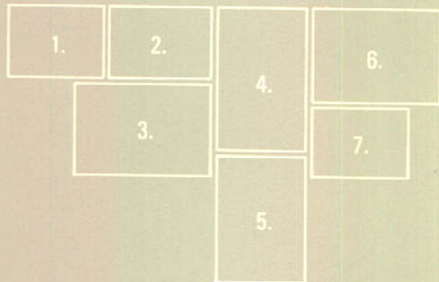
MARKBOROUGH PROPERTIES INC.
ANNUAL REPORT 1986

C O N T E N T S



Cover

1. Sunnymead Ranch Lake Club
   Moreno Valley, California
2. Hunter's Green Master Plan
   Tampa, Florida
3. Scottsdale Ranch Housing
   Scottsdale, Arizona
4. Meadowvale Business Park
   Mississauga, Ontario
5. The Simpson Tower
   Toronto, Ontario
6. Fairview Pointe Claire Shopping Centre
   Montreal, Qubec
7. Greystone
   Las Vegas, Nevada

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 $1.6 billion. Approximately 47% of its portfolio is located in the United States (Texas, Arizona, Florida, California, Washington D.C., Nevada, Colorado and Ohio) and the balance is located primarily in Canada. Markborough owns or has an interest in 71 income properties comprising 16.5 million square feet of leasable area in shopping centres, office buildings and industrial properties and land holdings of over 12,700 acres.

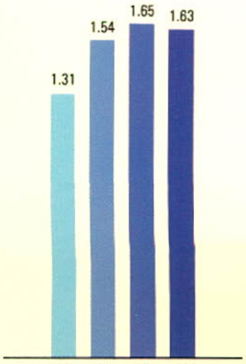
Markborough is a wholly-owned subsidiary of Hudson's Bay Company.

Financial Highlights

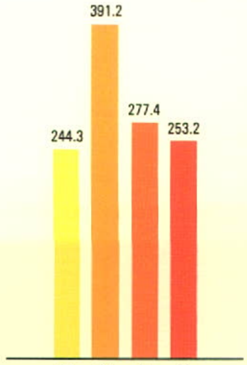
(thousands of dollars except where noted)

	1986	1985
Operating results for the year		
Revenue from land operations	**$ 82,360**	$ 120,993
Revenue from housing operations	**16,445**	19,471
Revenue from income properties	**154,443**	136,982
Income before taxes	**59,176**	61,774
Net income	**47,896**	37,216
Per common share: (note)		
Net income	**$4.90**	$3.80
Cash flow	**7.38**	6.15
Financial position at the year end		
Land and housing	**$ 616,933**	$ 562,641
Income properties	**773,744**	839,298
Bank indebtedness	**118,385**	110,171
Due to parent and affiliated company	**86,303**	129,613
Mortgages payable	**871,844**	815,053
Share capital	**145,989**	165,000
Retained earnings and contributed surplus	**204,444**	178,382
Statistical at the year end		
Common shares outstanding	**9,780,914**	11,054,625
Ratio of income properties to land and housing	**1.3 to 1**	1.5 to 1
Ratio of debt to equity	**3.1 to 1**	3.1 to 1

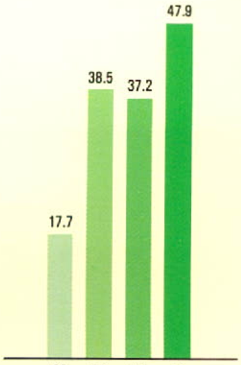
Note: The amounts per common share for 1985 have been restated to reflect the number of common shares outstanding as at January 31, 1987.



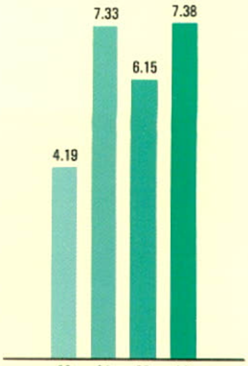
Total Assets (billions $)



Total Revenue (millions $)



Net Income (millions $)



Cash Flow Per Share ($)

Financial

Net profit for the 1986 fiscal year was $47.9 million compared to 1985 profit of $37.2 million. Cash flow from operations increased to $72.2 million from $60.1 million.

Increased operating profits from income property operations and gains from sales of income properties more than offset a decline in profits from land development operations and losses mainly related to the disposal of the corporation's interest in the Villages of Homestead partnership in Florida.

Operating profits from the income property portfolio increased by $11.6 million to $93.1 million from $81.5 million in 1985. Vacancy reductions and higher rentals from existing properties accounted for $4.2 million of this gain. The balance of the increase came from newly acquired or expanded properties net of dispositions.

During the year, 14 income properties (including a 50% interest in the Beaver House project in London, England) were sold for a gain of $67.3 million before tax.

Land development revenues decreased to $82.4 million from $121.0 million last year. A net loss of $3.5 million was incurred from these operations compared to a profit of $25.7 million in 1985. Land sales in Canada, with the exception of Calgary, were higher than last year but sales in the normally higher margin projects in the United States, particularly in Texas and Arizona, fell short of last year's levels.

Over the course of the year, the corporation reduced its exposure to floating interest rates through the use of mortgage bond financings on Canadian income properties and U.S. interest rate exchange agreements. As a result, the ratio of variable rate debt outstanding as a percentage of total debt declined to 36% from 50% at the end of last year. Fixing the rates on certain debt at an average of 10.5% in Canada and 9.6% in the United States had the effect of reducing the corporation's average borrowing cost on its fixed rate debt from 11.7% to 11.0%.

Overview of Operations

In 1986 the corporation disposed of six wholly-owned neighbourhood shopping centres, equity interests in two community shopping centres and one regional shopping centre and four office buildings. These sales were part of the corporation's continuing rationalization program designed to dispose of properties which do not conform to our long-term investment criteria, and to provide a stronger financial base for profitable expansion. In addition, a 50% interest in the Beaver House project was sold.

Shopping centre expansion projects are currently under construction at Fairview Mall (Toronto) and Market Mall (Calgary) at a cost to the corporation of approximately $64 million. When completed, the gross leasable area of the corporation's shopping centre portfolio will total 14.4 million square feet in 32 centres. Plans for 160,000 and 109,000 square foot expansions of Les Galeries de la Capitale in Quebec City and Southcentre in Calgary have now been approved and construction will be undertaken in 1987.

During the year, the corporation completed a major assembly of property in Toronto's downtown financial core and subsequently entered into an agreement with Trizec Corporation to develop as equal co-venturers a landmark office and retail project. The development will be constructed on one of the most important commercial sites in Canada, consisting of approximately 140,000 square feet bounded by Bay, Adelaide, Richmond and Yonge Streets. Conceptual planning presently underway contemplates a multi-use project comprised of an office space component of more than 1,000,000 square feet and a retail component of approximately 250,000 square feet. The occupancy level in downtown Toronto is healthy and improving. Strong demand for quality space is expected to continue.

In January, 1987 the smaller of the two buildings (the banking hall) comprising the Beaver House project in London, England was completed. The main building is scheduled for completion in

Neil R. Wood

PRESIDENT AND CHIEF EXECUTIVE OFFICER

June, 1987 with tenant occupancy expected in December, 1987. The corporation is exploring further opportunities in The City of London where the property market, spurred by deregulation in the financial sector, remains very buoyant.

Substantial completion of 2001 L Street, a 154,000 square foot office-retail project in Washington, D.C., occurred in April, 1986 and leasing is progressing well in the city's high demand downtown office market. Construction of phase 2 of the Greystone Office Park in Las Vegas, Nevada was finished in January, 1987. This market is very competitive, with high vacancy and low rental rates.

Land development results were disappointing except in Ontario. The Ontario division recorded significantly higher sales than last year because of a heavy demand for industrial land, build-to-suit premises and residential sites in the buoyant Toronto and surrounding area market. The Calgary, Denver and Houston land and housing markets are depressed consistent with the condition of the oil industry. The market for our products was also soft at Gainey Ranch in Arizona and for the relatively small amount of land remaining to be sold at Boca Pointe in Florida. Sales and profits at Sunnymead Ranch in California were fair but below expectations.

The corporation has three major new land development projects in the United States, two of which (Stonebriar in Dallas and Harris Branch in Austin) have recently been approved for development, while negotiations regarding development approval for the third (Hunter's Green in Tampa) are well advanced. These three projects total some 4,969 acres of land. Golf courses will be incorporated in Hunter's Green and in Stonebriar, where substantial work has already been done. Lot sales at Stonebriar and Harris Branch are expected to commence toward the end of 1987 and may possibly occur this year at Hunter's Green if development approval is quickly obtained.

Tax Reform

Tax reform legislation enacted in the United States should on balance have a positive influence on the corporation. Since the corporation will likely be in a taxable position in the United States, the reduction in corporate tax rates will be beneficial. The current oversupply of office space in many American cities is partly attributable to projects that were primarily tax-shelter motivated. The phase-out of such projects should in due course ensure that the development of commercial properties will again be guided by sound investment considerations.

