Markborough Properties Inc.

ANNUAL REPORT 1985

Contents

COVER: CENTRE COURT, WOODBINE CENTRE, TORONTO

Markborough Properties Inc.

Markborough Properties Inc. is a real estate development corporation carrying on business primarily in Canada and the United States. Markborough participates in two areas of the real estate industry; the development, ownership and management of income-producing properties and, the development of land for future residential, retail, office or industrial uses. Continued growth in both areas is the corporation's long term objective.

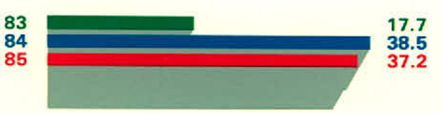
Markborough has total assets of over $1.7 billion. Approximately 60% of its portfolio is located in Canada and the balance is located primarily in the United States (Texas, Arizona, Florida, California, Washington, D.C., Nevada, Colorado and Ohio). Markborough owns or has an interest in 88 income properties comprising 18.2 million square feet of leasable area in shopping centres, office buildings and industrial properties and land holdings of over 13,500 acres.

Markborough is a wholly-owned subsidiary of Hudson's Bay Company.

Total Assets (billions $)

Total Revenue (millions $)

Net Income (millions $)



Cash Flow Per Share ($)

Financial Highlights

(thousands of dollars except where noted)

	1985	1984
Operating results for the year		
Revenue from land operations	**$144,803**	$253,936
Revenue from housing operations	**19,471**	16,111
Revenue from income properties	**136,982**	121,117
Income before taxes	**61,744**	71,716
Net income	**37,216**	38,500
Per common share:		
Net income	**$3.37**	$3.48
Cash flow	**5.44**	6.49
Financial position at the year end		
Land and housing	**$627,149**	$526,016
Income properties	**839,298**	709,554
Bank indebtedness	**110,171**	96,697
Due to parent and affiliated company	**129,613**	168,091
Mortgages payable	**815,053**	622,871
Share capital	**165,000**	233,223
Retained earnings	**178,382**	188,886
Statistical at the year end		
Common shares outstanding	**11,054,625**	11,054,624
Ratio of income properties to land and housing	**1.3 to 1**	1.3 to 1
Ratio of debt to common equity	**3.1 to 1**	2.8 to 1

PETER A. ANKER, PRESIDENT AND CHIEF EXECUTIVE OFFICER

1985 RESULTS Net profit for 1985 was $37.2 million, a slight decrease from 1984 record earnings of $38.5 million. This profit was achieved on a total revenue base of $301.3 million, down from $391.2 million in 1984. Cash flow was $60.1 million compared to $71.7 million the year before.

Income property operating profits increased by $10 million. In addition, the sale of income properties that did not meet the corporation's investment criteria for location and growth potential produced a gain of $15.6 million. These two factors offset lower sales and profits in land development and increased interest expense attributable in part to the acquisition, construction and expansion of income properties.

Operating profit from income property operations amounted to $81.5 million as compared to $71.5 million in 1984. Of this increase, $4.8 million was attributable to an improved performance from properties already owned and the balance came from properties that were acquired, constructed or expanded during the year, net of dispositions. Revenue increased to $137 million, an increase of 13.1% over 1984 revenue of $121.1 million. Dispositions of six shopping centres in which the corporation had an equity interest and the sale of two commercial buildings reduced rental revenue but in turn produced the above mentioned gain of $15.6 million. This compares to a gain of $435,000 realized on the sale of income properties in 1984.

Profit from land development was $33.4 million compared to $58.8 million in 1984. Revenues declined to $144.8 million from $253.9 million, largely because sales activities in Arizona and Texas developments were down from the exceptional levels of the year before.

REORGANIZATION The corporation embarked before year end on a reorganization that is intended to facilitate borrowing in the United States, where a significant number of its assets are located. A new holding company, Markborough Properties Inc., now holds the various operating entities of the Markborough group. In connection with this reorganization, independent appraisals of the property assets of the corporation were carried out as at July 31, 1985. On the basis of these appraisals, the appreciated equity of the corporation as at January 31, 1986, after deferred income taxes at book value and estimated taxes on the appraisal increment, was approximately $750 million compared to the corporation's book equity of $343 million.

OVERVIEW OF OPERATIONS AND OUTLOOK **In 1985 the corporation continued to expand its income-producing portfolio. The principal acquisitions were the purchase of an interest in Market Mall, a 761,000 square foot regional shopping centre in Calgary, and Greystone Office Park, a 13.11 acre site in the prime business section of Las Vegas, Nevada. Phase 1 of the Greystone project, consisting of 123,000 square feet of office space, was 94% leased as of year-end and a further 69,000 square feet are now under construction in Phase 2. In addition, Woodbine Centre in Toronto, the 610,000 square foot regional centre in which the corporation has a 40% equity interest, opened on schedule last August.**

The quality and productivity of the corporation's shopping centre portfolio has been improved with the completion in 1985 of expansions, renovations and remerchandising programs at Fairview Pointe Claire in Montreal, Cloverdale Mall in Toronto, Richmond Centre in Vancouver and St. Vital Shopping Centre in Winnipeg. Expansion and upgrading projects involving a total of 90,000 square feet of leasable area are almost finished at Village Green Mall in Vernon, B.C. and Southcentre in Calgary. Expansion and remerchandising plans are being considered for other centres in 1986.

The Heritage Place office-retail complex in Ottawa was officially opened in October, 1985 and the 150,000 square foot office-retail project at 20th and L Streets in Washington, D.C. will be available for occupancy in May, 1986. Leasing programs for both projects have been progressing well. The Beaver House project in The City of London is proceeding on schedule with completion expected in June, 1987. Virtually all of the nearly 200,000 square feet of net lettable floor space in the project has been pre-leased and will serve as European headquarters for The Royal Bank of Canada and its merchant banking subsidiary, Orion Royal Bank.

