

COMPARATIVE REAL ESTATE FINANCE ANALYSIS

Prepared for the
Ministry of Municipal Affairs and Housing
Housing Policy Branch
Housing Supply Working Group

 **ERNST & YOUNG**
FROM THOUGHT TO FINISH.™



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SUMMARY OF FINDINGS

This report analyzes the impact of various types of federal taxation on the construction of multi-family rental housing in Ontario. Comparisons are drawn to several U.S. markets, with a view to isolate the specific effects of tax rules relating to marginal tax rates, capital gains and depreciation rates, rollover provisions, deductibility of soft costs, pooling of assets, and capital taxes.

The following are the key findings of the analysis:

- Market conditions in Ontario are very strong, with low vacancy rates, rising rents, and strong economic growth, yet little new construction is taking place in the multi-family residential rental market
- Market conditions are very similar in the four American centres as well, yet some markets are experiencing much higher degrees of construction in the multi-family residential rental market
- There is a strong relationship between the financial returns available to builders and owners of multi-family rental housing, and the volume of new construction of rental housing
- On a pre-tax basis, returns are slightly higher in the U.S. markets than in Ontario
 - Merchant builder returns are approximately 8% higher in U.S. markets compared to Ontario
- After tax returns are far lower in Ontario than in the U.S.
- Tax rules relating to the treatment of capital gains and depreciation appear to be the most significant factors driving down returns in Ontario. The impact of capital gains taxation is greatly influenced by regulations relating to the pooling of assets and rollover provisions
 - After tax returns (considering capital gains and rollover provisions) are approximately 25% higher in the U.S., on average
 - A change in Canada's tax laws to restore rollover provisions would increase rental investment returns in Ontario by approximately 15%
 - A U.S. style depreciation system would increase after-tax cash flows by 16% in Ontario compared to the current system
- Marginal tax rates are higher in Ontario than in the U.S. cities, but the negative effect of this is less severe than the capital gains and depreciation issues
- Although not explicitly examined in this report, GST and PST, which increase construction and development costs, can have a significant impact on the margins available to builders of multi-family housing projects, and a lesser effect on the on-going operations of a building

- Realty tax rates appear to be a significant impediment to development of potential new multi-unit rental housing developments in Ontario under the current 8-year cliff provisions
 - In Ontario, residential rental developments are disadvantaged under the current system as realty tax rates are almost 300 percent higher for rental units than for condominium units, although there are provisions under recent legislation that enable municipalities to tax new rental housing at a lower rate for a period of eight years
- Municipal fees such as lot levies and other development charges are a significant factor in some markets, as they add significant costs to new developments
 - Municipal fees and charges can reduce rental development returns by approximately 6.5% in Toronto, and as much as 11 percent in other GTA municipalities
- The availability of financing for new projects is critical for the development of new rental housing projects

INTRODUCTION

This study will examine the impact of certain tax issues on the feasibility of new rental housing in Ontario, and will use several U.S. markets as the basis for comparison. Hypothetical projects in Ontario will be set alongside similar projects in the U.S. markets, in order to isolate the degree to which (if any) Canadian tax laws negatively affect new rental projects.

There have been a number of changes in the multi-family housing market in recent years, and some of these changes have improved market conditions to the point where construction of new inventory may be viable, but to date there has been limited progress in this area.

As tax legislation in both Canada and the U.S. is extremely complex, several simplifying assumptions are made. Firstly, the projects that will be compared are assumed to be very similar in each jurisdiction, regardless of specific local market conditions, which may be skewed to different segments of the market. For example, in Toronto at the present time, apartments aimed at the very high end of the market have a much better chance of profitability than those directed at the mid or low ends of the market. Other markets may have different supply and demand dynamics in play. It is also assumed that the builders and investors discussed in the analysis are typical in the marketplace, and their primary source of income is from the real estate market. Tax legislation can be significantly different for investors whose primary income source is from other operating businesses.

This report looks only at the mid-market segment of the market, in each of the six cities. That part of the market referred to as affordable is not viable given current market conditions, and is not included in the primary analysis, but is considered separately. Substantial subsidies would be required either in initial capital injection, or in terms of operating revenue. As there are no subsidies of this type available at this time, there is no mechanism to model such a scenario utilizing market driven data.

Both Toronto and Ottawa have strong fundamental conditions that are required to support new rental housing (rental rates, vacancy rates and other economic indicators are summarized in Addenda 8 of the report), yet there is little new construction. The following analysis will isolate as much as possible several variables (primarily federal taxes) that influence the viability of rental housing projects in Ontario.

Merchant Builders Versus Long Term Investors

There are two separate entities necessary in the production of new supply in the apartment market. First, a developer/builder (referred to as a merchant builder in this report) must construct the building, and generally is also responsible for the initial leasing of the building. Secondly, there must be a market for the finished product by institutional or private buyers. Most large private and public companies, REITS and institutional investors that are active in the multi-residential market in Canada generally do not have an interest in developing properties, but prefer to hold on to properties for the longer term, and avoid the many risks associated with constructing new buildings. This is an important segment of the market as it provides the merchant builders with the necessary liquidity. Merchant builders on the other hand, generally do not hold on to property for the longer term, as they wish to have capital available for the much riskier process of developing apartment buildings. Merchant builders are necessary in the market as they are willing to assume the greatest amount of risk, and are knowledgeable in the construction of apartment buildings.

In order to have the supply of new apartment units in Ontario increase, both these parties must be compensated with competitive rates of return. There must be enough of a spread between the two that both receive market returns, based on the risk each is assuming. Another way of describing this is to say that a builder must be able to cover construction costs and be provided with a profit margin. If the purchaser (presumably a long term investor) can be provided with a return commensurate with market risk at a purchase price that provides the builder profit, then all parties are satisfied, and construction will take place.

To establish this spread, a method of measuring the returns and value to the two parties is required. The most common method of relating value to income is the *Overall Capitalization Rate* (Cap Rate). This measures the net operating income of a property as a percentage of the purchase price. It is a widely accepted benchmark, used by investors, mortgagees, brokers, and appraisers. It is a relatively simple tool, and considers most aspects of the investment over its life. It is very useful in establishing value but does not account for the tax implications to individual investors. This is not problematic when comparing properties in similar tax jurisdictions, but is clearly an issue when comparing properties with varying tax regulations. For many investors, such as pension funds, this may not be a significant issue. For others such as REITS, individual investors etc., circumstances vary significantly for each transaction.

When a merchant builder is considering the construction of an apartment building, the measurement of returns is typically more sophisticated than it is for a long term investor, as the disposition of the asset is anticipated at a much earlier stage than the typical holding period that an investor uses (twenty years is used as the example in this report), and taxation issues are considered as well. The following analysis will consider the returns anticipated by both the builder and the investor, but will also analyze the tax implications of the investment decision, with comparisons between the U.S. and Canadian markets.

Four American cities - Boston, Chicago, Dallas and Atlanta - as well as Toronto and Ottawa will be studied. Data was gleaned from many sources and believed to be representative of circumstances in each market. The returns available to the original developer of a property are estimated, as are the ensuing returns to the long-term investor.

Findings

For the purposes of this analysis it was assumed that the builder's, and investor's principal business was constructing or investing in rental housing. If the investor's primary source of income were other than rental real estate, the findings would differ somewhat, as the tax regulations would be different.

The data indicates that returns available to the developer in Toronto today are approximately 8.9%, compared to a market cap rate of approximately 8% to 8.25%. This indicates that there is some spread available to the builder, allowing him to construct and lease an apartment building, sell it to a long-term investor, and be compensated for the many risks that were undertaken. This spread is likely not sufficient for most developers to assume the risk inherent in such a project. In Ottawa, however, there is virtually no spread available to the merchant builder (actually slightly negative in the analysis), and it is therefore unlikely that there would be any new housing inventory aimed at the rental market.

In the four American cities the analysis reflects actual experience in the individual cities. In Boston and Chicago, for example, where there has been only a modest amount of new construction, there is very little

spread available to the builder, but in Atlanta and Dallas, where there has been substantial growth in the inventory of rental housing, the spread between the return available to the builder and the investor is the greatest. The evidence indicates a strong relationship between the difference in returns available to a developer and an investor, and the rate at which rental housing is added to a city's inventory.

On a pre-tax basis, returns are slightly higher in the U.S. markets than in Ontario.

- **For merchant builders, returns are approximately 8% higher on average in the U.S. than in Ontario**

Tax Implications

Although the foregoing argument is true, it assumes that all markets are operating in an equal environment. Typical analyses can allow for differences in economic conditions in a community, such as rental rates, vacancy rates, required rates of return etc., but do not distinguish between changes in tax regulations from one jurisdiction and the next.

The most significant difference between the American and Ontario cities relates to the returns on an after-tax basis. There are a myriad of differences between the Canadian and American tax regulations, and they differ further depending on the legal status and circumstances of the individual investor, the type of property, and the local jurisdiction. U.S. states have the authority to tax corporations and individuals, and therefore tax rates are different in each city considered in this analysis, and the treatment of capital gains and soft costs can vary substantially. The most significant distinction between the two countries, however, is consistent across each American city, and that is the treatment of capital gains taxes. The tax rates themselves are not substantially different between the two countries, but the manner in which they are included as income can be very different.

In many situations, American investors are able to sell investment real estate (including rental housing) and avoid capital gains taxes. This is done through the exchange of real estate, or through purchasing a larger rental property. In this way, investors can actively manage their portfolios, and invest in properties appropriate to their circumstances. The market as a whole benefits as there is added liquidity in investments, which has the effect of reducing the required returns going into the investment initially. To the individual investor, the effect of Canadian capital gains treatment is to reduce the expected after-tax returns, decrease liquidity, thereby increasing risk, and increasing the required return on a pre-tax basis.

The summary of returns on a following page indicates that while on a pre-tax basis expected returns in Canada are only marginally lower than in the U.S., on an after tax basis over the life of the investment, the returns are far lower.

