smaller developers desire the chains as tenants because of their higher credit ratings, which naturally assist in obtaining the financing. On the other hand, the larger developers have considerably more flexibility in this respect, since their corporate creditability is a factor in obtaining financing. It appears that larger shopping centre developers would be more prepared than a smaller developer to accept an independent merchant in a new centre, although both appreciate the proven track record of the chains.

The proof of the fact that Cadillac Fairview is far from a dominating factor in new regional shopping centres is quite simple. Almost all their new capacity in the past two years has come from expanding existing centres. The company has publicly announced plans for only one new regional centre, in St. Bruno, which will open in 1978, although there are apparently many in the planning stage. Meanwhile, the industry, according to our calculations, will add over 30 centres in excess of 200,000 square feet in 1976 and 1977. The energies devoted to the Toronto Eaton Centre have been undoubtedly a contributing factor in the slowing of the company's expansion. Nevertheless, the company is clearly not in the process of increasing its share of the market. Indeed, there appears to be no evidence that the company has increased its share of the market in the last five years, or that it is about to do so in the next five years.

CHAPTER 6

THE RESIDENTIAL GROUP

The company includes in this group the rental portfolio, which is basically a property management role today, and, as well, the residential projects for sale, which effectively constitute the housing division. The rental side is considered first.

RESIDENTIAL RENTAL PROJECTS

PERFORMANCE

The performance of the rental side is summarized in Tables 65-69. Unfortunately, one cannot compare residential rental cash flow on a per square foot basis to that for office buildings and shopping centres, since apartment data is typically expressed on a unit basis only. Subsequently in this section, however, we make some arbitrary assumptions implying that cash flow per square foot in apartments is distinctly lower than in either shopping centres or office buildings. As a percentage of total investment in rental properties, cash flow from residential rentals was 3.9% in 1976 (Table 68) compared with 3.0% for office buildings, (Table 38) and 7.2% for shopping centres (Table 53). The free and clear return from residential rentals was 10.4% (Table 67) as compared with 9.5% for office buildings (Table 37) and 13.4% for shopping centres (Table 52).

These statistics appear to place residential rentals midway in profitability between office buildings at the bottom and shopping centres at the top. In actual fact, as we explain below, the economics of new apartments is the worst of the three. The reason that the historical returns do not demonstrate this is that the residential rental portfolio contains a higher percentage of older buildings than do those of the Urban Development and Shopping Centres Group.

CADILLAC FAIRVIEW'S SHARE OF RESIDENTIAL APARTMENT MARKET

Cadillac Fairview is mainly a Toronto apartment Builder (see Table 69). It might be noted that the company built many of its projects in phases. For example, Rosebury Square has a total of 1,056 suites and encompasses a series of buildings built from 1968 to 1972. Cadillac Fairview's terminology would call this one project.

SIZE OF TORONTO RENTAL MARKET

At the end of 1975, Toronto possessed 245,550 units in structures with more than six units. CMHC states that this tabulation reflects rental units only. On this basis, Cadillac Fairview possesses approximately 6.3% of the total market. This figure of 246,550 units is also consistent with some of the public statements issued by UDI in the fight over rent controls.

Table 65

The Cadillac Fairview Corporation Limited
Portfolio of the Residential Group
Income Producing Properties, February 1976

Completed	Year Opened	No. of Suites	Extent of Company's Interest: Percentage	Extent of Company's Interest: No. of Suites
Hamilton				
One Hundred Bay South	1966	175	50	88
Mississauga				
Morningstar Place	1971/72	246	100	246
Montreal				
Les Habitations				
Malicorne	1973	312	50	156
Ottawa				
The Seigniory	1965	199	100	199
Watergate	1972	289	100	289
Quebec City				
Les Jardins de Coulogne	1974	218	50	109
Toronto				
Ainsley Court	1958	56	100	56
Bayview Mews	1966	304	70	213
Bayview Mills	1970/72	345	80	276
Bayview Square	1969	310	100	310
Bretton Place	1967	629	100	629
Carolyn Court	1960	132	50	66
Castellana	1964	72	100	72
Charlton Court	1959	120	100	120
Chequers Place	1968	481	100	481
Clintwood Court	1961	64	100	64
Craigton Court	1958	125	100	125
Del Prado	1965	156	75	117
Don Ridge Towers	1963	65	100	65
Forest Grove	1964	114	100	114
The Four Thousand	1963	307	50	154

Completed	Year Opened	No. of Suites	Extent of Company's Interest: Percentage	Extent of Company's Interest: No. of Suites
Toronto - cont.				
Grenardier Square	1969	664	100	664
Hampton House	1969	438	100	438
Horizon House	1964	226	100	226
Horizon Village	1965	160	100	160
Humber Ridge	1962	190	100	190
Ivordale Maisonettes	1958	60	100	60
Keelgate Towers	1963	187	50	93
Maisonette Apartments	1957	84	100	84
Park Place	1968/74	1,971	100	1,971
Park Willow[1]	1966	496	66 2/3	331
Park Towers	1966	548	75	411
Parkway Forest	1966/73	1,854	100	1,854
Plaza 100	1971	412	100	412
Rosebury Square	1968/72	1,056	100	1,056
Rosedale East	1967	550	100	550
Summit Place	1966	249	100	249
The Towne	1967	185	100	185
University City	1971/75	1,480	100	1,480
Village Green	1966	687	50	343
West Park Village	1965	464	50	232
Woodview Court	1958	59	100	59
Total Units		16,739		14,997

Table 66

The Cadillac Fairview Corporation Limited
Residential Rentals: Cash Flow, 1975 and 1976

(Year end February 28)

	1975	1976
	($000's)	
Gross rentals - residential	39,300	44,700
Less: operating expenses*	18,352	21,700
interest** plus allocated G & A	12,643	14,309
Contribution to cash flow	8,305	8,691
Reported cash flow	34,442	40,827
Percentage from residential rents	24.1%	21.3%

* - Assumption: 46.7% in 1975 and 48.6% in 1976 (see Tables 19 and 20, pages 44-5).

** - Assumption: see Tables 23 and 24 (pages 47-48).

Table 67

The Cadillac Fairview Corporation Limited
Residential Rentals: Free and Clear Returns, 1975 and 1976

(Year end February 28)

	1975	1976	1976 Results per Average Suite*
	($000's)		
Gross rentals	39,300	44,700	$ 3,042
Less: operating expenses	18,352	21,700	1,477
Free and clear return	20,948	23,000	1,565
Gross investment	216,202	224,927	$15,308
Average for year		220,565	15,012
Free and clear return as a percentage of average gross investment		10.4%	10.4%

* - Based on 14,693 suites.

Table 68

The Cadillac Fairview Corporation Limited
Residential Rentals: Cash Flow as a Percentage of
Investment in Income Properties

February 29, 1976

	Total Portfolio		Residential Rentals
		($000's)	
Total investment at year-end	637,557		224,927
Average for year	615,718		220,565
Cash flow	28,932		8,691
As percentage of investment in rental properties	4.7%		3.9%

Table 69

The Cadillac Fairview Corporation Limited
Residential Rentals: Geographic Summary, 1976

Location	No. of Projects	No. of Suites	Equity of Suites Cadillac Fairview
Hamilton	1	175	88
Montreal	1	312	156
Ottawa	2	488	488
Quebec City	1	218	109
Toronto including Mississauga	36	15,546	14,156
Total	41	16,739	14,997

UDI has claimed that its members manage between 70,000 and 80,000 units in Metropolitan Toronto out of a total of 220,000 to 250,000 units. The only large apartment owners who do not belong to UDI are New Style Construction, Mr. Reuben Dennis and the Del Zotto Group. They probably account for 5,000 to 10,000 units among the three of them. It is generally thought that the four biggest landlords in Toronto are Cadillac Fairview, Greenwin Construction, Belmont Construction and the Meridian Group. We spoke to one of the owners of the latter three and he confirmed that the three of them owned approximately 40,000 units in Toronto. The bulk of Cadillac's apartment partnerships are with Greenwin, but we have not double-counted.

Additional proof of the fact that the Toronto market is made up of a multitude of small landlords is provided by the breakdown of the market by size of units (Table 70). The bigger developers are naturally concentrated in the projects in excess of 200 units. This part of the market took up only 5% of the structures and 29% of the units.

As said earlier, the Cadillac Fairview portfolio of residential rentals (Table 65) included as one entity all buildings built as part of a complex. We estimate that out of the total portfolio in Toronto of 15,547 suites, about 13,500 would be in structures of over 200 units. Thus Cadillac Fairview owned close to 19% of the market in buildings over 200 units. However, there is no reason to believe that this constitutes a separate market, and the figure is meaningless in our opinion. Also, Cadillac's portfolio is scattered all over metropolitan Toronto. For example, the company has four complexes with more than 1,000 suites: Park Place, Parkway Forest, Rosebury Square and University City. These four projects are distinctly separated from each other as is the mass of the portfolio. Cadillac Fairview may be the biggest landlord in Toronto, but by no stretch of the imagination can it be accused of dominating it.

Table 70

Breakdown of Toronto Apartment Market, 1975*

No. of Dwelling Units	No. of Structures	No. of Units	As a & of Total: No. of Structures	As a & of Total: No. of Units
6 - 19	2,337	22,434	47	9
20 - 49	1,204	39,070	24	16
50 - 199	1,169	113,089	24	46
200+	254	71,957	5	29
Total	4,964	246,550	100	100

ECONOMICS OF NEW APARTMENT CONSTRUCTION

Developers are prone to say publicly that the economics of new apartments are unfavourable. Table 71 provides evidence for this point of view. We compare the same hypothetical unit constructed in 1967, 1972, and 1976. The assumptions are all reasonable in our opinion.

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* - Canada, Canadian Mortgage and Housing Corporation, Annual Review, 1975 (Ottawa, 1976), p.

Table 71

Economics of New Apartments

	1967	1972	Current
Cost per suite	$12,000	$16,000	$25,000
Gross rents per suite			
- monthly	160	200	280
- annual	1,920	2,400	3,360
Operating expense at 45%	864	1,080	1,512
Free and clear return	1,056	1,320	1,848
As a per cent of capital cost	8.8%	8.3%	7.4%
Assume 80% mortgage	$ 9,600	$12,800	$20,000
Assume mortgage constant	7%	9½%	12%
Annual interest+ principal	672	1,216	2,400
Annual net cash flow	384	104	(552)
Original equity	2,400	3,200	5,000
Return on equity	16%	3.3%	negative

The apartment built in 1967 would be quite profitable by now. The 1972 unit would be modestly profitable and the new unit would still be a heavy drain. Table 72 looks at the 1976 results for three individual units and the total portfolio. These calculations have all been made on a net cash flow basis as opposed to gross cash flow. However, principal repayments in the exercise have been quite small in total.

Table 72

Hypothetical Apartment Project, 1976

	1967 Unit	1972 Unit	1976 Unit	Total of 3
Cost per suite	$12,000	$16,000	$25,000	$53,000
Gross rents per month	250	265	280	795
- annual	3,000	3,180	3,360	9,450
Operating expenses at 45%	1,350	1,431	1,512	4,293
Free and clear return	1,650	1,749	1,848	5,247
As % of cost	13.8%	10.9%	7.4%	9.9%
Annual interest + principal ($)	672	1,216	2,400	4,288
Net cash flow ($)	978	533	(552)	959
Initial equity ($)	2,400	3,200	5,000	10,600
Return on equity	40.8%	16.7%	negative	9.0%

The overall portfolio would be showing only a 9.0% return despite the high returns of the older project. The 1972 project is still only up to 16.7%.

These calculations demonstrate that if government policy is anxious to see new rental units built, there must be either a major drop in interest rates, which seems unlikely, or a big increase in rents. Otherwise, an alternative solution must be devised. In order for a new project to be economical, we believe rents would have to climb by $1,000 annually, or 30%. At that point we believe developers would be rushing to build them. It will be recalled that the rate of return figures for offices did not appear very attractive and yet office buildings are still being built. The current economics of new hotel construction is even more unfavourable yet construction continues. Similarly, in our opinion, apartments will be built as soon as the potential returns are visible.

COMPARISON WITH CADILLAC FAIRVIEW

Cadillac Fairview completed fiscal 1976 with an equity in 14,997 apartment units. They began the year with 14,388 units so theoretically they averaged 14,693 for the year. Cash flow of $8,691,000 divided into 14,693 units works out to be $592 per unit. If, for the sake of calculation, the average apartment was 800 square feet in size, then cash flow would be $0.74 per square foot, which is far lower than the company's other two important rental areas.

There are two major reasons for the relatively lower cash flow generated by apartment rentals: (1) renovations and repairs are much higher; (2) refinancings are more probable because of the age of the portfolio and the short-term nature of financings formerly used by Cadillac. In ordinary times, the quicker turnover of leases might compensate for the negatives. In a rent-controlled environment, the opportunities for such compensation are eroded sharply. In actual fact, expenses have a tendency to go up faster than rents.

It was said earlier that Cadillac's rise in the world was due to its leadership in apartments. Table 73 illustrates this growth.

The 14,997 units in the current portfolio were all built by the management with the exception of 265 contributed by Fairview and 185 by Canadian Equity and Development. The management that produced all these units during the 1960's is still active at Cadillac Fairview. Naturally, the emphasis has shifted to producing high or low-rise units for sale. Nevertheless, we believe they have a "soft spot" for the motivation. All that is needed is a change in rent levels. While there is considerable talk in the industry about the difficulties in coping with ratepayers, we suspect that it is the economics that are really crucial since the same obstacles are applicable to highrise condominiums.

Table 73

The Cadillac Fairview Corporation Limited
Growth of Apartment Portfolio, 1964-76
(Calendar year)

	Completed Residential Units	Increase for Year
1964	2,084	
1965	3,213	1,129
1966	4,850	1,637
1967	6,624	1,774
1968	8,347	1,723
1969	9,869	1,522
1970	10,462	593
1971	11,746	1,284
1972	12,898	1,152
1973	13,568	670
1974 - Feb. est.	13,907	341*
Feb. 1975	14,388	481
Feb. 1976	14,997	605

* - 14 months

Earlier we contrasted the barriers to entry between office buildings and shopping centres and concluded that offices were easier to enter and thus produced lower returns. Apartments are by far the easiest of the three to enter since the size of the operation at the bottom is very small indeed. There are no proprietory technological reasons. In fact, Cadillac or any of the other large developers would probably be pleased to construct an apartment project for investors on a fee basis. The problem with the business, as we have stated, is that rents are not high enough.

RESIDENTIAL PROJECTS FOR SALE

PERFORMANCE

Cadillac Fairview's performance in housing over the last two years is summarized in Table 74.

These gross profit numbers are before allocations of general and administration expenses. Thus pre-tax profits from housing appear to be between $3 and $4 million in each of the last two years.

Table 74

The Cadillac Fairview Corporation Limited
Housing Performance 1975 and 1976
(Year end February 28)

	1975	1976
	($000's)	
Housing sales	33,516	46,130
Direct costs	28,911	41,416
Gross profits	4,605	4,714
As a percentage of sales	13.9%	10.2%

Cadillac Fairview closed 1,054 units in fiscal 1976 compared to 828 units in fiscal 1975. These figures reflect the company's equity. Assuming for present purposes that pre-tax income from housing was $3.5 million in both years, this suggests a profit per unit of $4,227 in fiscal 1975 and $3,321 in fiscal 1976.

The data suggest two principal observations. First, Cadillac Fairview is not a major factor in Canadian housing. Secondly, the housing business is not as profitable as is generally believed. While these conclusions are valid, we believe that the Cadillac Fairview format tends to understate the contribution of the Residential Group to overall profits. For example, the Residential Group also undertakes some projects on a fee basis:

> *On behalf of the Metropolitan Toronto Housing Authority the Group will construct two apartment projects for senior citizens, a 400 suite building at Markham Road and Lawrence Avenue and a 330 suite building at Victoria Park and Eglinton Avenue. Construction on these two projects is expected to start by year-end.**

The company includes in its consolidated results only the fees earned in such activities, which are included in the income stated under Other Income.

THE PROBLEM OF DISTINGUISHING BETWEEN HOUSE-BUILDING AND LAND DEVELOPMENT PROFITS

In this report we consider land development to be the principal prerogative of the New Communities Group which manages Erin Mills (see Chapter 7). However, the residential side of Cadillac Fairview is also an active land developer, principally to supply lots to the building side. The company, on occasion, follows the common practice of selling lots or pieces of raw land to other builders. Apparently the company had some sales of this nature in fiscal 1976 and the results are included in

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* - Cadillac Fairview, Interim Report to Shareholders, Oct. 28, 1975.

Table 81 (page 135) under "Land Sales". We estimate that this provided another $1.5 million in profits in fiscal 1976. Thus total residential pre-tax profits in fiscal 1976 were probably closer to $6.5 million than to the $3.5 million mentioned above. However, our comments on margins from actual construction still hold true.

In our subsequent discussion of New Communities we examine more particularly the relationship between land development and house-building. For present purposes, we accept the generally held hypothesis that the land development side of the business is the highly profitable aspect of house building. We note that whereas Cadillac Fairview's gross profits in 1976 for house building were 10.2% of sales, for land development they were 42.6%.

The background and problems of land development, a controversial area in public life, will be explained in detail later. However, even James Lorimer, an outspoken opponent of the land development industry, has agreed that the house-building side is very competitive.

The majority of public real estate companies have as their principal activity some combination of land development and house-building. Earlier, we referred to a 35-company sample in Table 27 (page 58). Sixteen of those 35 companies are founded on this activity and only ten are not involved at all. Therefore, it would appear that in theory there should be an abundance of comparative data on profit margins in housing. This turns out not to be the case because, without exception, the public companies are either exclusively land developers like Carma, Markborough or Abbey Glen, or combination companies. We discuss industry profit margins in a subsequent section.

Even though a company does not sell any lots to outsiders, but builds on all of its lands, it is difficult to segregate profits. For example, a company may build lots on a piece of land with a very low book cost and actually lose money on the construction side. The reported totals for sales and profits would still show a healthy profit. It is interesting to note that this aspect of the business vexed the Anti-Inflation Board for approximately eight months before it managed to come up with a formula for distinguishing profit margins on land and housing.

NATURE OF CADILLAC FAIRVIEW'S HOUSING BUSINESS

While Cadillac Fairview's major land bank is its 6,000 acres in Erin Mills, the residential housing division also maintains an active land bank of its own. We believe that the company now controls over 2,000 acres of land in more than ten parcels in addition to the homes ready for construction described below.

The housing division is actually split into two components: land development on the one hand; construction and marketing on the other. On the surface, it may seem unusual to have two separate management groups both active in land development. The difference is that Erin Mills with 6,000 contiguous acres has a twenty-year life cycle, while the housing group is pre-occupied with bringing land on-stream in a much shorter time.

Mr. Gerald Shear, Executive Vice-President, New Communities Group, about four years ago referred to the Residential Land people as short order cooks, while,according to his analogy he was a gourmet chef.*

In actual fact, the planning process with its inevitable delays has tended to draw the processes of the two divisions closer together. Land that may originally have been acquired for a development target of three to five years may take a decade or more, if ever, to bring on-stream. We believe that the company now possesses more than $70 million of such land.

Thus, the profit margins referred to above for housing also include some land profits. Obviously the margins are quite thin as stated, so that the land profits do not appear to have been very high.

HISTORY OF CADILLAC AS A BUILDER

Cadillac Development was engaged in home building throughout its history. The record from 1964 is summarized in Table 75. It can be seen that from 1964 to 1972 the company was really a small but profitable builder. Homes sold on an average for $20,000 to $30,000 and production in any one year rotated around the 300 level.

The big increase in volume after 1971 came about as a result of the following;

1. The company's principal thrust during the 1960's had been as an apartment builder. From 1964 to 1970, the company constructed 8,376 units or an annual average of 1,396 suites. In the 1970's a considerable portion of this energy and land inventory was simply transferred to high-rise condominiums. This business only began in any size in the 1970's, and the industry leaders predictably included many former apartment builders such as Cadillac.

2. Prior to December 29, 1972, Cadillac owned 80% of Cadillac Homes and Norman Stone owned 20%. He conducted the actual management of the division. The partnership was naturally limited by financial resources and the risk-taking abilities of Mr. Stone. On December 29, 1972, Mr. Stone sold his 20% to the company and became an Executive Vice-President, a position he continues to maintain within Cadillac Fairview.

3. The scope and magnitude of the house-building and land development industry changed dramatically in the 1970's. The shortage of serviced lots and general inflationary pressures in the economy caused land and housing prices to rise sharply. The potential for large profits in this industry became more evident as a result.

