COSTAIN LIMITED

ANNUAL REPORT

1981

COSTAIN

Costain Limited is a Canadian public real estate development company actively engaged in business since 1953, whose shares are traded on the Toronto and Montreal Stock Exchanges.

Revenue is derived from the development and sale of land, the building and marketing of residential properties, and the development of commercial properties for retention or sale. Operating in North America, its activities are currently located in the provinces of Ontario and Alberta and in the states of Arizona, Colorado, Florida, Maryland, Virginia and Washington.

The Company's goals are to maximize growth in both earnings and cash flow, while at the same time enhancing the value of its real estate assets.

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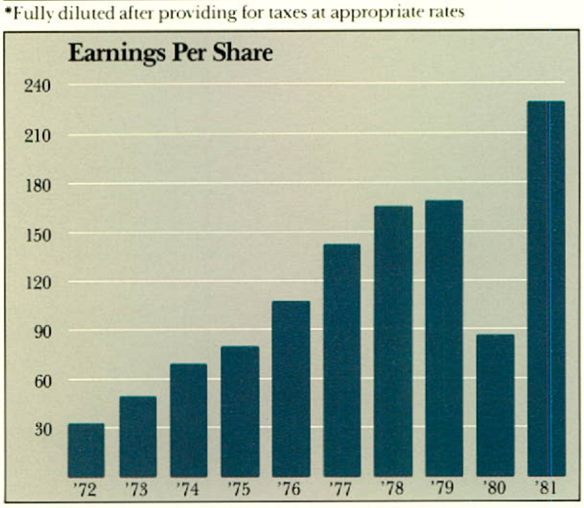
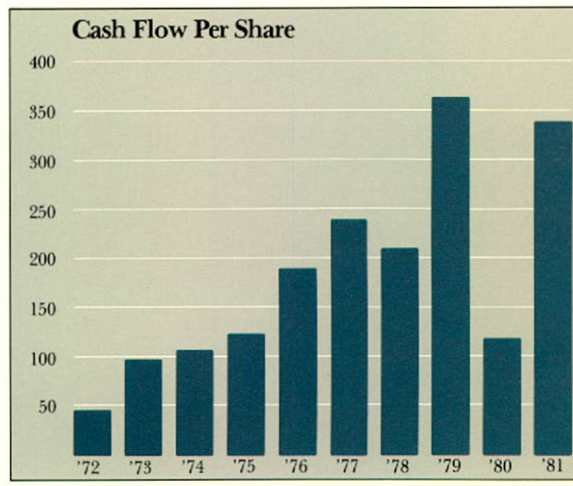
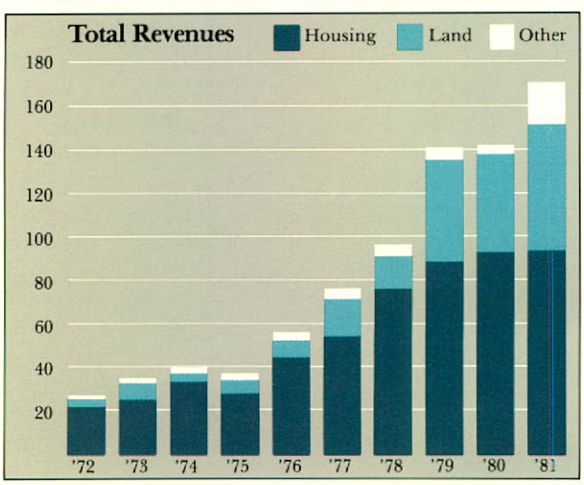
Financial Highlights

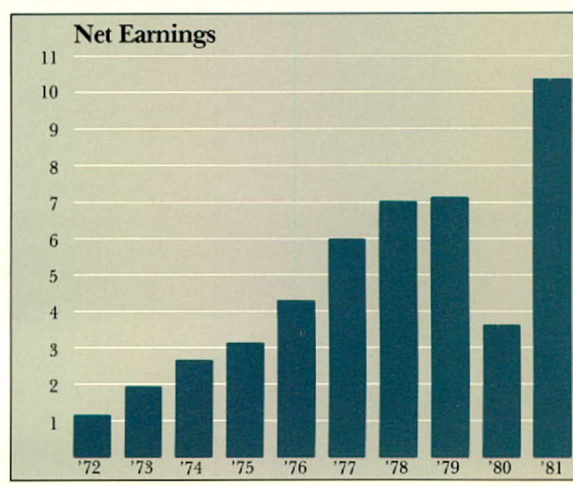
	1981	1980	Increase
Total revenues	$169,689,000	143,947,000	18%
Net earnings	$ 10,392,000	3,649,000	185%
Earnings per share	$ 2.28	.86	165%
Cash flow per share	$ 3.38	1.17	189%
Total assets	$407,736,000	264,724,000	54%
Dividends per share	$ .410	.380	8%
Shareholders' equity	$ 46,282,000	35,446,000	31%
Equity per share including appraisal surplus*	$ 19.76	14.95	32%