Internal rates of return for Ottawa and Toronto average about 10.75%, assuming a twenty-year holding period and no rollover provision at the time of disposition. In the U.S. cities, however, the average IRR is 13.5% since there is the ability to avoid taxes should the investor remain in the market. Even if an American investor wishes to exit the market entirely, there are more options available to avoid punitive capital gains taxes.

- **After tax returns (considering capital gains rollover provisions) are 25% higher in the U.S., on average.**

If the Canadian investor were able to reduce his tax exposure as long as he remained invested in the market in one form or another, the internal rates of return would rise to 11.76% and 13.02% in the examples given. This is still lower than in the U.S. cities, but is an improvement over the current situation.

- **A change in Canada's tax laws to restore rollover provisions would increase rental investment returns in Ontario by approximately 15 percent.**

Allowable depreciation rates also have an effect on after tax rates of return. The allowable Canadian rate is 2% in year one, and 4% thereafter, on a declining basis, compared to the U.S. rules, where a straight-line method over 27.5 years is used, with the first year being pro-rated on a monthly basis. Over the twenty-year term in this example, the result is that an American investor could depreciate an additional 18% of the capital costs of the building compared to the Canadian investor. The difference is particularly important in the later years of the investment, where the Canadian investor has less and less depreciation available at the very time that the building requires capital infusion. By the end of twenty years U.S. tax rules result in the asset being 73% depreciated, while in Canada, the asset is only 55% depreciated. Between the added depreciation allowed in the U.S., the ability to roll over assets and the lower tax rates, the result is that IRRs in the examples given are 25.5% higher on average in the U.S.

A U.S. style depreciation system would increase after-tax cash flow returns by approximately 16% in Ontario compared to the current system.

The remaining difference between the two countries is generally the result of lower overall tax rates. The marginal U.S. Federal tax rate of 35% is increased by various state taxes, and is summarized in the following table. The resultant marginal tax rates range from 38% to 41%, which compares to the marginal rate in Canada of 46%. It must be cautioned that tax legislation in both countries is complex, and this analysis assumes circumstances that are somewhat typical.

Assumptions

Assumptions*	Toronto	Ottawa	Boston	Chicago	Atlanta	Dallas
Land Cost (\$/unit)	35,000	15,000	50,000	35,000	15,000	15,000
Construction Cost (\$p.s.f., gross floor area)	110	100	182	172	139	135
Construction Cost (\$p.s.f., net rentable area)	138	125	228	215	174	169
Market Rent (\$/month/unit)	1,500	1,250	2,600	2,400	1,635	1,750
Loan to Value Ratio	75%	75%	75%	75%	75%	75%
Mortgage Rate	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Market Vacancy Rate	2%	2%	2%	6%	5%	5%
Income Tax Rate	46%	46%	41%	38%	39%	38%
Capital Gains Exemption	50%	50%	0%	0%	0%	0%
Investor's Required Return**	8.25%	8.50%	8.80%	8.90%	7.60%	8.90%

*All figures are in Cdn. \$, at a conversion factor of 0.65

Returns

Rates of Return	Toronto	Ottawa	Boston	Chicago	Atlanta	Dallas
IRR (No Rollovers Allowed)	10.12%	11.40%	12.93%	12.54%	10.36%	13.18%
IRR (Allowing Rollovers)	11.76%	13.02%	13.99%	13.84%	11.56%	14.63%
Merchant Builder's Return (NOI/Cost)	8.90%	8.30%	9.08%	9.35%	9.06%	9.78%
Long Term Investor's Required Return**	8.25%	8.50%	8.80%	8.90%	7.60%	8.90%
Spread between Merchant Builder and Long Term Investor's Rates of Return	0.65%	-0.20%	0.28%	0.45%	1.46%	0.88%
Investor's Avg. Annual return (after tax cash flow, assuming tax losses can be used)	2.79%	3.58%	4.30%	4.23%	2.72%	4.71%
Investor's Avg. Annual return (after tax) (Assuming straight-line depreciation - 27.5 yrs)	3.24%	4.14%	4.30%	4.23%	2.72%	4.71%
Builder's Cost (\$/unit)	151,985	121,350	243,557	217,922	162,827	158,573
Investor's Purchase Price (\$/unit)	161,626	116,707	247,757	225,669	191,620	171,917
Profit (loss) on Construction	9,641	-4,643	4,200	7,747	28,793	13,344
Current Tax Rules in each jurisdiction						

**CB Richard Ellis, National Real Estate Index

DESCRIPTION OF THE ANALYSIS

In order to compare the two Ontario cities with the four American cities, typical circumstances were assumed in each market. The basis for the data was taken from reliable sources, such as the U.S. Census Bureau, industry publications such as Marcus & Millichap, CB Richard Ellis reports, Colliers International reports, and internal Ernst & Young data. In Canada, data was provided by CMHC, Helyar, Statistics Canada, Colliers International, internal Ernst & Young sources, and industry contacts.

A pro-forma analysis was completed in each market, estimating cash flows in year one of the investment. This represents the returns available to the merchant builder. It was then assumed that the merchant builder then sold the property to an investor at a price determined by cap rates prevailing in the local market. The analysis then considers the investment over a twenty-year time frame, representing the investor's perspective on returns. If the price the investor is willing to pay were sufficient to allow the builder a reasonable profit, the project would become reality. If the investor's price does not allow a profit to the merchant builder, however, the exercise of analyzing the twenty-year cash flows is essentially fruitless, since the project would not proceed.

The summary on the previous page indicates the assumptions used in creating the projections, as well as the returns available to the merchant builder and investor. Perhaps the key indicator in this analysis is the "Spread between Merchant Builder's and Long Term Investor's Rates of Return". It is difficult to suggest what the minimum spread should be, but anecdotally, industry participants indicate numbers in the 0.75% to 1.5% range. The analysis shows that this is the case in Atlanta and Dallas, and these are the only two markets with significant inventory of rental units being added on an annual basis.

A more detailed description of the assumptions is given below.

Construction Costs

The construction costs are estimated for an 850 square foot, two-bedroom apartment, of average quality, and standard features and amenities. Costs include taxes such as GST and PST as they apply to various materials and labour. The costs for Toronto and Ottawa were taken from the Helyar Building Cost Manual. Discussions were held with a representative of Helyar as well as other industry professionals to ensure the data was up-to-date. Data for the U.S. markets was derived from U.S. Census Bureau statistics as reported by CB Richard Ellis in their annual report on the U.S. apartment market. It should be cautioned, however, that judgement is required in utilizing this type of data. The indicated costs per square foot are for the gross building area. For the purposes of this analysis it has been assumed that the net rentable area of 850 square feet has been grossed up by 25% (not all of a building's floor area is used for rentable apartment space, it is assumed that 20% of the building's area is used for hallways, laundry facilities, management offices etc.).

Land Costs

The land cost per unit has been estimated for average to good locations in each market. There are prime locations that would demand higher land costs per unit, and sites that are available at a much lower cost, but the locations must be good enough to be able to demand the higher rents that will be charged in the new property. Data for the U.S. markets was drawn from statistics provided the U.S. Census Bureau in a report prepared by CB Richard Ellis, and confirmed in discussions with local market participants, while data for the Canadian

markets was provided through several widely available sources (Marsh Report, Realnet, industry reports) discussions with brokers etc. Land costs also include all municipal charges and soft costs (municipal levies, education levies, costs for external servicing requirements etc.).

Market Rent

Market rent was based on Marcus & Millichap data for U.S. markets, and verified with discussions with local market experts. For the two Ontario markets, the estimation of market rent was somewhat more difficult. There is currently a gap between market rent within the existing inventory of apartments, and the market rent for new product. There is, however, a sufficient rental market within the condominium supply to establish reasonable parameters. Rents for a new condominium unit in a prime downtown Toronto location, for example, could be as high as \$2.50 p.s.f. for a 850 s.f. unit, or \$2,125 per month. This compares to CMHC data, which indicates that current rents are closer to \$1.25 for units within the existing inventory. CMHC data is the best available, but does not properly take into account the many condominium units that are individually owned and leased to third parties. It is logical to assume that rent for a new unit would command higher rents than most existing units, as they are new, have all modern amenities, and often take advantage of superior locations. For the purposes of this analysis, rents are estimated to be \$1.76 p.s.f. in Toronto, and about \$1.50 p.s.f. in Ottawa.

Mortgage Rate

For the first year analysis (merchant builder) it is assumed that financing is based on interest only payments. For the analysis of the individual markets, the same interest rate is applied to all markets, even though local market conditions might at times dictate otherwise. The interest rate calculations are based on annual compounding with blended interest and principal payments for the investor group in the analysis.

Tax Treatment

The following is a discussion of the effects of tax legislation on the investment in multi-family rental housing.

Capital Gains

The impact of capital gains legislation in Canada is to reduce the liquidity of the investment, as a large tax penalty is incurred upon disposition of the asset. In the U.S., there are capital gains provisions, but the impact is much less severe, due to the ability to avoid the tax entirely through proper estate planning for private investors and the pooling of assets for all investors. For an investor with multiple properties in Canada, a potentially large tax liability is realized whenever any one of the properties in the portfolio is sold. This contrasts with the U.S. model, where the asset that is sold is included in the overall portfolio, and the impact is far less severe.

A second method of avoiding large tax liabilities is through a rolling-over provision. An investor with a single asset can sell that asset, and purchase another of the same value or greater, and avoid paying capital gains taxes. In Canada that is not possible, further reducing the liquidity and profitability of the investment.