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* - Interview with Mr. Gerald Shear.

Table 75

The Cadillac Fairview Corporation Limited
Residential Housing Division, 1964-76*
(Calendar year)

	Housing Operation	Direct Costs	Gross Housing Profits	Profit Margin
	($000's)	($000's)	($000's)	(%)
1964	4,613	4,511	102	2.2
1965	6,903	6,250	653	9.5
1966	7,837	6,763	1,101	14.0
1967	4,563	3,921	642	14.1
1968	7,915	6,798	1,118	14.1
1969	9,025	7,367	1,658	18.4
1970	6,602	5,026	1,566	23.7
1971	7,313	6,105	1,208	16.5
1972	27,534	25,318	2,216	8.1
1973	47,921	42,089	5,832	12.2
to Feb. 28				
1975	33,516	28,911	4,605	13.9
1976	46,130	41,416	4,714	10.2

* - This table represents only the former Cadillac Development's historical results from 1964 to 1973 and the Cadillac Fairview performance in the last two years. Cadillac as a public company actually disclosed its housing performance under the heading of "Housing and Land". Thus, any land sales that did occur were included within this category, whereas any land sales of Cadillac Fairview are included under the category of "Land Sales". We have also excluded the unspectacular record of Fairview in housing and land. As a public company, in the two fiscal years to February 28, 1974, Fairview generated total sales of housing and land of $5 million and gross profits of $383,000.

4. We are not certain as to how Cadillac originally conceived Canadian Equity and Development as a provider of lots in Erin Mills. However, the uncertain political environment in Erin Mills plus the natural conflicts that arose from CED being a public company dictated that Cadillac find other sources of land on which to build houses.

5. Cadillac found that it was not the easiest thing in the world to become a successful land developer. The hazards of the development process suggested that a participant must have a variety of parcels underway in order to ensure always having the product on the market.

6. After 1968 Cadillac began seriously to diversity its base of operations. In addition to entering the office building and shopping centre markets as part of a program of product diversification, it was a logical strategy to diversify the housing operation geographically as well. Thus the corporation began building residential units in Windsor, Ottawa, Montreal and Florida.

Table 76

The Cadillac Fairview Corporation
Housing Completions, 1969-75
(Calendar year)

Period	Total Canadian Housing Completions	Closings Cadillac Fairview	Percentage Cadillac Fairview
1969	195,826	305	0.2
1970	175,827	214	0.1
1971	201,232	349	0.2
1972	232,227	989	0.4
1973	246,581	1,575	0.6
1974	257,243	828*	0.3
1975	216,964	1,054**	0.5
7-year total	1,525,900	5,314	0.3

* - Fiscal 1975 (year-end February 28, 1975).

** - Fiscal 1976.

Source: Canada, CMHC, and Cadillac Fairview.

Cadillac Fairview is not statistically a large factor nationally in the housing market (Table 76). However, housing, like all other forms of real estate, is actually a localized market although it appears statistically to be insignificant nationally. Despite its geographic diversification, Cadillac Fairview still relies heavily on the Toronto market. Tables 77 and 78 demonstrate the company's performance in Toronto relative to the available statistics.

It would appear that Cadillac Fairview is a tiny factor in the Metropolitan Toronto market. The company did have the one big year in 1973, when their share of market rose as high as 4.5%. However, this reflected an unusually high number of closings from one large condominium project.

Table 77

The Cadillac Fairview Corporation
Share of Toronto Market in Residential Housing, 1969-75
(Calendar Year

Period	Dwellings Completed in Metro. Toronto	Toronto Sales Cadillac Fairview	Per Cent Cadillac Fairview
1969	36,289	305	0.8
1970	28,276	214	0.8
1971	27,423	349	1.3
1972	41,156	989	2.4
1973	34,701	1,575	4.5
1974	39,448	644*	1.6
1975	26,055	651**	2.5
7 year total	233,348	4,727	2.0

Source: Ibid.
* Fiscal 1975.
** Fiscal 1976.

Table 78

The Cadillac Fairview Residential Group
Summary - # of Units Closed*
January 1/69 to February 29/76

	TOTAL	YEAR END FEB.29/76	YEAR END FEB.28/75	2 MOS. FEB./74	Y/E DEC. 73	Y/E DEC 72	71	Y/E DEC. 70	69
Toronto	4,902	651	644	175	1,575	989	349	214	305
Windsor	234	162	72						
Montreal	60	57	3						
Ottawa	272	162	109	1					
Florida	22	22							
	5,490	1,054	828	176	1,575	989	349	214	305

Source: Cadilac Fairview
* Cadillac Fairview equity only.

As a general rule, there is considerable flexibility in the preparation of statistics such as those shown here. One could be quite "choosy" about definitions of the Toronto market and employ different yardsticks for both the aggregate and the Cadillac Fairview totals. Our statistics have been conservative in this light and would tend to exaggerate Cadillac Fairview's Toronto position. We have included in the company's Toronto totals production from Bowmanville, Mississauga, Richmond Hill, Chinguacousey Township, Markham, Oakville and Newmarket. The CMHC data for Toronto probably also encompasses those regions, but we are not certain that this is so since they are constantly changing their statistical base.

OUTLOOK

There is no reason to suppose that Cadillac Fairview's penetration of the Toronto housing market is about to increase sharply. Similarly, their share of market in their other localities looks as though it will remain small. The subject of land development is significant and controversial. Essentially, the opportunity does not exist for Cadillac Fairview to increase its market share strongly because it does not have the land position. The corporation does have the Erin Mills acreage, but, as will be discussed, its whole approach is to use a number of different builders.

Table 79 summarizes the company's total inventory of units. It is a little difficult to interpret as it suggests that Cadillac Fairview has embarked on a program of building 5,000 units when only about a thousand have been closed annually in the last two years. The confusion stems from the fact that the schedule does not indicate how long it will take to produce and market the units. This is especially significant for high-rise condominiums, such as Lambton Square, Quebec Gothic and Victoria Towne, where the absorption rate is measured in years, not months. We would estimate the program as stated will take two to three years to complete with market conditions being the key variable. Thus, if it takes 2.5 years, the annual rate of production would be 1,980 units. Cadillac Fairview's share would probably amount to about 1,500 annually. This is probably a high estimate since the program will probably take closer to five years to realize. Even if Canadian housing completions average as low as 200,000 a year, the company's market share will still be less than 1% annually. Of course, there will be new situations coming along in the new two years that will probably go into production. This is offset by the fact that the 1500-unit figure includes some Florida production, where delays could easily materialize in the existing program.

THE ECONOMICS OF HOUSE BUILDING

As stated earlier, the really profitable and controversial side of housing is the land development. The "bricks and mortar" side, as it is known, is demonstrably competitive. The most obvious proof of this fact is the weekend Toronto Star. While we do not wish to imply that Toronto is completely representative of Canada, in this particular situation, Cadillac Fairview remains predominantly a Toronto builder, and in actual fact the

Toronto situation is symptomatic of the industry situation. The Star throughout much of 1976 was running two real estate sections, at approximately $7,000 a page, the bulk of which were filled with advertisements for new homes.

The journals of economists and real estate academics have included many articles discussing what factors are crucial in determining the price of new homes. There seems to be ample proof that since the inventory of existing homes is so much larger and the volume of resales so much bigger, it is only natural that new house prices follow this trend, not lead it. It becomes apparent after studying the matter that if 1500 square foot bungalows throughout Metropolitan Toronto are selling at $55,000 each, the new 1500 square foot bungalows must be priced somewhere near this level. Naturally, the price can vary depending on the location, quality of construction, amenity package, and so on. Nevertheless, the resale market puts a ceiling on the price.

In theory, the price of land should also be governed by such logical economic factors. However, the facts of life are that in most major cities in Canada west of Quebec there is a legitimate shortage of serviced lots. Thus small builders who constitute the majority of the housing producers are obliged to compete with each other for the acquisition of lots.

The result is that land prices are not synchronized with the shorter term cyclical moves of the housing market. Thus, for short periods of time, land prices because of their "stickiness" may remain relatively firm while housing prices come under pressure. This situation has initiated the accusation that only a small group of landowners maintains a tight grip on the market. We believe that this is not the case. Rather, the problem is the excess number of builders compared to the supply of serviced lots. We find no reason to shed tears for small builders. We discuss their economics below and conclude that the returns on equity are still quite satisfactory.

Builders can often make substantial land profits on their serviced lots when the reverse situation occurs. Developers sell lots to builders on a bulk basis with prices set at the time of purchase. There have also been occasions when lot prices have risen strongly between the time the builder acquired his lots and when the house was ultimately sold to the consumer. In our opinion, this time lag accounts for the big percentage of the industry's profits in many periods. For example, a developer and a builder will arrange the price of lots a considerable period of time before the building permits are available. Time lags of over a year between house completion and the agreement to buy the lot are common. This narrative has no villain or hero. Our general point is that the business is very competitive in ordinary circumstances because it is so easy to enter. Let us look at some simple economics.

Table 79

The Cadillac Fairview Corporation Limited
Summary of Residential Sale Projects, 1976

	Total Units in Project	Built or Under Construction	Units Remaining* Feb. 29/76	Extent of Company's Interest in Total Project %
LOW DENSITY				
Toronto Region				
Bayview Place	151	151	98	100
Bowmanville	265	148	143	100
Erin Mills - Brookmede	130	130	6	100
Erin Mills - Wabukayne	118	86	117	100
Erin Mills - Windwood	161	79	157	100
Etobicoke North - Neighborhood I	280	81	280	65
Yonge North - Neighborhood I	761	761	46	50
Yonge North - Neighborhood II	602	193	523	50
Windsor Region				
Little River Acres	503	466	153	67
Ottawa Region				
Barrhaven	73	53	72	100
Kanata	127	127	31	100
Lucerne	200	81	174	100
Pointe Gatineau	72	72	61	100
Sussex House	44	0	44	50
Montreal Region				
Brossard	129	72	84	100
Kirkland	103	49	89	100
Pierrefonds	137	26	136	100

RESIDENTIAL SALE PROJECTS
Continued

Table 79
(Continued)

	Total Units in Project	Built or Under Construction	Units Remaining* Feb. 29/76	Extent of Company's Interest in Total Project %
Florida Region				
Islandia	340	64	310	86
TOTAL LOW DENSITY	4,152	2,639	2,480	
HIGH DENSITY				
Toronto Region				
Avenue Road - Heath Street	52	52	52	70
Erin Mills - Brookmede	347	-	347	100
Erin Mills - Windwood	97	-	97	100
Lambton Square	1,024	768	673	100
Quebec Gothic	193	193	193	50
Victoria Towne	397	254	397	100
Yonge North	260	260	260	50
Montreal Region				
Cote St. Luc	236	-	236	100
Quebec City Region				
Jardins de Coulogne	79	-	79	50
Florida Region				
Sun and Surf	136	136	136	50
TOTAL HIGH DENSITY	2,821	1,663	2,470	
TOTAL UNITS	6,973	4,302	4,950	

* Agreements for the sale of some of these units have been executived but actual sales have not been completed.

A HYPOTHETICAL HOUSE-BUILDER

Assume a builder agrees to buy 100 serviced lots from a developer for $30,000 a lot. The total purchase price is $3,000,000. However, it is standard practice in this industry for builders to buy lots with 15% down payments. Thus the builder requires $450,000 cash. Let us suppose that the builder borrows half the money from a bank. This may seem to other businessmen like applying leverage upon leverage, but it is not uncommon in this industry. Thus the initial equity needed to obtain the land is $225,000. Assume that the builder plans to produce homes that sell for $80,000. Theoretically he can obtain mortgages for a conservative $60,000 or 75% of their value. Assume that the homes are 1,500 square feet each and that total construction costs are $28 per square foot or $42,000, which also includes the indirect costs of financing, marketing, and so on. Thus the builder has spent $30,000 on a lot and $42,000 to build or $72,000. If he does succeed in selling them for $80,000, as we suggested above, the pre-tax profits would be $8,000 a unit or 10% of sales. We mentioned the likelihood of the builder obtaining 75% mortgages on the houses. Assume he was able to finance himself 75% of the cost of construction or $31,500 per unit. The builder would be obliged to find himself the other 25% or $10,500 per unit. Typically he would rely on his suppliers for a good part of this. Assume half was financed in this manner and half from equity. The equity needs for construction would thus be $5,250 per unit or $525,000 in total. Theoretically total equity needs would thus be $750,000 for the entire project.

If the project were successful and did generate pre-tax profit margin of 10%, then total pre-tax profits would be $800,000. Assuming a tax rate of 50%, the return on equity would be 53.3%. If the builder were able to generate 5% pre-tax margins, the return on equity would still be 26.7%.

The conclusion is simple. Home building is generally a very levered business and, although quite competitive, still highly remunerative. Naturally, some builders are much more levered than the one in our example. When things get tough, they simply go bankrupt.

TREND TOWARD LARGER BUILDERS

The Canadian housing industry is slowly becoming more rationalized. If Canada does produce 250,000 housing starts this year, we would estimate that the ten largest builders in Canada would still account for less than 10% of the market (Table 80). Five years ago these same ten builders likely produced about 5,000 units in total, or less than 3% of the then-existing market. Thus a trend toward concentration is evident but from a very small base. (We do not have accurate statistics for privately owned builders. However, we doubt that many are producing more than 1000 units.)

The multi-project builder appears to have very little natural advantage over the smaller builder. The crucial aspect is that all of these ten builders have large land banks: the reason they are able to grow is that they have the land. This trend is unlikely to change. The combination of

Table 80

Top Ten Publicly Owned Builders
Estimate of Housing Sales, 1976

	Est. No. of 1976 Sales	Percentage of Total
Total industry	250,000	1.6
Nu-West Development	4,000	1.6
Genstar	3,500	1.4
Prusac Group*	2,500	1.0
Victoria Wood**	2,000	0.8
Bramalea	1,100	0.4
Cadillac Fairview	1,100	0.6
Campeau	1,100	0.6
Richard Costain	800	0.3
Daon	800	0.3
Consolidated Building	800	0.4
Total	18,500	7.4

* - Partially private

** - 100% owned subsidiary of publicly owned U.S. Company

land position and technical expertise should allow these companies to continue to increase their market share. However, even if the largest ten companies each double their production in the next ten years, they will represent under 20% of the total market.

As said before, being large does not give a building company a natural advantage over a smaller company; it is important to understand that there is no reason to believe that it leads to any diseconomies of scale. Nu-West has grown from a small company to the largest company in the industry. We see no evidence to suggest that it is having problems controlling a business of this magnitude. The crucial part of the equation is that all of these companies have a cushion to fall back on if times get rough: their inherent land profits. Often before they start building they already have a profit in the lands. A merchant builder attempting to build thousands of units would be very vulnerable in our opinion, as has been evidenced by the U.S. experience. We have assumed in our basic assumption that the level of land prices is going to remain high.

In our hypothesis of the economics of a home-builder, we stated that a 10% pre-tax margin was reasonable for a pure housing producer. This was higher than achieved by Cadillac Fairview in fiscal 1976 and one of the reasons is that margins in high-rise condominiums are lower than in low-rise construction whose business is more capital, intensive and generally quite competitive.

CHAPTER 7

THE NEW COMMUNITIES GROUP
ERIN MILLS AND THE LAND DEVELOPMENT QUESTION

The new Communities Group is charged with the task of developing complete urban communities where people live, work, and go to school. In 1976 the Group was in the sixth year of a long-range program to develop Erin Mills on some 8,000 acres in the City of Mississauga, Ontario, just west of Metropolitan Toronto. In addition, it manages on a fee basis a 2,800 acre residential-commercial project called Saga Bay* just south of Miami, Florida. Cadillac Fairview has an option to acquire 50% of the project. Also in 1976 Cadillac Fairview acquired a 50% interest on an 800 acre project called Indian Springs located in Palm Brook County, Florida.

Basically, this particular segment of the company is the old Canadian Equity and Development stripped of its income portfolio. The company reports the financial results of this Group under "Land Sales". The results for fiscal 1975 and 1976 are summarized in Table 81.

While some portion of the corporate overhead must be apportioned to a Group, the number of people and amount of space at head office devoted to it is relatively small in comparison to the house-building side, for example. For present purposes, we believe that this division easily contributed $5 million and $8.5 million to pre-tax profits in each of the past two years.

Table 81

The Cadillac Fairview Corporation Limited
Sales of Land*, 1975 and 1976
(Year end February 28)

	1975		1976
		($000's)	
Land sales	18,640		26,763
Direct costs	12,071		15,361
Gross profits	6,569		11,402
As a percentage of sales	35.2%		42.6%

*The great majority of the revenues and profits shown above are attributable to the company's performance in Erin Mills. However, if land is sold in other divisions, (a natural occurrence for a large diversified real estate company), the results would normally be reflected in the statements presented above.

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* Cadillac Fairview has since withdrawn from Saga Bay.

ERIN MILLS AND MISSISSAUGA

Cadillac Fairview's single biggest land assembly is its ownership of Erin Mills. The "New Town" of Erin Mills is conceded to be the largest single piece of land held by one owner in Mississauga. For convenience, let us say that the parcel of land contains 7,000 acres or roughly 10% of the whole city. The following descriptive background of the City of Mississauga is taken from a November 27, 1975, prospectus of S.B. McLaughlin Associates Limited. This company is believed to be the second largest land owner in Mississauga:

> *The City of Mississauga, an area of 70,634 acres in the Regional Municipality of Peel extending north from Lake Ontario to the Town of Brampton and adjacent to the western boundary of Metropolitan Toronto. The population of Mississauga is currently estimated at 223,000 persons and it is one of the fastest growing urban areas in Canada.*
>
> *Under the Ontario Government's regional development plan, "Design for Development: The Toronto-Centred Region", Mississauga was designated as one of the three future major regional urban centres along the lakeshore urbanised area extending from Hamilton to Oshawa along Lake Ontario....*
>
> *The Province of Ontario has recommended to the various municipalities in the Province that official plans be instituted. Official Plans are to provide a long range framework as to land uses in the municipality. Mississauga is in the process of revising its official plan to meet the changing land use designations of the city. To meet this objective Mississauga retained a team of consultants to provide a major input into the development of the new official plan for Mississauga. The consultant's report was received by city council in March, 1975. The Official Plan Review is now taking place by city council and will involve participation by the public, government agencies, the private development industry and other interested parties. It is expected that a draft of the revised official plan will be prepared for consideration by city council in the spring of 1976.*

The dry text of the prospectus omits some crucial facts. Prior to 1973, Mississauga was run by politicians who believed that growth was good. The citizens seemed in general to appreciate the fact that Mississauga was so fast-growing and apparently destined to have a million people before the year 2000. In 1973, a new anti-development group of politicians was elected, headed by a youthful mayor, Dr. Martin Dobkin. In addition, the creation of the regional government caused great consternation about the future policy toward development. As a matter of interest, the Official Plan is now scheduled to be published later in 1976 in preliminary form.

PORTRAIT OF ERIN MILLS

Table 82 is taken from Cadillac Fairview's 1976 annual report. It indicates that Erin Mills had remaining 5,966 acres of undeveloped land. We described earlier Erin Mills as a 7,000 acre parcel; this refers to the entire size of the development since over 1,000 acres have now been developed. The catalyst for the creation of Erin Mills was summarized in the 1969 prospectus of Canadian Equity and Development:

The Erin Mills Lands comprise a block of about 6,200 acres in the Towns of Mississauga and Oakville. The Erin Mills Lands are to be developed for residential, commercial and industrial uses as an integrated, planned community of more than 125,000 persons. Their accessability by means of three major existing east-west highways and the proposed Highway 403 and their proximinity to both Toronto and Hamilton make the Erin Mills Lands desirable for such a project.

Years of planning and discussions with various levels of government together with extensive negotiations in 1968 have resulted in two events which have significantly advanced the development of Erin Mills Lands.

In March, 1968 the Municipalities of Mississauga, Chinguacousy, Port Credit and Streetsville agreed in principle with the Ontario Water Resources Commission with respect to the production and supply of water and the collection, treatment and disposal of sewage for certain lands (including about 4,300 acres of the Erin Mills Lands) within such Municipalities. The formal agreement between such Municipalities and the Commission was entered into on December 17, 1968. Moreover, the official plan of the neighbouring Town of Oakville recognizes that certain lands within its boundaries (including the balance of the Erin Mills Lands) should be developed in conjunction with the adjacent lands in the Town of Mississauga due to their natural drainage to the Credit Valley.