Outlook

Overall we expect continued improvement in earnings from our Canadian income-producing properties. Our office building in London, England will come on stream before the end of the year with excellent results and we expect the leasing of the building in Washington, D.C. to be completed satisfactorily. However the company's office building in Denver will continue to incur substantial losses, and the office project in Las Vegas is expected to show unsatisfactory results.

Overall, we expect revenue and profits from land development to be at a relatively low level this year, before improving substantially in 1988 and 1989. We are almost sold out in Boca Pointe, and the Sunnymead project in southern California is also down to its last phases. The Ontario division should maintain last year's profit levels but we are expecting Houston, Denver, and Calgary to be slow markets again in 1987. The three major new projects, Harris Branch in Austin, Stonebriar in Dallas and Hunter's Green in Tampa, are not yet quite ready to make a significant contribution to earnings in 1987. However looking beyond this year, activity in the three new projects will be substantial, and we believe it is reasonable to expect improvement in Houston, Denver and Calgary, even without a major increase in oil prices.

It is the corporation's intention to continue to be active in the development of land for major new communities. At the same time we wish to expand our activity in the development of high quality shopping centres, office and industrial buildings. To achieve these objectives more effectively, management is being reorganized from the geographical format which prevailed in the past and in future will operate in three major product line groups, namely land development, shopping centres, and commercial-industrial.

Board Changes

During the year, the size of the Board was increased from 10 to 12 directors. Messrs. Peter W. Mills, Vice President and General Counsel, The Woodbridge Company Ltd. and Donald C. Rogers, Vice President, Real Estate and Development, Hudson's Bay Company, were elected to the new positions.

Appreciation

I am thankful for the warm welcome and cooperation I have received since joining the corporation and being appointed its President and Chief Executive Officer in June, 1986. On behalf of the Board, I wish to express our thanks for the excellent work of the corporation's employees in 1986.

Neil R. Wood

PRESIDENT AND CHIEF EXECUTIVE OFFICER

1. Fairview Pointe Claire Shopping Centre in Montreal has been expanded and modernized to provide shoppers a plentiful range of choice in an exciting and pleasing atmosphere.

1.

3.

Shopping Centres

In 1986, the corporation continued the process it began in 1985 of divesting itself of shopping centres considered to have modest growth potential. Joint venture equity interests of 33¹/₃% in Tamarack Mall (Cranbrook, B.C.), 25% in Village Green Mall (Vernon, B.C.) and 25% in Deerfoot Mall (Calgary, Alta.) were sold, as were six wholly-owned neighbourhood shopping plazas ranging in size from 5,000 to 86,000 square feet at various locations in Metropolitan Toronto, Guelph and Cambridge, Ontario.

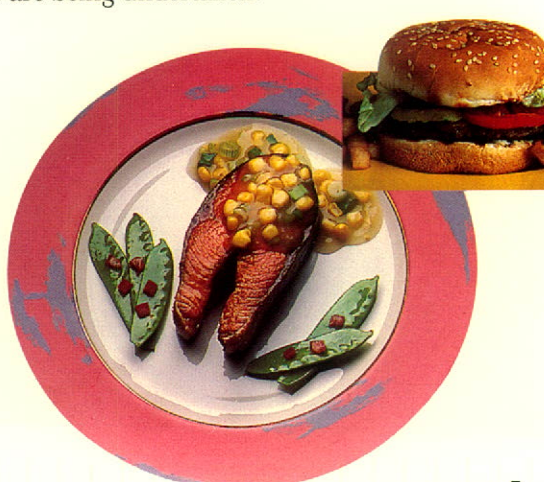
Funds re-invested in the shopping centre portfolio have been directed primarily to expansions and renovations of dominant regional malls in major markets and in community shopping centres that will achieve or maintain market dominance.

A major expansion and renovation of Fairview Mall in Toronto was commenced in 1986. On final completion of the project in August, 1988, approximately 290,000 square feet of leasable space will have been added to the centre at a cost of more than $90 million. Construction has been phased to allow stores to remain open for business. New two level department stores of 160,000 square feet for each of the Bay and Simpsons are scheduled to open in October this year and the existing department store space will then be renovated to accommodate new specialty retail shops.

An expansion of Market Mall in Calgary comprising an additional 85,000 square feet was undertaken in August 1986 and is expected to be completed in October this year at a total cost exceeding $38 million. At the same time existing building standards are being upgraded and road improvements around the periphery of the site are being undertaken.

2.

2, 3. Understanding and responding to customer and retailer needs ensured Woodbine Centre in Toronto would provide a unique place to shop, dine, work or be entertained.



Expansions designed to enhance and reinforce growing market share trends have recently been completed at Place du Royaume in Chicoutimi, Quebec and approved for Les Galeries de la Capitale in Quebec City. A unique feature of the 63,000 square foot Place du Royaume expansion was the provision for a 5,000 square foot community hall which will be made available for public activities. The expansion at Les Galeries de la Capitale will consist of 40,000 square feet of new retail store space and approximately 120,000 square feet for a family entertainment complex including an N.H.L. size skating rink, amusement rides and various small attractions.

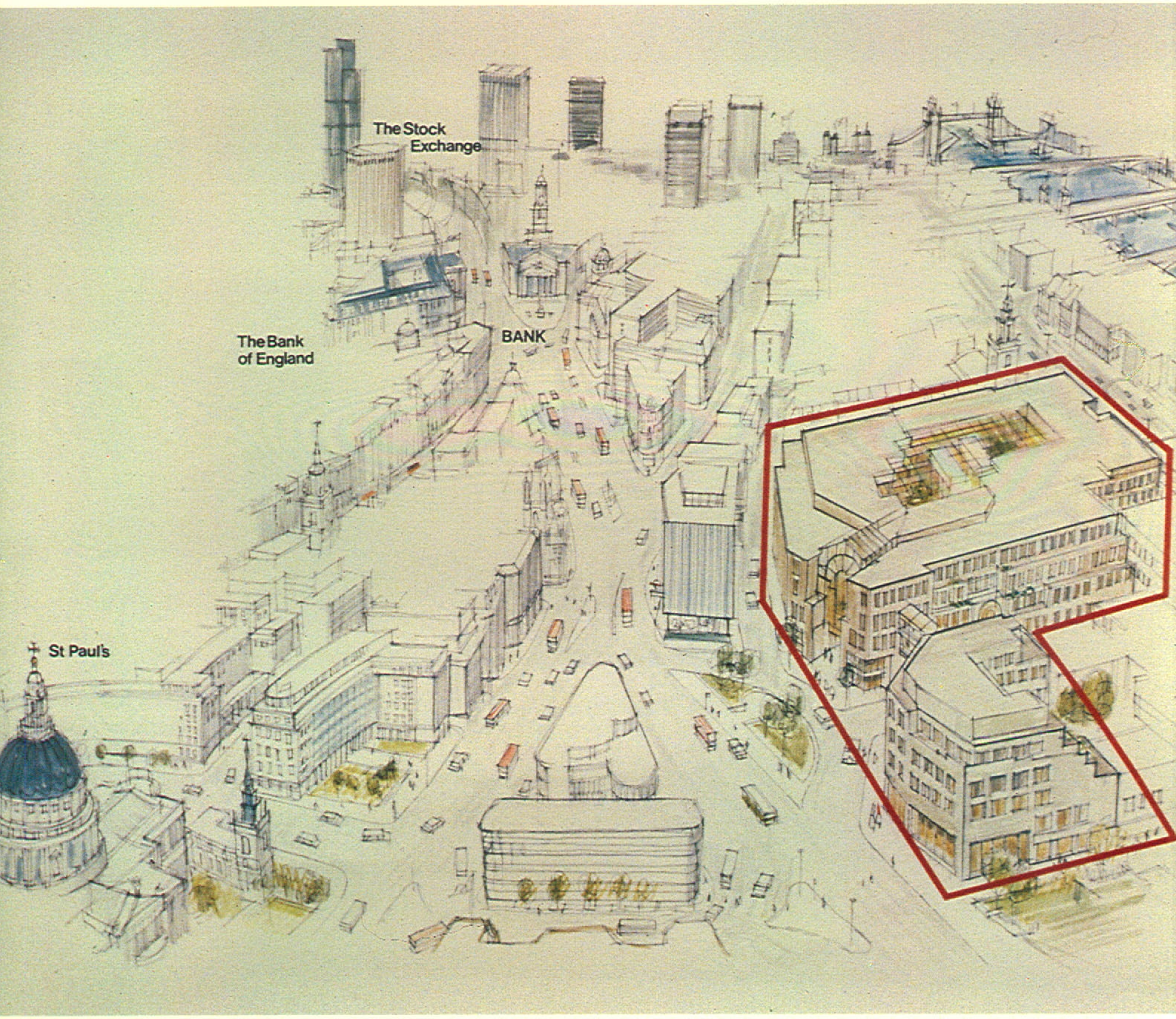
Markborough's shopping centre division will continue to enhance financial productivity of centres through renovation programs and to explore marketing techniques that will meet identified community needs, reinforce existing shopping patterns and serve to extend the trading areas of our centres.