Depreciation

Since the profit margins are very narrow in the multi-family housing investment market, the manner in which the asset is depreciated can have a relatively large impact on the after tax returns. In Canada the asset is depreciated on a declining basis, at 4% per year, 2% in the first year. This compares to the U.S. model, where buildings are depreciated at a rate of 3.64% per year (straight line, 27.5 years). In the early years of the investment, the difference is marginal, but as the investment ages, the difference is much more meaningful. By year 20, a U.S. investor has depreciated the asset by 73%, compared to the Canadian investor, who has depreciated it by 55%. In year 20, the American investor has deductions of about 50% of pre-tax cash flow available, while the Canadian investor has less than 30%. This clearly has a negative impact on the annual returns available to the investor as the investment matures, and discourages re-investment in the asset. To illustrate the impact, a Canadian investor would realize an increase of 16% (from 3.2% to 3.7% on average) in after tax cash flow if it were possible to accelerate depreciation to the equivalent U.S. rate. This is an average rate, as the difference is more pronounced in the later years of the analysis.

Financing

The difficulty in financing a rental project is not directly the result of tax legislation, but clearly has a tremendous influence on the viability of rental housing projects in Ontario. Financing has generally been the sole responsibility of the private banking system in Canada, but CMHC also has a large role to play.

Existing housing projects can be financed according to typical underwriting criteria. Mortgages in excess of 75% of the value of the building must be insured. In the past, this value was based on a 9% cap rate, regardless of the potential growth in rents or local market conditions. This requirement has been relaxed in recent months, with some flexibility available to the underwriter. In terms of cash flow, it has generally been the rule that cash flow must equal a minimum of 1.1 times the debt service. This rule has also been relaxed slightly, as it has been recognized that the ratio may be low in the first year or two, but will steadily climb with rental growth.

Difficulties arise when the loan to value ratio exceeds 75%, as insurance requirements can be rather onerous, penalizing projects that are already marginal in the eyes of CMHC and the underwriter. Insurance premiums can increase to as much as 5% of the loan value, making an otherwise viable loan unworkable.

The above discussion relates primarily to existing inventory, as the situation is far worse for new developments. As there has been little history of rental construction in Ontario over the past 20 years, lenders are sometimes overly cautious. As there is no contractual income in place, they are hesitant to lend, and there is no way to have leases in place prior to construction in most cases. The financing of projects is virtually impossible except as condominium projects with multiple owners.

Before large-scale multi-family development will take place in Ontario, financing must be made available for viable projects.

Realty Taxes

Realty taxes vary from market to market, but Ontario tax rates are generally comparable to those in the four U.S. cities. Average real estate taxes for each of the markets are summarized in Addenda 8 of the report. Recent reforms in Ontario have resulted in significant changes in recent years, and further changes are expected. Realty

taxes are intended to be a function of value, and as such will vary over time as the value of multi-family housing changes relative to other property types over time.

In Ontario, residential rental developments are disadvantaged under the current system, as realty tax rates are much higher for rental units than for condominium units, which are taxed at similar rates to single family housing. Recently enacted legislation (Fair Municipal Finance Act) allows for an eight-year period in which a lower tax rate can be applied to rental buildings (not to be less than the residential rate). If at the end of this period rates were to increase to the rates applied to existing rental units, the effect could be disastrous for rental projects. The effect also impacts projects currently being considered by developers. If it is a developer's belief that realty taxes will increase substantially several years after completion of a project, it is unlikely that the project would ever get underway. If taxes increased, values (and owner's equity) would decline and cash flows would be severely impaired. Assuming a 100% increase in realty taxes in the fifth year of the analysis (compared to current rate difference of approximately 300% between rental and condominium units), the IRR would decrease from 11.76% to 9.95% for the long-term investor. When considering the narrow margins being presented in this analysis, a substantial anticipated realty tax increase would eliminate virtually all proposed rental developments.

Municipal Fees

Municipal fees such as lot levies and other developmental charges are a significant factor that add to the cost of new development and lower returns. In old City of Toronto neighbourhoods, development charges could add up to \$10,000 to the cost of a new rental unit. In those jurisdictions just outside of Toronto, however, up to \$20,000 can be added to the cost of a unit by various development charges. This is clearly a significant factor. If the cost of a unit in Toronto were increased by \$10,000 due to levies or municipal fees, the return available to the developer would decrease from 8.9% to 8.35%, a 6.5% decline in the overall return to the developer. The impact of \$10,000 in additional costs (calculated as an increase in land cost) has the same effect as an increase of \$800 in annual realty taxes. Most people would strongly object to an increase of \$800 in annual taxes on an apartment, but few seem to realize the importance of municipal fees in the overall cost structure of apartment buildings.

CONCLUSION

There is not one single factor that explains the reason why there is construction in some U.S. markets, while very little in others, and virtually none in Canada. It is clear, however, that there is a strong relationship between financial returns generated by the construction and ownership of rental housing, and the volume of construction in a given market. The returns available to the merchant builder are affected primarily by input costs, such as GST, municipal levies, construction costs etc., while income tax implications are much more important to the long term investor.

What matters most of all from an enterprise standpoint, is the gap between the long-term returns, and the merchant builder's required returns. If the builder is not provided with a satisfactory return, he exits the market entirely. If the long-term investor wishes to be involved in the market, he can simply buy existing product at prices below replacement cost. Inventory is added only when both are satisfied.

AFFORDABLE HOUSING

Low Income Housing Tax Credit

There are many programs available in the U.S. that target affordable housing initiatives. Most are regional in nature, and are designed to handle local needs. The most significant program available on a national basis, however, is known as The Low-Income Housing Tax Credit (LIHTC).

LIHTC was enacted by Congress to encourage new construction and rehabilitation of existing rental housing for low-income households and to increase the amount of affordable rental housing for households whose income is at or below specified income levels. In establishing the tax credit incentive, Congress recognized that a private sector developer may not receive enough rental income from a low-income housing project to: 1) cover the costs of developing and operating the project, and 2) provide a return to investors sufficient to attract the equity investment needed for development. To spur investment, Congress authorized the states, within specified limits, to allocate tax credits to qualifying housing projects. The credits may be shared among the owners of a project (equity investors), much as income and losses are shared among business partners for tax purposes. Generally, the investors are recruited by syndicators, and ownership rights are controlled by limited partnership agreements.

The program is jointly administered by the program state tax credit allocation agencies. Currently, each state is annually allocated tax credits in an amount equal to a statutory dollar amount per state resident (for example, in 1999 the dollar amount was \$1.25 per state resident). Under Section 42 of the Internal Revenue Code, the state agencies are responsible for determining which housing projects should receive tax credits and the dollar amount of tax credits each should receive.

In making these determinations, the states are to consider housing needs and costs. The Internal Revenue Code provides the states with general guidance on how to consider needs and costs. The state tax credit agencies are required to have an allocation plan that identifies the states' priority housing needs and contains selection criteria for awarding credits to help meet those needs. Housing needs are intended to include consideration of such matters as the availability of low-income housing over extended periods of time. To ensure that no more tax credits are awarded than necessary to stimulate low-income housing development, the state agency is required to evaluate such factors as the reasonableness of development costs and the sources and uses of project funds.

After the state allocates tax credits to developers, the developers typically sell the credits to private investors. The private investors use the tax credits to offset taxes otherwise owed on their tax returns. The money private investors pay for the credits is paid into the projects as equity financing. This equity financing is used to fill the gap between the development costs for a project and the non-tax credit financing sources, such as mortgages, that could be expected to be repaid from rental income.

Generally, owners must place the projects in service within 2 years of carryover allocation or return the credits to the state for reallocation to other projects. Investors can claim the credits for each year of a 10-year period called the "credit period" as long as a minimum percentage of the projects' units are rented to low-income tenants at restricted rents for a 15-year compliance period. Individual and corporate investors attach Form 8609, Low-Income Housing Credit Allocation Certification, to their income tax returns when they claim the credits.

Once projects have been placed in service, state agencies are also responsible for monitoring the projects for compliance with federal requirements concerning household income, rents, and project habitability. If non-compliance is not corrected, the Service may recapture or deny credit for previously used or issued tax credits. The Service is responsible for issuing regulations on state monitoring requirements.

The following is a simplified example of how two projects would compare, one using the tax credits and supplying below market rents, and the other being a project with market rents and no credits. The basic assumption is that the two projects are physically identical, and that all capital costs and operating costs are the same. The differences are in the manner in which they are financed, and the revenue that is available. The project with tax credits must supply below market rents for a guaranteed period (minimum of 15 years, usually at least 30 years). In this example the actual rents are 26% below market levels. Financing rates are also assumed to be the same for each project. It is assumed in the model that the annual tax credits available to the developer have been sold for \$4,000,000 to a private investor. The discount charged in these transactions varies, but is typically no more than 20% of the face value of the credits.

	<i>Project One Using Tax Credits</i>	<i>Project Two* No Tax Credits</i>	<i>Project Two** No Tax Credits</i>
Total Project Cost	\$10,000,000	\$10,000,000	\$10,000,000
Equity	1,000,000	1,000,000	5,000,000
Debt	5,000,000	9,000,000	5,000,000
Tax Credits	4,000,000	0	0
Rental Income	930,000	1,250,000	1,250,000
Operating Costs	400,000	400,000	400,000
Net Operating Income	530,000	850,000	850,000
Debt Service	400,000	720,000	400,000
Cash Flow	130,000	130,000	450,000
Return on Equity	13%	13%	9%
*Assumes credits replaced with debt			
**Assumes credit replaced with equity			

The result of the program is that developers are able to achieve competitive rates of return, while supplying the market with affordable housing. The amount of tax credits available varies depending on the number of units made available, and the income and rent levels in the neighbourhood.

This is the program with the greatest impact in the U.S. Nationwide, it results in approximately 90,000 units per year being constructed, and has consistently done so since the introduction of the program in 1986. It is fair to say that the majority of these units would not have been built outside of this program (or a program offering similar benefits). However, it is difficult to estimate what percentage of all units that are built in the U.S. every year is the direct result of municipal, state or federal subsidy programs. The percentage of units that are built across the country without assistance, however, is much higher than in metropolitan Ontario markets at this time.