Don Mills Developments entered into an agreement dated October 24, 1968 with the Town of Mississauga which gives Don Mills Developments approval in principal to proceed with the development of the Erin Mills Lands within the said Town and sets forth in general terms the conditions for development. Further planning must take place and further negotiations at both the provincial and municipal levels of government must be concluded before actual construction on the Erin Mills Lands commences. Such planning and negotiations are being actively pursued by the Company.

Table 82

Erin Mills Summaries, February 29, 1976
(For February 26/76 Annual Report)

Land (Acres)

	Balance Feb.28/75	Changes During the Year: Purchases	Changes During the Year: Registration	Changes During the Year: Sales/ Leases/ Transfers*	Feb.29/76
UNDEVELOPED LAND	6,496	10	396**	144	5,966
LAND UNDER DEVELOPMENT					
Residential					
Single Family	-		160	55	105
Townhouse	24		63	25	62
Apartment	25		-	10	15
Total Residential	49		223	90	182
Industrial and Commercial	264		5	3	266
Institutional	20		16	-	36
TOTAL LAND UNDER DEVELOPMENT	333		244**	93	484

BUSINESS PARKS (to February 29, 1976)

ACREAGE SUMMARY	Total Net Acres Registered	Sold/Leased/ Transferred*	Balance Feb. 29/76
Northern Business Park	287.9	105.2	182.7
Southern Business Park	88.2	40.3	47.9
Auto Centre	40.8	20.7	20.1
Total	416.9	166.2	250.7

BUILDING SUMMARY	Land Sold/Leased/ Transferred	Building Area (square feet) Completed	Planned	Total
Northern Business Park	105.2	1,388,000	90,000	1,478,000
Southern Business Park	40.3	483,139	153,768	636,907
Auto Centre	20.7	79,592	55,880	135,472
Total	166.2	1,950,731	299,648	2,250,379

RESIDENTIAL DEVELOPMENT
(to February 29, 1976)

NEIGHBOURHOOD	Number of Builders	Land Sold/ Transferred* (Housing Units)	Builders' Sales	Occupied
Brookmede	3	1,100	751	747
King's Masting	5	549	549	549
Woodhurst	11	960	722	645
Windwood	8	624	224	144
Wabakayne	4	345	113	71
South Common	1	600	-	-
Pheasant Run	8	368	-	-
Total		4,546	2,359	2,156
HOUSING TYPE				
Single Family		2,696	1,982	1,802
Townhouses		934	307	288
Apartments		916	70	66
Total		4,546	2,359	2,156

Source: Cadillac Fairview, Annual Report, 1976, p.22.
* Includes land transferred to other Cadillac Fairview grcups.
** The 152 acre difference represents dedications to government authorities.

Table 83

Erin Mills
Residential Unit Sales and Transfers, 1971-77

Fiscal Year	Phase	No. of Units Sold - or Transferred	To Cadillac Fairview: Cadillac	To Cadillac Fairview: Fairview (West Credit)	To Cadillac Fairview: Cadillac Fairview	To Others
1971	R.P. 915	546	286	-	-	260
1972	938	549	152	73		324
1973	961	715	140	101	-	474
-	915	74	-	-	-	74
		789	140	101	-	548
1974	-	-	-	-	-	-
1975	915	480*	-	-	480*	-
	961	20	-	-	-	20
	306/307	775	-	-	245	530
		1275	-	-	725	550
1976	986	600	-	-	-	600
	306/307	197	-	-	129	68
	104C	222	-	-	-	222
	107/108	368	-	-	-	368
		1387	-	-	129	1258
1977	306/307	15	-	-	-	15
TOTAL		4561	578	174	854	2955

Source: Cadillac Fairview

*This includes 347 units of mixed multiple variety which could not be marketed expect through close coordination between land developer and builder rationalizing municipal requirements with market conditions. This has not yet been resolved and this land has still not commenced construction.

ERIN MILLS: SHARE OF THE MARKET

From 1971 to February 29, 1976, 4,546 residential units had been produced by Erin Mills, while builders' sales were only 2,359 units (Table 83). Of these units, 1,387 were delivered to builders who are only now getting around to building and selling. Another 347 units were transferred to Cadillac Fairview's residential group in 1975 and are awaiting a decision on how to be marketed. We estimate that outside builders have purchased 65% of the total available supply since 1971.

BIG THREE IN MISSISSAUGA

The three biggest landowners in Mississauga are Cadillac Fairview, S.B. McLaughlin and Markborough Properties. The last company is the developer of Meadowvale, a smaller version of Erin Mills. Our calculations indicate that the Big Three, as they are affectionately called by the local press, own about 12,000 acres in Mississauga. This represents about 17% of the total lands in the City. Assuming that one-third of Mississauga has already been developed, the Big Three own roughly 25% of the potential land for development in the city. It is interesting to compare the number of units sold in Erin Mills to the sales figures for both Mississauga and Metropolitan Toronto, (Table 84).

Table 84

Erin Mills Production as Percentage of the Market, 1971-75

	Total Toronto Housing Completions*	Mississauga Only*	Unit Sales in Erin Mills: Total	As a percentage of: Toronto	As a percentage of: Mississauga
1971 to 1975	168,783	25,890	2,359	1.4	9.1

*Source: CMHC

LAND DEVELOPMENT

THE DEBATE

The high cost of housing in Canada is a major social and political issue across the country. A recent front-page story in the Toronto *Star* was headlined "Why New Metro-Area Homes Cost So Much".* The article discussed the high land prices in Mississauga and summarized some of the standard topics as seen from the viewpoints of the local politicians,

* - Toronto *Star*, June 25, 1976,

the builder and the developer. It is our contention that the same issues and arguments appear all across Canada with the exception of Quebec. The same newspaper stories appear regularly in Vancouver, Calgary, Ottawa, Toronto, and so on; only the names of the suburbs and the politicians have been altered. The issues are almost exactly identical; the charges and counter-charges have a similar ring.

In search of a scapegoat for high land prices, there is no lack of sympathizers for the argument that the developer is the villain. In Canada, James Lorimer has pursued the subject relentlessly. We shall refer to some of his arguments below. A number of politicians have followed suit. The international Housing Conference in Vancouver held in May 1976, took up the same issues except on an international basis. Many accusations were made to the effect that the private enterprise system and private land holdings were responsible for the world's shelter problems. This subject has been debated in a thousand forums for hundreds of years. The only reason for mentioning it is to suggest why many Canadian land developers feel so paranoid and constantly under siege and, as a result, quite sensitive about the magnitude of their profits.

In discussing the basic issues of land development, we find little occasion for original thinking on our part. The Toronto Star story mentioned above has reappeared with slight variations literally every few weeks for the past four years. One of the significant issues of the 1975 Ontario election was the economics of real estate. There have been numerous studies made of all the problems in housing. The industry has presented many briefs, submissions and representations. We find that society does not listen too closely to the arguments of the organized real estate industry. This is unfortunate since the industry has consistently predicted what would happen to land prices, and offered solutions that have been ignored. We have found that developers do not lie: rather, they do not necessarily explain or even understand all of the story. The biggest gap in the documentation as portrayed by the development industry is the paucity of detail on the immense profits earned in land development.* The industry prefers to talk about the heavy risks, which is not an exaggeration, or else their desire to provide needed shelter, which is also true. The industry also discusses the high costs of the inevitable delays in getting land approved. However, the strenuous efforts to downplay the immense rewards have worked against them in some measure. Perfectly legitimate questions have arisen on the subject of whether developers collude at all or whether in the face of accelerating land prices they are really that keen about selling off their land. However, once it is understood that the really significant profits in the industry are made by "developing", then the "conspiracy" theory fades away.

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* - We have stated unequivocally in several sections of this report that the land development side of the housing business offers the most potential for high profits. The statistics on the other public land and housing companies tend to confirm this statement.

Our second criticism concerns some members of the industry who have been painfully slow in recognising that politicians, civil servants and planners (especially at the municipal level) have reasonable justification for their basically anti-development attitude. Few people can honestly claim that they have mastered the "costs versus benefits" side of municipal finance. The conventional belief is that rapid growth is costly to existing tax-payers. One must also agree that it is perfectly understandable that residents of an area want to maintain the status quo.

Who in his right mind wants a high rise in his back yard, or another subdivision in a lovely green field? The developers argue that nobody is looking after the rights of the unborn children, but surely in our society this dilemma should not be surprising.

Our discussion does not attempt to resolve whether it is intellectually honest of local politicians to be anti-development. We leave this problem to others. The important point, in our opinion, is the belief held by anti-development politicians that growth is fiscally bad.

ERIN MILLS AND THE LAND DEVELOPMENT DEBATE

Cadillac Fairview has only one significant land development project underway in Canada and that is Erin Mills. The housing division has a variety of smaller land parcels, but the New Communities Group is pre-occupied with Erin Mills. We believe that the situation in Erin Mills is a prototype of the actual situation in land development throughout Canada. As we mentioned earlier, only the names of the "players" would have to be substituted in order to recount the same tale in North Vancouver, or South Calgary, or West Ottawa.

We have described below a typical series of events in the land development process, a process which characterizes the Mississauga development exactly.

1. Developers over the last twenty years have acquired raw land whether directly from farmers or their successors, or from speculators or other developers. The sources are not important.

2. The developers seek approvals from the local governments to service their lands and either sell the lands to other builders or build houses themselves.

3. The municipality or town is usually in a tight financial position. The prevailing economic concept is that new development constitutes a net financial cost to the existing taxpayers of the entire municipality. The general belief is that the costs of providing schools, parks, transportation, police, firemen, welfare, and so on, outweigh the new taxation that will be generated. The most attractive type of development to the municipality, given the pressure for some development, is expensive housing on large lots, since it is believed that such residents will be less of a financial burden

to the municipality. In addition, the municipality attempts to secure the most leverage out of dealing with the developer. The method of extracting money is called lot levies. These are monies paid by the developer to the region and the municipality every time permission for development is given. When one realizes that the munipality has two basic sources of revenues, the aforementioned levies on developers and property taxes paid by citizen voters, it is not surprising that there is an accelerating trend to raise levies. This is currently a major topic of discussion in both Mississauga and Peel. The developers argue that they cannot afford these new levies, while the politicians argue that either their profits are too high or that the additional costs can be passed on to the consumer.

4. The developers tend to become quite antagonistic privately toward the local politicians and especially toward the local civil servants such as planners. Publicly the majority of developers are more restrained because a client-salesman relationship tends to be formed. We find that the developers' response is actually uncharitable as the politicians are simply reflecting the articulated or unspoken mandate of their constituents. A very important part of the whole equation is the desire of the existing residents to keep out newcomers. Each resident prefers to see land next to them in natural state, as opposed to being crowded with new humanity.

5. Situations such as this one are occurring at the periphery of most major Canadian cities. Meanwhile, there is a relentless cry for new housing coming from household formation and shifts in the population. Typically, the city itself has exhausted all of its vacant land; so the natural trend has been toward the suburban environment.

6. Developers have been able to sell serviced lots quite easily because of the artificial shortage. Lot prices are set by the prices of existing houses which has tended to produce substantial profits to the developers on the limited supply that they have been able to bring to market.

The results of these factors are twofold: high prices for <u>serviced</u> land, and friction between developers and local politicians. The two forces are inevitably self-defeating. The higher prices for serviced land become, the more incentive there is for the developer to see his lands transformed from their natural condition into serviced lots. If land prices were low, this friction would not exist as there would be little incentive for the developers to push forward. Please note that our discussion focuses on the word "serviced" land. All lands do not necessarily rise in price whenever this condition of shortage exists. Today, it is concentrated very heavily on non-speculative holdings. Although there are some observers who believe that all land is inherently speculative, there are in fact significant differences between land that has all the characteristics of being developed, i.e., location, zoning, services, and land that does not. As we suggested earlier, the profit potential in successful land development is very high. To put this into some perspective, we calculate that a successful land development operation is considerably more profitable than almost any other type of real estate development, no matter how the calculation is made. This will be discussed in a subsequent section.

The inevitable conclusion of this process is that the municipality is literally placed in the position of having a small amount of lucrative franchises to give out to a large group of applicants. Each landowner is suddenly eager to have his holdings registered, for it is only in this manner that the profit potential can be realized.

Theoretically, one can draw analogies to other situations where regulators have franchises to hand out, e.g., utilities. These analogies are flawed, however, and most developers would be aghast at even discussing such a topic. The biggest flaw in the analogy is that franchises given to utilities are natural monopoly situations with very little economic risk. Thus the applicants are willing to accept restraints on rates in return for the franchise. The developers would argue that when they purchased their lands originally, there was considerable risk involved. The same logic would be applied to the acquisition of new lands.

> *"Who knew if growth would ever reach this area or that we would ever receive permission to develop? We took this high risk and in return expect to be compensated. You cannot suddenly change the rules of the game on us now."*

This particular developer's argument shows some contradiction. One commentator has astutely noted that "if developers purchased land without assurance that it would receive any development permission, then surely partial permission cannot be viewed as a change in the rules of the game".

One must also realize that not all developers have chosen to speculate in their quest for lands. Many areas have so-called official plans whereby planning and governmental bodies indicate where development is to be encouraged. Developers often have paid quite handsomely for the privilege of purchasing such land because they are certain it represents a guarantee of development rights. If and when a municipality suddenly changes its mind about the course of development, the owners become quite upset about changes in the rules of the game. This is not a hypothetical considera-tion today since it represents the contemporary situation in Mississauga.

Regardless of the quandry of the municipality, there is little to be gained from regulating the price of new serviced lots. Housing prices in the remainder of the market would remain completely unaffected because the supply of existing residential units is so much greater than the new production.

It is worth noting that unbridled free enterprise is not allowed west of Quebec. It is evident to one and all that Canada possesses an abundance of land. But it is society who has decreed that consumers shall be allowed to move into homes only when the physical services are in place. Developers refer to this practice as "gold-plate" servicing. There are many consumers who would gladly give up sidewalks, first class roads, and modern pollution controls in return for cheaper housing.

DO DEVELOPERS HOLD LAND OFF THE MARKET?

We live in a cynical age in which the mythical influence of the CIA turns out to be real, and when corruption and bribery are revealed to be commonplace habits in big business. Therefore, it is not surprising that many people are prepared to accept the hypothesis that a small group of developers control most of the land, and that they have banded together to keep supplies down and prices high. The Weekend Magazine of the Toronto Globe and Mail published a two part article on this topic as recently as June 1976. More currently, Dr. Martin Dobkin, the mayor of Mississauga insinuated that Cadillac Fairview and S.B. McLaughlin were responsible for high land prices because of the Edper-Cemp family relationship.

We are not naive enough to believe that land developers do not include their quota of corrupt participants. However, our research suggests that critics of the industry who claim that developers are somehow keeping land off the market have got their logistics upside down. If corruption does exist, it is rather among those developers who are overly aggressive in their quest to get their lands developed.

Referring to our regulatory analogy, it is difficult even to imagine that all the cable television companies would band together in agreement not to go after the franchise of an attractive new territory. Corruption would more likely occur through one of the prospective applicants bribing a regulator to get the franchise. It is lunacy to suggest otherwise for the simple reason that the cable industry is composed not just of the people currently in the industry, but outside investors as well. The financial requirements are not awesome and the technology is no secret.

We believe that the same argument applies to the development industry. In theory, the Big Three in Mississauga holding 17% of the land might band together and agree not to pursue development of their lands. However, the remaining undeveloped lands in Mississauga are owned by literally hundreds of groups. Each would be only too glad to step into the breach. At present, the Big Three hold a natural advantage in development over the small groups. They have very large holdings, professional staffs and proven skills as well as superior physical locations. It is not surprising that they are generally more successful than the little groups. However, there can be little doubt that if the Big Three ever attempted to stop developing, the world would go on without them. In other words, other developers would supercede them in the expansion cycle.

The basis for the theory that the developers are not really anxious to see their lands developed is hindsight. In retrospect, many lands became more valuable each day that development did not occur. However, it is our observation that the extent of the land boom that occurred in the 1970's surprised most of the industry participants. Naturally, they were optimistic that land prices would rise; otherwise, why were they in the business? But, the magnitudes of the price rises were far larger than general expectations. An interesting example of this phenomenon is the attitude of eastern builders and developers toward western Canada. It is generally conceded that raw and serviced land prices in Alberta have risen much more strongly over the past two years than in Ontario. Two to three years ago, eastern developers had no such expectation, and there was little interest in even contemplating buying land out west. Today, it is something of a fad for the same people to be considering expansion there.

The essential error in the conspiratorial argument is the misunderstanding of how the real estate market works. Let us review some examples.

Most of the big developers in Canada own relatively low-cost acreage. Let us assume for present purposes that each of Cadillac Fairview, Markborough and S.B. McLaughlin originally bought their lands for $10,000 an acre. The costs of holding these lands over the last ten to twenty year period have brought the average total costs up to $20,000 an acre. Meanwhile, let us assume that serviced land in Mississauga is currently worth $150,000 an acre after adding $50,000 worth of servicing. We have good reason to believe that there are today a variety of buyers at these levels. They are primarily small to medium house-builders who own little land themselves, although on many occasions the potential buyers are other large developer-builders. As an example, in Mississauga today, Consolidated Building Corporation, Richard Costain (Canada) Ltd. and Victoria Wood Development Corporation are all buyers of serviced land from either Markborough or Cadillac Fairview. Each of these three builders is a large land developer in other parts of Ontario.

Let us estimate that the total costs of servicing an acre in Mississauga are as stated above, $50,000 an acre. The biggest single component of this cost is roads, with storm sewers being second. Thus, the net value of an acre of land prior to being serviced is theoretically $100,000 an acre. We said earlier that the developer's acreage cost was $20,000 an acre for these lands. In this particular exercise, the actual cost and time frame would not effect the calculations by very much. If the developers had paid a little more per acre, or been obliged to hold the land for a longer period of time, the terminal profitability would not have changed very much. This statement would be altogether different if the absolute price per acre had been much higher. This is another way of saying that interest costs can double in a relatively short period of time under current levels of interest rates. These three companies would be in virtual bankruptcy if their land costs had been anywhere near current price levels.

However, there is an important liquidity gap in the marketplace. Until the land is actually registered and serviced, it cannot be sold for anything approaching its real value. The mass of builder-buyers are not willing to speculate on the lands' being registered. They are interested only in buying land upon which they can immediately start building homes. This means that the developer really has no prospective buyer until the land is registered. Certainly, he can generally obtain more than $20,000 an acre for lands due to become registered in a short time. But, to generate anything at all like the full potential of the lands, they must become registered.

Informed readers will realize that we have constructed a case for more speculators in real estate. Indeed the academic journals on real estate have discussed this topic. Unfortunately, the real estate speculator is such an anathema to society today that the issue receives no serious consideration.

In actual fact, there are some attempts made to fill the gap in the marketplace. Block Brothers of Vancouver describes itself as a land developer in its publications. Essentially, the company steps into this mid-marketplace, between raw land and serviced land. However, Block does this partly because the company also functions as a mortgage broker and real estate agent. The profit contribution of these other two services narrows the risk level. To the best of our knowledge, there is no eastern version of Block.

There are other forces at work to cause the landowner to push for full development. The costs of holding land today are very high. We said earlier that acreage costs in our example are now $20,000 an acre. The owner is obliged to pay interest and taxes on this land each year. Let us estimate these requirements at $2,000 per acre annually. These costs must be applied to the whole land assembly, including those lands that from an optimistic perspective may not be developed for ten to twenty years. Prior to May 6, 1974, these charges could be deducted for federal income tax purposes:

> *Effective May 6, 1974, certain changes in federal income tax law were made that require postponement of the deduction of interest and property taxes allocable to land held as inventory until the land is sold. This change does not affect the reported earnings of the company but has some effect on cash flow by increasing currently payable income tax correspondingly reducing deferred taxes.**

Cadillac Fairview owns 5,966 acres in Mississauga. Assuming annual carrying costs of $2,000 would require cash payments annually of $11.9 million, according to this calculation. These figures are not accurate for

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* - Victoria Wood Development Corporation, p. 13.

Cadillac Fairview; in addition, the company has an immense rental portfolio which could generate this magnitude of cash. However, many developers are in the position of owning too much land for their cash flow. There is little doubt that real pressure is exerted by lending institutions for these developers to sell some of their lands. It is literally impossible to visualize developers in this position not trying their hardest to get their lands registered. One could say that the giant companies are different. Cadillac Fairview does have the rents to support the land holdings. However, this theory fails to take into account the pressures applied by shareholders on these companies to generate increased profits per share.

Other factors that validate the general theory that developers are not holding land off the market are reviewed below.