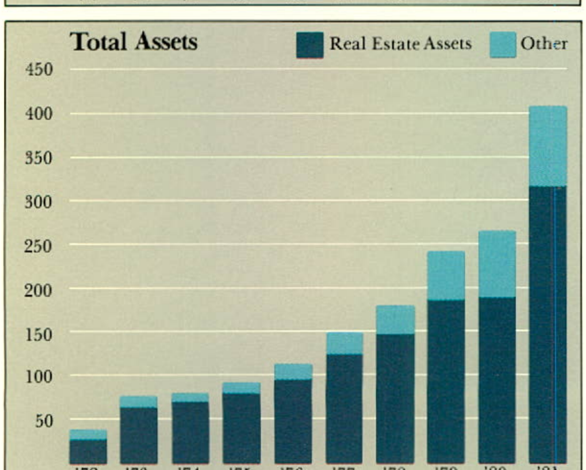
*Fully diluted after providing for taxes at appropriate rates

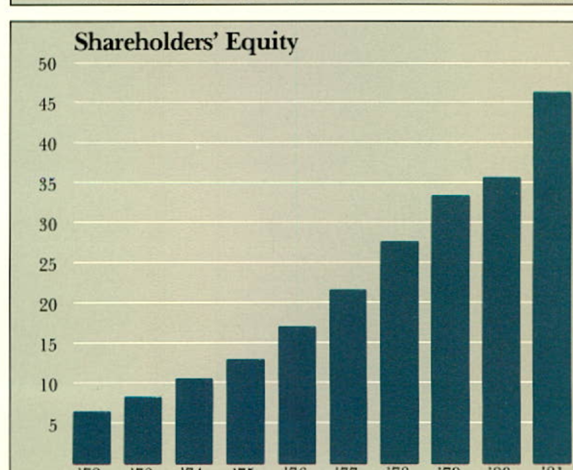












In millions of dollars, except per share figures which are in cents

Report to Shareholders

Grant L. Duff
President and
Chief Executive Officer

H. Keith Morley
Chairman of the Board

In spite of difficult economic conditions and a particularly harsh environment for the real estate industry throughout North America, 1981 was a successful year for the Company. Record earnings of $10.4 million, or $2.28 per share, on revenues of $169.7 million, were achieved after writing down inventory by $2.6 million. This financial performance raised the operating cash flow to $3.38 per share and enabled the Company to increase its annual dividend by 32 percent to a new level of 50 cents per share. These results placed the Company back on the path of steady upward growth achieved in every year but one since 1971. The substantial increase in assets, a growing diversity in real estate activities and a demonstrated ability to respond quickly to changing economic conditions all combined to make 1981 a year of achievement.

The business environment in 1981 posed rigorous challenges to the entire real estate industry. Interest rates, which had eased somewhat from the high levels in late 1980, provided a brief plateau of stability during the early months of 1981 but soon began an inexorable climb that brought them, by midsummer, to levels never before experienced within living memory either in Canada or the United States. These record rates, combined with the uncertainty caused by government economic policy in both countries, created a disastrous climate for housing investment, particularly in the United States, which suffered its lowest level of housing starts since World War II. Though mortgage rates began to ease late in the year, the chilling effect on both lending institutions and borrowers caused a sustained suppression in the aggregate demand for housing throughout the year and a corresponding slowdown in housing orders in markets right across the continent.

In the Company's housing operations, earnings increased significantly as a result of the surprising early strength of markets in Toronto and Ottawa. These markets heated up during a brief period of interest rate stability in the first two quarters, triggering a housing demand which, in part, stemmed from a growth in regional employment. The result was an increase not only in the number of units sold but in price levels as well, making a substantial contribution to profits during the third and fourth quarters when these early sales were completed. Earnings were considerably less favourable in the Company's other Canadian housing operations, including Alberta, where results were moderate, at best. In the United States, high interest rates combined with a reluctance on the part of purchasers to accept short-term mortgages produced disappointing results.