Affordable Housing in the Canadian Market

In order to create affordable rental units in metropolitan areas in Ontario, given current market conditions, it appears that intervention from the public sector is necessary. Within the existing parameters of the private sector, market conditions do not allow the development of privately owned units. The spread between the cost to build and the returns required by investors are insufficient to motivate the construction of units with rental rates below \$1,000 per month. Assuming \$900 per month is the targeted rental rate, there must be a subsidy of \$75,000 per unit, holding all other assumptions the same as in the privately funded model. If land could be located that was cheaper than \$35,000 per unit, this would partially fund the difference, but even if land were located at no cost, an additional \$40,000 per unit would be required to make units viable at \$900 per month. At that point, the spread between builder's cost and investor's expectations would be 1.45%. At a spread of 0%, the total subsidy would have to be \$26,500, with land provided at no cost. This would be feasible if long-term investor was also the builder, and had no perceived risk in the development of the project.

The requirement for this degree of subsidy would be reduced (far from being eliminated) if the quality of the units were also reduced relative to the units being provided in the private sector. This could be done through building of smaller units, fewer amenities, and overall lower quality materials. Given current market conditions, however, it is unlikely that privately funded affordable units will be constructed at any time in the foreseeable future.

ADDENDA 1

Summary of Markets

SUMMARY OF MARKETS

The pro-formas are based on actual market indicators in the individual U.S. markets. It is possible to establish rental rates, building costs and operating costs, and build a pro-forma analysis. Each of the U.S. markets, however, has a particular set of circumstances that influence the type and volume of product being introduced to the market. The following describes the dynamics of the market in each of the cities being considered.

Boston

Boston's economy has been very strong over the past several years, listed as one of the top eight markets for business viability, economic performance, and development capacity. The local unemployment rate is among the lowest in the country at 2.9%. The city's highly educated workforce is a key driver behind the growing information based economy. Local household income levels exceed the national average by about 11%.

Residential construction activity has been strong, although slowed recently by rising interest rates. An important consideration for many developers in Boston is a new "tax" of 10% on new development to be set aside for affordable housing. In terms of the fundamental economic indicators in the multi-family market, Boston's was among the strongest in the country, the result of low vacancy rates, rising rents, and strong barriers to entry for competition. There were a large number of developments proposed, but few units were actually delivered in 1999. Land costs are very high, with sites in Boston in the range of \$60,000 per unit, and \$30,000 to \$35,000 per unit in suburban locations. The result is that the market behaves in a similar fashion to the Toronto market, in that the majority of new construction is aimed at the luxury market.

Chicago

The local economy expanded at a rate of 1.2% in 1999, compared to the national average of 2%. There was job growth in almost every sector, with the exception of manufacturing which declined slightly. The most significant growth occurred in the business services sector, which increased by 6%. Local forecasters expect the local economy to grow at 1.3% annually for the next five years, compared to the national average of 1.5%. Because of the size of the local economy, however, more new jobs will be created in Chicago than all other markets with the exception of Los Angeles and Atlanta.

A new trend is beginning to emerge in Chicago, as 4,000 condominium units were added to the downtown inventory in 1999, with an additional 3,000 units expected to be added for each of 2000 and 2001. The majority of new construction is focused in the single-family market, however, with over 37,000 new units added in 1999. Most development is taking place in suburban locations, where there is an abundant supply of vacant land.

The apartment market has been strong in Chicago, as the vacancy rate is around 2.6% at this time. In 1999, it was estimated that approximately 3,500 new units were added to the inventory (in a market of 8,000,000 people), which represented a 50% increase from the previous period. Over 800 units were in one project alone in the downtown area, the first such project in ten years. This building was targeted at the luxury end of the market, with rents being in the range of \$1,700 for an 850 s.f. unit. Only about 2,000 institutional quality units were added in the Chicago market in 1999. A large factor in the lack of new construction is reported to be the result of a lack of appropriate sites for development.

Dallas

The Dallas/Fort Worth economy expanded by 3.4% in 1999, well above the national average. The greatest growth segment was in the business services sector. The low cost of living in the area is attracting many corporations, such as a call centre from Chase Manhattan Bank, and Compaq Computer Corp. On the other hand, some oil and technology firms have announce plans to downsize local operations.

Although there were over 44,000 new housing units added to the local inventory in 1999, this represented a decline of nearly 20% from the previous year. Most of the decline was due to the multi-family rental market, which was overbuilt in the previous year. Most development occurred in suburban areas, and remained strong as prices crept upward during the period. Several condominium projects were underway in 1999, but the majority of them were targeted to buyers in the \$250,000 to \$400,000 per unit range. Most of the projects were located in prestigious locations, and included a mix of high-rise and garden-style developments.

There was a significant amount of multi-family inventory in the pipeline in 1999, and heading into 2000, but construction delays slowed delivery of product to the market. As deliveries of units increased in late 1999, however, vacancies climbed to 7% at one point. Rents still managed to climb by 3% in the period, although landlords were beginning to make concessions in order to attract tenants to their projects.

Atlanta

Atlanta continues to enjoy a post-Olympic boom, spurred in large part by strong national economic factors. Local economic forecasters expect this boom to temper in the next several years as the national economy slows. Unemployment rates are low, which has had a negative impact on growth, as companies are hesitant to locate there because of the labour shortage.

The residential development market has been very strong, the result of the strong local economy and low interest rates, although sales slowed somewhat in recent months due to interest rate increases. New condominium sales have been very strong in Atlanta in the last several years, and a number of rental properties have been converted to condominium title. The multi-family market has been very strong, with over 11,000 units built in 1998, and even more completed in 1999. Overall vacancy rates stood at 4.4% in 1999, and are expected to remain at that level in the short term. Rental rates increased by 5.4% in the last year, with slightly lower increase expected going forward. The construction of new rental housing is expected to slow down, as the inventory of units currently under construction will likely outpace new demand.

Summary

Each of the four U.S. markets is enjoying very strong fundamental economic indicators, but only two of the four markets are experiencing a significant increase in the supply of rental housing. Some of the difference can be explained by the booming economies, as land prices have increased to the point where only units aimed at the luxury end of the market are viable. The lack of appropriately zoned and priced land is also an explanatory

factor in Boston and Chicago, but does not appear to be a significant issue in Atlanta or Dallas. Of the remaining factors, federal taxation policy is the significant factor.

ADDENDA 2

Summary of Major Income Tax Policies Related to Rental Real Estate In Canada

SUMMARY OF MAJOR INCOME TAX POLICIES RELATED TO RENTAL REAL ESTATE IN CANADA

Capital Cost Allowance (CCA)

Current Situation:

- Allows the depreciation on a rental building to be used as an expense for income tax purposes, at a rate above the actual rate of depreciation, CCA amount claimed is subject to recapture as income at sale of property
- Corporations that are principally (more than 50%) involved in the leasing, rental or development or sale of real property can use the deduction to offset income from other sources
- Investors that are not corporations or do not meet the “principally involved” test can only use the deduction to offset the income from the property itself or from other rental property
- Deductions start in the first year building is “available for rent”, rate is 2% in first year, and 4% thereafter

Key Past Changes:

- Prior to tax reform in 1972, individuals and companies not in the business of real estate could use the CCA deduction to offset income from other sources; MURB provision of the Income Tax Act temporarily reinstated this ability from late 1974 to end of 1979 and for part of 1980 through the end of 1981
- Tax reform also eliminated the ability to pool properties to avoid recapture of CCA at sale of property
- Rate of depreciation reduced over the years – prior to 1978, 10% for wood frame 5% for concrete and steel reinforced, in 1978 both set at 5%, in 1987, both reduced to 4%; “half-year rule” introduced in 1981

Deductibility Of Soft Costs

Current Situation:

- Soft costs are expenditures incurred by the owner in the construction of a new rental property such as financing costs, property taxes and utility connection fees which are not related to the actual acquisition of the fixed assets (i.e. the land, building and equipment)
- Some soft project costs may be deducted from income in calculating tax incurred prior to construction such as promotional expenses, site investigation costs and landscaping costs
- Most costs that relate to the period of construction or the costs of holding the land (including land subjacent to the building under construction) incurred during construction period must be capitalized to the value of the building and depreciated over time

Key Past Changes:

- Prior to 1979, soft costs could be deducted upfront in first year, regardless of the period they related to
- In 1981, the types of soft costs allowed were restricted for those not in the business of real estate.

Treatment Of Capital Gains

Current Situation:

- 50% of capital gains from sale of rental properties are included as income for tax purposes
- In Ontario, the capital gains inclusion rate would result in an effective marginal tax rate of approximately 23.93% for capital gains earned by an individual earning more than \$74,242

Key Past Changes:

Prior to tax reform in 1972, capital gains on rental properties were not taxable; following tax reform, 50% of capital gains were included for tax purposes; this was subsequently increased to 66.67% in 1988 and then 75% in 1990. The 1999 Federal Budget rolled the rate back to 66.67%, and a subsequent mini-budget effected a further reduction to 50%.