In land development, an expected reduction in 1985 land sales occurred in *Texas and Arizona* **where, in the year before, there had been a virtual sell-out of our lands in Austin and of our inventory in the Scottsdale Ranch project. In California, construction of a dam and 34.7 acre lake on the Sunnymead Ranch site were completed and finishings are now being added to the lakeside clubhouse which should be ready for operation in March of this year. The work on these facilities helped to generate substantial sales to builders during the last**

quarter of 1985 and additional sales of serviced lands at Sunnymead appear promising for 1986. Substantially increased sales volumes and improved margins were recorded in our Alberta land operations.

Markborough has established itself as a developer of quality residential planned unit developments and will continue to service this market. Major land purchases of 1,980 acres in Tampa, Florida and 978 acres in two locations in Houston, Texas were completed in 1985. In early 1986, the purchase of 406 acres in the Denver area was completed and a further 2,100 acres in Texas are under option contracts. High land sales in the last two years have resulted in a depletion of the corporation's inventory of land available for sale and these purchases should help to ensure a continued substantial profit contribution in future years from our operations in the United States.

In 1986 our priorities and strategies for the land development business are three-fold: (i) to improve the level of land sales in the United States, with particular emphasis on California and Texas; (ii) to expedite the development approvals needed to begin the servicing and readying for sale of recently acquired land tracts; and, (iii) to acquire additional lands in Arizona and Ontario.

Our priorities with respect to income-producing properties will be: (i) to improve returns on existing assets through carefully planned expansion, renovation, remerchandising, leasing and re-leasing programs and through the application of innovative financing and refinancing techniques; and (ii) to continue to expand the portfolio as opportunities for new projects are discovered or created.

Although there are growth opportunities in the commercial real estate market today, quality and location are increasingly crucial. This is mainly because of over-building and the participation in the market place of many new players, primarily insurance companies, savings and loans companies and pension funds under pressure to diversify. In many local office markets across North America, some time could elapse before the oversupply situation is rectified. Surprisingly, there appears to be continuing availability of capital for new projects, even in markets with a high vacancy factor. In these circumstances, expansion of our income-producing portfolio, particularly office buildings, will occur only through the acquisition of properties with opportunities for improvement through renovation and good management or, alternatively, when justified based on conservative pricing scenarios bearing in mind the status of the particular market. Markborough's growth will be more aggressive in shopping centres (while recognizing that locations for new regional centres are limited), and in planned light industrial parks.

H. PETER LANGER, F.R.I., S.I.R. When Markborough was formed in 1965, H. Peter Langer became its chief operating officer. The corporation at that time had assets of $15 million consisting primarily of raw land holdings west of Toronto. Peter Langer retired as Chairman of the Board of Directors in January of this year, leaving a thriving business entity with more than $1.7 billion in assets and having extensive interests across North America.

H. PETER LANGER, F.R.I., S.I.R.

That Markborough builds communities instead of subdivisions is attributable to Mr. Langer's style and philosophy which has been to build projects that set enduring standards. His vision, imagination and proven abilities to bring along like-minded people to head our development enterprises across North America will leave a continuing mark on the corporation.

Peter Langer has been involved in all aspects of real estate since 1947 and has earned a reputation for integrity and astuteness. We feel fortunate to have been the beneficiary of his wisdom and good judgment these last twenty-one years and wish him well on his retirement.

BOARD CHANGES Mr. T. Iain Ronald, Executive Vice President of Hudson's Bay Company, has been elected Chairman of the Board of Directors.

APPRECIATION I wish to thank our employees for their commitment and application in contributing to the ongoing success of the corporation.

PETER A. ANKER

PRESIDENT AND CHIEF EXECUTIVE OFFICER


EMPORIUM
CALDERONE

SHOPPING CENTRES **1985 was a year of expansion and selective rationalization of our shopping centre holdings. The gross leasable area of the portfolio increased by approximately 600,000 square feet to 14.8 million square feet. The corporation sold equity interests it held in six community or neighbourhood centres that for the most part did not fit its investment strategy. Consistent with our policy of concentrating investment in dominant regional centres, proceeds from the dispositions were in part redeployed in purchasing a 50% interest in Market Mall, a 761,000 square foot regional shopping centre, including a 90,000 square foot office component, located in north-west Calgary. Market Mall is anchored by the Bay and Woodwards department stores. Plans for an expansion are now being developed.**

Woodbine Centre, a new 610,000 square foot regional centre anchored by the Bay and Simpsons department stores, opened in Toronto last August. In addition to a day care centre, theatres and a conference facility, the 40,000 square foot children's indoor amusement park has introduced an exciting large-scale entertainment experience appropriate to the demographic profile of this market. Results from the centre have been excellent.

In 1985 and as of this date, expansions totalling more than 500,000 square feet have been completed at Fairview Pointe Claire in Montreal (250,000 square feet), Cloverdale Mall in Toronto (94,000 square feet), St. Vital Shopping Centre in Winnipeg (67,000 square feet), Southcentre in Calgary (67,000 square feet), Village Green Mall in Vernon, B.C. (23,000 square feet) and Richmond Centre in Vancouver (8,000 square feet). In all cases, the expanded

LOCATED UNDER A LARGE SKYLIGHT ON THE SECOND LEVEL OF WOODBINE CENTRE, THE FOOD COURT HAS A BRIGHT AND COLOURFUL AMBIANCE.

OPPOSITE: AFTER HOURS AT WOODBINE CENTRE. THE BARREL SHAPED SKYLIGHTS WITH MIRRORED ENDS PROMOTE A FEELING OF SPACIOUSNESS AND LIGHT IN THE MALLS.

THIS REFURBISHED ANTIQUE CAROUSEL WAS RESURRECTED FROM A WAREHOUSE IN CALIFORNIA AND INSTALLED AS ONE OF THE RIDES IN WOODBINE CENTRE'S FANTASY FAIR, A 40,000 SQUARE FOOT CHILDREN'S AMUSEMENT AREA.

premises have been fully leased in accordance with merchandising plans designed to take advantage of changing market trends and growth patterns.