A major contributor to 1981 profits was a strong performance in land activity. Several highly profitable transactions were negotiated in the form of finished lots and parcels of land, both being sold to builders preparing for the housing recovery. These occurred particularly in Toronto, Calgary, Phoenix and Virginia. In a period of high carrying costs, the Company adopted an approach of seeking trading profits in land wherever these would make a prudent and appropriate contribution to earnings.

During the year, the Company also pursued a policy of enlarging its land assets. Through an amendment to the Trust Deed for the Series A and B Debentures, the Company was permitted to increase its borrowings in relation to its capital base. By year end, real estate assets had grown to $315.8 million, of which new purchases totalled $131.6 million. Through continuing emphasis in the United States, real estate assets represented $171.7 million in that country, or 54 percent of the total.

The market value of assets continues to exceed by a considerable margin the cost recorded in the books. That margin or "appraisal surplus", according to professional appraisers, amounted to $90.1 million at year end. On this basis, the real value of shareholders' equity is $19.76 per fully diluted share, after allowing for tax at current rates. Included in the appraisal surplus is a net reduction in Canadian land assets in the amount of $2.3 million which was written off against earnings during the year.

The development and construction of commercial income-producing properties progressed slowly. Difficulties arose owing to the adverse economic environment and to delays in obtaining necessary planning permits. In spite of this, good progress was made in establishing a land inventory for future construction. At the same time, profits were achieved by the Commercial Division from the sale of several land parcels — transactions which, however, are expected to be less common in future years.

In response to the weak housing markets, the Company deliberately kept its unsold inventory as low as possible in order to avoid burdensome carrying costs. At year end, the number of unsold houses stood at 61 in Canada and 72 in the United States, exclusive of models.

Another development in 1981 saw the move of the Corporate Office from its traditional suburban location to the new Exchange Tower of First Canadian Place in the heart of downtown Toronto. This location, which also houses the Commercial Division, allows ready access to the financial community and other supporting services. The move is also a positive reflection of the Company's growth and optimism.

Looking to the year ahead, it is difficult to be overly optimistic about the business climate. As the North American economies continue to wrestle with high levels of inflation using monetarism as a primary tool, it is likely that interest rates, while moderating somewhat from the excesses of 1981, will remain high in historical terms. This, in combination with recessionary influences expected to last at least through the first half of 1982, will continue to suppress the demand for housing.

In the United States, the housing need is high, not only because of the recent reduced levels of construction but, more importantly, because of large growth in the number of households. The gradual reduction of inflation levels now occurring gives ground for encouragement and suggests that mortgage interest rates could ease in 1982 as the year progresses. Any reduction in those rates will come as a boon to the housing industry, and the Company is in a position to benefit quickly as conditions improve.

Trends in Canada may not be so encouraging. Housing construction in this country has not sagged to the same extent as in the United States — with correspondingly less latitude for improvement. Inflation levels in Canada, moreover, are not likely to be brought under control as quickly or as effectively as in the United States, diminishing the likelihood of significantly lower interest rates, at least in the short term.

The November 12, 1981 Canadian Federal Budget had little serious direct effect on the Company. It did eliminate the very successful MURB program, the effect of which will be to worsen the shortage of rental accommodation in the country. However, the Company did not participate directly in those schemes. The Budget also advanced the time of tax payment on land sales. This change will make it less attractive for the Company to finance the sale of lots to other builders. The most important consequence of the Budget, however, is the undermining of the confidence of the business community and the further discouragement of individual initiative and risk-taking in Canada. Coupled with interventionist policies such as The National Energy Program, businesses operating in Canada will find the climate less attractive and the rewards for individual enterprise reduced. The overall effect will not be positive for Canadians, however it is hoped that further changes will be made to the Budget before it is legislated.

The development of commercial income-producing properties will be increasingly expanded in the years ahead to complement the Company's housing and land development activities. The effect will be to create a substantially widened earnings base during the 1980s. Moreover, through a continuing program of careful diversification, the Company is confident that it can sustain vigorous growth, and provide a significant benefit to its customers, its shareholders and the communities it serves.