Office and Mixed-Use Properties

In 1986 the corporation completed an assembly extending over portions of two city blocks bounded by Bay, Adelaide, Richmond and Yonge Streets in downtown Toronto's financial core. Subsequently a 50% interest was sold to Trizec Corporation. This premier location bridges the space between what is presently the city's retail centre to the immediate north and financial office centre to the immediate south and presents a unique opportunity for the development of an outstanding office and retail complex. We will be moving ahead this year with our co-venturer to complete the predevelopment process and will undertake construction as soon as possible thereafter, likely in 1988.

The Beaver House project in London, England is rapidly approaching completion. The entire development of 193,000 square feet has been leased to The Royal Bank of Canada and its merchant banking subsidiary, Orion Royal Bank and will be renamed The Royal Bank of Canada Centre. The banking hall building has been completed and is being prepared for summer occupancy while construction on the main building is proceeding on schedule with completion expected in June and occupancy in December this year.

The Beaver House development is centrally located in The City of London. Work is progressing well on the main building which is planned around a sky-lit three level atrium with the portico of the demolished building forming a feature in the centre.



1.

2.

In January, 1987, a 68,000 square foot expansion of the Greystone garden office complex in Las Vegas, Nevada, was completed. The entire project has a total net leaseable area slightly under 200,000 square feet and is located in the city's main commercial and financial corridor. The office vacancy rate in this market is high and present lease rates reflect the overbuilt situation. However, Greystone's excellent location, quality design and striking interior landscaping should permit a substantial lease-up of the project in 1987.

In contrast, the office leasing market in Washington, D.C. is relatively strong and the 2001 L Street building which was completed in 1986 is now over 70% leased and should be fully leased this year.

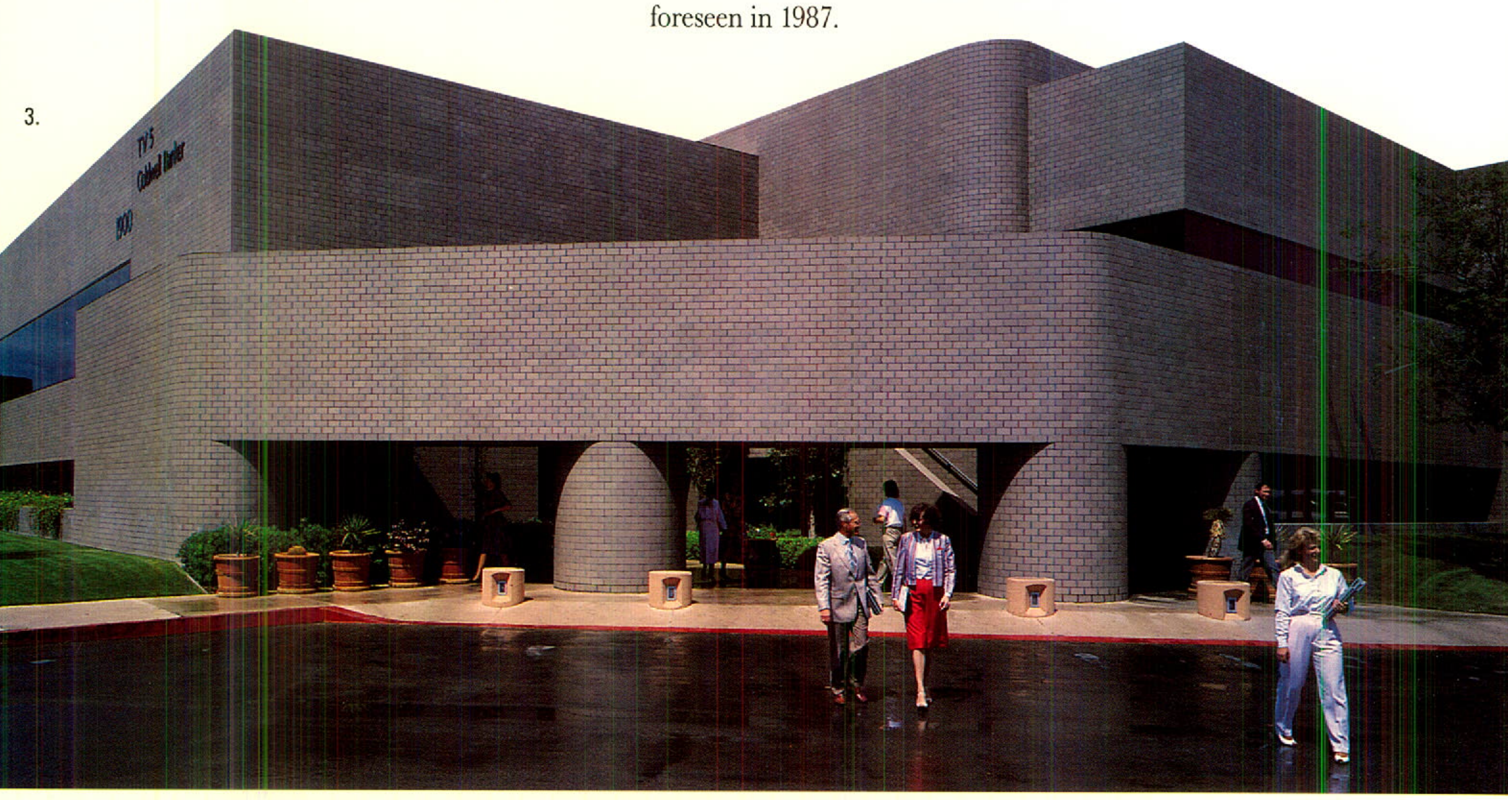
The Toronto office leasing market is among the healthiest of major North American cities and there exists only a modest vacancy rate in the corporation's portfolio of office buildings. Increased rental rates and a lower level of tenant inducements are foreseen in 1987.

Suburban Office and Industrial Developments

Sales of serviced land in the corporation's Ontario developments were very strong in 1986 as office and industrial building construction in the landscaped and design-controlled Meadowvale Business Park in Mississauga generated record revenues. Draft plans of subdivision to

1, 2, 3. Within its classic facade of imported grey stone, soft corners and black glass, Greystone offers elegant landscaped courtyard settings where light and shade play onto open air staircases, balconies and wide corridors that lead to cleanly-designed offices.

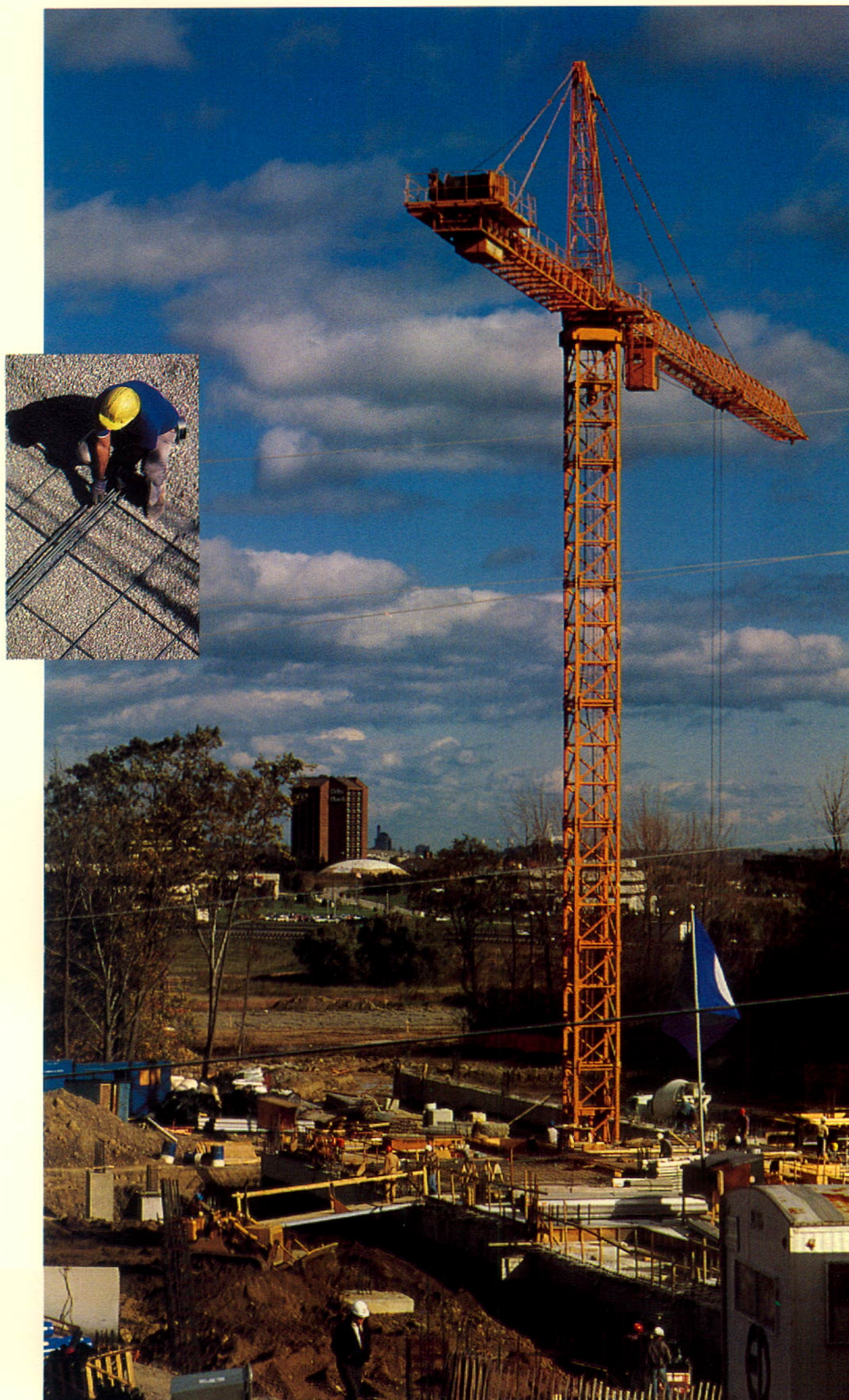
3.



