Real Estate Development

INDUSTRY PROFILE

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Publication Inquiries

For individual copies of ISTC or ITC publications, contact your nearest Business Service Centre or International Trade Centre. For more than one copy, please contact

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Canada

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I N D U S T R Y P R O F I L E

1990–1991

REAL ESTATE DEVELOPMENT

FOREWORD

In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to growth and prosperity. Promoting improved performance by Canadian firms in the global marketplace is a central element of the mandates of Industry, Science and Technology Canada and International Trade Canada. This Industry Profile is one of a series of papers in which Industry, Science and Technology Canada assesses, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological, human resource and other critical factors. Industry, Science and Technology Canada and International Trade Canada assess the most recent changes in access to markets, including the implications of the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the profiles.

Ensuring that Canada remains prosperous over the next decade and into the next century is a challenge that affects us all. These profiles are intended to be informative and to serve as a basis for discussion of industrial prospects, strategic directions and the need for new approaches. This 1990–1991 series represents an updating and revision of the series published in 1988–1989. The Government will continue to update the series on a regular basis.

Michael Wilson

Michael H. Wilson
Minister of Industry, Science and Technology
and Minister for International Trade

Structure and Performance

Structure

The real estate development industry is composed of companies whose services integrate land assembly, development, financing, building and the lease or sale of residential, commercial and industrial properties across Canada. Real estate brokerage and property management businesses are not addressed in this industry profile. Related profiles have been prepared on

- *Architectural Services*
- *Construction Contracting*
- *Consulting Engineering*

Statistics Canada in 1987[1] classified approximately 12 000 firms as real estate developers. Total revenues that year were close to $10.2 billion, total assets in Canada were $27.5 billion and after-tax profits were $633 million. Readers should note that fixed assets are normally reported at cost, so the effect of inflation on land and income properties can result in significantly higher market values. Conversely, during recessionary periods, declining land values may bring write-offs and significant losses. Industry revenues accounted for 2 percent of Canada's gross domestic product (GDP). Sales of real estate accounted for 82 percent of total revenue; rents made up 7 percent; interest payments contributed 3 percent; and the balance came from miscellaneous sources.

A principal activity of the industry is land development. Developers acquire land and retain it until urban population

[1] The most recent year for which complete Statistics Canada data are available.

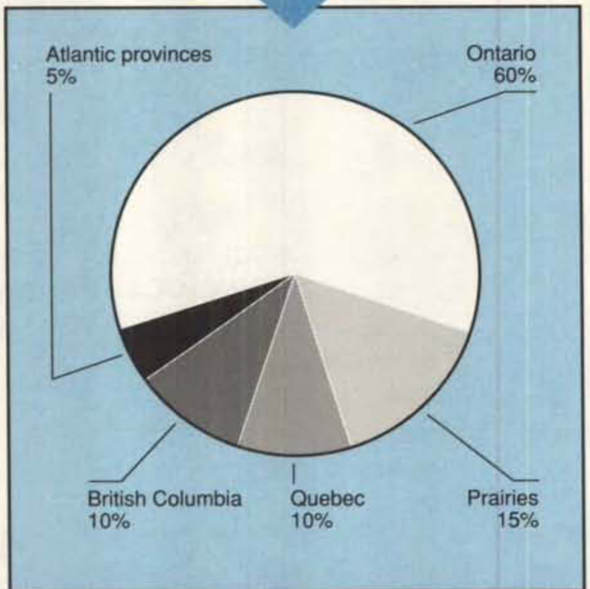

Figure 1 — Regional Distribution of Firms, 1987

growth allows the land to be profitably developed as sites for housing or commercial buildings. Increasingly, major developers are becoming involved with construction as well as with ongoing ownership and management of the properties created. Land development and the subsequent sale of housing and commercial buildings are sources of cash for developers. At the same time, maintaining ownership of income properties provides an investment vehicle for the cash raised as well as some shelter from current income taxes.