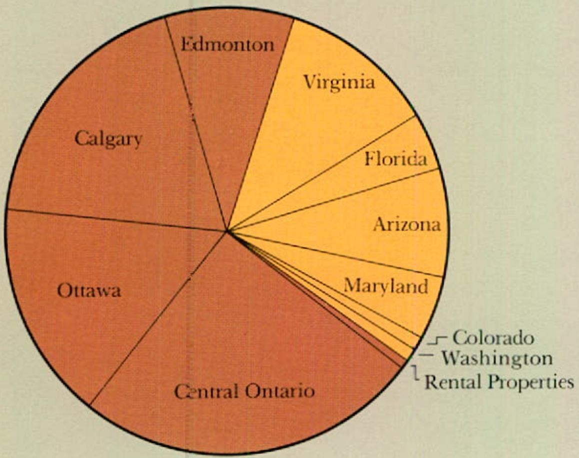
G.L. Duff
President and
Chief Executive Officer

H.K. Morley
Chairman of the Board

February 18, 1982

Canada | United States

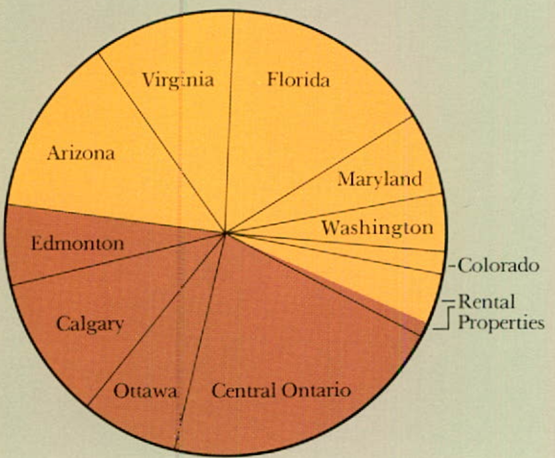
1981 Total Revenues



Total Revenues

($ millions)	**1981**		1980		1979		1978	
Housing, Land, Interest and Other								
Ontario	**70.3**	**41.4%**	52.0	36.1%	78.0	54.7%	72.9	75.7%
Alberta	**47.4**	**27.9**	46.7	32.5	34.5	24.2	18.3	19.0
United States	**51.2**	**30.2**	42.5	29.5	27.4	19.2	2.5	2.6
Rental Properties	**.8**	**.5**	2.7	1.9	2.7	1.9	2.6	2.7
Total	**169.7**	**100.0**	143.9	100.0	142.6	100.0	96.3	100.0

1981 Real Estate Assets



Real Estate Assets

($ millions)	**1981**		1980		1979		1978	
Housing and Land								
Ontario	**89.3**	**28.3%**	72.2	38.2%	77.7	42.0%	81.4	55.3%
Alberta	**51.7**	**16.4**	37.4	19.8	47.5	25.7	35.3	24.0
United States	**160.9**	**50.9**	62.1	32.9	41.7	22.5	14.8	10.0
Rental Properties	**13.9**	**4.4**	17.2	9.1	18.1	9.8	15.8	10.7
Total	**315.8**	**100.0**	188.9	100.0	185.0	100.0	147.3	100.0

Appraisal of Real Estate Assets

December 31, 1981 ($ thousands)	Appraisal Value	Book Cost	Appraisal Surplus
Housing and Land Under Development	114,451	92,891	21,560
Land for Future Development	276,374	209,074	67,300
Rental Properties	15,081	13,853	1,228
Total	405,906	315,818	90,088

Housing under construction has been valued at book cost.
Appraisal surplus is before tax.
Land for future development includes land under option at year end.

Joint Ventures and Partnerships

	Ownership	**Assets**
Convent Glen Orleans (Ottawa), Ontario	70%	531 acres
Brimley Forest Scarborough (Toronto), Ontario	30%	188 acres
Twin Brooks Edmonton, Alberta	50%	297 acres
Millrise Calgary, Alberta	50%	285 acres
Scottsdale Ranch Phoenix, Arizona	50%	866 acres
Tysons International Office Building Fairfax, Virginia	50%	163,700 sq. ft.

Assets shown represent the full interest of the joint venture or partnership.

Summary of Significant Accounting Policies

General

The financial statements are prepared in accordance with accounting principles generally accepted in Canada. The principles followed are also in conformity with the historical cost accounting standards of The International Accounting Standards Committee. In addition, the accounting policies and standards of financial disclosure are substantially in accordance with the recommendations of the Canadian Institute of Public Real Estate Companies of which the Company is a member.

Consolidation

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

Revenue Recognition

Sales are recorded on the following bases:
House sales - when title to the completed house passes to the purchaser.
Condominium sales - when the amount due on closing has been received and the purchaser has become entitled to occupancy.
Land sales - when all material conditions have been fulfilled and cash or appropriate security equal to at least 15 percent of the sale price has been received.