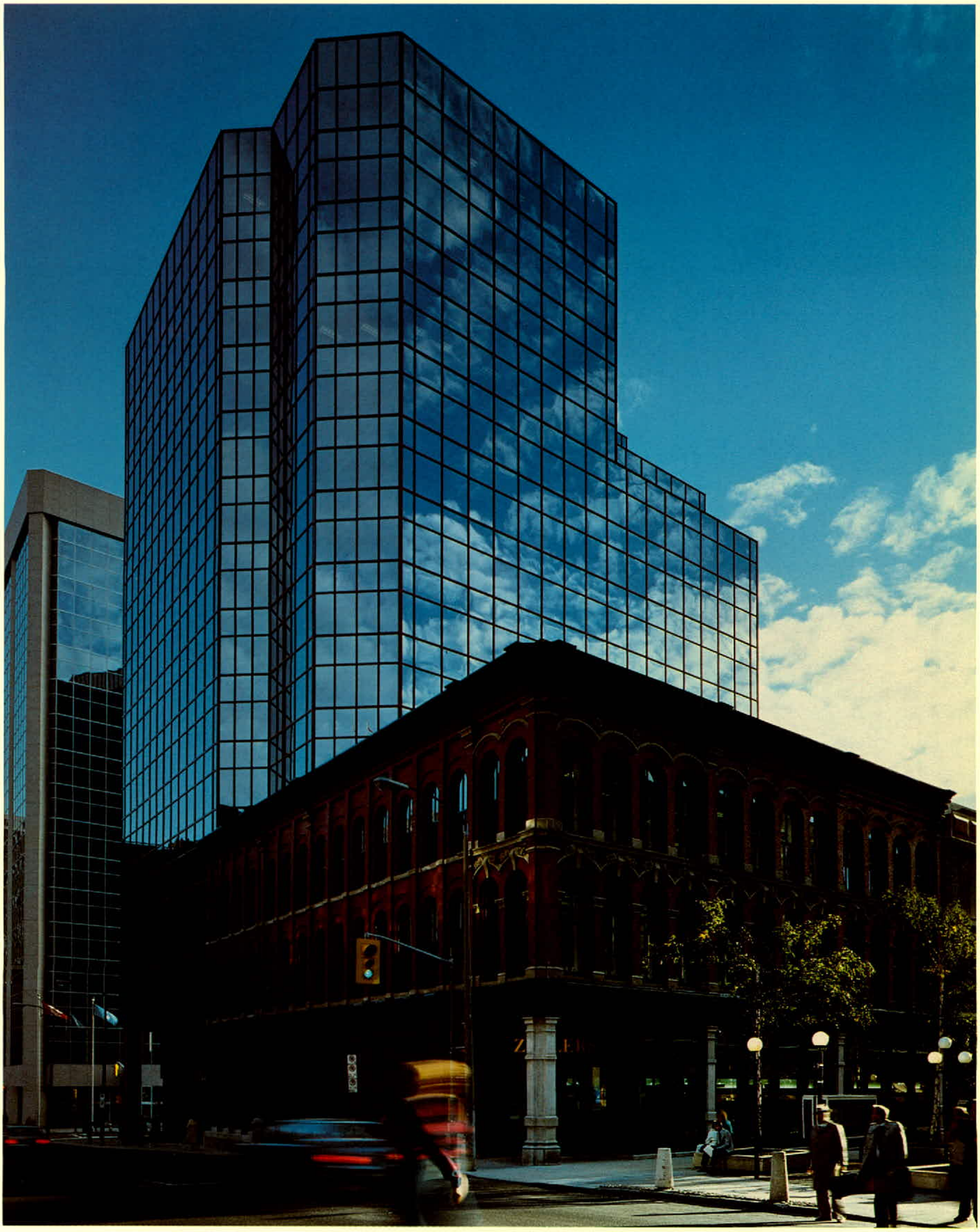
In 1986 our shopping centre group will explore further expansion or renovation plans and will continue the process of adjusting the merchandising mix of centres as market and demographic research identify changing consumer demands in each locale.

OFFICE AND MIXED-USE PROPERTIES In June, the corporation purchased Greystone Office Park. The first phase of the project is located on 8.76 acres of land on the primary east/west corridor in Las Vegas and consists of two first-class office buildings having a total of 123,000 square feet of leasable space and a restaurant. This phase of the project is virtually fully leased. Construction has started on the 69,000 square foot second phase located on an adjoining 4.35 acre site. The scheduled completion date is October, 1986. Spectacular water features within the buildings and numerous architectural design and development awards bestowed on the project have confirmed Greystone as one of the most prestigious business addresses in Las Vegas.

Occupancy of Heritage Place in downtown Ottawa commenced in September, 1985 and a 50,000 square foot Zellers store integrated into the project opened in the same month. The 14 storey, 239,000 square foot office-retail complex is ideally located within a five minute walk of Parliament Hill and in the centre of the downtown business district. The leasing program is progressing satisfactorily in this very competitive marketplace.

Current development projects in Washington, D.C., and Toronto are scheduled to be completed this summer. In Washington, the 10 storey, 150,000 square foot building containing office and specialty retail space at 20th and L Streets will be available for occupancy in May this year. The marketing program began in earnest with the recent enclosure of the building and a number of tenants are now committed. The 1303 Yonge Street project in Toronto involved the major renovation of an older office building and the construction of a new addition. The project is comprised of 55,000 square feet of pre-leased prime office space and 10,000 square feet of retail space.

OPPOSITE: HERITAGE PLACE, OTTAWA. THE FACADE OF THE ZELLERS STORE ADJOINING THE HERITAGE PLACE TOWER DATES FROM 1872 AND WAS CAREFULLY PRESERVED DURING THE DEMOLITION AND CONSTRUCTION PHASES OF THIS DEVELOPMENT.



20TH AND L STREETS, WASHINGTON, D.C.
WILL BE READY FOR OCCUPANCY
IN MAY, 1986.

The Beaver House project in The City of London is proceeding as planned for completion in the summer of 1987. Development of this site, which is surrounded by narrow streets and built on top of London Transport's Mansion House underground station, has presented several unique engineering and construction challenges. The major problem of how to carry out the works without disrupting subway service, which only closed down for a period of three hours early each morning, was solved by driving tunnels 90 feet below road level and underneath the tracks. Some 600 feet of tunnels were built and, in 53 pre-determined positions, holes were dug upwards to form the basis for columns to support a raft which in turn was built over the tracks to act as the building base. The whole system was then filled with concrete to form a massive foundation, resulting in a saving of several months of construction time. With the most technically difficult phases of the development works now completed, progress on the superstructures of the two linked buildings is proceeding quickly. There is considerable demand in The City of London for modern office accommodation which has recently been stimulated by de-regulation of certain areas of the financial markets in England. Markborough is actively considering new development opportunities in the area.