THE LAND SPECULATION TAX ACT OF ONTARIO

We quote directly from the S.B. McLaughlin prospectus discussed earlier:

> *The Land Speculation Tax Act of Ontario, which came into force as of April 9, 1974, imposes a tax of 20% of the "taxable value" on the disposition of designated land in the province. Taxable value is the amount by which the proceeds of the disposition of designated land exceed the value of the designated land at the time of acquisition or at April 9, 1974, whichever is later.**

In actual fact, the Act itself has played only a small role in business practice during the two years of its existence for the simple reason that April 9, 1974, was the peak of a very speculative boom in Ontario land prices. Prices generally fell sharply after that date until the summer or fall of 1974. Subsequently, prices have risen again to the extent that serviced lot prices are now roughly where they were in April, 1974. Land has definitely become less liquid than before the introduction of the Act.

This sequence of events has meant that anybody selling a piece of land in the last two years, whether or not it was intended for building, could logically claim that the price they received was below the value as of April 9, 1974. However, now that land prices have again reached their April 9 peak, the subject of land speculation is more relevant.

Let us assume that a developer owned some land that had a sale value above both cost and April 9, 1974. The only way to avoid paying the Speculation Tax is to ensure that building occurs on the land within 9 months. The developer no longer has an academic interest in what happens to the land after he has disposed of it: he now has an important material interest.

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* - S.B. McLaughlin Associates.

THE BUILDERS VERSUS THE DEVELOPERS

Our thesis, stated earlier, is that the land development side of an integrated firm is currently the major profit centre. The major developers in Canada fit into the following categories:

1. Some developers do not build at all, e.g., Markborough Properties, Carma Developers, Abbey Glen.

2. Some developers sell some lots to other builders and build on some themselves, e.g., Cadillac Fairview, Sifton Properties, Richard Costain, Victoria Wood.

3. Some developers prefer to build all, or almost all, of the homes themselves on their lands, e.g., Bramalea Corporation, Nu-West Developments, Campeau Corporation.

4. Almost without exception, all of the large builders in Canada are also large land developers.

The majority of the smaller builders in Canada buy all their serviced land requirements from developers, as opposed to developing themselves. It is for this reason that the UDI is a relatively small group compared to HUDAC. The reason most of the builders are not developers is the large capital requirement. The land development process can go on for years, during which interest and taxes must be paid. In the section on house-builders we described the high leverage available in the business. High leverage is also available in land development, but asset turnover is much slower.

One of the basic debates in industry concerns the pros and cons of being an integrated developer-builder. It has not been proven that Markborough and Carma are at a disadvantage to their competitors.

We find some of the transactions in this business between competitors convincing instances of the fact that there is a legitimate shortage of serviced lots. For example, we mentioned earlier that Victoria Wood Development Corporation, Richard Costain (Canada) Ltd. and Consolidated Building Corporation all are active buyers of serviced lots from Meadowvale and Erin Mills. Each of these three companies is a major land developer in its own right.* For example, Costain held 3,582 acres at December 31, 1975; Victoria Wood, 1,117 acres; Consolidated Building, 3,400 acres.

Accordingly, the question to be asked is why these three companies, who are all successful, highly profitable land developers, would pay "retail" prices for serviced land from other developers. The answer is that the three companies are also very large home-builders. They have large staffs and proficiencies in large-scale construction, but unfortunately they also have shortages of current serviced land. Although the three companies are

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* - Promotional brochures issued in Erin Mills and Meadowvale by Cadillac Fairview and Markborough Properties.

large land developers, they are still in the same position as almost everybody else! The quantity of undeveloped land outweighs the current serviced land.

We also noted earlier that, with some exceptions, most of the large land developers are themselves large builders. In this environment, where house-building remains a legitimate profit centre, it seems to us a ludicrous suggestion that any developer would be holding back lots from his own house-building side.

The economics of buying a home in a new area are well known to consumers. New subdivisions generally lack the amenities of build-up areas, such as transportation, schools, churches, and shopping. In addition, the subdivision is still dirty from on-going construction. The only reason to choose a new subdivision over a new house or resale in an older area is its lower price. That escalation in price is well known. Assuming no change in the overall price level, the last home in a subdivision will sell for considerably more than the first one. Obviously, this dictates to the land developer that he complete his community as soon as possible if he wants to get to the advanced stage.

EXCEPTIONS

In our analysis of the industry, we find only two exceptions to the general case:

1. There are some areas of Canada, primarily Quebec, where there is an excess of serviced land. The result is that many developers retain their lands because there are no prospective buyers.

2. Occasionally, a developer will be lucky enough to achieve a very large land registration, let us say, for example, of a size that would permit 3,000 units to be built. As far as the municipality may be concerned, it is perfectly amenable to seeing all 3,000 units built at once. However, the developer may not believe that the area can absorb this many units in one year. Instead, he may consider three years a more appropriate time frame, or an average of 1,000 units annually. In this illustration, it does not matter very much whether the developer was going to build all, some or none of the houses himself. Any prudent businessman does not want to flood the market with more units than it can absorb. Moreover, one cannot ignore the limitations on the capital of a developer.

The example given above is not typical, but it does happen on occasion. The only time it would be harmful to the economy is when the developer has miscalculated and the market is stronger than he earlier thought, or else when the company does not wish to strain its resources in an attempt to build all the units in one year. Thus, it is possible for developers on occasion to hold lots off the market. We believe these sets of factors would occur only rarely and the total amount of units in question would be very small. Also, many municipalities now have a policy of charging levies on the whole registered acreage, an added inducement for quick sales.

INFLATIONARY MENTALITY

Many citizens believe that developers must hold their lands off the market because prices will rise. In fact, we have heard eastern developers make these charges about western developers. We do not believe it to be a legitimate problem, especially in Ontario. Most developers seem to understand that they are on the verge or have already passed the point of pricing themselves out of the market. The 1973 mentality is no longer operative here in Ontario.

As we have stated on several occasions, the large developers are also large house builders. They are acutely aware of the fact that houses have an elastic demand curve. If prices rise, the potential market decreases. Developers are not being hypocritical when they decry the high price of land and houses.

INFLATIONARY EFFECT OF FIFO ACCOUNTING

The problems of the real estate business are very similar to many other capital or inventory intensive businesses. The profit and loss statement claims high profits on the surface but this is partly a reflection of inventory values rising.

Many industries find themselves in the position of generating a high level of reported profits but suffering from an inability to replace their current inventories and plants. The rental property situation is a classic example of this paradox.

There are many industries in Canada wherein the participants have run into serious financial problems as a result of inventory profit-taking and the need to replace inventories at current levels. The land development industry is not as badly off as many other industries because of the high margin potential of successful development. Also, there is still considerable scope for risk-taking in the industry. In former years, the progress of land development included a host of practical possibilities. A developer could buy a piece of land in suburbia and see it ultimately become developed as the city extended its boundaries outward. The crucial decision concerned the general location. Today, although all sorts of vacant lands appear to be in the path of progress, it is likely that they have been designated otherwise: as a greenbelt area; there is an ecology problem; the Official Plan of the region is being changed, or there is a noise problem; and so on. These are the day-to-day problems of development at the present time. The result is that there is an active demand for serviced lots at high prices, a reasonable market for land that appears likely to be developed in five years, and almost a dead market for what might be referred to as speculative holdings.

The implications of the set of conditions described above is that the successful speculator has very substantial potential capital gains which are intended to offset the business risks and the accounting problems.

COMPARISON OF DEVELOPERS AND FARMERS

We stated earlier our opinion that critics of the industry who contend that the industry is conspiring to hold land off the market had their logistics upside down. The industry spends hundreds of hours in meetings of all sorts in order to try to produce more lots. It is not a subterfuge. Industry spokesmen are fond of saying that the best policy for the government is to put large sums of money into the construction of large trunk sewers and flood the market with lots. All developers are in favour of such a policy because typically they have large inventories of lands compared to their current production. Each participant in the industry is prepared to accept lower dollar prices in return for more unit volume. It is a paradox that if the industry's advice were accepted, the price of land would fall sharply, but it would be impossible for each participant to market all of its production. The market for land is finite even at lower prices. In such an environment, many producers would go bankrupt.

An appropriate analogy is that of farmers; each formerly had an incentive to produce more of a given crop. Prior to the government's introduction of marketing boards and the like nobody ever seriously charged that farmers were hypocritical about trying to produce more crops. It was taken as a matter of fact that the farmer was not getting up at 6:00 a.m. in order to impress some outsider. We maintain that the same situation is applicable to development. Consultants, planners and management spend thousands of hours trying to work through the labyrinth of the development process. It is too expensive to be a facade.

ECONOMICS OF LAND DEVELOPMENT

OVERVIEW

Throughout this report we have referred to the high profits and high returns available in land development. We do not intend to withdraw those remarks, but feel that certain qualifications need to be added:

1. The profits earned in land development are high at the time that they are earned. However, in part this must compensate for the fact that by the very nature of the operation, no profits at all will be earned for some years.

2. Even after allowing for the non-profitable years, the returns on equity in land development are high. A good portion of this must be attributed to the leverage inherent in the business. Land is typically paid for by mortgages, on top of which developers often add bank or debenture financing. Without this leverage, the returns in successful land development operations would not seem extraordinary.

3. Some valid analogies can be drawn between the oil exploration and the land development businesses. On the surface, if an oil company makes an attractive strike, the profit potential appears very high when measured against the capital invested in the one project. However, when it is compared to the capital invested in all of the exploration activities and all of the dry holes that will surely come about, the profits no longer appear as high. The same logic applies in land development.

   The profits are very high on individual projects. However, it is extremely hazardous to try to be in the land development business with only one holding. A variety of parcels is necessary to be sure of getting one project begun. Similarly, if it is at all possible, the holdings in any one assembly should be very large to compensate for something going wrong with one aspect of the assembly.

A TYPICAL EXAMPLE

The reminder that there is no such thing as a "typical situation" is even more relevant when it comes to land development. With this caveat in mind, let us assume that a developer acquired five different parcels of land from 1960 to 1970, and that the vendors took back mortgages on each of the properties.

Table 85

Hypothetical Land Developer
Land Purchases, 1960-70

500 acres at $1,000 an acre	$ 500,000
500 acres at 5,000 an acre	2,500,000
500 acres at 10,000 an acre	5,000,000
500 acres at 15,000 an acre	7,500,000
500 acres at 25,000 an acre	12,500,000
Total of 2,500 acres at $11,200 per acre	$28,000,000

The average cost per acre of the land would be $11,200. Let us assume that up to 1970, the average cost figures include all carrying charges. Assume also that the company was financed by 20% equity and 80% debt. The balance sheet at January 1, 1970, might appear as in Table 86.

Table 86

Hypothetical Land Developer
Balance Sheet, January 1, 1970

Assets	
Land	$28,000,000
Liabilities and Shareholders' Equity	
Long-term liabilities	$22,400,000
Shareholders' equity	5,600,000
Total Liabilities and Shareholders' Equity	$28,000,000

Let us assume that the debt carries an average interest rate of 8%. Thus interest charges alone are $1,792,000 annually. We also assume that principal repayments are $200,000 annually, that property taxes are $300,000 annually and that the operating costs of running the operation, including paying lawyers and consultants, amount to another $500,000 annually. The total cash overhead annually is thus $2,792,000. Land produces no revenues until it is sold, and it is this cash shortfall that helps to explain why it is difficult to suddenly become a large land developer.

One could argue that it is unnecessary to hold so much land, but, as we have said, we believe the situation in land development is analoguous to drilling for oil, a hit or miss proposition. The successful large companies are always looking for oil in more than one locality. This strategy is similar to the need for large land assemblies in one particular geographic region. Erin Mills, for example, although commonly described as one assembly, can also be thought of as a group of smaller assemblies, some located in south Mississauga, north Mississauga, and in the former town of Streetsville. Therefore if something goes wrong in one area, there are alternatives. In actuality, something is always going wrong. Several instances are: the Parkway Belt eliminated several hundred acres from future development; the trunk sewers were not connected in another area; in a third area there was an argument with the conservationist. A builder has a reasonable chance of success with only one project, but a developer must accumulate land inventories far in excess of what may be really hoped for.

Referring back to our hypothetical developer, let us assume that he has a good credit rating,from either other real estate sources or outside interests, so that lenders will provide him with the necessary cash shortfalls. Let us assume that no development occurred until after 1972. The new balance sheet is shown in Table 87.

Table 87

Hypothetical Land Developer
Balance Sheet, January 1, 1973

Assets	
Cost of land held for development	$28,000,000
Carrying charges	3,500,000
Total assets	$31,500,000
Liabilities and Shareholder' Equity	
Bank loans	$ 4,000,000
Long-term debt	21,800,000
Shareholders' equity	5,600,000
Total Liabilities and Shareholders' Equity	$31,500,000

Under standard real estate accounting practices, all the costs would be capitalized. The average cost per acre of land would now stand at $12,600.

Let us imagine the following situation. In 1973, permission was obtained to develop 5% of the land or 125 acres. The developer was obliged to contribute 25 acres to parks and roads and so on. He had 100 net acres to sell to builders. He was able to product four units per acre, or 400 units, which were sold to builders for $25,000 a unit. The servicing costs including levies were $9,000 per unit. The profit and loss statement for 1973 appears in Table 88.

Table 88

Hypothetical Land Developer
Net Profits, 1973
($000's)

Gross revenues		$10,000
Direct costs - services	$3,600	
land	1,570	5,170
Gross profits		$ 4,830
Income taxes		2,415
Net profits		$ 2,425
As a percentage of equity		43.1%

This appears to be a very successful operation considering the reported profit margins and the return on equity. However, it is the leverage in the operation that actually makes it so attractive. If in our original example, we have conceived of a company with an original all equity capitalization, the pro-forma numbers would change considerably (Table 89). We have ignored throughout our calculations in this report internal discounted rates of return as the information is simply not available to us.

Table 89

Hypothetical Land Developer
With No Original Debt
Balance Sheet, January 1, 1970, and 1973

	Jan. 1, 1970	Jan. 1, 1973
	($000's)	
Assets		
Land under development - cost	28,000	28,000
Carrying charges	-	1,600
Total Assets	28,000	29,600
Liabilities and Shareholders' Equity		
Bank Loans	-	1,600
Shareholders' Equity	28,000,000	28,000
Total	28,000,000	29,600

For present purposes we have chosen to ignore corporate general and administrative expenses as well as sales commissions in our calculations. They would tend to make only a small reduction in our returns.

The cost of land would be $12,160 per acre. The profit and loss return on equity would drop to 8.7% (Table 90).

COMMENT ON NATURE OF LAND DEVELOPMENT PROFITS

At this juncture we should summarize and perhaps clarify some thoughts about profitability in land development. There can be no doubt that the absolute level of profits in the development industry has inclined sharply over the past five years. The author has made this statement quite openly and disagrees with the statements of the industry spokesmen who fail to acknowledge the high profit level.

Table 90

Hypothetical Land Developer
With No Original Debt
Net Profits, 1973

			($000's)
Gross revenues			$10,000
Direct costs - services		$3,600	
	land	1,520	5,120
Gross profits			4,880
Income taxes			2,440
Net profits			$ 2,440
As a percentage of equity			8.7%

It is the leverage that accounts for the high profitability.

As far as the public companies are concerned, the absolute levels of profits obtained in the 1970's dwarfed earlier periods to the extent that calculations are meaningless. By virtue of hindsight, some of those years were so bountiful that almost anyone in the business could make money. However, we would argue that previous and subsequent to the 1972-1974 period this was not true. Heavy losses have also been sustained in the business.

It must also be noted that profitability in any one year reflects the success of past years. Land values only appear on the books of a company when the transaction is incurred even though the values might have appreciated earlier. It is also true that the nature of the accounting process and the high interest leverage factor both serve to bring the true level of profitability back into line. It is unfortunate that the information does not exist to compile data more comprehensive than our tables shown above.

Our statistics on return on assets suggest that the land development industry is more profitable, than the housing side. However, we know of no measurement tool that can serve to adjust for the risk interest in the business. We believe that industry centres are unrealistic because they fail to recognize that land development by definition is a high risk business since so much lead time is required. The proof of this statement lies in the heavy land investments owned by the major companies. Common sense dictates the realization that public companies would not have hindered themselves with such high carrying charges on so many different pieces of land if they did not fear that something could go wrong with the outlook for any one piece of land.

CHAPTER 8

DIVERSIFICATION AND THE CORPORATE DEVELOPMENT GROUP

UNITED STATES INTERESTS

The mandate of the Corporate Development Group was stated in the 1975 annual report as follows:

> *In recognition that a great deal of the success of Cadillac Fairview as a large diverse real estate company is its ability to respond to opportunities, The Corporate Development Group was formed.*
>
> *The Corporate Development Group seeks to broaden and diversify the company's operations, both geographically and into new areas of real estate endeavour. The responsibility for adding to the growth of Cadillac Fairview through the acquisition of other real estate companies and income producing properties also rests with the Group.*
>
> *One of the first priorities of The Corporate Development Group was the formation of an industrial division to enable Cadillac Fairview to expand in this important sphere of activity.*
>
> *The Industrial Division is presently planning a program of several projects in the Metropolitan Toronto area and will initially build multiple occupancy buildings, with land also available for buildings tailored to clients' specifications. A major focus of the division's activities will be in Erin Mills where the company has substantial industrial land holdings. The division, which intends to expand its activities to other areas of Ontario, into Quebec and ultimately from site acquisition through planning, design, construction and leasing.*
>
> *The Corporate Development Group also has the responsibility for overseeing the company's interest in Continuous Colour Coat Limited, a metal processing company in which Cadillac Fairview holds a 50 percent interest.*
>
> *The Corporate Development Group is presently exploring several major proposals which could add to the growth of the company.**

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* - Cadillac Fairview, Annual Report, 1975, p. 18.

The last paragraph is crucial since it is our impression that the Corporate Development Group has been given the responsibility to increase the company's position in the U.S. market. The arrangements for the project were apparently left open. It does not take too much imagination to understand that there are severe organizational limitations on the longterm duration of such an entity as the Corporate Development Group. For example, it would be only logical to assume that if an acquisition were made in the office building area, the Urban Development Group would be destined to manage it. Another possibility is a semi-autonomous U.S. operation such as Cadillac Fairview U.S.

We mentioned earlier that the New Communities group is managing a 2,800-acre land development project in Florida. The Residential Group is responsible for the company's small housing operation in the United States, which it also located in Florida. The company is also approaching shopping centres in the United States via a joint venture agreement with a prominent United States developer; he owns 25% of the United States company and Cadillac Fairview owns 75%. Cadillac Fairview's U.S. shopping centre program apparently has several projects under active study, including a major urban renewal project in White Plains, U.Y. Nothing, however, has as yet been announced.*

Given this background, it is interesting that the company's first large acquisition of property in the United States was in industrial real estate. The company acquired approximately $89 million of industrial properties and land from Cabot, Cabot & Forbes Co. in 1976.

There is a current fad among large Canadian developers to expand into the United States. It has been caused by the following:

1. Frustration of some developers with the extent of government involvement in our economy.

2. Desire to participate in the revival of U.S. real estate industry after the recent "bloodbath".

3. Some foreign-controlled Canadian real estate companies find themselves unable to enter large new projects because of restrictive federal and provincial legislation.

4. Canadian real estate companies, such as Cadillac Fairview and Oxford and, to a lesser degree, Trizec, are among the leaders in all of North America among real estate companies. U.S. space users and financial institutions are quite eager to deal with reputable, financially strong developers, and the Canadian companies are near the top of the list.

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* - In May, 1977 the Company made its first announcement on the subject of developing U.S. shopping centres. Approximately three are now under way and others are in the development stage.

5. Large Canadian real estate companies specializing in large projects find that the Canadian market is too small for them. In order to continue to grow rapidly, it becomes necessary to go into the United States.

We believe that the last factor exerted the most influence on Cadillac Fairview's decision to go south of the border, rather than the fad element mentioned above. It should be noted that the concept of a Corporate Development Group was decided upon over two years ago, while there was still a boom in Canadian real estate. Aside from pursuing such product diversification alternatives as industrial property and hotels, it was always clear that the Corporate Development Group was intended to emphasize the United States.

The U.S. investment could grow dramatically or slowly, depending upon the situation. In this vein, it would be similar to the aborted decision to acquire Abbey Glen. It was not in the game plan but suddenly materialized. Thus, if a large U.S. real estate company became available, we are convinced that the corporation would be prepared to buy it. Conversely, it apparently will not extend itself for the purpose of doing a deal. Prior to Oxford's acquisition of Cambridge, we understand that Cadillac Fairview negotiated with the management of Cambridge. We suspect that the price was too "rich". Similarly, Cadillac Fairview's management spent thousands of hours studying the operations of Abbey Glen. Nevertheless, when Genstar came along with a competitive offer, Cadillac Fairview decided not to make a counter bid.