Revenue from rental properties is included in the consolidated statement of earnings commencing with the month during which 70 percent of rental occupancy is achieved, subject to a reasonable maximum period, from which time all operating and carrying costs are included in the determination of earnings. Prior to such time these costs, net of rental revenue, are capitalized as costs of rental properties.

Capitalization of Costs

Capitalized costs include: development costs which are net of miscellaneous revenue; mortgage interest; realty taxes; interest on general borrowings; and the salaries and expenses of personnel directly involved in development.

Housing and Land

Housing and land under development and land for future development are recorded at the lower of cost and net realizable value. Costs of land and development and capitalized costs are allocated in each subdivision to saleable lots and acreage in proportion to anticipated revenues.

Depreciation and Amortization

Depreciation is recorded on rental properties on a 5 percent, fifty-year sinking fund basis. Under this method, depreciation is charged to income in an amount which increases annually, consisting of a fixed annual sum, together with interest compounded at the rate of 5 percent per annum so as to fully depreciate the buildings over fifty years. Depreciation on other fixed assets is recorded at rates which will depreciate each asset over its estimated useful life.

Deferred financing costs are amortized to income over the term of the debt in relationship to the amount outstanding.

Translation of Foreign Currencies

The accounts of foreign subsidiaries are translated into Canadian dollars as follows:
Monetary assets and liabilities at the exchange rate prevailing at the end of the year;
Real estate assets, fixed assets and depreciation at the rates of exchange prevailing at dates of acquisition;
Cost of housing and land sold, at the weighted average exchange rate prevailing over the development period;
Revenues and other items of expense at the weighted average exchange rate for the year.

Exchange gains or losses (whether realized or unrealized) relating to monetary liabilities which arise with respect to land and housing are considered to be part of the capitalized carrying cost and accordingly are included in the determination of the value of real estate assets. Other gains or losses arising on translation of foreign financial statements are deferred until realization, at which time they are included in the computation of earnings.

Consolidated Statement of Earnings

Costain Limited	Year ended December 31	Notes	1981 ($000s)	1980 ($000s)
	Revenues			
	Housing		**93,872**	93,569
	Land		**64,878**	41,460
	Rental properties		**772**	2,717
	Interest and other		**10,167**	6,201
	Total revenues		**169,689**	143,947
	Expenses			
	Housing		**85,302**	86,499
	Land		**42,780**	31,866
	Rental properties		**835**	2,684
	Interest	11	**12,438**	7,797
	General and administrative		**9,668**	8,096
	Total expenses		**151,023**	136,942
	Earnings before income taxes		**18,666**	7,005
	Income taxes			
	Current		**3,938**	2,698
	Deferred		**4,336**	658
	Total income taxes		**8,274**	3,356
	Net earnings		**10,392**	3,649
	Earnings per share: Basic	10	**2.28**	.86
	Fully diluted	10	**2.23**	.83

Consolidated Statement of Retained Earnings

Costain Limited	Year ended December 31	1981 ($000s)	1980 ($000s)
	Retained earnings, beginning of year	**31,777**	29,744
	Net earnings	**10,392**	3,649
		42,169	33,393
	Less: Dividends	**1,887**	1,616
	Retained earnings, end of year	**40,282**	31,777

Consolidated Balance Sheet

Costain Limited	December 31	Notes	1981 ($000s)	1980 ($000s)
	Assets			
	Cash and short term deposits		**1,257**	12,902
	Accounts receivable		**8,312**	9,039
	Mortgages and other secured receivables	1	**75,446**	49,190
	Real estate assets	2		
	Housing and land under development	3	**92,891**	80,713
	Land for future development	4	**209,074**	91,047
	Rental properties	5	**13,853**	17,214
	Other assets	6	**6,903**	4,619
	Total assets		**407,736**	264,724
	Liabilities			
	Bank loans	7	**77,389**	40,615
	Accounts payable and accruals		**23,810**	21,879
	Income taxes payable		**287**	2,050
	Mortgages and other secured payables	8	**167,561**	75,015
	Debentures payable	9	**64,854**	66,502
	Deferred income taxes		**27,553**	23,217
	Total liabilities		**361,454**	229,278
	Shareholders' Equity			
	Capital stock	10	**6,000**	3,669
	Retained earnings		**40,282**	31,777
	Total shareholders' equity		**46,282**	35,446
	Total liabilities and shareholders' equity		**407,736**	264,724
	Commitments and contingent liabilities	14		