DESIGN/BUILD PROJECTS IN REXWOOD BUSINESS PARK (MALTON MEDICAL ARTS BUILDING) AND MEADOWVALE (ONTARIO EGG MARKETING BOARD, STERISYSTEMS LTD. AND INTERAUTOMATION LIMITED).

INDUSTRIAL BUILDINGS **Markborough manages industrial buildings with a gross leasable area of over one million square feet, in which our net interest is 832,000 square feet. Almost 90% of the buildings are located in the Metropolitan Toronto area and the majority are constructed on sites which have been developed by Markborough. Activity in the industrial market was brisk in 1985 and revenues increased by 15% over 1984. Nearly 100,000 square feet were leased to new tenants and over 184,000 square feet were taken up through renewals in 1985. Virtually all available space in our portfolio is now leased.**

RESIDENTIAL COMMUNITY AND INDUSTRIAL DEVELOPMENTS

Markborough's development emphasis has been concentrated in recent years on residential community developments in the sun-belt states of Florida, Arizona, Texas and California, where solid corporate reputations and excellent management teams are well-established.

At the Boca Pointe development in Boca Raton, Florida, land development on the east side of the project was completed and the Fitness and Racquet Club opened in June, 1985. Builders in the project generated sales of over $100 million in 1985 and further strong sales are expected this year. With inventory at Boca Pointe now almost depleted, our Florida subsidiary last year purchased a 1,980 acre land parcel in Tampa for a new residential community to be named Hunter's Green. Design work has commenced on the golf course, clubhouse, sales pavilion and other facilities.

Notwithstanding a soft housing market in the Phoenix/Scottsdale region of Arizona, builders at Gainey Ranch have experienced a successful year in 1985 and prospects for major sales in 1986 are promising. The hotel site at Gainey was sold in August. Work on the 487 room luxury resort hotel, owned and operated by Hyatt Hotels, began immediately after the sale and opening is scheduled for early 1987.

In Texas, Lexington Development Company (80% owned by Markborough and operating in Houston, Austin and Dallas) continued its profitable sales record but did not match the record sales pace and profits of 1984 when a major percentage of its Austin properites were sold.

At Sunnymead Ranch near Riverside, California, work continued last year on extending the infrastructure systems throughout the development, while the dam and lake systems and adjacent community recreation centre were completed. Tract maps providing for approximately 1,000 dwelling units in product types ranging from custom lakeside estates to townhomes terraced around the lake will be recorded in 1986. The sales momentum established in 1985 should continue to build as the community matures and an extensive marketing effort is undertaken.

THE INTERIOR OF ONE OF THE MODEL HOMES AT BOCA POINTE.

THE TERRACES RESTAURANT, GAINEY RANCH GOLF CLUB

OPPOSITE: CONSTRUCTION COMMENCES ON THE 487 ROOM LUXURY HYATT HOTEL AT GAINEY RANCH.

THE CLUB AT GAINEY RANCH

HOUSING DEVELOPMENT AT SCOTTSDALE RANCH

In Ontario, the corporation commenced development for a residential community on a 280 acre site in the East Credit District of Mississauga. Sales in the first phase of the development have been very strong and planning for the development of subsequent phases is now underway. The Ontario division is also very active in developing industrial land. The current major project is the 1,000 acre business park in Meadowvale, Mississauga where the registration and servicing of a second phase of 139 acres was completed in 1985. Du Pont Canada began construction of its head office facility in Meadowvale last year and Canadian General Electric is expected to begin construction of its new Canadian headquarters this year.

HOUSING Revenue from housing operations, carried on mainly by Markland Properties in Arizona, increased to $19.5 million from $16.1 million in 1984 and profit increased to $3 million from $2.5 million. Sales of the Golf Cottages at Gainey Ranch have been excellent and the feasibility of other Markland housing projects in this development is being examined.

COMMERCIAL AND INDUSTRIAL DESIGN/BUILD Markborough has been a participant for nine years in the custom design and build market in the greater Metropolitan Toronto area and has, in over 50 transactions, demonstrated its ability to assemble and deliver land, building, project financing and legal documentation to the satisfaction of investors. In 1986, the corporation will expand its land holdings in Brampton and/or in Vaughan to be used for design/build purposes and will be marketing numerous sites in Meadowvale.