Our conclusion is that real estate remains a pragmatic business; the company may suddenly find itself with a huge foreign business one day, or it may not.*

OTHER FOREIGN INTERESTS

<u>BRAZIL</u>

In 1975 a preliminary announcement was made concerning a joint real estate venture between Brascan and Cadillac Fairview. A final arrangement has not been concluded, but we understand that negotiations are continuing. We believe that the management of Cadillac Fairview maintains a positive outlook for real estate in Brazil but that a careful selection of the people to head the division is essential.

<u>CEMP OVERSEAS</u>

In the late summer of 1973, Cemp Investments, which at that time owned approximately 70% of The Fairview Corporation, created a United Kingdom real estate company. The purpose of the company was apparently

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* - See Appendix H re: Irvine Co.

to acquire and develop real estate in the U.K. and Europe. The company was 100% owned by Cemp. The original President, who has retained the position, was Mr. Phillip White, former Dean of the Faculty of Commerce and Business Administration at the University of British Columbia. It is believed that Fairview Corporation was given a longterm option to acquire Cemp's interest at cost. Shortly afterwards, the merger intentions of Cadillac Fairview and Canadian Equity and Development were made public. Also around this time, the property market in the United Kingdom collapsed. As a result, there has been very little publicity about the U.K. operation over the past three years and we understand that Cadillac Fairview has dropped its option.

INDUSTRIAL RENTALS

Cadillac Fairview generated approximately $1.1 million in industrial rents in fiscal 1976, compared to $1.0 million in 1975 (Table 91). The company is presently managing 1.1 million square feet of total space, including 804,000 square feet in one buiding leased to Chrysler in Erin Mills.

Table 91

The Cadillac Fairview Corporation Limited
Industrial Rentals: Summary of
Cash Flow, 1975 and 1976
(Year end February 28)

	1975	1976
	($000's)	
Gross rentals	1,000	1,100
Less: operating expenses*	100	100
Rental operating profits	900	1,000
Less: interest & allocated G & A	628	686
Contribution to rental cash flow	272	314
Reported cash flow total company	34,442	40,827
Percentage industrial rentals	0.8%	0.8%

* - Company nets out all expenses paid directly by the tenant.

We suspect that it is unnecessary to document that the company is not a statistical factor in the industry. For example, A.E. LePage maintains that in Toronto 21.7 million square feet of space is currently available for sale or rent. This is not the inventory of occupied space but only the unrented space. A further indication of the size of the market was presented in Table 30 (page 65). Table 92, which lists the portfolio of the Industrial Division of the Corporate Development Group, completes our profile of the company's rental activities.

ECONOMICS OF INDUSTRIAL REAL ESTATE

This will be a brief review since Cadillac Fairview's share of the market is so undeniably small.

The industry is actually divided into two completely separate markets. One is the speculative multiple-unit market and the other is the "package plant deals" (pre-arranged custom built industrial plants for sale or lease). The multiple market is one of the easiest businesses to enter. All that one need do is obtain a piece of land zoned industrial, have the space constructed, subdivide the space into mini-factories, and wait for the tenants. Many hundreds of would-be developers did this in the 1970's; consequently, a hugh glut of space exists today. The package or custom market is entirely different, as the developer makes a deal prior to building and must theoretically demonstrate technical prowess. In this kind of business, one is more likely to be dealing in larger projects with more sophisticated clients. The multiple market, though, can produce higher returns because, when space is tight, the smaller tenants are obliged to pay higher rents; but, in the package market, one has a lower potential return obtained in return for safety.

In the industrial business, land availability is a key consideration. One must have the location that the tenants want, obviously. The bigger custom deals naturally require much larger pieces of acreage, and this tends to give the larger landowners a competitive advantage. However, there are always enough operative large landowners giving the tenants a strong bargaining position. Typically, in this business, new large deals are won or lost by fractions of cents. For example, a larger user may want a new 500,000 square foot warehouse. He may let it be known to one and all that he is interested in such a facility, and in a specific location, say the western extremities of Metropolitan Toronto. There would probably be well under ten developers who own or have access to serviced land of this magnitude, including Cadillac Fairview in Erin Mills, S.B. McLaughlin, Markborough Properties, Bramalea Corporation and Orlando Corporation. To win the deal, the developer must offer the best possible contract including a reasonable price.

Table 92

The Cadillac Fairview Corporation Limited
Portfolio of the Industrial Division,
Corporate Development Group, 1976

		Year Opened	Site Acreage	Net Rentable Building Area	Extent of Company's Interest (Percent)
Completed					
Chrysler Canada Ltd. Erin Mills, Ontario	National Parts Depot	1972	58.0	804,000	100
The Dunwin, Erin Mills, Ont.	Industrial Mall	1972	2.0	19,000	100
Millrace Court, Erin Mills	Industrial Mall	1974	8.0	129,000	100
Erin Mills Auto Center Erin Mills, Ontario	Auto Service Mall	1975	2.5	38,000	100
Cushman Industrial Mall St. Catharines, Ontario	Industrial Mall	1975	2.0	39,000	100
Millen Industrial Mall Stoney Creek, Ontario	Industrial Mall	1975	2.5	43,000	100
				1,071,000	
Under Construction					
Albion Way, Etobicoke, Ont.	Industrial Mall	1976	7.0	118,000	100
Merivale Industrial Complex I Ottawa, Ontario	Industrial Mall	1976	4.2	74,000	100
Auto Campus, Waterloo, Ont.*	Auto Service Mall	1976	0.5	7,800	100
				199,000	
Serviced, Zoned Industrial Lands					
Erin Mills South Industrial Park			11.1		
Erin Mills North Industrial Park			185.198		
St. Catharines, Ontario			8.0		
Stoney Creek, Ontario			2.5		
Etobicoke, Ontario			4.0		

*Sold

CHAPTER 9

A COMPARISON OF CADILLAC FAIRVIEW WITH OTHER PUBLIC REAL ESTATE COMPANIES

In this chapter we compare the performance and some of the financial practices of Cadillac Fairview with those of other public real estate companies, noting as we go the share of the various sectors of the market they control. Our principal focus is the relative profitability of rentals as compared with housing and land sales. As well, we discuss the use of leverage in the industry.

In Table 27 (page 58) we presented a brief summary of 35 public real estate companies on an aggregate basis. We calculated that these companies had total assets of $6.7 billion with total gross revenues of $1.8 billion. In the following tables, we look a little closer into these statistics and make some subsequent calculations of where the profits are earned.

SUMMARY OF GROSS REVENUES

Table 93 presents a summary of gross revenues for the 35 public real estate companies broken down into their principal components. Table 94 compares these with Cadillac Fairview's gross revenues. From this data can be seen that Cadillac Fairview is not especially dominant in housing and land but is significant in terms of rents. Let us explore the latter area first.

RENTAL PROPERTY REVIEW

Of the 35 companies listed in Table 93 only four had no rental income at all. We were able to obtain reasonable operating numbers for 23 of the remaining 31 companies. Table 95 presents data on these 23 companies, who represent gross rentals of $505.6 million, or 91% of total.

Table 93

35 Public Real Estate Companies
Summary of Gross Revenues, 1975
($000's)

	Sales of Land	Sales of Houses	Sales of Land & Houses	Gross Rents	Hotel Gross Revenues	Other	Total Gross Revenues
Cadillac Fairview	26,763	46,130	72,893	122,898	-	4,605	200,396
Trizec	-	-	-	117,200	17,700	35,427	170,327
Campeau	4,929	51,573	56,502	50,537	6,459	26,471	139,969
Oxford	-	-	-	40,987	-	4,924	45,911
Abbey Glen	53,378	-	53,378	22,789	-	31,580	107,747
Bramalea	n/a	n/a	46,433	14,479	-	5,427	66,339
S.B. McLaughlin	n/a	n/a	31,182	10,081	-	19,828	61,091
Nu-West*	17,028	117,820	134,848	2,750	-	5,801	143,399
M.E.P.C.	-	-	-	22,952	-	695	23,647
Markborough	16,925	-	16,925	7,741	-	1,851	26,519
Orlando	1,123	-	1,123	11,679	-	15,964	28,766
Consolidated Building	n/a	n/a	27,978	3,047	-	1,256	32,281
Revenue Properties	n/a	n/a	4,726	11,291	-	5,462	21,479
Carma	37,390	-	37,390	-	-	2,097	39,487
Y & R	1,073	-	1,073	13,794	-	7,931	22,698
Alliance	n/a	n/a	30,103	2,890	-	1,209	34,262
Sifton	n/a	n/a	20,275	8,572	-	-	28,847
Richard Costain	6,865	28,713	35,578	2,069	-	689	38,336
Monarch	n/a	n/a	21,065	5,228	-	671	26,964
Melcor	8,667	10,764	19,431**	1,986	-	15,896	37,313
Four Seasons Hotels	n/a	n/a	621	-	29,257	1,290	31,168
Block Brothers	n/a	n/a	32,946	8,496	-	48,192	89,634
Douglas Leaseholds	-	-	-	1,326	-	47	1,373
Halifax	-	-	-	8,154	-	-	8,154
Major Holdings	8,349	2,440	10,789	818	-	561	12,168
Sub-Total							

TABLE 93 CONTINUED

Allarco	n/a	n/a	9,387	3,612	1,000	48,594	62,593
Abacus Cities	6,821	9,669	16,491	570	-	154	17,215
Skyline	-	-	-	-	32,782	-	32,782
Daon	35,729	32,800	68,529	10,073	-	24,337	102,939
Headway	n/a	n/a	27,631	3,924	2,902	30,628	65,085
Corporate Properties	n/a	n/a	8,290	4,027	-	952	13,269
Deltan***	n/a	n/a	27,795	31,119	-	8,858	67,772
Imperial General	-	-	-	5,854	-	483	6,337
Cmwlth Holiday Inns	-	-	-	-	119,897	798	120,695
Sobey Leased Props.	-	-	-	2,000E	-	809E	2,809
Totals	225,040	299,909	813,382	552,943	209,997	353,387	1,929,709+

Fiscal year ends are set out in Table 27.

* Nu-West owns approximately 48% of the outstanding shares of Carma but this does not affect calculation.

** Company reports only its equity in the earnings of its real estate affiliates.

*** Deltan owns indirectly 52% of the shares of Y & R Properties Ltd. and 74% of Imperial General Properties Ltd. The results of these two companies are consolidated. We calculate that Deltan's total assets would be $230.2 million excluding the investment in these two companies.

n/a - not available.

E - estimate.

METHODOLOGY

Table 95 examines the industry in terms of six numbers and two ratios. The terms are discussed below.

Gross rental income was disclosed by all the companies.

Operating expenses was disclosed separately by most of the companies and can be computed for most of the remainder.

Free and clear return represents gross rentals less property operating expenses. There are some minor inconsistencies in the industry in terms of how much corporate general expenses are charged directly to rentals or segregated elsewhere in the operating statement.

Table 94

The Cadillac Fairview Corporation Limited
Comparison with Aggregate Industry Results, 1975

	35 Public Companies ($000's)	Cadillac Fairview ($000's)	Percentage
Sales of land and houses	813,382	72,893	9.0
Gross rentals	552,943	122,898	22.2
Hotel gross revenues	209,997	-	-
Other	353,387	4,605	1.3
Total	1,929,709	200,396	10.4

Interest expense. The industry is divided roughly in two: those companies who allocate interest to the rental account; those who provide an all-inclusive number. For those companies where it is not allocated, we have made our own estimates.

Cash flow from rents is the free and clear return less the interest. It might also be described as operating profits. The true net cash flow would subtract principal repayments as well, but this number is not usually available.

Average net income properties is the mean arithmetic average of the book investment in rental properties for the last two years. Depreciation is a small amount for most public companies.

Free and clear return as percentage of average net properties indicates the profitability of the portfolio before financing.

Cash flow as percentage of average net properties. Financing is an integral part of the real estate decision-making process. In our opinion, this is the single most important ratio we can calculate.

WHY NOT MARGINS OR RETURN ON EQUITY?

Ordinarily financial analysts look at companies in terms of margins as a percentage of gross revenue. We cannot do this for rentals for three reasons:

1. As noted earlier, some companies include some of the rechargeable expenses in gross revenues and operating expenses while other companies net them out.

2. Each company with rental properties tends to have a different mix. The "typical" margins in each of the major categories of income property real estate tend to be different.

3. It is impossible to obtain the equity investment allocated between income properties and other activities. Similarly the returns on equity are quite different in housing and land development as opposed to rental. The higher risks of land are compensated by the higher available returns.

SIGNIFICANCE OF OUR SAMPLE

There is nothing magical about our 35 Company sample. There are another four or five smaller public companies that could possibly have been included but they would not have affected our discussion at all.

Table 95

Comparative Income Property Returns
23 Public Companies, 1975
($000's)

	Gross Rentals	Operating Expenses	Free and Clear Return	Interest	Cash Flow from Income Properties*	Average Net Income Properties		
						Amount	Percentage Free and Clear Return	Percentage Cash Flow
Cadillac Fairview	122,898	54,261	68,637	34,409	34,228	572,024	12.0	6.0
Trizec	117,200	52,800	64,400	42,400	22,000	590,000	10.9	2.0
Campeau	50,537	23,120	27,417	14,000	13,417	232,705	9.6	5.8
Oxford	40,987	10,908	30,079	21,543	8,536	238,885	12.6	3.6
MEPC	22,952	8,655	14,297	8,757	5,540	143,988	9.9	3.8
Abbey Glen	22,789	11,440	11,349	10,223	1,126	142,865	7.9	0.8
Bramalea	14,479	7,200	7,279	5,845	1,434	59,000	12.3	2.4
Y & R	13,794	6,759	7,035	3,086	3,949	62,967	11.2	6.3
Orlando	11,679	1,614	10,065	5,982	4,083	76,325	13.2	5.4
Revenue	11,291	7,207	4,084	3,000	1,084	35,504	11.5	3.1
S.B. McLaughlin	10,081	3,110	6,971	5,813	1,158	51,675	13.5	2.2
Daon	10,073	4,155	5,918	5,500	418	57,375	10.3	0.7
Sifton	8,572	3,158	5,414	3,605	1,809	43,265	12.5	4.2
Block Brothers	8,496	3,134	5,362	3,000	2,362	52,234	10.3	4.5
Halifax	8,154	4,759	3,395	2,420	975	35,732	9.5	2.7
Markborough	7,741	3,333	4,408	2,376	2,032	41,398	10.7	4.9
Imperial General	5,854	1,620	4,234	2,342	1,892	40,315	10.5	4.7
Monarch	5,228	2,273	2,955	1,200	1,755	21,033	14.1	8.3
Consolidated Building	3,047	2,146	901	1,100	(199)	15,741	5.9	neg
Alliance	2,890	538	2,352	3,300	(52)	25,795	9.1	0.2
Nu-West	2,750	1,200	1,550	1,200	350	13,381	9.0	2.6
Richard Costain	2,069	1,292	777	1,082	305)	14,101	5.5	neg
Melcor	1,986	857	1,129	836	293	9,965	11.3	2.9
Totals	505,547	215,539	290,008	182,019	107,989	2,577,133	11.3	4.2

* Before allocation of corporate, general and administrative expenses.

GROSS RENTALS: CADILLAC FAIRVIEW AND THE INDUSTRY

Table 96

Income Property Returns
Cadillac Fairview Compared to 22 Public Companies, 1975

($000's)

	23 Companies (1)	22 Companies (ex Cadillac Fairview) (2)	Cadillac Fairview Amount	Cadillac Fairview As a percentage of (1)	Cadillac Fairview As a percentage of (2)
Gross rents	505,547	382,649	122,989	24.3	32.1
Less: property operating expense	215,539	161,278	54,261	25.2	33.6
Free and clear return	290,008	221,371	68,637	23.7	31.0
Less:interest	182,019	147,610	34,409	18.9	23.3
Cash flow from rents	107,989	73,761	34,228	31.7	46.4
Average net income properties	2,577,133	2,005,109	572,024	22.2	28.5
Percentage free and clear return	11.3	11.0	12.0	106.2	109.1
Percentage cash flow	4.2	3.7	6.0	142.9	162.2

Cadillac Fairview is a significant company among the public companies with slightly above-average returns (Table 96). However, it is far from being the leader in terms of returns. There were five companies with higher free and clear ratios and four with higher cash flow yields (Table 95).

Hypothetically one should be able to compare the rates of return of the companies with their actual rental activities; unfortunately this is not feasible. The practical problem is that in real estate the general rule applies that the older the property, the higher the current return today. Thus an older portfolio of apartment buildings might generate satisfactory returns despite the fact that new projects have profitability.

Similarly, companies that have very youthful portfolios tend to produce inferior results as we calculate them. Despite these caveats we believe that the data still support our thesis: shopping centres offer the highest returns and apartments the lowest.

A list of the five most profitable companies, in terms of cash flow as a percentage of "average net income properties", is given in Table 97, that of the five least profitable companies in Table 98.

Of the first five companies, four are very active in shopping centres with Y & R being the exception. We note that Oxford has a below-average rate of return (Table 95). However, this reflects the fact that Oxford acquired Cambridge in 1975 for cash and paid a $40 million premium over book value. If Cambridge had been included by itself, its return would have been close to the highest.

Two of the least profitable companies had residential apartments as the mainstream of their portfolios: apartments were also important parts of Daon and Abbey Glen. Three of them had no shopping centres at all.

Table 97

Most Profitable Public Companies in Rentals, 1975

Company	Cash Flow as a Percentage of Average Net Income Properties
Monarch Investments	8.3%
Y & R Properties	6.3%
Campeau Corporation	5.8%
Orlando Corporation	5.4%
Cadillac Fairview	6.0%

Table 98

Least Profitable Public Companies in Rentals, 1975

Company	Cash Flow as a Percentage of Average Net Income Properties
Costain	neg.
Consolidated Building	neg.
Alliance	0.2
Daon	0.7
Abbey Glen	0.8

PHYSICAL COMPARISON OF RENTAL PORTFOLIOS

Ideally, one would like to determine the profitability of each of the various companies by sector. Unfortunately, the detailed breakdowns that we have been able to provide on Cadillac Fairview cannot be duplicated on the other companies as the data is not available. The companies in many cases are quite secretive about many aspects of their rental portfolios. We have, however, been able to quantify the data on the physical aspects of their portfolios as opposed to the financial. They are presented in Tables 99 - 102. On this data we can make the following comments:

Office buildings. We calculated earlier that Canada has a minimum of 150 million square feet of office space. The 17 companies listed in Table 99 are involved in less than 27% of this total.

Shopping centres. The 14 leading publicly-owned companies are involved with 42 million square feet of space (Table 100). We stated earlier that shopping centres in total represent over 150 million square feet of space out of a total retailing space of over 400 million square feet. The leading companies thus account for less than 28% of the total shopping centre space.

Residential apartments. We stated that Canada has over one million residential units. The 18 leading publicly-owned companies account for less than 4% of the residential market (Table 101).

Industrial space. Industrial space is by far the most fragmented as the overall market is measured in the hundreds and hundreds of millions of square feet. The leading publicly-owned companies possess just under 1% of the market (Table 102).

Table 99

Leading Public Office-Building Companies, 1975
(000's of rentable sq. ft.)

Company	Total size of project	Company equity in project
Trizec	14,414	12,653
Cadillac Fairview	8,197	4,787
Oxford	3,748	2,793
Campeau	3,063	2,837
Y & R	2,266	2,166
M.E.P.C.	3,000	3,000
Halifax	1,300	900
Abbey Glen	1,584	1,337
Daon	804	804
Markborough	480	480
Revenue	457	457
S. B. McLaughlin	350	350
Block Brothers	306	306
Monarch	375	375
Orlando	217	217
Sifton	207	173
Melcor	124	124
Total	40,892	33,379

Table 100

Leading Public Shopping Centre Companies, 1975
(000's of sq. ft.)