The real estate development industry consists of a large number of small firms and a small group of large, world-scale companies that account for a major share of the industry assets. The latter includes Olympia & York Developments, Carena Developments, Trizec and Bramalea. In 1989, the latter three firms had assets in the United States of about C$9 billion. The assets, in Canadian dollars, of seven of the largest real estate developers were reported to be $20 billion in Canada and $15 billion in the United States. These figures do not include the assets of privately owned Olympia & York Developments, the largest of the developers.

The total number of people employed in the industry is not available. The value of salaries and wages in 1987, however, was $540 million. In terms of regional distribution, about 60 percent of developers are based in Ontario; the Prairie provinces account for 15 percent; Quebec and British Columbia account for 10 percent each; and 5 percent are located in the Atlantic region (Figure 1).

Most companies, particularly the smaller ones, tend to concentrate their activities in their home region. The larger, more diversified developers, however, are active across Canada and abroad. Most of these larger companies have pursued opportunities in the U.S. market because of its larger size, and proximity and similarity to the Canadian marketplace. Approximately 250 Canadian-owned firms are now active there.

Corporate developers raise funds through investors and by borrowing through mortgage and institutional lenders. Projects are structured to use financial leverage, which can provide high returns during periods of economic expansion but poses significant risks during cyclical contractions.

The industry is predominantly Canadian-owned, although a number of foreign-owned or foreign-controlled companies operate in this country, mainly from the United Kingdom, Belgium and Italy as well as the more recent addition of Middle Eastern countries, Japan, the United States and Hong Kong. Over the years, several foreign-owned firms, such as Genstar and Trizec (now both Canadian-owned), have strengthened their position in Canada through acquiring smaller firms.

The real estate development industry uses goods and services and is linked to the banking community and all facets of the construction sector. Many developers frequently manage or undertake the construction phase of their projects. They often hold equity positions in a number of firms related in some way to the development business, such as general contractors or real estate operators. To spread risks, a number of the larger developers have diversified their investments into other sectors of the economy such as energy, pulp and paper and retailing. For example, Olympia & York Developments has holdings in Abitibi-Price and Gulf Canada Resources, while Campeau, in a much-publicized takeover, acquired the U.S.-based Allied Stores and Federated Department Stores, although subsequent restructuring has taken place. Other developers have become specialized, concentrating on the construction and ownership of such properties as shopping centres and high-profile downtown office and commercial developments.

The industry's clientele represents most aspects of the Canadian economy. On the residential side, house and condominium buyers as well as tenants are the principal customers. For industrial and commercial properties, clients include a broad range of tenants such as professionals, retail merchants and light industry manufacturers.

Performance

The real estate development industry in its present form came into existence after World War II. Encouraged by the government through direct mortgage lending and preferential