OPPOSITE: THE FITNESS AND RACQUET CLUB AT BOCA POINTE

Property Portfolio

SHOPPING CENTRES

	Year Opened	Number of Stores	Gross Leasable Area (Square Feet) Total [1]	Anchors	C.R.U.'s	Markborough's Interest %	G.L.A.
Regional Shopping Centres							
Les Galeries D'Anjou, Montreal, Quebec	1968	172	1,006,000	598,000	408,000	50%	503,000
Fairview Pointe Claire, Montreal, Quebec	1965	188/200	895,000	478,000	417,000	50%	447,500
Les Galeries de la Capitale, Quebec City, Quebec	1981	180	857,000	502,000	355,000	25%	214,250
Southgate, Edmonton, Alberta	1970	135	780,000	563,000	217,000	40%	312,000
Market Mall, Calgary, Alberta	1971	86	761,000	491,000	270,000	50%	380,500
St. Vital, Winnipeg, Manitoba	1979	126	694,000	445,000	249,000	25%	173,500
Woodbine Centre, Toronto, Ontario	1985	180	610,000	314,000	296,000	40%	244,000
Southcentre, Calgary, Alberta	1974	146	606,000	390,000	216,000	50%	303,000
Fairview Mall, Toronto, Ontario	1970	130	576,000	294,000	282,000	50%	288,000
MicMac Mall, Dartmouth, Nova Scotia	1973	150	530,000	259,000	271,000	100%	530,000
Place Vertu, Montreal, Quebec	1975	165	527,000	246,000	281,000	25%	131,750
Deerfoot Mall, Calgary, Alberta	1981	102	512,000	327,000	185,000	25%	128,000
Unicity Mall, Winnipeg, Manitoba	1975	80	471,000	309,000	162,000	33¹/₃%	157,000
Kildonan Place, Winnipeg, Manitoba	1980	86	449,000	280,000	169,000	40%	179,600
Oakville Place, Oakville, Ontario	1981	105	431,000	262,000	169,000	49%	211,190
Cataraqui Town Centre, Kingston, Ontario	1982	106	405,000	246,000	159,000	50%	202,500
Community Shopping Centres							
Cloverdale Mall, Etobicoke, Ontario	1956	108	408,000	235,000	173,000	100%	408,000
Armdale Mall, Halifax, Nova Scotia	1975	49	238,000	116,000	122,000	50%	119,000
Armdale – Simpsons Store	1983	1	147,000	147,000	—	100%	147,000
Mayflower Mall, Sydney, Nova Scotia	1980	70	366,000	242,000	124,000	50%	183,000
Rutherford Mall, Nanaimo, British Columbia	1980	81	360,000	226,000	134,000	100%	360,000
Meadowvale Town Centre, Mississauga, Ontario	1978	93	338,000	184,000	154,000	100%	338,000
St. Albert Centre, St. Albert, Alberta	1980	64	325,000	238,000	87,000	100%	325,000
Village Green Mall, Vernon, British Columbia	1975	75	281,000	180,000	101,000	25%	70,250
Woodside Square, Scarborough, Ontario	1977	70	276,000	160,000	116,000	50%	138,000
Tamarack Mall, Cranbrook, British Columbia	1977	54	272,000	176,000	96,000	33¹/₃%	90,667
Richmond Centre, Richmond, British Columbia	1973	63	224,000	113,000	111,000	100%	224,000
REG Place du Royaume, Chicoutimi, Quebec	1977	75	? 193,000	83,000	110,000	25%	48,250
Lloydmall, Lloydminster, Alberta	1974	52	186,000	120,000	66,000	100%	186,000
Champlain Mall, Vancouver, British Columbia	1973	41	176,000	118,000	58,000	100%	176,000
Weyburn Square, Weyburn, Saskatchewan	1980	28	137,000	88,000	49,000	50%	68,500
Carrefour Gaspe, Gaspe, Quebec	1980	31	135,000	84,000	51,000	10%	13,500
Thunderbird Mall, Port Hardy, British Columbia	1981	30	89,000	54,000	35,000	100%	89,000
Neighbourhood Shopping Centres							
10 Centres in various provinces	Various	186	581,000	231,000	350,000	50-100%	445,200
		3,308	14,842,000	8,799,000	6,043,000		7,835,157

(1) Includes 132,000 square feet of office space in Market Mall and Weyburn Square.

OFFICE AND MIXED-USE PROPERTIES

COMPLETED	Year Opened	Net Leasable Area (Square Feet)	Markborough's Interest %	Markborough's Interest N.L.A.
Canada				
Toronto, Ontario				
The Simpson Tower*	1968	349,000	100%	349,000
7 Overlea	1969	143,000	100%	143,000
15 Overlea	1967	142,000	100%	142,000
Markborough Place	1979	132,000	100%	132,000
Meadowvale Professional Centre	1981	33,000	100%	33,000
Other (4)	Various	67,000	100%	67,000
Ottawa, Ontario				
Heritage Place	1985	239,000	100%	239,000
Edmonton, Alberta				
Principal Plaza	1980	422,000	25%	105,500
United States				
Denver, Colorado				
Hudson's Bay Centre	1984	169,000	100%	169,000
Las Vegas, Nevada				
Greystone	1982	123,000	100%	123,000
Total Completed		1,819,000		1,502,500

*Leased

UNDER CONSTRUCTION	Net Leasable Area (Square Feet)	Markborough's Interest %	Markborough's Interest N.L.A.	Scheduled Year of Completion
Canada				
Toronto, Ontario				
1303 Yonge Street	65,000	100	65,000	1986
United States				
Washington, D.C.				
20th & L Streets	150,000	50	75,000	1986
Las Vegas, Nevada				
Greystone, Phase 2	69,000	100	69,000	1986
England				
London				
Beaver House	193,000	100	193,000	1987
Total Under Construction	477,000		402,000	

CONSTRUCTION ON THE BEAVER HOUSE SITE, LONDON, ENGLAND

LOBBY OF THE SIMPSON TOWER AS RENOVATED IN 1985

INDUSTRIAL BUILDINGS

	Leasable Area (square feet) Net	Markborough's Interest
Wholly-Owned Buildings		
Toronto, Ontario (11 buildings)	446,600	446,600
Phoenix, Arizona (3 buildings)	141,900	141,900
	588,500	588,500
Jointly-Owned Buildings (50%)		
Toronto, Ontario (11 buildings)	487,200	243,600
	1,075,700	832,100

RESIDENTIAL AND HOTEL PROPERTIES

Apartment Buildings (Markborough's Interest is 50%)	Numbers of Rental Units
49 Thorncliffe Park, Toronto	400
53 Thorncliffe Park, Toronto	279
Hotels (Markborough's Interest is 100%)	Number of Rooms
Delta Meadowvale Inn, Mississauga	192

LAND FOR SALE AND FUTURE DEVELOPMENT

CONSTRUCTION OF THE LAKE SPILLWAY AT SUNNYMEAD RANCH, CALIFORNIA.