Company	Total size of Project	Net Rentable to Company
Cadillac Fairview	11,975	7,367
Oxford	7,457	5,298
Bramalea	5,259	4,759
Campeau	4,016	3,855
Trizec	4,367	3,218
Orlando	2,079	1,979
M.E.P.C.	2,000	1,800
Abbey Glen	2,237	1,694
S. B. McLaughlin	1,300	1,300
Sifton	457	457
Markborough	250	250
Monarch	450	250
Block Brothers	250	250
Daon	134	134
Total	42,231	32,581

Table 101

Leading Public Residential Apartment Companies, 1975

Company	Total Number of Units	Company Equity
Cadillac Fairview	16,734	14,997
Abbey Glen	3,100	3,028
Campeau	2,600	2,600
Sifton	2,172	2,150
Block Brothers	1,857	1,795
Markborough	1,785	1,404
Nu-West	1,055	1,055
Daon	1,331	1,048
Bramalea	863	863
Imperial General	800	800
Trizec	763	763
Costain	744	744
Revenue	464	464
Monarch	450	450
Melcor	421	421
M.E.P.C.	350	350
S. B. McLaughlin	300	300
Consolidated Building	340	340
Total	36,179	33,572

Table 102

Leading Public Companies in Industrial Space, 1975
(000's of rentable sq. ft.)

Company	Total Space	Comapny Owned
Orlando	4,688	4,688
M.E.P.C.	4,500	4,500
Alliance	2,736	2,015
Revenue	1,892	1,892
Imperial General	1,800	1,800
Bramalea	1,364	1,364
Cadillac Fairview	1,071	1,071
Block Brothers	947	742
Markborough	575	488
Daon	588	424
Total	20,161	19,014

HOUSING AND LAND SALES

POSITION OF CADILLAC FAIRVIEW

Leading house-building companies (Tables 103 and 104) rank the publicly owned companies in terms of size in housing and land sales. In the case of the 12 companies which do not provide a breakdown of sales between housing and land we have made estimates.

Table 103

Sales of Leading Public Housing Companies, 1975
($000's)

Company	Sales
Nu-West	117,820
Campeau	51,573
Cadillac Fairview	46,130
Bramalea	40,000 E
Daon	32,800
Costain	28,713
Deltan	25,000 E
McLaughlin	20,000 E
Headway	20,000 E
Consolidated Building	20,000 E
Sifton	15,000 E
Monarch	15,000 E
Melcor	10,764 E
Block	10,000 E
Abacus	9,669
Revenue Properties	4,000 E
Major Holdings	2,440
Total	468,909

E - estimated.

Table 104

Sales of Leading Public Land Companies, 1975
($000's)

Company	Sales
Abbey Glen	53,378
Daon	35,729
Carma	37,390
Cadillac Fairview	26,763
Block Brothers	22,946 E
Nu-West	17,028
Markborough	16,925
Deltan	12,795 E
S. B. McLaughlin	11,182 E
Melcor	8,667
Major Holdings	8,349
Consolidated Building	7,978 E
Headway	7,631 E
Costain	6,865
Abacus	6,821
Bramalea	6,433 E
Sifton	5,275 E
Campeau	4,929
Revenue	726 E
Total	297,810

E - estimated.

Cadillac Fairview is the third largest of the publicly owned housing companies (Table 103) and fourth in land (Table 104). Overall, it is the second largest company when sales for the two categories are combined.

PUBLIC COMPANIES WITHIN THE TOTAL REAL ESTATE INDUSTRY

Let us assume that land represented one-third of the final selling price of a new home. Thus the $290 million worth of land sold by 19 companies noted in Table 104 might translate into $870 million of housing. Combined with total housing sales of $471 million, this indicates that the public companies supplied $1.34 billion of new housing. Assuming the low price of $35,000 per unit, this indicates that the public companies supplied about 38,000 housing units, or less than 16% of the total Canadian supply in 1975.

RATES OF RETURN IN LAND AND HOUSING

The following tables examine at the aggregate numbers of the public companies that are active in land and building. Table 105 details the published results for 20 publicly owned companies with total gross revenues from land and building of $804.6 million in 1975. In Table 93 the 35 companies had total gross revenues from land and housing of $812 million so obviously we have covered just about all of the publicly owned industry in this table.

RETURN ON LAND SALES

One can be precise about the profit margins in land development because of the pure companies. However, it is more difficult to do so for house-building because most of the companies build houses on land that they predominately developed themselves. Therefore, it is not clear from which source the profits are derived. However, from the data on the seven companies that provide pure land results it is clear that land development is the truly profitable side of the total business (Table 105).

RETURN ON ASSETS

The analytical problem in determining returns on equity arises from the fact that companies such as Cadillac Fairview and Campeau are major factors in both rental properties and housing. Under income properties, we examined the return on assets and we have done the same below for land and housing. However, because interest costs are not usually specified for land and housing companies, we cannot calculate asset return on a pre-interest basis. In the case of land development, most of the interest is added to the cost of land until development occurs. In Table 106 we look at the total investment in inventories of houses and lots, plus land and related receivables. We have attempted to separate those land inventories that are destined for commercial use. Most of the data is available in the annual reports.

It becomes evident that the very high dollar profits of the industry also involve considerable sums of dollars invested. In our opinion, it is impossible to determine from the data on asset return whether house-building or land development, or a combination of the two provides the superior return. The leading five companies in terms of asset returns are:

Abacus Cities	44.6%
Headway	22.3
Sifton	21.5
Melcor	17.7
Carma	15.8

Only Carma is a pure land company.

Table 105

Comparative Land and Housing Returns
20 Public Companies, 1975
($000's)

	Sales			Gross Profits			. Percentage Margin		
	Land	Houses	Total Land and Houses	+ Land	+ Houses	Total Land and Houses	Land	Houses	Land and Houses
Cadillac Fairview	26,763	46,130	72,893	11.402	4,714	16,116	42.6	10.2	22.1
Campeau	4,929	51,573	56,502	3,037	6,358	9,395	61.6	12.3	16.6
Deltan	n/a	n/a	27,795	n/a	n/a	4,588	n/a	n/a	16.5
Abbey Glen*	53,378	-	53,378	17,536	-	17,536	32.9	-	32.9
Bramalea	n/a	n/a	46,433	n/a	n/a	10,135	n/a	n/a	21.8
Revenue	n/a	n/a	4,726	n/a	n/a	637	n/a	n/a	13.5
McLaughlin	n/a	n/a	31,182	n/a	n/a	7,547	n/a	n/a	24.2
Daon	35,729	32,800	68,529	10,686	4,930	15,616	29.9	15.0	22.8
Sifton	n/a	n/a	20,275	n/a	n/a	6,022	n/a	n/a	29.7
Block Brothers	n/a	n/a	32,946	n/a	n/a	4,590	n/a	n/a	13.9
Markborough*	16,925	-	16,925	7,538	-	7,538	44.5	-	44.5
Monarch	n/a	n/a	21,065	n/a	n/a	5,395	n/a	n/a	25.6
Headway	n/a	n/a	27,631	n/a	n/a	4,232	n/a	n/a	15.3
Costain	6,865	28,713	35,578	n/a	n/a	9,028	n/a	n/a	25.4
Melcor	8,667	10,764	19,431	4,114	1,543	5,657	47.5	14.3	29.1
Nu-West	17,028	117,820	134,848	n/a	n/a	18,000	n/a	n/a	13.3
Carma*	37,390	-	37,390	15,791	-	15,791	43.2	n/a	42.2
Consolidated Building	n/a	n/a	27,978	n/a	n/a	6,213	n/a	n/a	22.2
Major Holdings	8,349	2,440	10,789	3,405	200	3,605	40.8	8.2	33.4
Abacus	6,821	9,669	16,490	n/a	n/a	4,240	n/a	n/a	25.7
Total	222,844	299,909	762,784	73,509	17,745	171,881	n/a	n/a	22 .5

Source : Company annual reports.
* Exclusively land developers
n/a - not available.

Excludes Orlando, Y & R, Allorlco, Corporate Properties, Alliance.

Table 106

20 Public Housing and Land Companies
Estimated Return on Assets, 1975
($000's)

Company	Housing Projects under Construction	Land under Development	Land Held for Future Development	Receivables	Total Investment in Land and Houses	Operating Profits from Land and Houses	Return
							(%)
Cadillac Fairview	66,109	30,000	111,000	30,000	237,109	16,116	6.8
Campeau	60,000	15,000	45,000	11,000	131,000	9,395	7.2
Deltan	117,000	10,000	25,000	12,000	164,000	4,588	2.8
Abbey Glen	-	30,000	90,000	37,000	157,000	17,536	11.2
Bramalea	15,000	23,000	44,000	10,000	92,000	10,135	11.0
Revenue Properties	4,000	4,000	30,000	5,000	43,000	637	1.5
S.B. McLaughlin	14,000	10,000	85,000	33,000	142,000	7,547	5.3
Daon	58,000	5,000	35,000	20,000	118,000	15,616	13.2
Sifton	5,000	11,000	11,000	1,000	28,000	6,022	21.5
Block Brothers	10,000	20,000	5,000	6,000	41,000	4,590	11.2
Markborough	-	7,000	55,000	18,000	80,000	7,538	9.4
Monarch	3,600	4,800	20,500	1,000	39,900	5,395	13.5
Headway	7,900	2,100	3,000	7,000	19,000	4,232	22.3
Costain	7,000	11,600	47,000	7,000	72,600	9,028	12.4
Melcor	4,800	4,300	13,900	9,000	32,000	5,657	17.7
Nu-West	59,600	53,900	24,400	14,000	151,900	18,000	11.8
Carma	-	10,100	64,700	25,000	99,800	15,791	15.8
Consolidated Building	15,500	12,000	15,000	15,000	57,500	6,213	10.8
Major Holdings	2,000	5,000	13,900	5,000	25,900	3,605	13.9
Abacus	100	1,900	1,500	6,000	9,500	4,240	44.6
Total	449,609	270,700	748,900	272,000	1,741,209	172,081	9.9%

The bottom five companies assessed for asset returns are:

Revenue	1.5%
Deltan	2.8
McLaughlin	5.3
Cadillac Fairview	6.1
Campeau	7.2

The logical reasons for the poor performance of Cadillac Fairview and Campeau by this measure is that they have made high investments for the short run and the long run. The short run is indicated by the high inventories which are an inherent part of producing high-rise condominiums. In addition, the companies have made significant land investments for the long run, e.g., Erin Mills.

It is worth noting that in contrast many of the other companies which have made significant land investments for the future are more profitable today.

RENTAL AND SALES PROFITS COMPARED

Table 107

Comparison of Rental Profits with those on Housing and Land

	Rentals	Land and Housing
Total investment	2,573,133	1,741,209
Operating profits after interest	107,989	171,881
As percentage of total investment	4.2%	9.9%

We would be the first to admit that our comparisons in Table 107 are not exactly fair for the following reasons. First, for income properties, we employed an average for the year, while the residential side was deduced from the latest year end numbers. We suspect that if an average number had been used for the residential computations, the rate of return would have exceeded 10%. Secondly, all our calculations are made before allocation of general and administrative expenses. We calculate that the G & A expenses as reported by public companies indicate a much larger percentage of assets invested in land and housing than in rentals. For example, general and administrative expenses might amount to 3% of assets for a sample of residential companies compared to under 1% for income property companies.

It may be a valid criticism that we have overstated the profitability of the income property side. Our calculations have made no mention of the monies invested in both rental properties under construction and land held for future development, whereas in our analysis of residential results, we assumed that the heavy inventories of current and future land were necessary for remaining in business. However, we believe that our calculations generally are firmly based. A high-class rental operation can be conducted without any investment in the future. There is no need for high-powered management or new projects. The existing projects can stand by themselves. Of course, the housing and land operations would quickly die without any fresh investment in lands and inventories.

We note that a developer of income properties concerned with the future is in a different situation from that of a passive manager. A longterm developer is compelled to retain development specialists, current projects and future lands. Thus the returns of the major companies are probably overstated in this respect.

Regardless of the adjustments to the basic calculations in Table 105, there is no doubt that land and housing seem to generate between two and three times the cash flow per dollar of invested assets as do income properties. This result does not come from the leverage capacities discussed below; rather, it is a reflection of three basic factors.

1. Housing and land development are generally acknowledged to be higher risk situations, on which one should normally expect higher returns.

2. Our calculations are based on cash flows before income taxes. It appears that successful housing and land companies who remain out of income properties inevitably end up paying cash income taxes. The proof of this is that Nu-West, Melcor, Monarch and Consolidated Building are currently paying almost full tax rates. In comparison, the pure income property companies in general defer all their taxes. We believe that the diversified companies are also deferring income taxes primarily because of their thrust into income properties. Thus, when one compares the returns on income properties and residential adjusted for income taxes, the differentials are narrowed considerably.

3. The profits earned in housing and land development are for one year only. To generate them again the following year requires a certain amount of business acumen plus some inventories of land. In general, rental properties have the characteristics of sustaining, if not increasing, their earnings over a long period of time. Management and luck, while still relevant factors, are much less important.

INFLUENCE OF LEVERAGE

We stated above that the difference in return on assets, in real estate was not related to the leverage characteristics. We maintain that real estate is generally very highly levered and that one cannot derive from the data that whether income property development or residential property is much more levered. Prudent business practice, however, would dictate that the latter side would be well advised to have a higher component or equity.

Table 108 presents the 35 company sample in terms of equity plus deferred taxes as a percentage of total assets. Our calculations indicate that on the average the industry has 13.8% of its assets represented by equity and 19.2% when deferred taxes are included. We have avoided the question of whether or not deferred taxes are part of shareholders equity or total liabilities. The correct answer is that the present value of deferred taxes is significantly less than the stated liability, indicating the truth is halfway in between.

Tables 109 and 110 list the most and least levered companies respectively. No clear pattern can be seen which favours one type of company over the others.

Table 108

Comparison of Shareholder Equity and Deferred Taxes
35 Public Real Estate Companies, 1975

	(1) Total Shareholder Equity	(2) Deferred Taxes	Total (3) Equity + Deferred Taxes 1 + 2	(4) Total Assets	1 as % of 4	2 as % of 4	3 as % of 4
Cadillac Fairview	138,436	62,738	201,174	1,045,157	13.2	6.0	19.2
Trizec	115,844	29,354	145,198	899,714	12.8	3.3	16.1
Campeau	54,839	34,633	89,472	481,695	11.4	7.2	18.6
Oxford	46,558	37,202	63,760	474,800	9.8	3.6	13.4
Deltan	20,330	26,711	47,041	390,495	5.2	6.8	12.0
Abbey Glen	75,511	23,661	99,172	387,586	19.5	6.1	25.6
Bramalea	26,193	15,162	41,355	279,143	9.4	5.4	14.8
S.B. McLaughlin	33,228	20,166	53,394	256,402	12.9	7.9	20.8
Daon	19,319	15,241	34,560	209,963	9.2	7.3	16.5
Nu-West	36,509	365	36,874	187,143	19.5	0.2	19.7
M.E.P.C.	34,414	11,827	46,241	179,505	19.2	6.6	25.8
Commonwealth Holiday Inns	26,290	17,053	43,343	160,361	16.4	10.6	27.0
Block Brothers	24,303	7,643	31,946	146,767	16.6	5.2	21.8
Markborough	38,424	11,981	50,405	142,104	27.0	8.4	35.4
Orlando	12,680	10,329	23,009	120,230	10.5	8.6	19.1
Revenue Properties	20,510	2,255	22,765	104,476	19.6	2.2	21.8
Carma	23,282	9,468	32,750	103,523	22.5	9.1	31.6
Allarco	17,417	5,069	22,486	101,356	17.2	5.0	22.2
Consolidated Building	17,802	7,471	25,273	100,583	17.7	7.4	25.1
Y & R Properties	21,436	7,501	28,937	98,149	21.8	7.6	29.4
Alliance Building	10,319	6,830	17,149	97,706	10.6	7.0	17.6
Sifton	9,240	7,379	16,619	94,354	9.7	7.8	17.6
Richard Costain	13,143	6,807	19,950	92,618	14.2	7.3	21.5
Headway Corporation	10,813	4,395	15,208	81,899	13.2	5.4	18.6
Four Seasons Hotel	19,801	4,786	24,587	67,123	29.5	7.1	36.6
Monarch Investments	17,025	865	17,890	63,923	26.6	1.4	28.0
Imperial General	11,240	3,665	14,905	62,126	18.1	5.9	24.0
Halifax	8,543	427	8,970	48,149	17.7	0.9	18.6
Melcor	9,990	2,904	12,894	46,931	21.3	6.2	27.5
Skyline Hotels	5,247	1,108	6,355	42,469	12.4	2.6	15.0
Major Holdings	5,685	3,443	9,128	34,681	16.4	9.9	26.3
Corporate Properties	3,268	748	4,016	24,385	13.4	3.1	16.5
Sobey	3,296	615	3,911	19,407	17.0	3.2	20.2
Abacus Cities	3,648	2,249	5,897	16,658	21.9	13.5	35.4
Douglas Leaseholds	5,428	402	5,830	13,508	40.2	5.7	43.1
	940,011	382,453	1,322,464	6,675,089	14.1	5.7	19.8

Table 109

Highest Levered Public Real Estate Companies, 1975

Company	Equity as a Percentage of Total Assets
Deltan	5.2
Daon	9.2
Bramalea	9.4
Sifton	9.7
Oxford	9.8
	Equity + Deferred Taxes as a Percentage of Total Assets
Deltan	12.0
Oxford	13.4
Bramalea	14.8
Skyline	15.0
Trizec	16.1

Table 110

Least Levered Public Real Estate Companies, 1975

Company	Equity as a Percentage of Total Assets
Douglas	40.2
Four Seasons	29.5
Block	27.0
Monarch	26.6
Carma	22.5
	Equity + Deferred Taxes as a Percentage of Total Assets
Douglas	43.1
Four Seasons	36.6
Abacus	35.4
Block Brothers	35.4
Carma	31.6

POSITION OF CADILLAC FAIRVIEW

Leverage

Cadillac Fairview is perhaps slightly more levered than the industry but not by a great deal.

The advantage of a strong balance sheet is that it becomes easier to finance a speculative project regardless of its nature. However, it is our contention that what makes a company strong in the real estate industry is the avoidance of too many speculative projects.

Control of both Trizec and Abbey Glen changed hands in 1976. Trizec and Abbey Glen have few things in common. One of the most important similarities, though, was the fact that they were regarded by the financial community as financially weak. This is not straightforward from the balance sheet items on Table 111 below.

Table 111

Comparison of Cadillac Fairview, Trizec and Abbey Glen

Company	Total Assets	Shareholders' Amount	Equity as Percentage of Total Assets
Cadillac Fairview	1,045,157	138,436*	13.3
Trizec	899,714	115,844	12.8
Abbey Glen	397,586	75,511	19.5

* includes $2,647,010 of preferred shares.

The strengths of Cadillac Fairview are not in its balance sheet but the credibility of the management with space users and financial institutions.

Return on Assets Translated into Return on Equity

We calculated earlier that Cadillac Fairview was obtaining a cash flow return of 6.0% on its income properties and 6.8% on its residential investment. It makes nothing on its income properties under development. The result is that the company generated a cash flow return of $40.8 million on average assets of $983.2 million in fiscal 1976, or 4.2%. However, since the capitalization was composed of only 19.2% equity plus deferred taxes at year-end, the company produced a cash flow return of 32.3% on average common equity and 13.1% in terms of net profits. Out of the 35 companies in Table 27 (page 56), there were 15 with a higher cash flow return on equity; 12 companies produced a higher return on equity in terms of net profits. The total industry itself had a cash flow return on total assets of 6.4% in 1975, and 29.5% cash flow return on equity and 14.8% in terms of net profits.

Cadillac Fairview seems to be in line with the aggregate industry results by all measures.

CHAPTER 10

CONCLUSION

Cadillac Fairview, with gross revenues of $200 million and total assets of $1.05 billion, is the largest public real estate company in Canada. Our research has indicated that it is also the largest even when all the numerous private companies are included. However, despite the high visibility of some major companies, such as Cadillac Fairview, the Canadian real estate industry remains highly fragmented. We calculate that the Canadian real estate industry has total assets in excess of $35 billion at book value. Of this, 35 public companies (including Cadillac Fairview) have total assets of about $6.5 billion, or less than 20% of the total.

It is true that the company operates nationally across a variety of real estate endeavours. However, it is equally true that Cadillac Fairview is a prominent Toronto land developer, house builder and office developer and a leading Montreal shopping centre developer. Even when the company's markets are thus narrowed, it can be demonstrated that it has no power to dominate them.

CONCENTRATION IN THE CANADIAN REAL ESTATE INDUSTRY

In Chapter 2 we discussed the apparent trend toward increased concentration in the Canadian real estate industry. This tendency poses no threat because the industry remains in essence highly fragmented. Ease of entry continues high in most fields, especially when one considers that the "power" in real estate lies in the hands of the large users of space, such as chartered banks, government bodies and department stores. As we shall discuss below, each of these customers is perfectly capable of developing real estate on its own account, and is prepared to do so if the specialist developers either overcharge or underperform.