In 1985, the lifetime capital gains exemption was introduced for individuals, at the time the intent was to raise the limits from an initial \$20,000 to \$500,000 by 1990, the level however was capped at \$100,000 in 1987; the exemption was eliminated in early 1994

Treatment Of Rental Losses**Current Situation:**

- Losses on any rental property can be deducted from income from other sources in order to determine income for tax purposes (losses may not be created as a result of claiming CCA on the building except in the case of a principal business corporation as noted above)
- Such losses could result where rental income is insufficient to cover out-of-pocket expenses (i.e. operating costs and the interest portion of mortgage payments)

Key Past Changes:

- This has been an on-going tax feature

Source: Based on a summary report by Clayton Research Associates of Rental **Housing: A Study of Selected Local Markets**, prepared by Clayton Research Associates Limited, Jules Hurtubise and CitySpaces Consultants for CMHC and British Columbia Housing Management Commission, 1991

ADDENDA 3

CMHC Mortgage Insurance for Rental Properties

CMHC MORTGAGE INSURANCE FOR RENTAL PROPERTIES

Current Situation

(policies in effect when study was conducted)

General:

- Both for financing new construction and purchase of existing buildings
- Required where equity is less than 25% of project value
- Optional where equity is at least 25% of project value; however a lower interest rate can generally be obtained if CMHC insured
- Interest rates for CMHC insured loans typically 50-75 basis points above bond rate for comparable term (at least 50 basis points below rate for conventional, which are typically 100-150 above bond rate)

Basic Premium Rates:

Loan-to-Value Ratio:	<u>New Construction*</u>	<u>Existing</u>
Up to 75%	2.0%	1.5%
76%-80%	2.5%	2.0%
81%-85%	5.0%	3.0%

** A premium of 0.5% is incurred if mortgage is advanced in stages during the construction period*

Standard Underwriting Criteria:

- Debt-coverage ratio (DCR): Net operating income (NOI) must be at least 1.1 times mortgage payment based on a 9% mortgage interest rate and 25-year amortization period
- For projects of more than 6 units, value for lending purposes established based on minimum cap rate of 9%
- Personal guarantees/covenants may be required

Changes Effective Jan. 1/99

Changes apply to existing rental properties only; policies related to new units currently under review.

Changes to Basic Premium Rates:

Loans-to-Value Ratio:	<u>Current</u>	<u>Effective Jan. 1/99</u>
Up to 65%	1.50%	1.75%
66%-70%	1.50%	2.00%
71%-75%	1.50%	2.25%
76%-80%	2.00%	3.50%
81%-85%	3.00%	4.50%

Key Changes to Standard Underwriting Criteria:

- DCR increased to 1.3 for mortgage terms of less than 10 years and 1.2 for mortgage terms of 10 years or more for projects of more than 6 units; the mortgage rate of the application to be used to determine the DCR, not a minimum 9% rate
- Lending value to be determined using “market derived capitalization rates”, rather than the previous 9% minimum
- Additional guarantees limited to a maximum of 50% of the loan amount for 85% LTV; reduction of 2% points for each percentage point reduction in the LTV

Source: Clayton Research based on information obtained from CMHC and structured interviews with lenders

ADDENDA 4

Apartment Vacancy Rates (Toronto)

**VACANCY RATES BY RENT RANGE BY BEDROOM
TYPE / PRIVATE APARTMENTS-THREE UNITS AND OVER**

Toronto CMA, 1995-1999 (Source: Toronto 1999 RMS Report)										
	Bachelor	Bachelor	Bachelor	Bachelor	Bachelor	1Bedroom	1Bedroom	1Bedroom	1Bedroom	1Bedroom
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
\$400 and under	6	7.5	1.1	2.8	0.2	0.6	7.7	1.7	0.4	0
\$401-\$500	2.4	2	1.5	2.1	0.9	0.9	0.8	0.4	0.9	1.3
\$501-\$600	0.8	1.4	1.1	1.1	0.9	0.8	0.7	0.8	1.1	0.9
\$601-\$700	1.3	1	1.2	0.6	0.9	0.8	1.1	0.7	0.8	0.7
\$701-\$800	0.9	0.5	0.6	0.4	0.7	0.8	1.2	0.9	0.9	0.8
\$801-\$900	2.7	6	2.2	0.9	5.2	0.8	1.1	0.6	1	0.9
\$901-\$1000	*	*	*	*	0	0.7	1.3	0.5	0.9	0.6
\$1001-\$1100	*	*	*	*	0	0.4	2.1	3.1	0.3	0.5
\$1101-\$1200	*	*	*	*	0	0	0	0.6	1.2	1.1
\$1201 and over	*	*	*	*	2.1	4.6	2	0.4	1.3	4.3
	2Bedroom	2Bedroom	2Bedroom	2Bedroom	2Bedroom	3Bedroom	3Bedroom	3Bedroom	3Bedroom	3Bedroom
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
\$400 and under	0	0	0	0	0	*	*	*	*	*
\$401-\$500	0.4	1	0.8	1	3	*	*	0	0	0
\$501-\$600	0.4	0.1	0.3	0.2	0.2	0	0	0.2	0.9	0
\$601-\$700	0.4	0.7	0.7	0.7	0.4	0	0.2	0	0.3	1.5
\$701-\$800	0.8	1.1	0.9	0.8	0.8	0.7	0.6	0.6	0.5	0.5
\$801-\$900	0.6	2.1	1.2	0.8	0.8	1.2	1.1	0.8	0.9	1.7
\$901-\$1000	0.7	1.7	1.1	0.6	0.9	0.7	1.5	1.2	1.2	0.9
\$1001-\$1100	0.6	1.8	0.8	0.9	1.2	1.3	1.6	1.2	0.8	1.6
\$1101-\$1200	0.6	1.1	0.3	0.8	1.3	2.5	3.1	1.8	1.7	2.2
\$1201 and over	0.5	1.9	0.5	0.8	1.1	1.2	2.3	1.3	2.3	2.5

ADDENDA 5

Corporate Tax Regulations (U.S.)

CORPORATE TAX REGULATIONS (U.S)

Tax	Boston	Chicago	Atlanta	Dallas
Federal Income tax rates	35%	35%	35%	35%
State Income Tax Rates	9.5%	4.8%	6%	4.5%*
Capital Gains Federal State	Taxed as regular income (100% inclusion) Taxed as regular income (100% inclusion)	Taxed as regular income (100% inclusion)	Taxed as regular income (100% inclusion) Taxed as regular income (100% inclusion)	Taxed as regular income (100% inclusion) See "State Income Tax Rates" above
Municipality			May levy 1% but none presently	
<u>Depreciation</u> Federal State	27.5 Years straight line same as Federal	27.5 Years straight line same as Federal	27.5 Years straight line same as Federal	27.5 Years straight line same as Federal
Rollovers (Federal)	Like kind exchanges	Like kind exchanges	Like kind exchanges	Like kind exchanges
Soft Costs				
Capital tax	.228% of taxable property			.25% of taxable capital
Other			credit equal to federal housing credit, may be carried forward 3 years and freely allocated to participants	

* Texas does not levy an income tax but rather a tax on net taxable earned surplus

ADDENDA 6

Individual Tax Regulations (U.S.)

INDIVIDUAL TAX REGULATIONS (U.S.)

Tax	Boston	Chicago	Atlanta	Dallas
Federal	0 – 43,050 15% over 43,050 28% over 104,050 36% over 283,150 39.6			
State	5.95%	3% - flat	6% - over \$7,000	none
Capital Gains	Where hold period is < 1 year 12% >1year<2years 5% >2years<3years 4% >3years<4years 3% >4years<5years 2% >5years,6years 1% >6years 0	< 1 year 1year>18 months >18 months	Taxed as regular income (100% inclusion) 1year hold period	none

Sources

CCH State Tax Guide, CCH Incorporated, (2000, Chicago, IL)

All States Tax Handbook, Research Institute of America, (2000, New York, NY)

ADDENDA 7

Summary of Capital Tax Regulations (Canada)

SUMMARY OF CAPITAL TAX REGULATIONS

Ontario Corporate Capital Tax Payable							
Value of Assets							
Year	Up to \$2M	Up to \$2.1M	Up to \$2.5M	Up to \$2.8M	Up to \$3.2M	Up to \$3.6M	Up to \$4.0M
2000	0	1,050	5,250	8,400	9,600	10,800	12,000
2001	0	800	4,000	6,400	9,600	10,800	12,000
2002	0	675	3,375	5,400	8,100	10,800	12,000
2003	0	600	3,000	4,800	7,200	9,600	12,000

SUMMARY

Ontario

There is a 0.3% tax payable on capital in excess of \$2,000,000. The deduction of \$2,000,000 is clawed back for taxable capital between \$2,000,000 and \$2,800,000.

Financial institutions, including mortgage lending companies, but not insurance companies pay capital tax according to the following schedule.

- 0.6% on taxable capital up to \$400,000,000
- 0.9% on taxable capital over \$400,000,000 for deposit taking institutions
- 0.72% on capital over \$400,000,000 for non-deposit taking institutions

Insurance companies pay Ontario capital tax of 1.25% but get a deduction for income tax paid. Insurance companies also pay 2% of premiums for accident, life and sickness insurance and 3% for all other types of policies.

Federal Capital Tax – Part I.3

0.225% payable on taxable capital over \$10,000,000 which is reduced by Canadian Surtax payable (sec. 125.3(4))

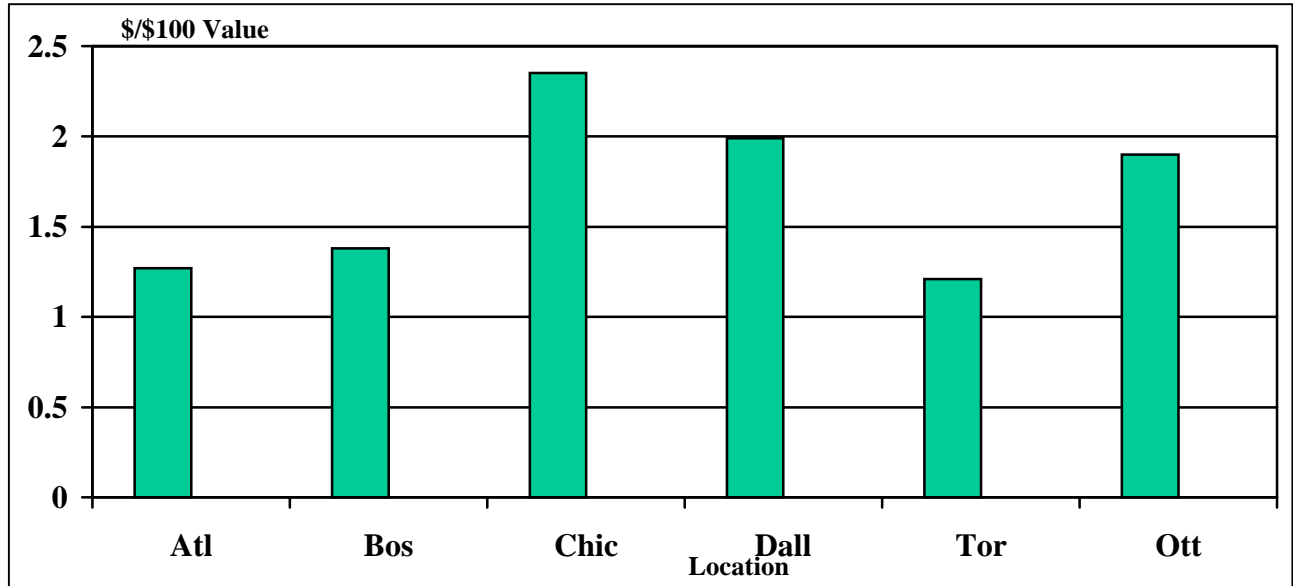
Tax on Capital of Financial Institutions

1.25% payable on taxable capital over 420,000,000 of financial institutions, including life insurance companies.