				Markborough's Interest	
Location	Year(s) of Acquisition	Original Acreage	Total Remaining Acreage	%	Total Remaining Acreage
Canada					
Ontario					
Meadowvale	1972/85	2,905	944	100%	944
Mississauga	1977	284	258	100%	258
Other (including sites)	Various	899	644	100%	644
Alberta					
Woodbine	1976	634	209	100%	209
Other	1984	156	156	100%	156
Other (including sites)	Various	549	416	100%	416
		5,427	2,627		2,627
United States					
Arizona					
Scottsdale Ranch	1978	1,119	112	50%	56
Gainey Ranch	1980	562	394	100%	394
Other	1979	135	28	100%	28
California					
Sunnymead Ranch	1980	1,366	689	100%	689
Other (including sites)	Various	330	221	100%	221
Florida					
Boca Pointe	1979	1,019	225	100%	225
Hunter's Green	1985	1,980	1,980	100%	1,980
Homestead	1974	3,276	3,026	50%	1,513
Texas					
Northview Park	1985	128	128	80%	102
Harvest Bend	1977	599	191	80%	153
Northchase	1980	487	265	82%	217
First Colony	1980	760	272	80%	218
New Territories	1984	3,082	2,982	80%	2,386
Vicksburg	1982	411	139	80%	111
Other	Various	2,832	144	80%	115
Other	Various	658	219	100%	219
		18,744	11,015		8,627
		24,171	13,642		11,254

Consolidated Statement of Income

YEAR ENDED JANUARY 31, 1986

	This year	Last year
	(000's)	(000's)
Revenue from land operations	$144,803	$253,936
Less cost	111,384	195,178
Profit from land operations	33,419	58,758
Revenue from housing operations	19,471	16,111
Less cost	16,482	13,641
Profit from housing operations	2,989	2,470
Revenue from income properties	136,982	121,117
Less:		
Operating expenses	36,390	31,831
Realty taxes	19,074	17,812
Operating profit from income properties	81,518	71,474
Interest and other income	17,882	14,115
Gain on sale of income properties	15,583	435
Income before interest, depreciation and general and administrative expenses	151,391	147,252
Less:		
Interest	60,656	49,771
Depreciation on income properties	12,480	11,394
General and administrative expenses	16,511	14,371
Income before income taxes	61,744	71,716
Provision for income taxes (Note 10):		
Current	14,100	11,389
Deferred	10,428	21,827
	24,528	33,216
Net income for the year	$ 37,216	$ 38,500
Earnings per share	$3.37	$3.48

Consolidated Statement of Retained Earnings

YEAR ENDED JANUARY 31, 1986

	This year	Last year
	(000's)	(000's)
Retained earnings at beginning of the year	$188,886	$255,386
Net income for the year	37,216	38,500
	226,102	293,886
Capitalization of retained earnings (Notes 1 and 11)	(34,245)	—
Dividends paid on common shares	(13,475)	(105,000)
Retained earnings at end of the year	$178,382	$188,886

Consolidated Balance Sheet

January 31, 1986

	This year (000's)	Last year (000's)
Assets		
Accounts receivable	$ 45,800	$ 43,681
Mortgages and other secured receivables (Note 3)	178,393	173,670
Land and housing for sale	292,897	253,939
Land for future development	334,252	272,077
Prepaid expenses and other assets	20,240	16,014
Income properties (Note 4)	839,298	709,554
Investments in affiliated companies (Note 5)	—	142,373
	$1,710,880	$1,611,308
Liabilities and Shareholder's Equity		
Bank indebtedness	$ 110,171	$ 96,697
Accounts payable and accrued liabilities (Note 7)	101,393	99,345
Due to parent and affiliated company (Note 8)	129,613	168,091
Provision for development costs	64,508	67,304
Mortgages payable (Note 9)	815,053	622,871
Deferred income taxes	146,760	134,891
	1,367,498	1,189,199
Capital stock (Note 11)	165,000	233,223
Retained earnings	178,382	188,886
	$1,710,880	$1,611,308

APPROVED BY THE BOARD:

PETER A. ANKER, DIRECTOR

DONALD F. PROWSE, DIRECTOR

Auditors' Report

To the Shareholder of
Markborough Properties Inc.:

We have examined the consolidated balance sheet of Markborough Properties Inc. as at January 31, 1986 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at January 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse

Toronto, March 14, 1986

Chartered Accountants

Consolidated Statement of Changes in Financial Position

YEAR ENDED JANUARY 31, 1986

	This year	Last year
	(000's)	(000's)
Cash provided from (applied to):		
Operating activities		
Net income for the year	$ 37,216	$ 38,500
Add:		
Depreciation	12,480	11,394
Provision for deferred income taxes	10,428	21,827
Cash flow from operations	60,124	71,721
Costs recovered through sales		
Land and housing	127,866	208,819
Income properties	55,154	2,881
Other assets and liabilities, net	(4,297)	38,479
	238,847	321,900
Financing activities		
Dividends paid on common shares	(13,475)	(105,000)
Mortgages on income properties and land	371,897	221,169
Mortgage principal repayments	(199,719)	(131,301)
Mortgages and other secured receivables	(4,723)	(91,167)
Parent company advances, net	(38,478)	127,170
Redemption of investments in affiliates	142,373	—
Redemption of preferred shares	(102,469)	—
	155,406	20,871
Cash provided	394,253	342,771
Cash applied to:		
Investing activities		
Land		
Acquisition	84,918	60,292
Development and related costs	84,576	139,635
Carrying charges	37,817	35,570
Housing construction	15,120	10,366
Income properties		
Acquisition	78,879	41,267
Construction	106,417	46,342
Cash applied	407,727	333,472
Increase (decrease) in bank indebtedness	$ 13,474	$ (9,299)
Cash flow from operations per share	$5.44	$6.49

1. Reorganization

On December 18, 1985, Markborough Properties Inc. acquired all the issued and outstanding shares of Markborough Properties Limited from Hudson's Bay Company in exchange for 11,054,125 common shares with a stated value of $164,999,500. Prior to this acquisition, all the issued and outstanding shares of both Markborough Properties Inc. and Markborough Properties Limited were owned by Hudson's Bay Company. Prior to the reorganization, the assets, liabilities, revenues and expenses of Markborough Properties Inc. were insignificant. Accordingly, the transaction has been accounted for as a reorganization of Markborough Properties Limited. The comparative financial statements thus reflect the assets, liabilities, revenues and expenses of Markborough Properties Limited.

2. Summary of significant accounting policies

The accounting policies of the Company conform to accounting principles generally accepted in Canada. The Company's significant accounting policies are as follows:

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company's subsidiaries, all of which are wholly-owned, and the Company's share of the assets, liabilities, revenues and expenses of the incorporated and unincorporated joint ventures in which it participates.

(b) Land and housing

Land and housing are carried at the lower of cost or net realizable value at the estimated time of development and sale.