CONTRAST WITH THE UNITED STATES

We also stated in Chapter 2 that the trend towards rationalization in the real estate industry appears to be a Canadian, rather than a North American, phenomenon. The major reasons for the differences in the trend in Canada as compared to the United States are the following:

The major companies in the U.S. real estate market are not necessarily public ones; thus share valuations and growth per se are not that important. In Canada, the major real estate companies are publicly owned.

Traditionally, the entrepreneurship has been considered all important in real estate, as it still is in the United States, where the growth mentality, less trammelled by regulation than in Canada, generally still prevails. In Canada, on the other hand, the forces of anti-development have eroded this attitude. Here it is probably as important today to be able to put together a team that can negotiate with planners, politicians, consultants, and so on, as it is to make strategic locational decisions.

As a result, the ownership of enough land suitable for development is also a key to large profits and growth in Canadian real estate, particularly housing. The opposite is true in the United States, where large land inventories can be a major liability. There the leading companies owe their prominence much more to skills in marketing and construction, a relatively widely available commodity. However, suitable land, necessary for success in Canada, is limited.

We have stated on several occasions that in Canada the successful large commercial developers are those who have earned the respect of large space users -- large department stores and chartered banks. While this is also true in the United States, far more large space users exist there than in Canada. This larger body of potential tenants provides greater opportunities for individual developers.

The geographical size and spread of the U.S. market also means that different markets are always coming into prominence. The focus is constantly shifting from the northeast to the northwest to the southeast and so on. Canada, in contrast, has only a handful of major cities, and when one is overbuilt, there is not necessarily a replacement. Typically that market is already well served by an existing large developer. For example, in office buildings, Trizec is large in Montreal while Cadillac Fairview is active in Toronto. Campeau is dominant in Ottawa, while Oxford enjoys leadership in Calgary and Edmonton. In our opinion, none of the four companies has any real power, although they have made a head start by becoming involved in new projects in the five cities named above.

The large dollar profits in the Canadian real estate industry by themselves influence mergers and acquisitions. For example, because of the sizeable profits that Nu-West Development has generated and its resulting borrowing power, the company is able to contemplate a large program of income property acquisitions. Since the U.S. companies are not as profitable initially, they do not have the financial base to begin such a program.

We have been told (but have not verified) that the tax laws in the United States are not as conducive to retaining income property portfolios as in Canada. One of the basic strengths of the large Canadian development companies is their large existing portfolios and the cash flows that they generate.

Finally, in real estate finance, non-recourse loans have been quite common in the United States but not in Canada. Recourse financing places a greater need on a good corporate credit rating, and thus favours large successful companies. It has been stated that the United States financial community has learned from its experience with REITS; hence non-recourse financing is less available currently.

WHO HAS THE POWER IN CANADIAN REAL ESTATE?

It is our contention that the power in Canadian real estate lies in the hands of the major users of space rather than with the developers. The key department store tenants,major corporations and government bodies control the destiny of major office and commercial projects. It is the users' desire for new facilities that prompts new real estate investment decision for these corporate giants. Occasionally, and only in very strong business booms, a developer may, through persistence or imagination, persuade a user to commit itself to a new project not on the corporate drawing boards. However, this occurs rarely. Typically, a bank will have decided on its own volition that it needs a new national, provincial or regional headquarters. The decisions concerning specified size, design and location will come later. Similarly, the department stores will have game plans for new locations; for example, Simpsons-Sears will have made its own decision to have two new stores on the eastern boundary of Metropolitan Toronto. Subsequently, the exact locations will be dictated by the availability of sites that fit the criteria and the imagination of the developers.

In this situation, the opportunity for creating major power blocks is quite easy to see. The major space users are very large corporations with all the prejudices inherent in such large, conservative institutions. There is a natural tendency for such institutions to seek out developers who are equally large and conservative and preferably well capitalized. Such a pattern could surely create a situation whereby the "big get bigger".

Often this is exactly what happens. The bigger developers are indeed in a strong position when it comes to undertaking very large new projects. However, there is a variety of obstacles preventing them from creating an oligopolistic market. We explore some of the most pertinent ones below.

Users can develop themselves. In our opinion, this poses the biggest threat to large developers. Examples are many: Commerce Court was developed entirely by the Canadian Imperial Bank of Commerce; The Government of Canada is continually talking about doing more of its own development, and in many projects has already done so; Hudson's Bay and Woodward's have developed entire shopping centres by themselves or in partnership with each other.

The reasons that developers need to fear such a situation are twofold and actually somewhat contradictory. A big institution developing its own facilities will often be quite amateurish in its approach. It may build a lot more space than the market can absorb and at much too high a cost level. The result is over-building in a market area. Undoubtedly, true developers are themselves often guilty of such a practice. However, the institutional developer may decide to lease the extra space at a very low, uneconomical rent as the losses from this one project may be miniscule in the context of consolidated total profits. The result is lower rent levels for everybody, because the private developers must generally follow suit or lose business. In defense of the institutions vis-a-vis the developers, it might be pointed out that the institution could probably afford to keep the stated rental level high and accept high vacancies for a much longer period of time than could a highly levered developer, who had overbuilt. This last situation is probably the most likely.

The other side of the coin is the possibility that the institution may be generally successful in its execution. Logically, such institutions are going to be much tougher in their future negotiations with private developers; returns and margins will be squeezed. Even worse for the real estate developers, the successful institutional developer will likely boast about its success to its corporate peers thus increasing its popularity.

Users can also hire experienced developers on a fee basis to fulfill a construction management role. Project managers are really an extension of user development. A specific example would be the new Ontario headquarters for the Royal Bank of Canada in Toronto. Y & R Properties Ltd. of Toronto, an experienced Toronto office building developer, has managed the project since its inception on a fee basis. Although it was probably impossible for it to be involved with such a showplace project on any other basis, this practice does undercut the developer's competitive position <u>qua</u> developer. To the user institution, however, it is a shrewd method of doing business, by gaining the technological skills of a good developer while retaining the long-term benefits of direct ownership.

Attractive sites may be controlled by smaller developers who insist on developing the project themselves. Even though the natural tendency is for big institutions to want to deal with other big institutions, the catalyst in most decisions, as we said earlier, is the user. For instance, although Sears may wish to have Cadillac Fairview or Oxford/Cambridge develop its proposed new centre in X-ville, it may be that the one suitable location in the area is owned by a smaller developer. Sears may attempt to persuade the smaller developer to sell out to the bigger or to form a joint venture with him; however, if the small developer is stubborn and at all capable, he may win out in the end. The users <u>prefer</u> to deal with the larger developers, but they are not adamant on the subject.

Furthermore, the economics of big projects are often so tenuous that the developer is lucky to make a profit at all. For example, the Toronto Eaton Centre when completed will have entailed over 15 years work and $250 million. Almost every developer we know in Canada would agree that only Cadillac Fairview would have the necessary kind of management; but money is no guarantee that the project will make money. The very nature of the project is hazardous, so having a monopoly on such projects is no guarantee of anything. While tenants may sympathize with the developer's claim that very high rents are necessary in the project because of the cost, they may not be prepared, or able, to pay them.

Finally, a key tenant is not necessarily a guarantee of obtaining other tenants. The Toronto Eaton Centre exists primarily because Eaton's wanted a new million square foot store in downtown Toronto. (A second reason was that Eaton's had large amounts of money tied up in unproductive land.) The smaller tenants may still not join in if they feel the rental and operating cost structure is prohibitive.

FINANCIAL STRENGTH: IMPLICATIONS OF SIZE

We believe that size by itself is vastly overrated as an asset in real estate. For example, Trizec Corporation and Abbey Glen Property Corporation are two of Canada's largest real estate companies. Both are in the process of changing control and their financial weakness is a common topic in real estate circles. It is interesting to note that Bramalea, a company with assets at November 30, 1974, of $164 million, was able to acquire almost $100 million of income properties from Trizec, which at the time was almost six times the size. It was Bramalea, the smaller company, that was able to borrow $25 million from the Canadian Imperial Bank of Commerce to swing the deal. However, we do understand that excess short-term debt was a vital factor in Trizec's decision to sell these assets.

MEASURES OF FINANCIAL STRENGTH

As noted in Chapter 9, all public real estate companies are highly levered by conventional standards. Thus, while a few crucial factors are relevant in assessing financial strength, debt to equity at book is not one of them.

Interest coverage from the rental pool is very important. For example, a company with rental income and a coverage ratio of only 1.5 to 1 is generally considered a higher quality credit than a company whose coverage is 5 to 1 derived from land and housing.

It is commonly believed that high short-term debt is an ominous sign for real estate companies, that many real estate bankruptcies have resulted from the practice of companies financing longterm assets with short-term liabilities. In our view, lenders pay close attention to this practice and until long term funding of such loans, the companies are considered to be "under a cloud". Also, short-term funding is a systematic practice used by less conservative real estate companies. In other words, conservative companies tend to finance longterm as well as pre-lease and obtain fixed price construction contracts. Less conservative companies do exactly the opposite.

Debt to appraised value is also of some importance. Land-based companies with little predictable earnings or cash flow are often able to continue borrowing if the appraised value of the lands is acknowledged by the lender to be considerably in excess of the debt obligations.

AVAILABILITY OF CAPITAL

The expression is heard quite often that money or capital is the raw material of the real estate industry. In our statement on the widespread use of leverage, we accept this as being true. However, large size does not guarantee a large credit rating, although it can help to obtain one. Most real estate projects can be accomplished with the aid of existing equity bases and standard borrowings.

It is interesting to note how many real estate companies went public around 1968. Since that time many have more than tripled their size without additional equity funds. In actual fact, the amount of equity offerings since 1972 has been very small. Fairview went public in mid-1972 and, as we mentioned, with a glowing reputation. In contrast, Alliance Building had a rights offering in 1975, as did Revenue Properties in 1972, and both companies were in poor financial shape at the time. Oxford has just completed a convertible preferred offering, to finance and takeover, primarily for cash, of Cambridge Leaseholds. In 1972, both Carma Developers and Monarch Investments had small public underwritings. This constitutes the majority of public equity financings in real estate in the last four years.

In fact, the public real estate companies have accomplished their massive growth from internal cash and debt sources. The reasons for this are quite straightforward. Generally, most equity offerings were prohibited by the fact that the stock market price of real estate assets was far under the "true values". Good income property situations are generally close to self-financing. If a proposition is able to be financed, it is usually because it has an attractive free and clear return. If it cannot be financed, it is not worthwhile to undertake it. Housing, which is the principal activity of most real estate companies, is mainly self-liquidating. Land development by definition requires large amounts of capital. Most of the public companies fortunately acquired their lands before the sharp capital appreciation of the past three years. They have therefore been able to borrow against the capital appreciation inherent in the lands and against the profits being generated. Public companies are not the risk-takers in the industry. The people who have undertaken what appear to be high-risk projects are either private companies or major business corporations. For example, the two new bank towers in Toronto were clearly uneconomical ventures from inception. One was 100% owned by the Royal Bank; the ownership of the other was shared by the Bank of Montreal and North American Life. This is, of course, purely our own speculation since the information is not available. We doubt that Cadillac Fairview would have gone ahead with the Toronto Eaton Centre without the financial guarantees of the Toronto-Dominion Bank.

There are other methods of proving that capital is freely available to real estate companies of all types, not just the biggest. If this were not the case, the financial institutions would be the leading developers in Canada. Over the past decade, many insurance companies have expressed publicly their determination to become more active in real estate. Many have indeed increased their real estate assets dramatically, but on close examination it will be found that the institutions were obliged to purchase these assets from smaller developers or via participation with them. The risks of initiating development for financial institutions have turned out to be greater than the rewards. The principal exceptions have occurred when an institution could itself become a key tenant in its new project. In such cases, the actual costs seem to be buried much more easily.

Other evidence confirms our thesis. For instance, no other company could possibly be as well endowed for real estate development as Marathon. This company has preferred access to some of the best sites in Canada and the sponsorship of one of Canada's largest corporations. Nevertheless, as we illustrated earlier the total assets of Marathon are only $275 million and much of this has been purchased from other developers. Similarly, Markborough Properties was created in the 1960's as a vehicle for financial institutions to enter the real estate market. Yet, today the company is only a middling public company. The inhibiting factor both before and after the acquisition of control by the Hudson's Bay Company has been management.

We mentioned earlier that the public real estate companies had been able to show high growth rates even though they had been prohibited from raising new equity funds. The same situation also applies to the many private companies that constitute the bulk of the industry's assets. They have also been able to grow from internally generated assets. For instance, Olympia and York, purely a family company, has assets of almost a billion dollars by our calculations. On the other hand, the three apartment companies in Canada that originally grew along with Cadillac -- Greenwin, Belmont, and Meridian -- have chosen not to diversify aggressively for personal, not financial, reasons.

Many of the large private real estate companies in Canada are actually offshoots of other businesses. For example, the Spurr report notes that two leading Toronto developers are Pinetree Development and Runnymede Development.* Each has a similar family background. Max and Joseph Tannenbaum of Toronto are brothers. Each controls independently large steel fabricating businesses: York Steel and Runnymede Steel. The brothers and their families control hundreds of million of dollars of Ontario real estate. We understand that each is autonomous.

Lists such as this one could go on indefinitely. The point is that capital seems to be available to many companies in real estate.

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* - Peter Spurr, <u>Land and Urban Development: A Preliminary Study</u> (Toronto, 1976).

PRESCRIPTION FOR FINANCIAL STRENGTH

On several occasions in this report we have mentioned Cambridge Leaseholds Limited. This company was acquired by Oxford Development Group in 1975. Cambridge ranked with Cadillac Fairview as Canada's leading shopping centre developers. However, according to Cambridge's annual report for the fiscal year ended February 28, 1975, it had shareholders' equity of only $6.5 million compared to Cadillac Fairview's $120 million. Cambridge was able to finance almost all the costs of its new centres by debt. The company grew literally from nothing in ten years by virtue of the excellent centres that it was able to conceive. Lenders examined each centre on its own merits and were prepared to lend against the cash flow of the assured rental flow. Hence Cambridge was very shrewd financially because it was so conservatively managed. The company financed all its projects with longterm debt before the project was even begun.

We detail this practice of Cambridge because it is consistent with the methods used by Fairview prior to the merger. Prior to going public and afterwards, Fairview had a reputation for being financially strong as a Cemp subsidiary. Cemp's net worth, while never published, is believed to be in the many hundreds of millions. In our opinion, however, the real strength of Fairview was its own astute financial management. Fairview followed the same practices as Cambridge, tending to fund almost all projects with longterm debt prior to construction.

A number of recommendations follow from our prescription for financial strength in real estate. It may sound like a platitude to recommend financing all income projects with longterm debt before construction begins. In the last decade, this has turned out to be fortuitous method because of the fact that interest rates have tended to be higher after a project has been completed. In addition, as inflation rates increased, so did construction costs and, most significantly, rental rates. Those developers able to develop projects that had firm construction and interest costs often could obtain rents higher than projected, and, as a result, the overall financial performance was excellent. This was an added benefit to prudent conservative practices.

We also argue that it is relatively simple to finance good situations. For a lending institution, an office building or shopping centre with major key tenants is obviously a superior financial proposition to a speculative project. The "trick" is to obtain the good situation in the first place and, in this endeavour, management outweighs money in importance.

The medium-sized public or private companies do not appear to be disadvantaged by the larger companies in most aspects of real estate. As we have shown, size and financial strength are not necessarily related; large companies have little natural advantage because of their size. Real estate financing continues to be handled on a project-by-project basis, and therefore the advantages of a larger asset or equity base are supplemental.

Bigger companies do tend to have an extra advantage in the undertaking of very large projects, but in these situations it is more likely to be their technical and managerial competence that is important, rather than their balance sheet.

We are unable to assess whether Canadians are "better or worse off" because of the existence of large public or private real estate companies. In some rare cases we can point to construction activity and related employment opportunities that would have been produced only by the risk-taking abilities of a very large development company. We can also point to tastefully conceived and architecturally impressive projects produced by these companies. Yet, we can just as easily find the opposite: very large companies unable to push certain new projects off the ground because of internal weaknesses or over-conservatism; and many examples of large companies producing projects that are complete aesthetic failures. We do not want to understate the significance of large companies in real estate being able to use corporate debt as an advantage.

Finally, we believe that each case is unique. When the management of real estate companies is ethical and honest, the public is well served, as are the suppliers, customers, and work force of the company. Cadillac Fairview appears to be such a company, as were both Cadillac Development and Fairview Corporation. Thus the high standards of Cadillac Fairview today would appear to be a function of management, not size.

In summary, the trend to larger companies is neither good nor bad. However, it is definitely not dangerous to the health of the country.

APPENDIX A

Table A - 1

Cadillac Development Corporation Limited
Review of Rentals, 1964-73
(Year-end December 31)

	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973
					($000's)					
Gross rental income	2,133	3,919	6,989	11,270	15,005	19,372	22,796	26,495	31,135	38,165
Property operating expenses	947	1,638	2,807	4,906	6,636	8,507	10,348	11,920	14,301	17,132
Mortgage interest	687	1,330	2,361	3,869	5,037	6,407	7,589	8,903	10,718	13,231
Depreciation	103	204	376	576	740	925	1,076	1,293	1,529	1,857
Net rental income	396	747	1,445	1,917	2,592	3,533	3,783	4,379	4,587	5,945
As a percentage of gross rental income										
Property operating expenses	44.4	41.8	40.2	43.5	44.2	43.9	45.4	45.0	46.0	44.9
Mortgage interest	32.2	33.9	33.8	34.3	33.6	33.1	33.3	33.6	34.4	34.6
Depreciation	4.8	5.2	5.3	5.2	4.9	4.8	4.7	4.9	4.9	4.9
Net rental income	18.6	19.1	20.7	17.0	17.3	18.2	16.6	16.5	14.7	15.6
Net rental income percent increase	-	88.6	93.4	52.7	35.2	36.3	7.1	15.8	4.7	29.6
Gross rental income percent increase	-	83.7	78.3	61.2	33.1	29.1	17.7	16.2	17.5	22.6
Gross rental cash flow ($000's)	499	950	1,821	2,494	3,331	4,457	4,859	5,672	6,316	7,802
Increase over prior year	-	90.4	91.	37.0	33.6	38.8	9.0	16.7	11.4	.5

Table A - 2

Cadillac Development Corporation
Breakdown of Revenues, 1964-73
(Year end December 31)

	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973
					($000's)					
Net rental income	396	747	1,445	1,917	2,592	3,533	3,783	4,397	4,587	5,945
Profit on sales of houses and land	102	653	1,101	642	1,118	1,658	1,566	1,208	2,216	5,832
Equity in income of Canadian Equity & Development (less intercompany transactions)	-	-	-	-	306	357	428	467	915	1,470
Other income	321	333	98	626	63	118	222	933	935	1,392
Gross profits	819	1,733	2,644	3,185	4,079	5,666	5,999	6,987	8,653	14,639
Other corporate expenses	477	517	368	525	964	871	972	1,145	1,659	3,036
Pre-tax profits	342	1,216	2,276	2,660	3,115	4,795	5,027	5,842	6,994	11,603
Income taxes	171	608	1,138	1,330	1,506	2,320	2,342	2,732	2,913	5,068
Net profits	171	608	1,138	1,330	1,609	2,475	2,685	3,110	4,081	6,535
Less : Preferred dividends available for common		29	109	115	107	288	225	186	181	175
Outstanding shares (000's)		9,092	9,092	9,092	9,092	9,092	9,094	9,112	9,222	9,485
Earnings per share		0.064	0.113	0.134	0.165	0.240	0.270	0.322	0.428	0.67
Cash flow				3,284	3,902	5,770	6,130	7,157	8,538	13,488
Cash flow per share (after preferred dividend)										
Percentage Breakdown of Gross Profit						(%)				
Net rental income	48	43	55	60	64	62	63	63	53	41
House profits	12	38	42	20	27	30	26	17	26	40
CED	-	-	-	-	8	6	7	7	10	10
Other	40	19	3	20	1	2	4	13	11	9
Total gross profits	100	100	100	100	100	100	100	100	100	100
Percentage Increase over Prior Year										
Net rental income	-	88	93	33	35	36	7	16	5	30
Gross profits	-	112	53	20	28	39	6	16	24	69
Pre-tax income	-	256	87	17	17	54	5	16	20	66
Cash flow					19	48	6	17	19	8
	50	50	50	50	48.3	48.4	40.1	46.8	41.6	.6

APPENDIX B

RELATIONSHIP OF CEMP AND EDPER

BACKGROUND

Cemp Investments Ltd. of Montreal owns 8,729,861 shares of Cadillac Fairview, or approximately 35% of the outstanding shares. Cemp is clearly the dominant shareholder in the company; the next largest individual shareholder has approximately 1.5 million shares. Edper Investments Ltd. of Montreal now has voting control of Trizec Corporation as a result of a complicated transaction which closed on June 16, 1976.* Edper Investments also has a significant involvement in S.B. McLaughlin Associates Ltd. This latter company is publicly owned and ranks with Cadillac Fairview as one of the major landowners in Mississauga, Ontario. Appendix C reviews the involvement of Edper with McLaughlin.