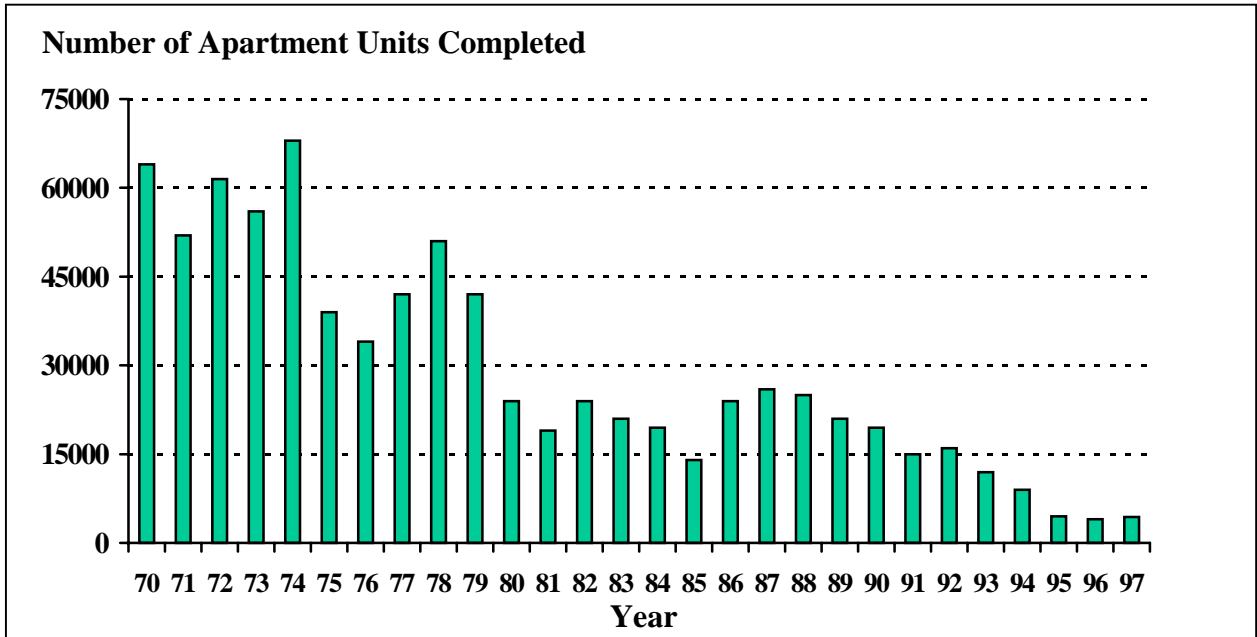
ADDENDA 8

Summary of Market Conditions

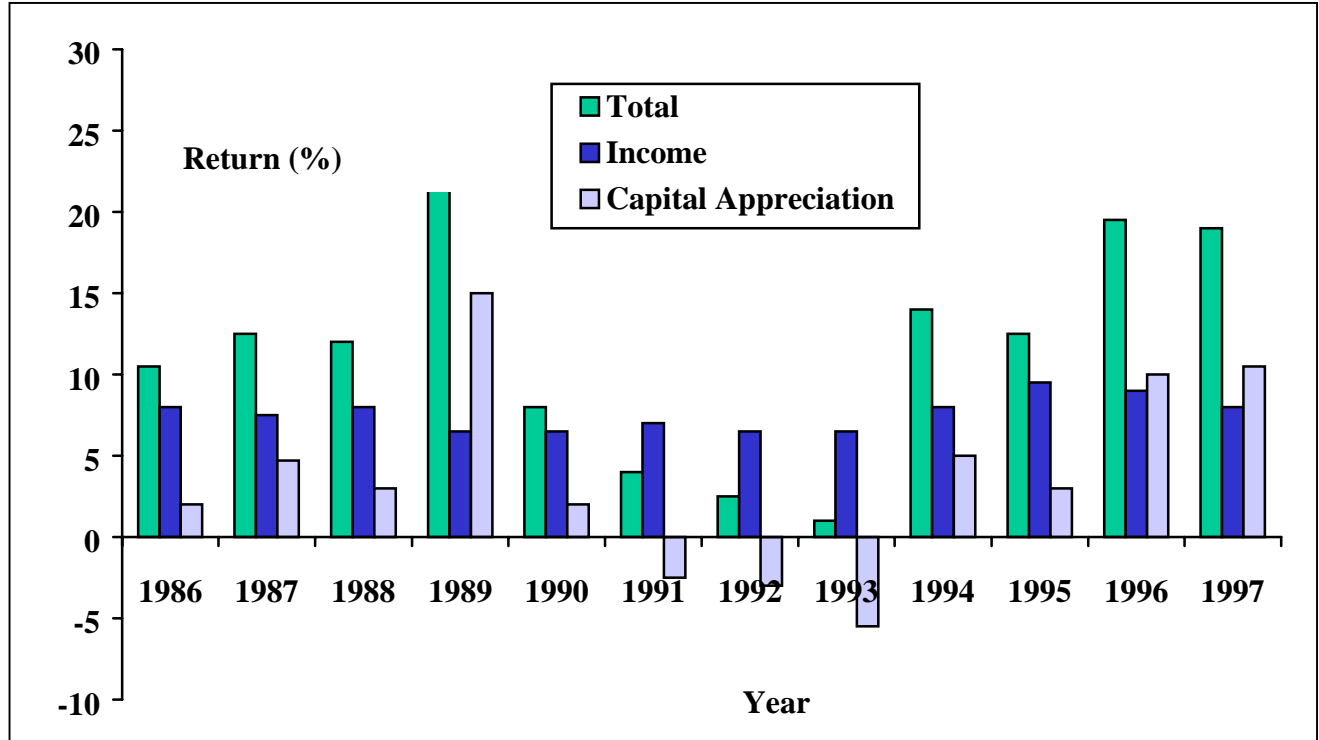
**Local Residential Property Taxes:
1998 Residential Property Tax Effective Rate
(Per \$100 Valuation)**



Private Rental Apartment Completions Major Canadian Markets, 1970 - 1997



**Returns on Rental Apartment Investment,
Canada Institutional Investors**



ADDENDA 9

Cash Flow Projections

Assumptions

Assumptions*	Toronto	Ottawa	Boston	Chicago	Atlanta	Dallas
Land Cost (\$/unit)	35,000	15,000	50,000	35,000	15,000	15,000
Construction Cost (\$p.s.f., gross floor area)	110	100	182	172	139	135
Construction Cost (\$p.s.f., net rentable area)	138	125	228	215	174	169
Market Rent (\$/month/unit)	1,500	1,250	2,600	2,400	1,635	1,750
Loan to Value Ratio	75%	75%	75%	75%	75%	75%
Mortgage Rate	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Market Vacancy Rate	2%	2%	2%	6%	5%	5%
Income Tax Rate	46%	46%	41%	38%	39%	38%
Capital Gains Exemption	50%	50%	0%	0%	0%	0%
Investor's Required Return**	8.25%	8.50%	8.80%	8.90%	7.60%	8.90%

*All figures are in Cdn. \$, at a conversion factor of 0.65

Returns

Rates of Return	Toronto	Ottawa	Boston	Chicago	Atlanta	Dallas
IRR (No Rollovers Allowed)	10.12%	11.40%	12.93%	12.54%	10.36%	13.18%
IRR (Allowing Rollovers)	11.76%	13.02%	13.99%	13.84%	11.56%	14.63%
Merchant Builder's Return (NOI/Cost)	8.90%	8.30%	9.08%	9.35%	9.06%	9.78%
Long Term Investor's Required Return**	8.25%	8.50%	8.80%	8.90%	7.60%	8.90%
Spread between Merchant Builder and Long Term Investor's Rates of Return	0.65%	-0.20%	0.28%	0.45%	1.46%	0.88%
Investor's Avg. Annual return (after tax cash flow, assuming tax losses can be used)	2.79%	3.58%	4.30%	4.23%	2.72%	4.71%
Investor's Avg. Annual return (after tax) (Assuming straight-line depreciation - 27.5 yrs)	3.24%	4.14%	4.30%	4.23%	2.72%	4.71%
Builder's Cost (\$/unit)	151,985	121,350	243,557	217,922	162,827	158,573
Investor's Purchase Price (\$/unit)	161,626	116,707	247,757	225,669	191,620	171,917
Profit (loss) on Construction	9,641	-4,643	4,200	7,747	28,793	13,344
Current Tax Rules in each jurisdiction						