The cost of land for future development includes pre-development expenses and carrying charges (interest and realty taxes).

The Company records as land for sale, the estimated cost on a fully developed basis of those parcels of land on which the planning, engineering, servicing and governmental authorization procedures are completed to the point that the land can be regarded as available for sale. The amount recorded includes land costs and full provision for the estimated complete development costs. The liability for the unexpended portion of the estimated development costs is shown as provision for development costs and includes any costs still to be incurred on land which has been sold. Housing includes construction costs incurred to date.

(c) Income properties

Income properties completed and under construction are carried at cost. Cost includes interest, realty taxes and other carrying charges incurred in the pre-development and construction periods and initial leasing costs.

Revenue is recorded as income at the earlier of the date when 70% of the property is leased or when a period has elapsed subsequent to substantial completion deemed under the circumstances to be reasonable for leasing. Operating results prior to this date are capitalized.

Buildings are generally being depreciated on the sinking fund basis at rates ranging between 3% and 5% over terms of 35 to 50 years. Equipment is being depreciated on a straight-line basis over the estimated useful life of the asset.

(d) Interest allocation

Interest on specific debt secured by land or income properties under construction is capitalized to such assets when their cost is lower than net realizable value.

Interest on other borrowings is pooled. Interest is capitalized to income properties under construction and land for future development, when their cost is lower than net realizable value, at the weighted average rate for that portion of the project not financed by specific debt. The remaining unallocated interest is expensed.

3. Mortgages and other secured receivables

Mortgages and other secured receivables, which arise from sales of real property, bear interest at an average year-end rate of 10.5% and mature as follows:

	(000's)
Fiscal year ending January 31, 1987	**$ 50,926**
1988	**45,928**
1989	**24,962**
1990	**34,459**
Subsequent to January 31, 1990	**22,118**
	$178,393

Under certain conditions, the amounts due may be paid prior to maturity.

4. Income properties

Income properties consist of:

	This year	Last year
	(000's)	(000's)
Land	**$ 94,968**	$ 81,771
Buildings	**684,186**	601,320
Equipment	**7,097**	6,841
	786,251	689,932
Less accumulated depreciation	**58,038**	51,921
	728,213	638,011
Construction in progress – Land	**26,191**	26,374
– Buildings	**84,894**	45,169
	111,085	71,543
	$839,298	$709,554

The Company's share of the estimated cost to complete construction of seven projects in progress is $91,926,000. Specific project financing and general lines of credit are available to fund the construction of these projects.

5. Investments in affiliated companies

Investments in affiliated companies as at January 31, 1985 consisted of 8% non-cumulative, non-voting, redeemable, retractable Class A shares of the affiliated companies listed below.

	(000's)
Hudson's Bay Company Real Estate Limited	**$ 87,147**
Hudson's Bay Company Investments Limited	**48,446**
Hudson's Bay Company Fur Sales International Limited	**4,929**
Zellers Inc.	**1,851**
	$142,373

On February 1, 1985, these shares were redeemed for cash and the proceeds were in part used to redeem the Company's Class A shares at their full redemption price of $102,469,000.

6. Interest

Interest incurred during the year has been allocated as follows:

	This year	Last year
	(000's)	(000's)
Capitalized		
Land and housing	**$ 36,436**	$35,368
Income properties under construction	**13,587**	3,616
Expensed	**60,656**	49,771
	$110,679	$88,755

7. Accounts payable and accrued liabilities

Accounts payable and accrued liabilities consist of the following:

	This year	Last year
	(000's)	(000's)
Trade accounts payable and accrued liabilities	$ 76,253	$70,967
Partner's minority interest in joint venture	25,140	28,378
	$101,393	$99,345

8. Due to parent and affiliated company

The amounts due to parent and affiliated company are unsecured. These amounts have an average year-end interest rate of 12.2% and are due as follows:

	(000's)
Fiscal year ending January 31, 1987	$ 39,377
1988	21,000
1989	21,000
1990	21,000
1991	—
Subsequent to January 31, 1991	27,236
	$129,613

Interest incurred during the year on amounts due to parent and affiliated company amounted to $15,063,000.

9. Mortgages payable

Mortgages payable comprise the following:

	This year	Last year
	(000's)	(000's)
On land, at an average year-end interest rate of 9.6% (last year – 11.4%) and maturing by 1993	$269,381	$226,753
On income property permanent financing, at an average year-end interest rate of 11.6% (last year – 11.4%) and maturing by 2008	380,811	293,773
On income property interim financing, at an average year-end interest rate of 10.4% (last year – 11.1%) and maturing by 1994	164,861	102,345
	$815,053	$622,871

Included in mortgages payable is debt attributable to assets in the United States in the amount of U.S. $252,130,000 and debt attributable to assets in the United Kingdom in the amount of £18,697,903.

Principal repayments are due as follows:

	(000's)
Fiscal year ending January 31, 1987	$143,498
1988	123,066
1989	69,029
1990	58,422
1991	49,935
Subsequent to January 31, 1991	371,103
	$815,053

10. Income taxes

The Company's effective income tax rate is arrived at as follows:

	This year	Last year
Combined Canadian federal and Ontario income tax rate	**52.1%**	51.0%
Increase (decrease) in income tax rate resulting from:		
Lower foreign rate	**(0.5)**	(2.3)
Lower effective rate on capital gains	**(11.3)**	(1.5)
Lower rate in other provincial jurisdictions	**(1.4)**	(0.9)
Other	**0.8**	—
Effective income tax rate	**39.7%**	46.3%

Deferred income taxes represent the effects of amounts which are reported in different periods for financial and tax reporting purposes. The deferred income tax provision reflects the tax effects of:

	This year	Last year
	(000's)	(000's)
Depreciation	**$ 5,630**	$ (2,264)
Carrying charges	**5,068**	16,120
Reserves	**(5,576)**	(5,189)
Losses carried forward	**5,306**	13,160
	$10,428	$21,827

11. Capital stock

The authorized capital stock of the Company consists of an unlimited number of common shares and an unlimited number of Class A and Class B preference shares, all without par value.