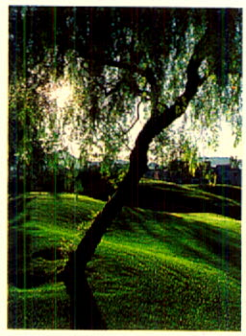
divide further 24 and 30 acre blocks in the Park are proceeding. Registration of plans and servicing of these blocks should be completed by the fall of 1987. Major construction projects for the new head office facilities of Du Pont Canada and Canadian General Electric are progressing well and have generated considerable interest in the section of the Park located north of Highway 401.

Markborough's participation in the custom design-build market in the greater Metropolitan Toronto area continues to grow. Construction starts on eight buildings having approximately 500,000 square feet of space were undertaken this past year on projects in Brampton, the Town of Vaughan and Mississauga. The corporation has an excellent supply of sites and has the proven ability to design, build, finance, lease and manage office and industrial buildings, convenience shopping plazas and computer and research facilities.

Meadowvale Business Park was chosen by Canadian General Electric for the location of its new head office. The corporation's Delta Meadowvale Inn is in the background.



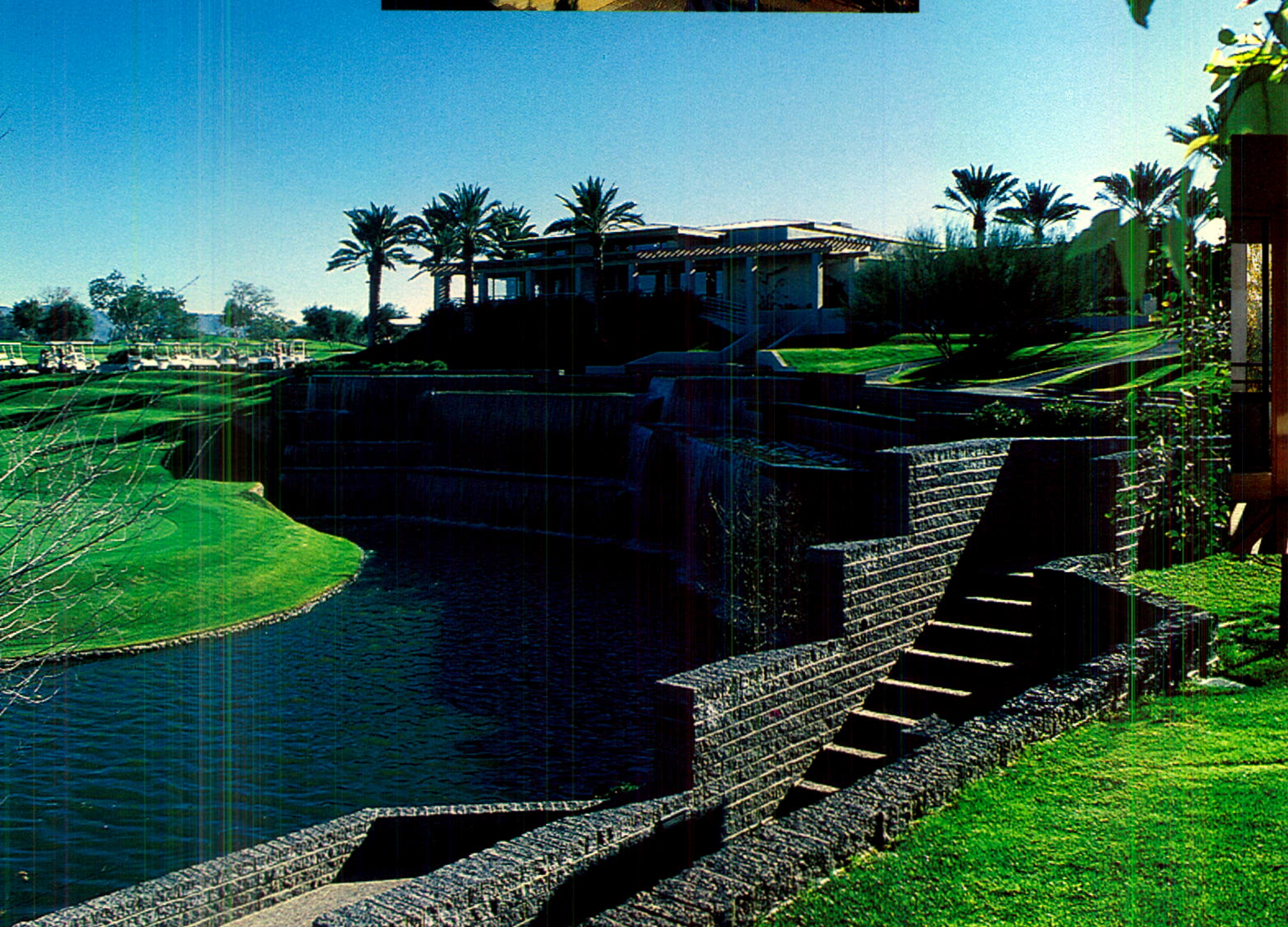
L A N D   D E V E L O P M E N T



1. The Gainey Ranch Golf Club has become the social centre of the Gainey Ranch community.

2.

1.



Residential Community Developments

The corporation recorded disappointing results in 1986 from residential community development operations in the United States and in Calgary, Alberta.

Developments in Houston, Denver and Calgary were affected by local economies that had been heavily reliant for growth on oil-related markets. Where appropriate, projects in these locations will be redesigned and marketed so as to address the available demand more closely.

In Scottsdale, Arizona an extremely competitive market made lenders cautious and home builders had difficulty obtaining financing. Demand for luxury second homes also softened. Notwithstanding the relatively quiet market that resulted, the corporation's Scottsdale and Gainey Ranch projects captured approximately 37% of 1986 sales in the $100,000 to $200,000 range of Scottsdale's housing market (and a greater percentage in prices above this range) with approximately 18% of the supply. The remaining parcels of land at Scottsdale Ranch were sold to developers in 1986 and this project will near build-out in 1987. In 1987, builders at Gainey Ranch should continue to capture a disproportionately large share of Scottsdale's housing market and the corporation's sales should show improvement.

Sales at Sunnymead Ranch in The City of Moreno Valley, California were at a reasonable level but below expectations for 1986. This project was the first and is still the only master planned community in the marketplace. As the community matures and a number of new neighbourhoods open for sale this year, we expect product demand and market share will be maintained.

In the Ontario division, land sales were significantly higher than planned due mainly to the sale of the entire unimproved second phase of lands in the East Credit area of Mississauga and the sale of all remaining lots in the first phase of that development.

3.

2. The 487 room luxury Hyatt Regency Scottsdale Hotel at Gainey Ranch opened in December 1986.

3. Markland Properties expects to sell the balance of its Golf Cottages which overlook the Gainey Ranch Golf Club and Hyatt Regency in 1987.

The sale and construction of the last homes in the residential portion of Meadowvale south of Highway 401 occurred this past year. Processing of plans for the development of residential estate lots north of Highway 401 will be delayed pending the conclusion of environmental hearings relating to road alignments. In 1987, the Ontario division is expected to maintain approximately the same level of gross profit as was recorded last year.

Results from land operations in the United States should improve in 1987 as new projects in Austin, Dallas and Tampa begin to make contributions, although their major impact will not be felt until 1988.

Approvals have now been obtained and work is proceeding on Harris Branch, a 2,153 acre project near the proposed Austin International Airport in which the corporation has an 80% interest and on Stonebriar, an 836 acre mixed-use development in Dallas in which Markborough has a 50% interest. Initial sales of serviced land in both planned community developments are expected to close in the latter part of this year.