**CB Richard Ellis, National Real Estate Index

Apartment Development Pro-Forma (Year 1 Forecast)						
Merchant Builder						
	Toronto	Ottawa	Boston	Atlanta	Chicago	Dallas
(assumes Cdn \$1 = US\$.065)						
Construction costs						
Price per square foot	110	100	182	139	172	135
Construction Cost	116,875	106,250	193,375	147,688	182,750	143,438
Land Cost	35,000	15,000	50,000	15,000	35,000	15,000
Total Development Costs	151,985	121,350	243,557	162,827	217,922	158,573
Revenue and Expenses						
Revenue						
Rental Income (ann.)	18,000	15,000	31,200	19,620	28,800	21,000
Other Income	900	750	1,560	981	1,440	1,050
Gross Income	18,900	15,750	32,760	20,601	30,240	22,050
Vacancy Rate	2.00%	2.00%	2.00%	5.00%	6.00%	5.00%
Vacancy Allowance	378	315	655	1,030	1,814	1,103
Effective Gross Income	18,522	15,435	32,105	19,571	28,426	20,948
Operating Costs						
Maintenance & Other	2,835	2,678	7,449	3,597	4,275	3,554
Property Taxes	1,612	2,220	1,569	628	2,929	1,255
Management Expense	556	463	963	587	853	628
Total Operating Costs	5,003	5,361	9,981	4,812	8,057	5,437
Net Operating Income	13,519	10,074	22,124	14,759	20,369	15,510
Market cap rate	8.25%	8.50%	8.80%	7.60%	8.90%	8.90%
Value	163,871	118,523	251,405	194,195	226,320	174,271
Cost	151,985	121,350	243,557	162,827	217,922	158,573
Financing 75%	113,989	91,013	182,668	122,120	163,442	118,929
Equity	37,996	30,338	60,889	40,707	54,481	39,643
Mortgage Payments(int. only)						
Principal	0	0	0	0	0	0
Interest	9,119	7,281	14,613	9,770	13,075	9,514
Total P&I	9,119	7,281	14,613	9,770	13,075	9,514
Debt Service coverage	1.48	1.38	1.51	1.51	1.56	1.63
Cash Flow	4,400	2,793	7,510	4,989	7,294	5,996
Leveraged Return (pre-tax)	11.58%	9.21%	12.33%	12.26%	13.39%	15.12%
Overall Return	8.90%	8.30%	9.08%	9.06%	9.35%	9.78%
Cash-on-Cash	11.58%	9.21%	12.33%	12.26%	13.39%	15.12%
The above analysis assumes the construction of an 850 s.f. medium quality high-rise apartment. Cost for the American cities is converted to Canadian dollars at an exchange rate of Cdn. \$1.00 = U.S. \$0.65.						
The costs and revenues are given for one unit, but would be typical for a building with 100 to 200 units.						

Summary of Returns

Rates of Return	Toronto	Ottawa	Boston	Chicago	Atlanta	Dallas
IRR (No Rollovers Allowed)	10.12%	11.40%	12.93%	12.54%	10.36%	13.18%
IRR (Allowing Rollovers)	11.76%	13.02%	13.99%	13.84%	11.56%	14.63%
Merchant Builder's Return (NOI/Cost)	8.90%	8.30%	9.08%	9.35%	9.06%	9.78%
Long Term Investor's Return*	8.25%	8.50%	8.80%	8.90%	7.60%	8.90%
Spread between Merchant Builder and Long Term Investor's Rates of Return	0.65%	-0.20%	0.28%	0.45%	1.46%	0.88%
Investor's Avg. Annual return (after tax cash flow, assuming tax losses can be used)	2.79%	3.58%	4.30%	4.23%	2.72%	4.71%
Investor's Avg. Annual return (after tax) (Assuming straight-line depreciation - 27.5 yrs)	3.24%	4.14%	4.30%	4.23%	2.72%	4.71%
Builder's Cost (\$/unit)	151,985	121,350	243,557	217,922	162,827	158,573
Purchase Price (\$/unit) (Based on market rates of return)	161,626	116,707	247,757	225,669	191,620	171,917
Profit (loss) on Construction	9,641	-4,643	4,200	7,747	28,793	13,344
Current Tax Rules in each jurisdiction						
*CB Richard Ellis, National Real Estate Index						

Assumptions

Assumptions*	Toronto	Ottawa	Boston	Chicago	Atlanta	Dallas
Land Cost (\$/unit)	35,000	15,000	50,000	35,000	15,000	15,000
Construction Cost (\$p.s.f., gross floor area)	110	100	182	172	139	135
Construction Cost (\$p.s.f., net rentable area)	138	125	228	215	174	169
Market Rent (\$/month/unit)	1,500	1,250	2,600	2,400	1,635	1,750
Loan to Value Ratio	75%	75%	75%	75%	75%	75%
Mortgage Rate	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Market Vacancy Rate	2%	2%	2%	6%	5%	5%
Income Tax Rate	46%	46%	41%	38%	39%	38%
Capital Gains Exemption	50%	50%	0%	0%	0%	0%
Investor's Required Return**	8.25%	8.50%	8.80%	8.90%	7.60%	8.90%

*All figures are in Cdn. \$, at a conversion factor of 0.65

Returns

Rates of Return	Toronto	Ottawa	Boston	Chicago	Atlanta	Dallas
IRR (No Rollovers Allowed)	10.12%	11.40%	12.93%	12.54%	10.36%	13.18%
IRR (Allowing Rollovers)	11.76%	13.02%	13.99%	13.84%	11.56%	14.63%
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Current Tax Rules in each jurisdiction						

**CB Richard Ellis, National Real Estate Index

Apartment Development Pro-Forma (Year 1 Forecast)						
Merchant Builder						
	Toronto	Ottawa	Boston	Atlanta	Chicago	Dallas
(assumes Cdn \$1 = US\$.065)						
Construction costs						
Price per square foot	110	100	182	139	172	135
Construction Cost	116,875	106,250	193,375	147,688	182,750	143,438
Land Cost	35,000	15,000	50,000	15,000	35,000	15,000
Total Development Costs	151,985	121,350	243,557	162,827	217,922	158,573
Revenue and Expenses						
Revenue						
Rental Income (ann.)	18,000	15,000	31,200	19,620	28,800	21,000
Other Income	900	750	1,560	981	1,440	1,050
Gross Income	18,900	15,750	32,760	20,601	30,240	22,050
Vacancy Rate	2.00%	2.00%	2.00%	5.00%	6.00%	5.00%
Vacancy Allowance	378	315	655	1,030	1,814	1,103
Effective Gross Income	18,522	15,435	32,105	19,571	28,426	20,948
Operating Costs						
Maintenance & Other	2,835	2,678	7,449	3,597	4,275	3,554
Property Taxes	1,612	2,220	1,569	628	2,929	1,255
Management Expense	556	463	963	587	853	628
Total Operating Costs	5,003	5,361	9,981	4,812	8,057	5,437
Net Operating Income	13,519	10,074	22,124	14,759	20,369	15,510
Market cap rate	8.25%	8.50%	8.80%	7.60%	8.90%	8.90%
Value	163,871	118,523	251,405	194,195	226,320	174,271
Cost	151,985	121,350	243,557	162,827	217,922	158,573
Financing 75%	113,989	91,013	182,668	122,120	163,442	118,929
Equity	37,996	30,338	60,889	40,707	54,481	39,643
Mortgage Payments(int. only)						
Principal	0	0	0	0	0	0
Interest	9,119	7,281	14,613	9,770	13,075	9,514
Total P&I	9,119	7,281	14,613	9,770	13,075	9,514
Debt Service coverage	1.48	1.38	1.51	1.51	1.56	1.63
Cash Flow	4,400	2,793	7,510	4,989	7,294	5,996
Leveraged Return (pre-tax)	11.58%	9.21%	12.33%	12.26%	13.39%	15.12%
Overall Return	8.90%	8.30%	9.08%	9.06%	9.35%	9.78%
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Summary of Returns

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Merchant Builder's Return (NOI/Cost)	8.90%	8.30%	9.08%	9.35%	9.06%	9.78%
Long Term Investor's Return*	8.25%	8.50%	8.80%	8.90%	7.60%	8.90%
Spread between Merchant Builder and Long Term Investor's Rates of Return	0.65%	-0.20%	0.28%	0.45%	1.46%	0.88%
Investor's Avg. Annual return (after tax cash flow, assuming tax losses can be used)	2.79%	3.58%	4.30%	4.23%	2.72%	4.71%
Investor's Avg. Annual return (after tax) (Assuming straight-line depreciation - 27.5 yrs)	3.24%	4.14%	4.30%	4.23%	2.72%	4.71%
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Purchase Price (\$/unit) (Based on market rates of return)	161,626	116,707	247,757	225,669	191,620	171,917
Profit (loss) on Construction	9,641	-4,643	4,200	7,747	28,793	13,344
Current Tax Rules in each jurisdiction						
*CB Richard Ellis, National Real Estate Index						