The issued and outstanding capital stock comprises the following:

	This year	Last year
	(000's)	(000's)
Common shares	**$165,000**	$130,754
Class A shares	**—**	29,313
Contributed surplus	**—**	73,156
	$165,000	$233,223

Common shares

The issued and outstanding common share capital of the Company is as follows:

	Number	**Amount**
Markborough Properties Inc. prior to amalgamation	**500**	$ 500
Issued in connection with reorganization (Note 1)	**11,054,125**	164,999,500
	$11,054,625	$165,000,000

The increase in stated capital of the Company over the stated capital of its predecessor companies, Markborough Properties Inc. and Markborough Properties Limited, has been effected by a capitalization of retained earnings of $34,245,000.

Class A shares and contributed surplus.

On February 1, 1985, the Class A shares of Markborough Properties Limited were redeemed for $102,469,000, being the total of the stated capital of the Class A shares and the contributed surplus.

12. Joint venture operations

The Company's share of its joint venture operations is summarized as follows:

	This year (000's)	Last year (000's)
Assets		
Accounts receivable	$ 19,874	$ 17,855
Mortgages and other secured receivables	75,736	101,508
Land and housing for sale	70,935	56,499
Land for future development	121,728	84,267
Prepaid expenses and other assets	8,023	7,687
Income properties	425,564	382,254
	$721,860	$650,070
Liabilities and equity		
Bank indebtedness	$ —	$ 1,114
Accounts payable and accrued liabilities	52,214	68,370
Provision for development costs	15,374	18,769
Mortgages payable	453,455	338,641
Deferred income taxes	10,477	8,614
	531,520	435,508
Investment in joint ventures	190,340	214,562
	$721,860	$650,070

	This year (000's)	Last year (000's)
Income and Expenses		
Revenue from land operations	$41,515	$143,830
Less cost	27,235	99,472
Profit from land operations	14,280	44,358
Revenue from housing operations	—	215
Less cost	—	189
Profit from housing operations	—	26
Revenue from income properties	72,402	63,551
Less expenses	24,235	22,981
Operating profit from income properties	48,167	40,570
Interest and other income	9,443	7,447
Income before interest, depreciation and general and administrative expenses	71,890	92,401
Interest	30,598	29,703
Depreciation on income properties	7,219	6,901
General and administrative expenses	2,430	2,511
Income before income taxes	$31,643	$ 53,286

The Company is contingently liable at January 31, 1986 for $66,212,000, representing the liabilities of its co-owners in unincorporated joint ventures but against such liabilities the Company would have a claim upon the joint venture assets of its co-owners. The value of the assets of each of these joint ventures exceeds the contingent liability.

13. Related party transactions

In the normal course of business, the Company enters into transactions with its parent and certain affiliated companies. These transactions are negotiated as if the parties are dealing at arm's length.

14. Segmented information (thousands of dollars)

Segmented information is summarized as follows:

	Canada		United States		Total	
	This year	Last year	**This year**	Last year	**This year**	Last year
Assets						
Land operations	**$177,199**	$ 195,580	**$442,371**	$327,826	**$ 619,570**	$ 523,406
Housing operations	**—**	—	**7,579**	2,610	**7,579**	2,610
Income property operations	**733,940**	649,017	**105,358**	60,537	**839,298**	709,554
Other	**75,932**	197,865	**168,501**	177,873	**244,433**	375,738
	$987,071	$1,042,462	**$723,809**	$568,846	**$1,710,880**	$1,611,308
Revenue						
Land operations	**$ 49,845**	$ 39,580	**$ 94,958**	$214,356	**$ 144,803**	$ 253,936
Housing operations	**—**	—	**19,471**	16,111	**19,471**	16,111
Income property operations	**131,802**	119,908	**5,090**	1,209	**136,892**	121,117
	$181,647	$ 159,488	**$119,519**	$231,676	**$ 301,166**	$ 391,164
Profit						
Land operations	**$ 8,288**	$ 5,655	**$ 25,131**	$ 53,103	**$ 33,419**	$ 58,758
Housing operations	**—**	—	**2,989**	2,470	**2,989**	2,470
Income property operations	**79,348**	71,225	**2,170**	249	**81,518**	71,474
	87,636	76,880	**30,290**	55,822	**117,926**	132,702
Interest and other income	**5,606**	3,121	**12,276**	10,994	**17,882**	14,115
Gain on sale of income properties	**15,583**	435	**—**	—	**15,583**	435
	$108,825	$ 80,436	**$ 42,566**	$ 66,816	**151,391**	147,252
Interest					**60,656**	49,771
Depreciation on income properties					**12,480**	11,394
General and administrative expenses					**16,511**	14,371
Income before income taxes					**61,744**	71,716
Provision for income taxes					**24,528**	33,216
Net income for the year					**$ 37,216**	$ 38,500

Board of Directors

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President and Chief Executive Officer
Markborough Properties Inc.
Toronto

Tullio Cedraschi
President and Chief Executive Officer
CN Investment Division
Canadian National Railways
Montreal

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George Wimpey Canada Limited
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Toronto

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Hudson's Bay Company
Toronto

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President
Candor Investments Ltd.
Calgary

*Chairman of the Board and of the Executive Committee
†Chairman of the Audit Committee

Officers

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Chairman of the Board

Donald S. McGiverin
Deputy Chairman of the Board

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President and Chief Executive Officer

Donald F. Prowse
Executive Vice President

John A. Brough
Vice President and Treasurer

Christopher J. Desjardins
Vice President and Secretary

Simon W. Nyilassy
Controller

Patricia I. Thomas
Assistant Secretary

Principal Operating Company

Markborough Properties Limited

Officers

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Executive Vice President

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David B. Hunt
Vice President, Construction

Simon W. Nyilassy
Controller

Patricia I. Thomas
Assistant Secretary

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Assistant Treasurer

Principal Subsidiary Companies

Beaver House Limited
Markborough California, Inc.
Markborough California Properties, Inc.
Markborough Colorado, Inc.
Markborough Columbia, Inc.
Markborough Equities Limited
Markborough Florida, Inc.
Markborough Holdings Inc.
Markborough Inc.
Markborough Nevada Inc.
Markborough Ohio, Inc.
Markborough Properties Limited
Markborough Texas, Inc.
Markland Properties, Inc.

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