Hunter's Green, a project encompassing 1,980 acres in Tampa, will feature a balanced complement of neighbourhoods, natural surroundings and recreational amenities (including a Tom Fazio designed 18 hole golf course and a tennis and fitness centre). Negotiations with respect to final development approvals are well advanced at this time.

1.

Housing

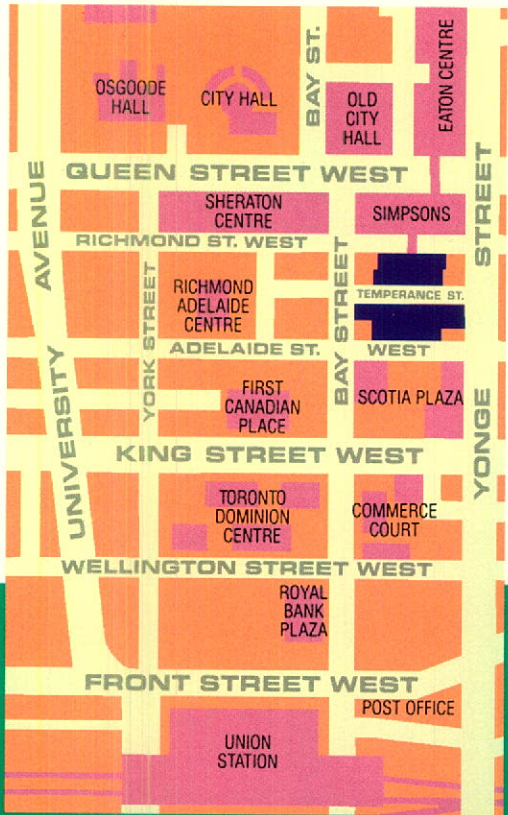
Profits from house building operations declined in 1986 to $1.7 million from $3.0 million the year before. Revenue fell to $16.4 million from $19.5 million. The sales decline mirrored the softer market conditions experienced in Scottsdale last year, where the corporation's housing activities are carried on by Markland Properties. The balance of homes remaining in inventory at Country Ridge and Mirador, as well as a majority of the Golf Cottages at Gainey Ranch should be sold by the end of this summer. New products to fill identified gaps in the range of housing offered at Gainey are being investigated.

1. The Marina Club at the Hunter's Glen development outside Denver, Colorado.

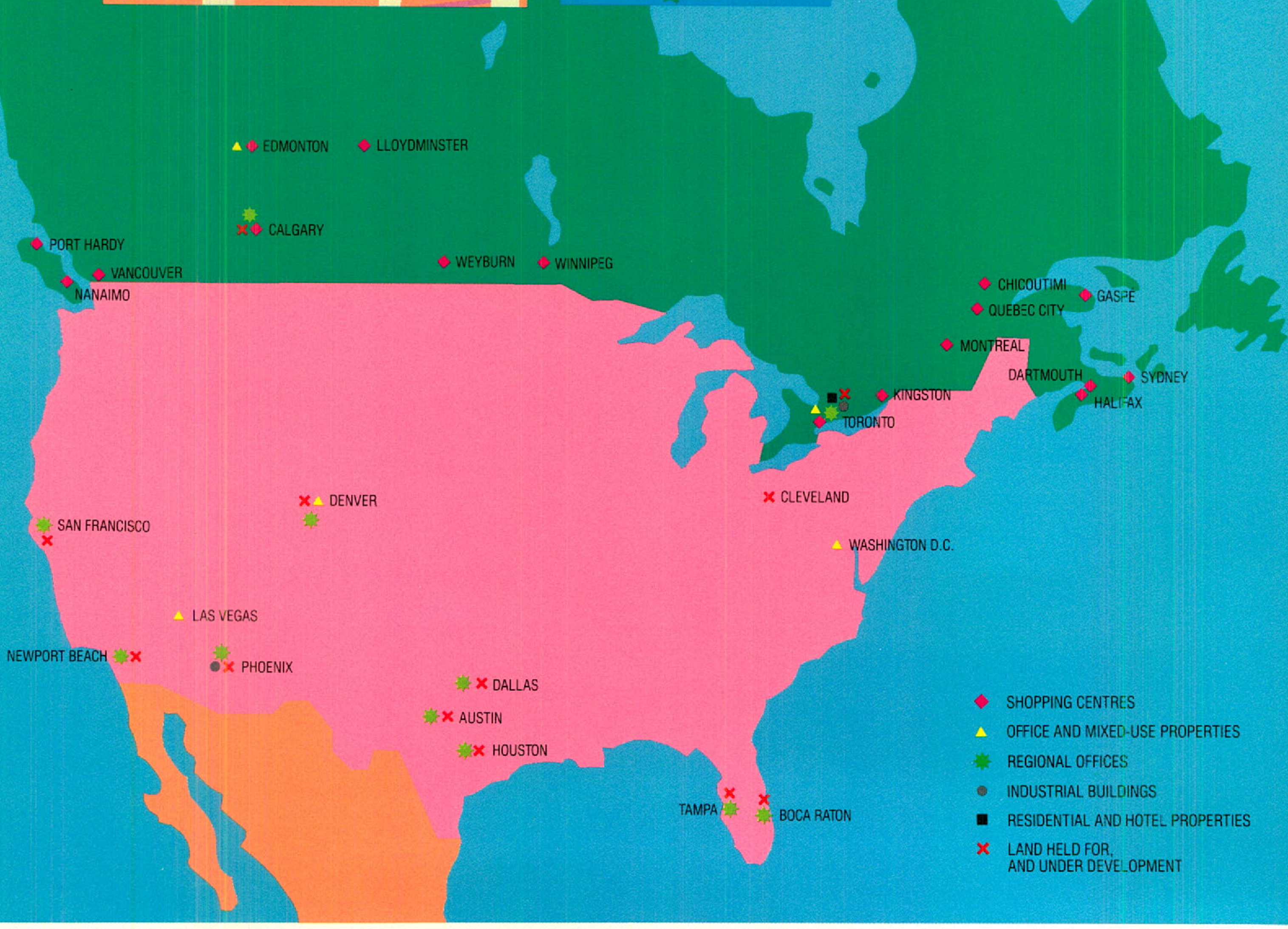
2. For the second year in a row, sales of residences valued at more than $100 million occurred at Markborough's showcase Boca Pointe community in Boca Raton, Florida.

2.

PROPERTY PORTFOLIO



In 1986, the corporation completed assembly of the shaded area shown on this sketch of downtown Toronto's financial core.



Shopping Centres

	Year Opened	Number of Stores	Gross Leasable Area (Square Feet) Total (1)	Anchors	Ancillary Stores	Markborough's Interest %	G.L.A.
Regional Shopping Centres							
Les Galeries D'Anjou, Montreal, Quebec	1968	172	1,159,000	598,000	561,000	50%	597,500
Fairview Pointe Claire, Montreal, Quebec	1965	188	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
Place Vertu, Montreal, Quebec	1975	165	727,000	443,000	284,000	25%	181,750
St. Vital, Winnipeg, Manitoba	1979	126	694,000	445,000	249,000	25%	173,500
Southcentre, Calgary, Alberta	1974	146	642,000	370,000	272,000	50%	321,000
Woodbine Centre, Toronto, Ontario	1985	180	610,000	314,000	296,000	40%	244,000
Fairview Mall, Toronto, Ontario	1970	130	576,000	294,000	282,000	50%	288,000
MicMac Mall, Dartmouth, Nova Scotia	1973	151	530,000	259,000	271,000	100%	530,000
Unicity Mall, Winnipeg, Manitoba	1975	80	471,000	309,000	162,000	33 1/3%	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	111	449,000	235,000	214,000	100%	449,000
Armdale Mall, Halifax, Nova Scotia	1975	49	238,000	116,000	122,000	50%	119,000
Armdale - The Bay	1983	1	150,000	150,000	—	100%	150,000
Meadowvale Town Centre, Mississauga, Ontario	1978	100	368,000	184,000	184,000	100%	368,000
Mayflower Mall, Sydney, Nova Scotia	1980	70	366,000	242,000	124,000	50%	183,000
Rutherford Mall, Nanaimo, British Columbia	1980	89	363,000	232,000	131,000	100%	363,000
St. Albert Centre, St. Albert, Alberta	1980	66	325,000	238,000	87,000	100%	325,000
Woodside Square, Scarborough, Ontario	1977	70	279,000	158,000	121,000	50%	139,500
Place du Royaume, Chicoutimi, Quebec	1977	126	256,000	83,000	173,000	25%	64,000
Richmond Centre, Richmond, British Columbia	1973	72	224,000	113,000	111,000	100%	224,000
Lloydmall, Lloydminster, Alberta	1974	52	190,000	120,000	70,000	100%	190,000
Champlain Mall, Vancouver, British Columbia	1973	44	181,000	118,000	63,000	100%	181,000
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	32	89,000	54,000	35,000	100%	89,000
Neighbourhood Shopping Centres							
3 Centres in various provinces		129	243,000	55,000	188,000	50-100%	187,500
		3,106	13,980,000	8,124,000	5,856,000		7,554,290
Expansions Under Construction							
Fairview Mall, Toronto, Ontario		140	290,000	91,000	199,000	50%	145,000
Market Mall, Calgary, Alberta		75	85,000	—	85,000	50%	42,500
		215	375,000	91,000	284,000		187,500