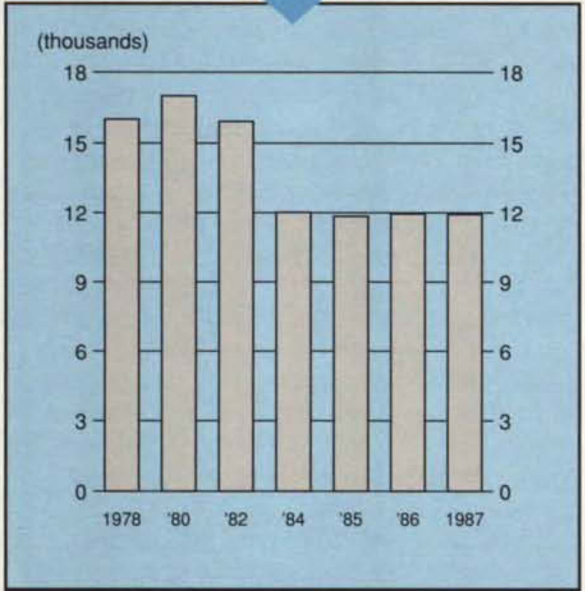

Figure 2 — Industry Establishments

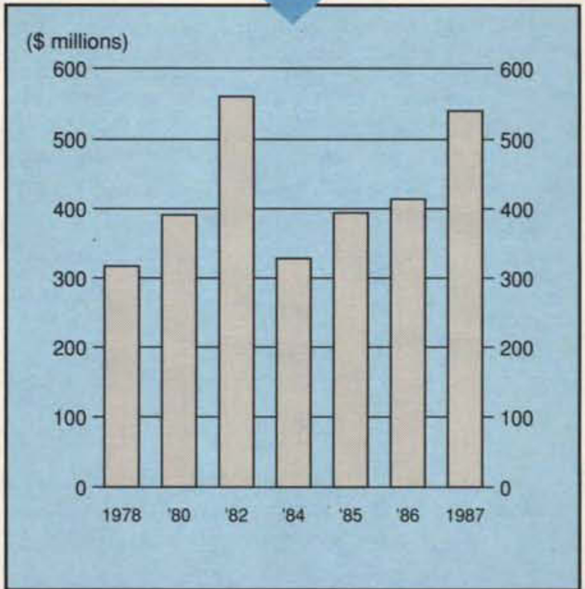

Figure 3 — Industry Salary and Wage Bill

taxation, risk-taking Canadian entrepreneurs initiated the development of the industry, principally in the residential field. The industry grew rapidly, expanding into commercial and industrial development, and is now a major component of Canada's economy. The firms were originally managed by their founders. Although a few of the larger firms continue to be guided by individual entrepreneurs, many others are now governed by professional corporate managers dedicated to increasing assets, cash flow and profits. Small entrepreneurs continue to enter the business.

After World War II, the industry underwent a period of rapid expansion in the number and size of companies. In the mid-1960s, it underwent a period of rationalization, which featured a number of acquisitions and mergers. The 1970s were characterized by rapid expansion both domestically and into the United States, particularly in regions where oil and gas revenues were high. During this period, a number of the larger companies achieved the sophistication, reputation, capacity and financial strength to be active internationally, capable of packaging the largest and most complex projects with creative financing.

Several factors contributed to the creation of these large enterprises. In order to grow in the relatively small and highly competitive Canadian market, they diversified from residential development into industrial, commercial and urban redevelopment markets throughout North America. The industry's need for financing was supported by a strong national banking system that, through regional networks, could readily fund projects outside a developer's home region. This factor provided Canadian firms with a competitive edge over their U.S. counterparts, who were required to syndicate loans among the smaller American regional banks. Entry into the United States during the early 1970s was aided by a collapse in that market due to overinvestment by the regional banks, enabling the Canadian firms to acquire properties at favourable prices. Their ability to comply with the more stringent Canadian regulations at all levels of government, such as planning acts, building standards, rent control and land use policies, and their experience in developing projects long distances from head offices prepared them well for their thrust into the United States.

Following rapid expansion in the late 1970s, Canadian developers were hard-hit by the 1981–1982 recession. Revenues, normally about 2.5 percent of total Canadian GDP, dropped to approximately 1.5 percent between 1983 and 1986. The effect of very rapid expansion, combined with high interest rates for long-term debt financing and overdevelopment in many metropolitan areas, led to the overextension of a number of prominent Canadian firms. As a result, these firms were forced to divest themselves of assets and undertake restructuring programs. The number of establishments dropped from an all-time high of almost 17 000 in 1980 to 11 922 in 1987 (Figure 2). Meanwhile, employment, as reflected in salaries and wages paid, fluctuated (Figure 3).

Industry assets reached $26.4 billion in 1982, decreased to $20.2 billion in 1986, and recovered to $27.5 billion in 1987. The industry, normally profitable, recorded overall losses from 1982 to 1985.

From 1985 through 1989, the Canadian market experienced a steady 16 percent annual growth in the total residential and commercial construction value of all new real estate, and industry profit margins strengthened. Activity was particularly strong in Central Canada and on the West Coast. During 1990 and 1991, however, both residential and commercial development activity slowed as a result of a slumping economy and high interest rates. The largest drop, which was widely felt across the country, was in residential development. Reductions in commercial development activity have been most pronounced in the major urban centres.