**Twenty Year Forecast
Chicago**

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Income and Expenses																				
Revenue																				
Rental Income (nm.)	28,800	29,376	29,964	30,563	31,174	31,798	32,433	33,082	33,744	34,419	35,107	35,809	36,525	37,256	38,001	38,761	39,536	40,327	41,133	41,956
Other Income	1,440	1,469	1,498	1,528	1,559	1,590	1,622	1,654	1,687	1,721	1,755	1,790	1,826	1,863	1,900	1,938	1,977	2,016	2,057	2,098
Gross Income	30,240	30,845	31,462	32,091	32,733	33,387	34,055	34,736	35,431	36,140	36,862	37,600	38,352	39,119	39,901	40,699	41,513	42,343	43,190	44,054
Vacancy Rate	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
Vacancy Allowance	1,814	1,851	1,888	1,925	1,964	2,003	2,043	2,084	2,126	2,168	2,212	2,256	2,301	2,347	2,394	2,442	2,491	2,541	2,591	2,643
Effective Gross Income	28,426	28,994	29,574	30,165	30,769	31,384	32,012	32,652	33,305	33,971	34,651	35,344	36,051	36,772	37,507	38,257	39,022	39,803	40,599	41,411
Operating Costs																				
Maintenance & Other	4,275	4,361	4,448	4,537	4,627	4,720	4,814	4,911	5,009	5,109	5,211	5,315	5,422	5,530	5,641	5,754	5,869	5,986	6,106	6,228
Property Taxes	2,929	2,988	3,047	3,108	3,170	3,234	3,299	3,365	3,432	3,500	3,570	3,642	3,715	3,789	3,865	3,942	4,021	4,101	4,183	4,267
Structural Reserve	284	290	296	302	308	314	320	327	333	340	347	353	361	368	375	383	390	398	406	414
Management Expense	853	870	887	905	923	942	960	980	999	1,019	1,040	1,060	1,082	1,103	1,125	1,148	1,171	1,194	1,218	1,242
Total Operating Costs	8,341	8,508	8,678	8,852	9,029	9,209	9,393	9,581	9,773	9,968	10,168	10,371	10,578	10,790	11,006	11,226	11,450	11,679	11,913	12,151
Net Operating Income	20,085	20,486	20,896	21,314	21,740	22,175	22,618	23,071	23,532	24,003	24,483	24,973	25,472	25,982	26,501	27,031	27,572	28,123	28,686	29,259
Market cap rate	8.90%																			
Value	225,669	230,183	234,786	239,482	244,272	249,157	254,140	259,223	264,408	269,696	275,090	280,592	286,203	291,927	297,766	303,721	309,796	315,992	322,311	328,758
Mortgage Balance	169,252	166,937	164,437	161,736	158,820	155,670	152,268	148,594	144,627	140,341	135,713	130,715	125,317	119,487	113,191	106,391	99,046	91,115	82,549	73,297
Equity	56,417	63,246	70,350	77,746	85,452	93,487	101,872	110,629	119,781	129,354	139,376	149,876	160,886	172,440	184,575	197,331	210,749	224,877	239,763	255,460
Financing																				
Principal	2,315	2,500	2,700	2,916	3,150	3,402	3,674	3,968	4,285	4,628	4,998	5,398	5,830	6,296	6,800	7,344	7,932	8,566	9,251	9,992
Interest	13,540	13,355	13,155	12,939	12,706	12,454	12,181	11,888	11,570	11,227	10,857	10,457	10,025	9,559	9,055	8,511	7,924	7,289	6,604	5,864
Total PG I	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855	15,855
Debt Service coverage	1.27	1.29	1.32	1.34	1.37	1.40	1.43	1.46	1.48	1.51	1.54	1.58	1.61	1.64	1.67	1.70	1.74	1.77	1.81	1.85
Cash Flow (Pre-tax)	4,229	4,631	5,041	5,459	5,885	6,320	6,763	7,216	7,677	8,148	8,628	9,117	9,617	10,126	10,646	11,176	11,716	12,268	12,830	13,404
CCA	6,645	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216	5,216
UCC	176,105	170,889	165,673	160,457	155,241	150,025	144,809	139,593	134,377	129,161	123,945	118,730	113,514	108,298	103,082	97,866	92,650	87,434	82,218	77,002
Taxable Income	-101	1,915	2,525	3,159	3,819	4,505	5,221	5,967	6,746	7,560	8,410	9,300	10,231	11,207	12,230	13,304	14,432	15,618	16,866	18,180
Tax	-38	728	960	1,200	1,451	1,712	1,984	2,268	2,564	2,873	3,196	3,534	3,888	4,259	4,647	5,056	5,484	5,935	6,409	6,908
After Tax Income	6,583	6,403	6,782	7,175	7,584	8,009	8,453	8,916	9,399	9,903	10,430	10,982	11,559	12,164	12,799	13,464	14,164	14,899	15,673	16,487
Annual return (after tax)	11.67%	10.12%	9.64%	9.23%	8.87%	8.57%	8.30%	8.06%	7.85%	7.66%	7.48%	7.33%	7.18%	7.05%	6.93%	6.82%	6.72%	6.63%	6.54%	6.45%
After Tax Cash Flow	4,268	3,903	4,081	4,258	4,434	4,608	4,779	4,948	5,113	5,275	5,432	5,583	5,729	5,868	5,998	6,120	6,232	6,333	6,421	6,496
Proceeds from Disposition of Asset																				239,023
Recapture UCC																				105,748
Capital Gains Tax																				73,111
Net Cash Flow	-52,150	3,903	4,081	4,258	4,434	4,608	4,779	4,948	5,113	5,275	5,432	5,583	5,729	5,868	5,998	6,120	6,232	6,333	6,421	172,407
IRR (Rollover)	13.84%																			
IRR (Disposition)	12.54%																			

Twenty Year Forecast (27.5 yr. Straight line depreciation)

Ottawa

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	
Income and Expenses																					
Revenue																					
Rental Income (ann.)	15,000	15,300	15,606	15,918	16,236	16,561	16,892	17,230	17,575	17,926	18,285	18,651	19,024	19,404	19,792	20,188	20,592	21,004	21,424	21,852	
Other Income	750	765	780	796	812	828	845	862	879	896	914	933	951	970	990	1,009	1,030	1,050	1,071	1,093	
Gross Income	15,750	16,065	16,386	16,714	17,048	17,389	17,737	18,092	18,454	18,823	19,199	19,583	19,975	20,374	20,782	21,197	21,621	22,054	22,495	22,945	
Vacancy Rate	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	
Vacancy Allowance	315	321	328	334	341	348	355	362	369	376	384	392	399	407	416	424	432	441	450	459	
Effective Gross Income	15,435	15,744	16,059	16,380	16,707	17,041	17,382	17,730	18,085	18,446	18,815	19,191	19,575	19,967	20,366	20,773	21,189	21,613	22,045	22,486	
Operating Costs																					
Maintenance & Othe	2,678	2,731	2,786	2,841	2,898	2,956	3,015	3,076	3,137	3,200	3,264	3,329	3,396	3,464	3,533	3,604	3,676	3,749	3,824	3,901	
Property Taxes	2,220	2,264	2,310	2,356	2,403	2,451	2,500	2,550	2,601	2,653	2,706	2,760	2,815	2,872	2,929	2,988	3,048	3,109	3,171	3,234	
Structural Reserve	154	157	161	164	167	170	174	177	181	184	188	192	196	200	204	208	212	216	220	225	
Management Expens.	463	472	482	491	501	511	521	532	543	553	564	576	587	599	611	623	636	648	661	675	
Total Operating Costs	5,515	5,625	5,738	5,852	5,970	6,089	6,211	6,335	6,462	6,591	6,723	6,857	6,994	7,134	7,277	7,422	7,571	7,722	7,877	8,034	
Net Operating Income	9,920	10,119	10,321	10,527	10,738	10,953	11,172	11,395	11,623	11,855	12,093	12,334	12,581	12,833	13,089	13,351	13,618	13,891	14,168	14,452	
Market cap rate	8.50%																				
Value	116,707	119,041	121,422	123,850	126,327	128,854	131,431	134,060	136,741	139,476	142,265	145,111	148,013	150,973	153,992	157,072	160,214	163,418	166,686	170,020	
Mortgage Balance	87,530	86,333	85,040	83,643	82,135	80,506	78,747	76,847	74,795	72,579	70,185	67,601	64,809	61,794	58,538	55,021	51,223	47,121	42,691	37,906	
Equity	29,177	32,708	36,382	40,207	44,192	48,348	52,684	57,213	61,946	66,897	72,080	77,510	83,204	89,179	95,455	102,051	108,991	116,297	123,996	132,114	
Financing																					
Principal	1,197	1,293	1,397	1,508	1,629	1,759	1,900	2,052	2,216	2,393	2,585	2,792	3,015	3,256	3,517	3,798	4,102	4,430	4,784	5,167	
Interest	7,002	6,907	6,803	6,691	6,571	6,440	6,300	6,148	5,984	5,806	5,615	5,408	5,185	4,944	4,683	4,402	4,098	3,770	3,415	3,033	
Total P&I	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	8,200	
Debt Service coverage	1.21	1.23	1.26	1.28	1.31	1.34	1.36	1.39	1.42	1.45	1.47	1.50	1.53	1.57	1.60	1.63	1.66	1.69	1.73	1.76	
Cash Flow (Pre-tax)	1,720	1,919	2,121	2,328	2,538	2,753	2,972	3,195	3,423	3,656	3,893	4,135	4,381	4,633	4,890	5,151	5,418	5,691	5,969	6,252	
CCA	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	3,864	
UCC	139,574	135,710	131,847	127,983	124,119	120,256	116,392	112,528	108,665	104,801	100,938	97,074	93,210	89,347	85,483	81,619	77,756	73,892	70,028	66,165	
Taxable Income	-946	-652	-346	-28	303	648	1,008	1,384	1,776	2,185	2,614	3,063	3,533	4,026	4,543	5,086	5,657	6,257	6,889	7,556	
Tax	-435	-300	-159	-13	140	298	464	636	817	1,005	1,202	1,409	1,625	1,852	2,090	2,339	2,602	2,878	3,169	3,476	
After Tax Income	3,353	3,512	3,677	3,849	4,027	4,214	4,408	4,611	4,823	5,044	5,275	5,518	5,771	6,037	6,317	6,610	6,918	7,243	7,584	7,944	
Annual return (after tax)	11.49%	10.74%	10.11%	9.57%	9.11%	8.72%	8.37%	8.06%	7.79%	7.54%	7.32%	7.12%	6.94%	6.77%	6.62%	6.48%	6.35%	6.23%	6.12%	6.01%	
After Tax Cash Flow	2,156	2,219	2,280	2,340	2,399	2,455	2,508	2,559	2,606	2,650	2,690	2,726	2,756	2,781	2,800	2,812	2,816	2,812	2,799	2,776	
Proceeds from Disposition of Asset																				123,613	
Recapture UCC																				77,273	
Capital Gains Tax																				46,204	
Net Cash Flow	-27,021	2,219	2,280	2,340	2,399	2,455	2,508	2,559	2,606	2,650	2,690	2,726	2,756	2,781	2,800	2,812	2,816	2,812	2,799	2,799	
IRR (Rollover)	13.83%																				
IRR (Disposition)	12.16%																				