(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	330,000	100%	330,000
Markborough Place	1979	134,000	100%	134,000
Meadowvale Professional Centre	1981	33,000	100%	33,000
Other (3)	Various	29,000	100%	29,000
Edmonton, Alberta				
Principal Plaza	1980	420,000	25%	105,000
United States				
Denver, Colorado				
Hudson's Bay Centre	1984	167,000	100%	167,000
Washington, D.C.				
2001 L Street	1986	154,000	50%	77,000
Las Vegas, Nevada				
Greystone	1982	131,000	100%	131,000
Greystone, Phase 2	1986	68,000	100%	68,000
Total Completed		1,466,000		1,074,000

*Leased

Under Construction

	Scheduled Year Of Completion	Net Leasable Area (Square Feet)	Markborough's Interest %	Markborough's Interest N.L.A.
England				
London				
Beaver House	1987	193,000	50	96,500
Total Under Construction		193,000		96,500

Industrial Buildings

Wholly-Owned Buildings	Leasable Area (square feet) Net	Markborough's Interest
Toronto, Ontario (9 buildings)	405,500	405,500
Phoenix, Arizona (3 buildings)	141,900	141,900
	547,400	547,400
Jointly-Owned Buildings (50%)		
Toronto, Ontario (11 buildings)	485,000	242,500
	1,032,400	789,900

Residential and Hotel Properties

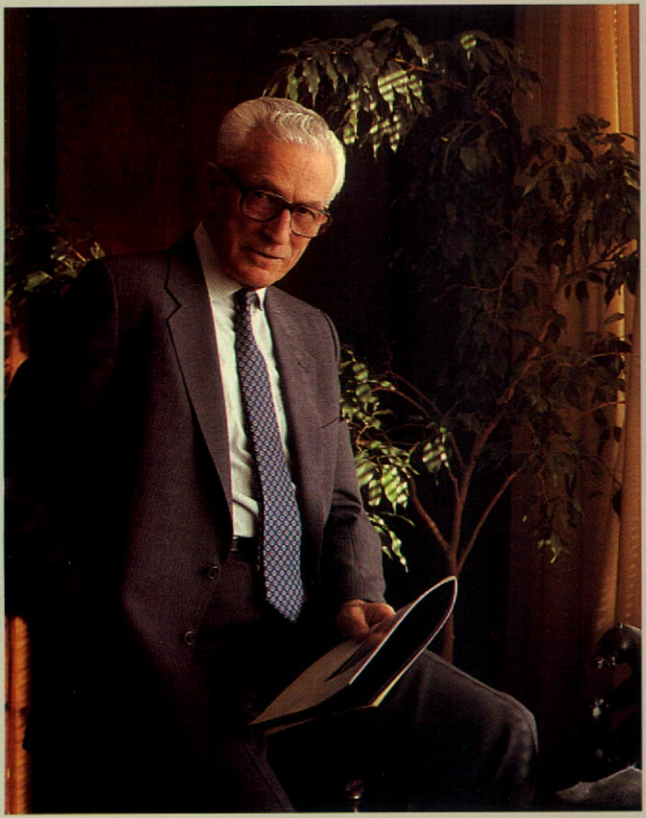
Apartment Buildings (Markborough's Interest is 50%)	Number of Rental Units
49 Thorncliffe Park, Toronto	400
53 Thorncliffe Park, Toronto	279

Hotels (Markborough's Interest is 100%)	Number of Rooms
Delta Meadowvale Inn, Mississauga	192

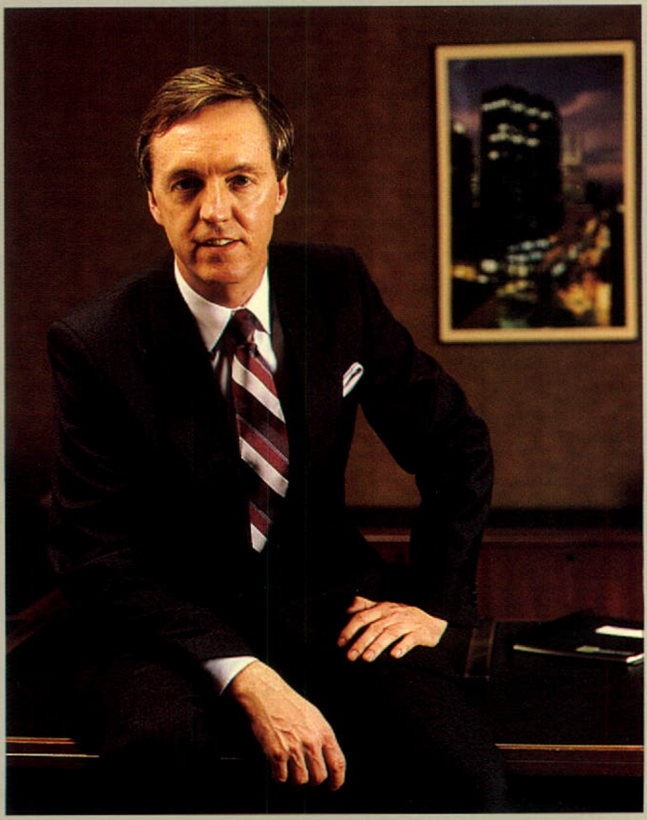
Land Held For and Under Development

Location	Year(s) of Acquisition	Original Acreage	Total Remaining Acreage	Markborough's Interest %	Markborough's Interest Total Remaining Acreage
Canada					
Ontario					
Meadowvale	1972/85	2,905	850	100%	850
Other (including sites)	Various		636	100%	636
Alberta					
Woodbine	1976	634	158	100%	158
Other	1984		307	100%	307
Other (including sites)	Various		135	100%	135
			2,086		2,086
United States					
Arizona					
Gainey Ranch	1980	562	373	100%	373
Other	Various		19	100%	19
California					
Sunnymead Ranch	1980	1,366	216	100%	216
Other (including sites)	Various		218	100%	218
Colorado					
Hunter's Glen	1986	325	282	80%	226
Trailside	1986	150	150	80%	120
Florida					
Hunter's Green	1985	1,980	1,980	100%	1,980
Boca Pointe	1979	1,019	208	100%	208
Texas					
New Territories	1984	3,082	2,982	80%	2,386
Harris Branch	1986	2,153	2,153	80%	1,722
Stonebriar	1986	836	836	50%	418
Northchase	1980	487	265	82%	217
Harvest Bend	1977	599	140	80%	112
Vicksburg	1982	411	139	80%	111
Northview Park	1985	128	128	80%	102
Other	Various		468	80%	374
Other	Various		76	100%	76
			10,633		8,878
			12,719		10,964

1986 Consolidated Financial Statements



Donald F. Prowse
Executive Vice President



John A. Brough
Senior Vice President and Chief Financial Officer

Consolidated Statement of Income

YEAR ENDED JANUARY 31, 1987

	This year (000's)	Last year (000's)
Revenue from land operations	$ 82,360	$120,993
Less cost	85,857	95,252
Profit (loss) from land operations	(3,497)	25,741
Revenue from housing operations	16,445	19,471
Less cost	14,757	16,482
Profit from housing operations	1,688	2,989
Revenue from income properties	154,443	136,982
Less:		
Operating expenses	39,099	36,390
Realty taxes	22,286	19,074
Operating profit from income properties	93,058	81,518
Interest and other income	17,978	17,882
Gain (loss) on undeveloped properties (Note 2)	(19,745)	3,703
Gain on sale of income properties	67,304	15,583
Income before the undernoted items	156,786	147,416
Interest expense (Note 3)	66,098	56,681
Depreciation on income properties	13,339	12,480
General and administrative expenses	18,173	16,511
Income before income taxes	59,176	61,744
Income taxes (Note 4):		
Current	344	14,100
Deferred	10,936	10,428
	11,280	24,528
Net income for the year	$ 47,896	$ 37,216
Earnings per share (Note 5)	$4.90	$3.80

Consolidated Statement of Retained Earnings

YEAR ENDED JANUARY 31, 1987

	This year (000's)	Last year (000's)
Retained earnings at beginning of the year	$178,382	$188,886
Net income for the year	47,896	37,216
	226,278	226,102
Premium on repurchase of common shares (Note 10)	(102,246)	—
Capitalization of retained earnings arising from reorganization	—	(34,245)
Dividends paid on common shares	(68,026)	(13,475)
Retained earnings at end of the year	$ 56,006	$178,382