WHAT ARE CEMP AND EDPER?

Both Cemp and Edper owe their existence to the success of the Seagram Company Ltd., formerly known as Distillers Seagram Corporation. According to the 1975 annual report:

> *The Seagram Company is the world's largest producer and marketer of distilled spirits.... The company has subsidiaries and affiliates in 23 countries and its products are sold virtually worldwide. In 1975 its assets approached $2 billion, sales reached $1.95 billion and earnings were $74 million.*

Cemp Investments owns approximately one third of the shares of the Seagram Company and is by far the controlling shareholder. Edper Investments is generally believed to hold less than five per cent of Seagrams.

In order to understand properly the relationship of Cemp and Edper, it is necessary to review the history of Seagrams. The company was essentially the creation of one of Canada's most publicized businessmen, the late Samuel Bronfman of Montreal. Mr. Bronfman died in 1971 after "running" the company for approximately 47 years. The company is currently headed by two of his sons. Mr. Edgar Bronfman of New York is the Chairman and Chief Executive Officer; Charles Bronfman is the President and Chairman of the Executive Committee. The two Mr. Bronfmans named above are the C and E of Cemp. The M and the P are their two sisters.

Samuel Bronfman was clearly the driving force behind Seagrams during his lifetime. His career inspired numerous articles in the press before and

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* Financial Post, June 19, 1976, p. 25.

after his death. However, he also had a brother Allan Bronfman, who until 1975 was also a Vice-President and had been a director of the company for 46 years. Edward and Peter Bronfman of Montreal are the sons of Allan Bronfman, and along with their families are the beneficial owners of Edper Investments.

Cemp and Edper were formed approximately 25 years ago to rationalize the holdings of both sides of the Bronfman family. Undoubtedly tax considerations were the primary force behind the legal structure of both Cemp and Edper. Each company was endowed with large holdings of Distillers Seagram. Over the years, Cemp has maintained its holdings, while Edper has liquidated most of its shares. There apparently was a decision taken over twenty years ago that the sons of Samuel Bronfman would go into the management of Seagrams and ultimately would run it, while Allan Bronfman's two sons would not be active in management.

In 1957 Samuel Bronfman selected a relatively young man named E. Leo Kolber of Montreal to head up Cemp. Mr. Kolber was given the responsibility of diversifying Cemp with the resources being the annual dividend income from the Seagrams shares, and naturally their collateral value and prestige. Mr. Kolber selected real estate as his principal business endeavour and proceeded to build up what became the Fairview Corporation of Canada Ltd. It is our understanding that Mr. Kolber, although initially only a professional manager, is heavily responsible for the success of Cemp, as the four children of Samuel Bronfman pursued other activities.

Edward and Peter Bronfman, with no future role in Seagrams, have been very active in the management of Edper, although using a variety of professional associates.

IMPLICATIONS

It is our understanding that Cemp and Edper have never engaged in a common business transaction in their twenty years of corporate life. We have interviewed several members of management of both Edper and Cemp for this report and none of them claims to have knowledge of the inner workings of the other. There is no reason to believe that behind the scenes there was any sort of "family compact". The record of Cadillac Fairview, Trizec and S. B. McLaughlin confirms the independent courses of action. In real estate, joint ventures are very common procedures for new projects. None of these three companies noted above has ever dealt with one another. It is our impression that the management of these three companies have often competed with one another on specific deals.

Indeed, the evidence would indicate that Edper and Cemp are bitter competitors. For example, Cemp controls a public company called Multiple Access Limited. One of the principal assets of this company is a radio station in Montreal. In 1971, both Edper and Cemp conducted a bitter fight to gain control of this property. At the time, the press had a field day on the topic of "rival factions of the same family vie."

APPENDIX C

RELATIONSHIP OF EDPER INVESTMENTS TO S.B. MCLAUGHLIN ASSOCIATES

S. B. McLaughlin Associates has eight directors; four are members of management. None of the other four associates has any logical connection with Edper. The company has approximately three million outstanding shares. According to the information circular, the only shareholder owning a record or beneficially, directly or indirectly, of more than 10% of such outstanding shares was Mr. S. B. McLaughlin who had beneficial ownership of 1,318,006 shares or approximately 45% of the total. A footnote to the circular stated that these shares were held through S. B. McLaughlin and Company Limited, a company controlled by Mr. McLaughlin.

Edper Investments owns part of this holding company. This information was publicly announced over two years ago, although no details were released. It is also believed that Edper owns approximately 200,000 shares directly, having purchased part of a private placement in 1970.

Edper is also the dominant shareholder in a public company called Mico Investments. The following paragraphs appeared in the 1975 annual report of Mico dated August 15, 1975.

> *S. B. McLaughlin Associates Limited:*
>
> *Following a decision to refrain in the future from making direct land development investments because of the attendant management and timing uncertainties, your company sought an indirect investment position in this area through an established land development corporation. A holding company, owned 28 per cent by your company, was established to acquire over a period of time, a 51 per cent interest in S. B. McLaughlin Associates Limited and to develop the facilities to provide secondary financing to other land developers. S. B. McLaughlin Associates Limited is listed on the Toronto Stock Exchange, and has assets in excess of $200 million and earnings for the year ended December 31, 1974 of $2.7 million.*
>
> *In keeping with the policy of reducing the company's direct real estate exposure in favour of equity investment in an established property development company, the company sold its interest in Far Hills Inn and surrounding development land and further reduced its other property holdings. It is also the intention to sell or restructure the Mississauga land joint venture to avoid possible future conflicts of interest as a result of the company's recently acquired indirect equity holding in S.B. McLaughlin Associates Limited.*

It is difficult to gauge the exact extent of Edper's influence on McLaughlin. It appears that Edper has shown very little direct interest. McLaughlin moved into Quebec about three years ago, implicitly with the sponsorship of Edper. There are rumours that the land for one of McLaughlin's Montreal projects was initially assembled by Edper. The management of McLaughlin has claimed that they are not acquainted with the management of Trizec. Apparently, both companies have competed with each other in a quest to assemble key Montreal downtown properties and to obtain key office building tenants.

APPENDIX D

Table D - 1

Comparative Office Building Companies
(Fiscal 1976 and 1975)

Year ends :	Cadillac Fairview 28 Feb 76	Trizec* 31 Oct 76	Oxford* 31 Mar 76	Campeau* 31 Dec 75	Y & R* 31 Dec 75	Total
Number of projects in existing portfolio	17	45	18	30	11	121
Total rentable sq. ft.	8,197	14,414	3,748	3,063	2,266	31,688
Equity of company (000 sq. ft.)	4,787	12,871	2,793	2,836	2,166	25,453
Gross assets in office buildings ($000)	190,611	407,000	177,000	100,000	62,000	936,611
Per square foot ($)	39.82	31.62	57.69	35.30	28.62	36.83
Gross revenues ($000)	33,400	76,900	20,000	20,000	13,794	164,194
Operating expense ($000)**	16,061	37,800	7,000	10,000	6,700	77,800
Percent of gross revenue	48.1	49.2	35.0	50.0	49.0	47.4
Interest ($000)	10,529	27,200	9,000	7,800	3,000	58,934
Percent of gross revenue	31.5	35.4	45.0	39.0	21.7	35.9
Cash flow ($000)	6,810	11,900	4,000	2,200	4,094	27,460
Per net rentable sq. ft. ($)	1.43	0.92	1.31	0.78	1.89	1.08
Free and clear return ($000)	17,339	39,100	13,000	10,000	7,094	86,394
As percentage of gross investment at year-end	9.1	9.6	7.3	10.0	11.4	9.2
Cash flow as percentage of assets	3.6	2.9	2.3	2.2	6.6	2.9

Sources: Cadillac Fairview - our calculations as described in this report: others - annual reports and prospectuses.
*See also notes on following page.
**Direct operating expenses only excluding general and administrative expenses.

NOTES ON TABLE D-1

TRIZEC

Trizec publishes a table at the end of its annual report which subdivides the portfolic into eight parts. Included are the gross investment in total properties by sector and the gross rentals, operating expenses and interest expense by sector. The company also publishes a list of all the properties with their individual sizes. The only adjustment of any consequence we have made was an interest expense. The company does not allocate $12 million of interest in its presentation. We assumed that since office buildings constituted 57.5% of the total property investments, approximately the same percentage of the unallocated interest should go against office buildings.

We also note that Trizec, in common with Cadillac Fairview, has a considerable amount of retail space in its office buildings. In addition, approximately 30% of the effective office portfolio is located in the United States.

OXFORD

The company has recently issued a prospectus providing the unit data. The calculations on margins were estimated from the information in the prospectus and from the historical information on Cambridge Leaseholds, which constitutes most of Oxford's shopping centre portfolio. A considerable portion of the office space is devoted to retailing as well.

CAMPEAU CORPORATION

The unit information came from the 1975 annual report. The estimated breakdowns are our own estimates, the most approximate of all our calculations. Additional information on Campeau Corporation is available from a very detailed report on the company recently published by Brown, Baldwin, Nisker Limited.

Y & R

Y & R publishes its current portfolio in gross terms of gross square footage. A 1972 prospectus contains the relevant net information on most of the properties. The company's rental portfolio is almost exclusively office buildings. Since the company has other sources of revenues, we have been obliged to estimate the direct property expenses, but we understand that our estimates are reasonable. We have been obliged to estimate the size of the rental portfolio since the company also includes in its property account the amount invested in parking lots. We consider the latter a separate business for Y & R because they conduct a specialized parking business on a fee basis as well as servicing their own office clients.

APPENDIX E

THE SPURR REPORT*

One of the basic documents of the argument that "a small group of developers is in a position to manipulate the land market" is the so-called Spurr Report. We believe that the author of the report was sincere in his efforts to calculate the extent of the acreage owned by the larger developers. However, his conclusions are flawed for the following reasons:

1. Mr. Spurr calculates that 40 member firms of the Ontario Chapter of the Urban Development Institute held 41,693 acres of land for future residential development in Metropolitan Toronto. He concludes that this same physical area also contains roughly the same physical area of undeveloped land and therefore that UDI members controlled all of the land. His basic mistake lies in a misunderstanding of the actual amount of land available in the general area. The brief submitted by CIPREC to the** Royal Commission on Corporate Concentration calculates the extent of undeveloped land at 564,800 acres. Perhaps CIPREC exaggerated the total but even so, Mr. Spurr's conclusion is faulty.

2. Mr. Spurr from misinterpreted data concluded that the 40 UDI members would be in a position to supply all of the market. The point he missed is that any legitimate large land developer is compelled to own considerably more land than is actually desired. In Chapter 7 we contrasted the land development industry with the oil industry. If we were to take all the lands owned by any large company and assume that oil was discovered on all of these lands, it would appear that the world's oil needs for generations could be satisfied by a few chosen holdings. In fact, many dry holes are dug before a gusher is discovered. The same logic should be applied to land development. Every company holds more lands than it can ever hope to develop. However, the risks in any one piece are so great that good business sense requires greater holdings for compensation. The CIPREC brief mentioned above lists the following ten reasons for inhibited development:

   (a) Conflicts with Toronto Centred Region Plan;
   (b) Within Parkway Belt;
   (c) Municipal restrictions - "no growth" policy;
   (d) Future highway use;
   (e) Provincial and Federal Government restrictions;
   (f) Ministry of the Environment requirements;
   (g) Hydro alignment;
   (h) Regional Government restrictions;
   (i) Conservation Lands;
   (j) Sanitary, store and water servicing problems.

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* - Peter Spurr, Land and Urban Development: A Preliminary Study (Toronto, 1976).
** - Undated mimeographed typescript, p. 6.

We find no reason to disagree with their statements. Mr. Spurr in his research on Toronto land holdings was led to believe that development in the Toronto region would automatically proceed westward:

> *In general UDI's data clearly locates problems in the region's land supply, and points to both their solution and future problems. Development can't occur in the east for several years as major sewage works must be constructed. Supply must come from northern fringe, and the west. The limited holding north of Toronto indicates that, even if some supply is released in this area, most of Toronto's new development will occur in the west for at least five years. This heightened concentration will place enormous demands on public and private facilities in the western region, and the few firms who control development there will be "the only game in town" in Toronto. Moreover, it will be difficult, very costly, and perhaps unlikely, for development which emerges in the east to compete with the awesome momentum of growth which has built up, and will swell, in the west. Again, this demonstrates the public sector's ability to create monopoly conditions for a few land developers.**

But, he has been proven wrong by actual circumstances. Scarborough, Pickering, Whitby and Oshawa, to name only four areas in the east, have been strong providers of land in the last two years.

We would also like to make a reference to a Report To The Ontario Economic Council on the topic Data on Land Available for Housing in Toronto CMA as at December 31, 1975. This report was prepared by Coopers and Lybrand and is dated September 24, 1976. Page 15 of the study under Conclusion states the following:

> "... *the degree of concentration in the ownership of land in the CMA is much lower than commonly believed. Under generous assumptions, it appears that the six largest land holders and developers control less than 40% of the developable land in the CMA*".

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* Ibid.

APPENDIX F

WHY THE STOCK MARKET DOES NOT LIKE PUBLIC REAL ESTATE STOCKS

It is interesting to observe the different attitudes toward real estate held by the social critics versus the institutional stock investors:

1. The critics think that the industry's profits are understated. Not only do the critics want to look at cash flow, they also include unrealised capital appreciation as part of the calculations of rates of return. The "market", on the other hand, intuitively believes that both profits and cash flow are overstated for the following reasons:

    a. The industry's accounting policies allow for capitalization of interest and general and administrative expenses on properties under construction and held for development. This is considered to be too liberal in comparison to other industries.

    b. The industry is allowed to capitalize start-up losses on new projects which again causes consternation among critics.

    c. The industry utilizes the sinking-fund method of depreciation which tends to make reported depreciation very low in the early years.

    d. The popular calculation of cash flow makes no provision for principal repayments which for many companies is quite serious.

    e. The critics point to unrealised appreciation in land. The market notes the collapse in real estate and real estate values in the last two years in the United Kingdom and United States and believes that Canada is to undergo a similar experience in the near future.

2. The market is very concerned about overbuilding in all of the principal areas of real estate, i.e., office buildings, hotels, shopping centres and industrial.

3. The market is concerned about the low rates of return in new projects, a reflection of (2) above.

4. The market believes that residential land values are overstated. They believe that house prices are beyond the earning power of most consumers. Thus it is felt that a collapse in both housing and land is imminent.

5. Some stock market analysts believe that real estate and real estate stocks perform best in the inflationary era. It is felt by some that Canada's inflation rate is due to decline.

6. Some investors believe that real estate companies cannot be legitimate investment vehicles by their very nature. They claim that the managements are all entrepreneurs who are unable to build up strong continuing management groups to succeed the original entrepreneur.

7. Real estate companies have very highly levered balance sheets by conventional measurements.

8. There are few public companies outside Canada that have the apparent investment qualities of our public Canadian real estate stocks. In typical Canadian fashion, it is felt that Canada could not possibly be a leader and that therefore something must be wrong.

9. Equity investors are traditionally interested in net profits whereas many real estate companies profess to be cash flow oriented.

10. Equity investors presumably place great value on the level and growth prospects of dividends. Public real estate companies pay little dividends and appear to have little prospect of change.

11. Institutional investors are interested primarily in major companies that have large liquid capitalizations. Very few, if any, public real estate companies score well on this count.

12. Some institutional investors do have great faith in Canadian real estate. However, they have decided to enter the industry via direct participation themselves.

APPENDIX G

LISTING OF 35 PUBLIC COMPANIES

FULL NAME OF COMPANY	ABBREVIATION	ADDRESS
Abacus Cities Ltd.	Abacus	Calgary, Alberta
Abbey Glen Property Corporation	Abbey Glen	1230, 123 Edward St., Toronto, Ont.
Allarco Developments Ltd.	Allarco	11456 Jasper Ave., Edmonton, Alta.
Alliance Building Corporation Limited	Alliance Building	101 Duncan Mill Rd., Don Mills, Ont.
Block Bros. Industries Ltd.	Block Bros.	1030 West Georgia St., Vancouver, B.C.
Bramalea Consolidated Developments Limited	Bramalea	1867 Yonge St., Toronto, Ont.
The Cadillac Fairview Corporation Limited	Cadillac Fairview	300, 1200 Sheppard Ave. E., Toronto, Ont
Campeau Corporation	Campeau	2932 Baseline Rd., Ottawa, Ont.
Carma Developers Ltd.	Carma	1700 Varsity Estates Dr. N.W., Calgary Alta.
Commonwealth Holiday Inns of Canada Limited	Commonwealth Holiday Inns	304 York St., London, Ont.
Consolidated Building Corporation Limited	Consolidated Building	99 Avenue Rd., Toronto, Ont.
Corporate Properties Limited	Corporate Properties	500, 102 Bloor St. W., Toronto, Ont.
Richard Costain (Canada) Ltd.	Richard Costain	3500 Dufferin St., Downsview, Ont.
Daon Development Corporation	Daon	300, 1050 W. Pender St., Vancouver, B.C.
Deltan Corporation Limited	Deltan	1305, 797 Don Mills Rd., Don Mills, Ont.
Douglas Leaseholds Limited	Douglas Leaseholds	1000, 21 St. Clair Ave. E., Toronto, Ont
Four Seasons Hotels Limited	Four Seasons	1100 Eglinton Ave. E., Toronto, Ont.
Halifax Developments Limited	Halifax	400 Scotia Sq., Halifax, N.S.
Headway Corporation Limited	Headway Corp.	291 South Court St., Thunder Bay, Ont.
Imperial General Properties Limited	Imperial General	25 Wingold Ave., Toronto, Ont.
Major Holdings & Developments Limited	Major Holdings	220, 50 Westmount Rd. N., Waterloo, Ont.

FULL NAME OF COMPANY	ABBREVIATION	ADDRESS
Markborough Properties Limited	Markborough	90 Eglinton Ave. W., Toronto, Ont.
S. B. McLaughlin Associates Limited	S. B. McLaughlin	77 City Centre Dr., Mississauga, Ont.
Melcor Developments Ltd.	Melcor	900, 10310 Jasper Ave., Edmonton, Alta.
M.E.P.C. Canadian Properties Limited	M.E.P.C.	300, 1027 Yonge St., Toronto, Ont.
Monarch Investments Limited	Monarch Investments	2025 Sheppard Ave. E., Willowdale, Ont.
Nu-West Development Corporation Ltd.	Nu-West	301-14th St. N.W., Calgary, Alta.
Orlando Corporation	Orlando	6205 Airport Rd., Mississauga, Ont.
Oxford Development Group Ltd.	Oxford	2300 One Edmonton Centre, Edmonton, Alta.
Revenue Properties Company Limited	Revenue	1619, 44 King St. W., Toronto, Ont.
Sifton Properties Limited	Sifton	785 Wonderland Rd., London, Ont.
Skyline Hotels Limited	Skyline Hotels	1 Cityview Dr., Rexdale, Ont.
Sobeys Stores Limited	Sobeys	Kint St., Stellarton, N.S.
Trizec Corporation Ltd.	Trizec	800, 5 Place Ville Marie, Montreal, Que.
Y & R Properties Limited	Y & R Properties	390 Bay St., Toronto, Ont.

APPENDIX H

CADILLAC FAIRVIEW AND THE IRVINE COMPANY*

Late in 1976 Cadillac Fairview made a dramatic public attempt to acquire Irvine Company of California. The bidding war between Cadillac Fairview and two other large companies began and subsequently Cadillac bowed out of the fray. Originally Cadillac Fairview was going to borrow in excess of $260 million to finance this acquisition, which indicates the substantial financial resources available to this company. These funds would have been obtained from Canadian Chartered Banks utilizing U.S. dollars.

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* - Readers are referred to Wyndham Robertson's article "The Greening of the Irvine Co." in Fortune Magazine (December 1976), pp. 84-96, for details on the background to this situation.