The international dimension of Canada's major developers has been highlighted during the past few years by a number of events. Toronto-based Cadillac Fairview was purchased by J.M.B. Realty of Chicago in the largest real estate transaction in Canadian history. In addition, Olympia & York Developments has undertaken the development of the $8.8 billion Canary Wharf project in London, England, the largest office complex in Europe. In two separate transactions, Campeau diversified its operation through the acquisition of Allied Stores and Federated Department Stores, both of the United States, for a total of approximately U.S.$10 billion. Campeau is now encountering severe financial difficulty due to the huge debt load it has incurred and has been divesting its assets.

Strengths and Weaknesses

Structural Factors

The factors that influence industry profitability and level of activity, in addition to the effect of general economic fluctuations on market demand, include availability of financing, interest rates, tax and regulatory structure, the strength of management and the capacity to provide a product that satisfies a range of client needs.

A large proportion of the funds required to construct a new development project are borrowed, usually in the form of mortgages. The ability of firms to undertake specific projects can be affected by the availability of financing, which can be in short supply during periods of high economic activity. During periods when lenders tend to be more selective, large corporations can acquire capital that would not be available to small firms. In addition, it has become common for two or more large companies to combine their resources for certain large projects. The existence of a national banking system in Canada and the close links banks have formed with developers have proven valuable to those firms that expanded across Canada and into the United States. Once established, they borrow from U.S. sources.

Since developers use a high degree of leverage in their operations, which raises large amounts of borrowed funds, interest rates are of the utmost importance. They affect the profitability of the industry by determining the operating costs of the companies and their properties. While inflation can contribute to an increase in the asset values of developers, the accompanying high interest rates suppress market demand and act as a deterrent to new investment. In these circumstances, profit margins are adversely affected by competitive pressures to maintain occupancy rates for rental properties, resulting in lower income flows from the reduced sales of residential units. Conversely, low interest rates stimulate market demand and allow developers to utilize leverage against rising property values.

Real estate development is traditionally capital-intensive and its management is lean, but the large firms in particular have assembled strong management teams that are highly competent in the acquisition of financing and land, administration of cash flows, marketing and project construction. They employ regional managers and professional design firms sensitive to the needs of the local communities in which they operate.

Over the years, the industry, in association with designers and contractors, has demonstrated its flexibility to adapt to differing regional markets and to rapid market changes. Housing concepts have undergone dramatic changes to maintain affordability as a result of the high price of serviced land, and the design and construction of buildings have undergone substantial technical change to conserve energy in their operation. More recently, developers have been faced with the need to provide clients with more sophisticated services in the form of "smart houses" in the residential market that are equipped with computerized, automated systems to control heating, cooling, lighting, appliances and security systems. In the commercial market, there has been an increased demand for "intelligent buildings" that, in addition to more highly automated heating, cooling and lighting, provide the infrastructure to accept the rapidly expanding requirement for more sophisticated information technology.

Trade-Related Factors

Real estate development activity outside Canada is related more to investment than to trade. Although some firms have encountered difficulties, many of the larger developers have been very successful in expanding their operations outside the country, mainly in the United States, after having established a solid base at home.

Developers initially entered the U.S. market by purchasing existing properties below market value and by holding them for a good return on investment. They now conduct their business from subsidiaries incorporated in the United States and are involved in all facets of development, including housing projects, highrise apartments and office buildings, light industrial parks, shopping plazas and multipurpose high-profile downtown development and redevelopment projects. The Canadian developers normally work with U.S. designers and contractors who are knowledgeable about local zoning and building regulations and who are sensitive to the needs and concerns of a particular community. While they have strong links to Canadian banks, the developers now raise a great deal of their financing locally in the United States, where interest rates are usually lower.