Consolidated Balance Sheet

JANUARY 31, 1987

	This year (000's)	Last year (000's)
Assets		
Land and housing under development	**$ 263,877**	$ 228,389
Land held for development	**353,056**	334,252
Income properties (Note 6)	**773,744**	839,298
Accounts receivable	**40,473**	41,013
Mortgages and other secured receivables (Note 7)	**180,013**	183,180
Prepaid expenses and other assets	**21,973**	20,240
	$1,633,136	$1,646,372
Liabilities and Shareholder's Equity		
Mortgages payable (Note 8)	**$ 871,844**	$ 815,053
Bank indebtedness (Note 8)	**118,385**	110,171
Due to parent and affiliated company (Note 8)	**86,303**	129,613
Accounts payable and accrued liabilities (Note 9)	**75,998**	101,393
Deferred income taxes	**130,173**	146,760
	1,282,703	1,302,990
Capital stock (Note 10)	**145,989**	165,000
Contributed surplus (Note 11)	**148,438**	—
Retained earnings	**56,006**	178,382
	350,433	343,382
	$1,633,136	$1,646,372

Approved by the Board:

Neil R. Wood, 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, 1987 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, 1987 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
Chartered Accountants

Toronto, March 12, 1987

Consolidated Statement of Changes in Financial Position

YEAR ENDED JANUARY 31, 1987

	This year (000's)	Last year (000's)
Cash provided from operating activities:		
Net income for the year	$ 47,896	$ 37,216
Add:		
Depreciation	13,339	12,480
Provision for deferred income taxes	10,936	10,428
Cash flow from operations	72,171	60,124
Costs recovered through sales		
Land, housing and undeveloped property	216,856	131,841
Income properties	111,064	55,154
Other assets and liabilities, net	1,289	(34,125)
	401,380	212,994
Cash applied to investing activities:		
Land		
Acquisition	157,458	84,918
Development and related costs	79,880	74,752
Carrying charges	46,244	41,792
Housing construction	12,850	15,120
Income properties		
Acquisition	—	78,879
Construction	61,784	106,417
	358,216	401,878
Dividends paid on common shares	68,026	13,475
	426,242	415,353
	$ 24,862	$202,359
Cash provided from (applied to) financing activities:		
Mortgages on income properties and land	$179,505	$391,901
Mortgage principal repayments	(122,714)	(199,719)
Mortgages and other secured receivables, net	3,167	(4,723)
Repayment of parent company advances	(43,310)	(38,478)
Increase in bank indebtedness	8,214	13,474
Repurchase of common shares	(121,257)	—
Contribution of capital by parent company	121,257	—
Redemption of investments in affiliates	—	142,373
Redemption of preferred shares	—	(102,469)
	$ 24,862	$202,359
Cash flow from operations per share (Note 5)	$7.38	$6.15

Notes to Consolidated Financial Statements

JANUARY 31, 1987

1. Summary of significant accounting policies

The Company is an associate member of the Canadian Institute of Public Real Estate Companies. The Company's accounting policies and its standards of financial disclosure are substantially in accordance with the recommendations of that Institute. The Company's significant accounting policies are as follows:

(a) Principles of consolidation

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

(b) Land held for and under development 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 includes pre-development expenses, interest, realty taxes and other directly related expenses.

Allocated costs are charged to saleable acreage on the basis of anticipated revenues.

(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 held for 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.

2. Undeveloped properties

The results from disposals of and provisions for loss in value of undeveloped properties are as follows:

	This year (000's)	Last year (000's)
Proceeds on disposal	**$ 96,497**	$23,810
Costs, including provision for loss in value	**116,242**	20,107
	$(19,745)	$ 3,703

3. Interest

Interest incurred during the year has been allocated as follows:

	This year (000's)	Last year (000's)
Capitalized		
Land and housing	**$ 35,740**	$ 36,436
Income properties under construction	**8,483**	13,587
	44,223	50,023
Expensed		
Cost of sales	**10,021**	3,975
Interest expense	**66,098**	56,681
	76,119	60,656
	$120,342	$110,679

4. Income taxes

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

	This year	Last year
Combined Canadian federal and provincial income tax rates	**52.2%**	50.7%
Increase (decrease) in income tax rate resulting from:		
Foreign rates	**(1.3)**	(0.5)
Lower effective rate on capital gains	**(31.8)**	(11.3)
Other	**—**	0.8
Effective income tax rate	**19.1%**	39.7%

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 (000's)	Last year (000's)
Section 85 election on related party transaction (Note 13)	**$ 6,329**	$ —
Depreciation	**5,884**	5,630
Carrying charges	**7,251**	5,068
Reserves	**(5,937)**	(5,576)
Losses carried forward	**(2,591)**	5,306
	$10,936	$10,428

5. Earnings and cash flow from operations per share

Earnings and cash flow from operations per share for the current year have been calculated using the number of shares outstanding as at January 31, 1987, reflecting the consolidation of shares which effectively took place as the result of the transactions described in Notes 10 and 11. Earnings and cash flow from operations per share for the prior year have also been restated using the number of shares outstanding as at January 31, 1987.

Cash flow from operations was increased by the $27,181,000 reduction in income taxes referred to in Note 13. This results in an increase in the current year's cash flow from operations per share of $2.78.

6. Income properties

Income properties consist of:

	This year (000's)	Last year (000's)
Land	**$ 92,849**	$ 94,968
Buildings	**654,343**	684,186
Equipment	**7,449**	7,097
	754,641	786,251
Less accumulated depreciation	**63,588**	58,038
	691,053	728,213
Construction in progress		
Land	**14,626**	26,191
Buildings	**68,065**	84,894
	82,691	111,085
	$773,744	$839,298

The Company's share of the estimated cost to complete construction of six projects in progress is $77,380,000. Specific project financing and operating lines of credit are available to fund the construction of these projects.

7. 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 9.0% and mature as follows:

	(000's)
Fiscal year ending January 31, 1988	$ 70,981
1989	40,994
1990	41,537
1991	8,898
Subsequent to January 31, 1991	17,603
	$180,013

Under certain conditions, the amounts due may be paid prior to maturity. Mortgages and other secured receivables include advances on behalf of a joint venture partner of $10,561,000 (last year – $nil).

8. Debt

Debt of the Company by category and by interest obligation is as follows:

	This year (000's)	Last year (000's)
By category		
Mortgages payable	$ 871,844	$ 815,053
Bank indebtedness	118,385	110,171
Due to parent and affiliated company	86,303	129,613
	$1,076,532	$1,054,837
By interest obligation		
Floating rate at an average year-end interest rate of 8.3% (last year – 9.8%)	$ 391,715	$ 525,713
Fixed rate at an average year-end interest rate of 11.0% (last year – 11.7%)	684,817	529,124
	$1,076,532	$1,054,837

Included in fixed rate obligations is U.S. $100,000,000 (Canadian equivalent $134,000,000) of bank indebtedness and mortgages payable on which the interest rates have been fixed for an average period of approximately nine years at an average effective rate of 9.6% by way of various interest exchange agreements.

Mortgages payable comprise the following:

	This year (000's)	Last year (000's)
On land, at an average year-end interest rate of 8.4% (last year – 9.6%) and maturing by 1993	$316,588	$269,381
On income property permanent financing, at an average year-end interest rate of 11.6% (last year – 11.6%) and maturing by 2008	413,666	380,811
On income property interim financing, at an average year-end interest rate of 7.8% (last year – 10.4%) and maturing by 1994	141,590	164,861
	$871,844	$815,053

Principal repayments of mortgages payable are due as follows:

	(000's)
Fiscal year ending January 31, 1988	$152,271
1989	144,128
1990	67,149
1991	26,247
1992	25,020
Subsequent to January 31, 1992	457,029
	$871,844

Included in mortgages payable is debt in the amount of U.S. $308,040,000 (Canadian equivalent $412,774,000) attributable to assets in the United States.

Bank indebtedness is payable on demand and is composed of amounts which are outstanding under various operating lines of credit. Included in bank indebtedness are amounts denominated in United States dollars of U.S. $75,098,000 (Canadian equivalent $100,621,000). Certain land under development and income property assets have been pledged as security for $33,772,000 of the bank indebtedness.

The amounts due to parent and affiliated company are unsecured. These amounts have an average year-end interest rate of 12.4% and are due as follows:

	(000's)
Fiscal year ending January 31, 1988	$24,557
1989	21,000
1990	21,000
1991	—
1992	19,746
	$86,303

Interest incurred during the year on amounts due to parent and affiliated company amounted to $17,451,000.

9. Accounts payable and accrued liabilities

Accounts payable and accrued liabilities consist of the following:

	This year (000's)	Last year (000's)
Trade accounts payable and accrued liabilities	$62,863	$ 76,253
Partner's minority interest in joint venture	13,135	25,140
	$75,998	$101,393

10. 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 comprise the following:

	Number	Amount (000's)
Common shares		
Beginning of the year	11,054,625	$165,000
Shares repurchased and cancelled	1,273,711	19,011
End of the year	9,780,914	$145,989

During the year, the Company repurchased 1,273,711 of its common shares from an affiliated company at an aggregate fair value of $121,257,000. The repurchase of shares resulted in a charge to retained earnings of $102,246,000, representing the excess of the fair value of the shares over their book value.