Although the Canadian and U.S. real estate development markets were already open to firms from both countries as well as from other countries, the implementation of the Canada-U.S. Free Trade Agreement (FTA) on 1 January 1989 extends elements applicable to the industry. These elements include the principles of national treatment, right of establishment, relaxation of border-crossing requirements for short-term entry of businesspeople and the intention to work towards harmonized accreditation standards for professionals.

Technological Factors

Real estate developers, like many service firms, have had to automate and update office, accounting and management practices, but they are seldom directly involved in the development of technology. However, in order to maintain their productivity and to provide the latest technology to clients, they are concerned with technological factors involving the design, construction and operation of the facilities and equipment used in their developments. Therefore, particularly on large, complex projects, real estate developers employ architectural, engineering, planning and construction companies well-versed in state-of-the-art design, construction and information technology.

Computer-aided design, construction management and scheduling techniques are used to construct energy-efficient buildings, a field in which Canada is a leader. Canadian development projects also incorporate the latest technology in building materials as well as in mechanical and electrical systems designed to accept the sophisticated office, communications and manufacturing equipment demanded by many of today's tenants and clients.

Other Factors

The activities of real estate developers are affected by the political and economic environment created by government policies at all levels and by the impact of these policies on investment and development. The industry itself is not directly regulated. It is, however, significantly affected by government regulations and controls such as planning acts, municipal regulations and standards, rent controls and land use policies. These regulations and controls increase the complexity of the development process.

Tax reform has resulted in reduced tax rates and a wider tax base for corporations. However, the industry maintains that gains from lower rates are offset by decreases in the rate of capital cost allowance for new buildings and the requirement to capitalize interest and property taxes on vacant land in inventory.

Evolving Environment

At the time of writing, the Canadian and U.S. economies were showing signs of recovering from a recessionary period. During the recession, companies in the industry generally experienced reduced demand for their outputs, in addition to longer-term underlying pressures to adjust. In some cases, the cyclical pressures may have accelerated adjustments and restructuring. With the signs of recovery, though still uneven, the medium-term outlook will correspondingly improve. The overall impact on the industry will depend on the pace of the recovery.

Real estate markets will continue to be influenced by cyclical demand patterns resulting from changes to the overall economic environment, particularly changes in interest rate levels. The demand for commercial space that drove the building boom of the 1980s is expected to be moderate during the coming decade as the number of people entering the job market declines. Demand in the immediate future will be particularly weak, as office vacancy rates in most major centres are rising, creating a surplus of space. Similarly, slower rates of household formation and disposable income growth will decrease levels of residential housing starts over the balance of the 1990s relative to those of recent years.

In response to these demand patterns, real estate developers will be likely to take a more active interest in foreign markets, and foreign developers will become increasingly active in the Canadian market. Strong foreign investment from Japan and Hong Kong is expected to continue, since North American real estate prices are relatively low and are considered to provide good long-term value. The increased activity of foreign developers in the Canadian market will provide opportunities for joint ventures on both domestic and international projects. Some Canadian developers have shown interest in new project opportunities in Europe and the Soviet Union, and recent developments in Eastern Europe could provide new challenges.

Changes in the product offered by real estate developers can also be expected. Changing demographics and increasing land values will extend the trend towards multiple unit housing and towards higher investment in building renovation rather than in new construction. Building trends in institutional markets will respond to the need for increased health care and recreational facilities as the population ages. In addition, an increased demand for the construction of residential complexes for seniors can be expected.

Real estate developers can also expect new pressures related to protection of the environment. In particular, the industry will face increasing public sentiment opposed to development and will have to demonstrate that new developments can embrace community concerns. It will also continue to strive to make housing affordable to a larger cross section of the population through innovative design and technological advances.

The FTA has not significantly affected this industry. Those elements of the agreement that address the right of establishment, national treatment, short-term cross-border movement of businesspeople and greater harmonization of accreditation standards for professionals have alleviated some of the irritants that existed in the past. In the longer term, enhancement of the investment climate as a result of the FTA will be beneficial to real estate developers through the increased level of investment in real estate properties.

The 7 percent goods and services tax (GST) now places Canadian design-build firms on an equal footing with foreign competitors by increasing taxes on the competition's inherent cost. The price effect of the GST on new housing in Canada may act as a stimulant for increased demand for home repairs and renovations of existing houses. The net impact of the GST on new housing has been softened by the removal of the federal sales tax on many material inputs and by GST rebates on less expensive houses.

Competitiveness Assessment

The evolution of many of the large Canadian real estate developers into world-scale, internationally recognized firms is demonstrated by their success in the United States. The industry as a whole can be expected to continue to improve its position domestically and expand in foreign markets, particularly the United States. Further diversification into other sectors of the economy such as energy, pulp and paper, and retailing is also a possibility.

For further information concerning the subject matter contained in the profile or in the ISTC sectoral study (see page 9), contact

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PRINCIPAL STATISTICS

	1978	1980	1982	1984	1985	1986	1987	1988	1989
Establishments[a]	16 004	16 984	15 913	12 012	11 842	11 943	11 922	N/A	N/A
Salary and wage bill[a] ($ millions)	317	391	560	328	394	414	540	N/A	N/A
Total construction activity[b] ($ millions)	38 190	48 327	56 064	56 574	67 983	71 701	81 971	90 871	100 065
Total residential and commercial construction[b] ($ millions)	17 636	19 784	20 644	23 776	32 842	39 004	48 203	53 052	59 276
Total assets[a] ($ millions)	17 798	20 818	26 354	20 926	20 840	20 196	27 504	N/A	N/A
Total revenues[a] ($ millions)	6 393	7 724	7 851	6 454	6 918	7 401	10 190	N/A	N/A
Total expenditures[a] ($ millions)	6 035	7 286	8 186	6 663	7 080	7 218	9 557	N/A	N/A
Profits after tax[a] ($ millions)	358	438	-335	-209	-162	183	633	N/A	N/A

[a]Data are based on special tabulations provided by the Industrial Organization and Finance Division of Statistics Canada and published in a slightly different format in *Corporation Financial Statistics*, Statistics Canada Catalogue No. 61-207, annual.

[b]See *Construction in Canada*, Statistics Canada Catalogue No. 64-201, annual.

N/A: not available

REGIONAL DISTRIBUTION[a] (1987)

	Atlantic	Quebec	Ontario	Prairies	British Columbia
Establishments (% of total)	5	10	60	15	10

[a]ISTC estimates.

MAJOR FIRMS

Name	Country of ownership	Location of head office	Total assets, 1989[a] ($ billions)	Percentage assets in Canada, 1989[a]
Bramalea Limited	Canada	Toronto, Ontario	5.32	68
Brookfield Development Corporation	Canada	Toronto, Ontario	2.37	19
Cadillac Fairview Corporation Limited	United States[b]	Toronto, Ontario	N/A	N/A
Carena Developments Limited	Canada	Toronto, Ontario	11.86	68
Coscan Development Corporation	Canada	Toronto, Ontario	1.20	40
Marathon Realty Company Limited	Canada	Toronto, Ontario	2.25	59
Markborough Properties Inc.	Canada	Toronto, Ontario	1.91	55
Olympia & York Developments Limited	Canada	Toronto, Ontario	N/A	N/A
Trizec Corporation Ltd.	Canada	Calgary, Alberta	10.17	50

[a] Data derived from The Globe & Mail, *Business 1000*, July 1990.
[b] Recent U.S. acquisition.
N/A: not available

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SECTORAL STUDIES AND INITIATIVES

The following information is available from Industry, Science and Technology Canada (see address on page 6).

Canadian Construction Outlook and Issues Study
This study, sponsored by ISTC and conducted by Revay and Associates Ltd., reviews the activity and performance of seven non-residential segments of the construction industry during the past 10 years and provides an outlook for the 1990s.

Printed on paper containing recycled fibres.