11. Contributed surplus

During the year, the Company's parent made a contribution of capital amounting to $121,257,000. In addition, as described in Note 13, a reduction in the Company's deferred income taxes of $27,181,000 occurred. Both of these amounts have been recorded as 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		
Land and housing under development	$ 62,331	$ 55,561
Land held for development	276,223	121,728
Income properties	461,712	425,564
Accounts receivable	17,793	17,084
Mortgages and other secured receivables	55,840	78,526
Prepaid expenses and other assets	9,453	8,023
	$883,352	$706,486
Liabilities and Equity		
Mortgages payable	$541,889	$453,455
Accounts payable and accrued liabilities	31,123	52,214
Deferred income taxes	13,341	10,477
	586,353	516,146
Investment in joint ventures	296,999	190,340
	$883,352	$706,486

	This year (000's)	Last year (000's)
Income and Expenses		
Revenue from land operations	$20,097	$41,515
Less cost	19,909	30,467
Profit from land operations	188	11,048
Revenue from housing operations	214	—
Less cost	256	—
Loss from housing operations	(42)	—
Revenue from income properties	84,207	72,402
Less expenses	27,809	24,235
Operating profit from income properties	56,398	48,167
Interest and other income	8,600	9,443
Income before the undernoted items	65,144	68,658
Interest expense	34,689	27,366
Depreciation on income properties	7,371	7,219
General and administrative expenses	2,899	2,430
Income before income taxes	$20,185	$31,643

The Company is contingently liable at January 31, 1987 for $85,163,000, representing certain liabilities of its co-owners and partners in unincorporated joint ventures but against such liabilities the Company would have a claim upon the joint venture assets of its co-owners and partners. The value of the assets of each of these joint ventures exceeds the contingent liability.

13. Related party transactions

During the year, the Company sold certain properties to an affiliated company for the properties' fair market value of $195,011,000. Subsequently, these properties were sold to third parties for substantially the same amounts. The sales resulted in gains to the Company before tax of $48,174,000 and a deferred tax expense, calculated at capital gains rates, of $6,329,000. The Company and the affiliated company have agreed to file an election under Section 85 of the Income Tax Act, Canada allowing the sale of the properties to occur for tax purposes at the Company's tax cost. As a result of this election, no income tax will be payable by the Company on these sales. After taking into account amounts recorded in prior years as deferred taxes with respect to these properties, together with the $6,329,000 recorded in the current year, a $27,181,000 reduction of income taxes payable results from this transaction. This reduction has been recorded in the accounts as contributed surplus.

In the normal course of business, the Company has also entered into other transactions with its parent and certain affiliated companies. Such transactions were negotiated as if the parties were dealing at arm's length.

14. Reclassification of prior year's financial statements

Certain prior year amounts have been reclassified to conform with the current year's presentation.

15. Segmented information

Segmented information is summarized as follows (thousands of dollars):

	Canada		United States		Total	
	This year	Last year	This year	Last year	This year	Last year
Assets						
Land operations	$121,122	$163,653	$489,536	$391,409	$ 610,658	$ 555,062
Housing operations	—	—	6,275	7,579	6,275	7,579
Income property operations	664,060	733,940	109,684	105,358	773,744	839,298
Other	87,378	75,932	155,081	168,501	242,459	244,433
	$872,560	$973,525	$760,576	$672,847	$1,633,136	$1,646,372
Revenue						
Land operations	$ 25,420	$ 26,035	$ 56,940	$ 94,958	$ 82,360	$ 120,993
Housing operations	—	—	16,445	19,471	16,445	19,471
Income property operations	147,614	131,892	6,829	5,090	154,443	136,982
	$173,034	$157,927	$ 80,214	$119,519	$ 253,248	$ 277,446
Profit (loss)						
Land operations	$ 2,101	$ 4,585	$ (5,598)	$ 21,156	$ (3,497)	$ 25,741
Housing operations	—	—	1,688	2,989	1,688	2,989
Income property operations	90,089	79,348	2,969	2,170	93,058	81,518
	92,190	83,933	(941)	26,315	91,249	110,248
Interest and other income	7,151	5,606	10,827	12,276	17,978	17,882
Gain (loss) on undeveloped properties	830	3,703	(20,575)	—	(19,745)	3,703
Gain on sale of income properties	67,304	15,583	—	—	67,304	15,583
	$167,475	$108,825	$(10,689)	$ 38,591	156,786	147,416
Interest expense					66,098	56,681
Depreciation on income properties					13,339	12,480
General and administrative expenses					18,173	16,511
Income before income taxes					59,176	61,744
Provision for income taxes					11,280	24,528
Net income for the year					$ 47,896	$ 37,216

Included in Canada are $45,208,000 in income property assets (last year – $52,562,000) and a $19,129,000 gain on sale of income property (last year – $nil) relating to operations located in the United Kingdom.

Board of Directors

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

Gordon C. Gray
Chairman of the Board
Royal LePage Limited
Toronto

Stuart S. Jardine
Chairman of the Board
George Wimpey Canada Limited
Toronto

Alexander J. MacIntosh, Q.C.
Partner
Blake, Cassels & Graydon
Toronto

†Douglas W. Mahaffy
Senior Vice President, Finance and Administration
Hudson's Bay Company
Toronto

Donald S. McGiverin
Governor
Hudson's Bay Company
Toronto

Peter W. Mills
Vice President and General Counsel
The Woodbridge Company Ltd.
Toronto

Donald F. Prowse
Executive Vice President
Markborough Properties Inc.
Toronto

Donald C. Rogers
Vice President, Real Estate and Development
Hudson's Bay Company
Toronto

*T. Iain Ronald
Executive Vice President
Hudson's Bay Company
Toronto

William W. Siebens
President
Candor Investments Ltd.
Calgary

Neil R. Wood
President and Chief Executive Officer
Markborough Properties Inc.
Toronto

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

Officers

T. Iain Ronald
Chairman of the Board

Donald S. McGiverin
Deputy Chairman of the Board

Neil R. Wood
President and Chief Executive Officer

Donald F. Prowse
Executive Vice President

John A. Brough
Senior Vice President and Chief Financial Officer

Christopher J. Desjardins
Vice President and Secretary

Simon W. Nyilassy
Controller

Patricia I. Thomas
Assistant Secretary

Principal Operating Company

Markborough Properties Limited

Officers

T. Iain Ronald
Chairman of the Board

Neil R. Wood
President and Chief Executive Officer

Donald F. Prowse
Executive Vice President

John A. Brough
Senior Vice President and Chief Financial Officer

Dennis L.M. Harrs
Senior Vice President, Shopping Centres

James C. Shapland
Senior Vice President, Administration

Christopher J. Desjardins
Vice President and Secretary

Douglas W. Kelly
Vice President, Western Canadian Region

F. Peter Langer
Vice President, Industrial Marketing

Kenneth E. Nixon
Regional Vice President, Central Region

Simon W. Nyilassy
Controller

Patricia I. Thomas
Assistant Secretary

Simon M.H. Chan
Assistant Treasurer

Offices

Head Office
90 Eglinton Avenue West
Toronto, Ontario
M4R 2E7

Austin, Texas
901 South Mopac
Suite 540
Austin, Texas 78746

Robert A. Moorman
Vice President and General Manager
Provident Development Company

Boca Raton, Florida
5355 Town Center Road
Suite 702
Boca Raton, Florida 33432

Galen B. Custard
President, Boca Pointe Division
Markborough Florida, Inc.

Calgary, Alberta
1305-11th Avenue Southwest
Suite 302
Calgary, Alberta
T3C 0M7

Douglas W. Kelly
Vice President, Western Canadian Region

Dallas, Texas
12221 Merit Drive
Suite 1150
Dallas, Texas 75251-2212

Mark C. Webb
Vice President and General Manager
Camden Development Company

Houston, Texas
6671 Southwest Freeway
Suite 210
Houston, Texas 77074

John P. Collins
President
Lexington Development Company

London, England
Prince Rupert House
64 Queen Street
London EC4R 1AD

Geoffrey Bryan
Project Director

Newport Beach, California
4000 McArthur Boulevard
Suite 3500
Newport Beach, California 92600

William W. Johnson
President
Markborough California, Inc.

Northglenn, Colorado
11990 North Grant Street
Suite 314
Northglenn, Colorado 80233

Benjamin F. Carter, Jr.
Vice President and General Manager
Concord Development Company

Phoenix, Arizona
5251 North 16th Street
Suite 900
Phoenix, Arizona 85016

James M. Kilday
President
Markland Properties, Inc.

San Francisco, California
595 Market Street
Suite 2130
San Francisco, California 94105

David Fitzpatrick
President
Markborough California Properties, Inc.

Tampa, Florida
201 E. Kennedy Blvd.
Suite 1522
Tampa, Florida 33602

Thomas Brown
President
Markborough Florida, Inc.

Markborough
PROPERTIES INC.

PRINTED IN CANADA