On behalf of the Board:

G.L. Duff
Director

H.K. Morley
Director

Consolidated Statement of Changes in Financial Position

Costain Limited	Year ended December 31	1981 ($000s)	1980 ($000s)
	Financial resources were provided by		
	Net earnings	**10,392**	3,649
	Add non-cash items		
	Income taxes deferred	**4,336**	658
	Depreciation		
	Fixed assets	**445**	324
	Rental properties	**32**	137
	Amortization of deferred financing costs	**208**	222
	Cash flow from operations*	**15,413**	4,990
	Increase in mortgages and other secured payables	**92,546**	—
	Increase in bank indebtedness	**36,774**	11,779
	Issue of additional capital stock	**2,331**	98
	Net change in other assets and liabilities	**8,876**	3,922
		155,940	20,789
	Financial resources were used for		
	Additions to real estate assets	**126,876**	4,034
	Increase in receivables	**25,529**	8,513
	Dividends	**1,887**	1,616
	Redemption of debentures	**1,648**	3,822
	Decrease in mortgages and other secured payables	**—**	2,804
		155,940	20,789
	***Cash flow per share (Basic)**	**3.38**	1.17

Notes to Consolidated Financial Statements

(Refer to Summary of Significant Accounting Policies)

1. Mortgages and Other Secured Receivables

These amounts bear interest at rates from 8.0% to 17.5%, with a weighted average of 12.4% and mature as follows:

		1981 ($000s)	1980 ($000s)
	1981	-	14,888
	1982	26,920	8,347
	1983	15,391	10,408
	1984	12,462	6,386
	1985	4,265	506
	1986	7,484	6,099
Subsequent to	1986	8,924	2,556
		75,446	49,190

2. Segmented Information

The predominant business of the Company is the development and sale of real estate in Canada and the United States. The following summarizes the Company's operations and assets on a geographic basis.

	Canada		United States		Total	
	1981	1980	1981	1980	1981 ($000s)	1980 ($000s)
Operations						
Total revenues	118,456	101,416	51,233	42,531	169,689	143,947
Trading profit	30,611	18,634	10,161	4,264	40,772	22,898
Interest expense					12,438	7,797
General and administrative					9,668	8,096
Income taxes					8,274	3,356
Net earnings					10,392	3,649
Assets						
Real estate assets						
Housing and land under development	43,785	45,445	49,106	35,268	92,891	80,713
Land for future development	97,190	64,162	111,884	26,885	209,074	91,047
Rental properties	3,129	11,198	10,724	6,016	13,853	17,214
	144,104	120,805	171,714	68,169	315,818	188,974
Other assets	54,905	58,256	37,013	17,494	91,918	75,750
Total assets	199,009	179,061	208,727	85,663	407,736	264,724

3. Housing and Land Under Development

	1981 ($000s)	1980 ($000s)
Housing including related lots	33,518	31,174
Building lots acquired	10,482	7,502
Land under development	48,891	42,037
	92,891	80,713

4. Land for Future Development

	1981 ($000s)	1980 ($000s)
Opening inventory	91,047	94,629
Acquisitions	100,594	10,204
Costs capitalized		
Interest	18,350	5,291
Real estate taxes	365	128
Salaries and expenses	1,314	429
Preliminary development costs	8,481	2,427
	220,151	113,108
Transfers to land under development or charged to expense	9,873	22,061
Reduction in inventory values from cost to net realizable value	1,204	-
	209,074	91,047

During 1981 a write down in the aggregate amount of $2,599,000 was made to the carrying cost of real estate assets. Of this amount $1,204,000 was a reduction of land for future development, $1,107,000 was applied against interest that had been capitalized to land for future development and $288,000 reduced the carrying value of housing.

5. Rental Properties

	1981 ($000s)	1980 ($000s)
Buildings and equipment, at cost	2,415	10,500
Less accumulated depreciation	23	382
	2,392	10,118
Land, at cost	737	1,080
	3,129	11,198
Under construction	10,724	6,016
	13,853	17,214

6. Other Assets

	1981 ($000s)	1980 ($000s)
Fixed assets - at cost less accumulated depreciation of $1,412,000 (1980 - $1,092,000)	2,023	1,183
Unamortized portion of deferred financing costs	2,493	2,673
Loans to officers under share purchase plan	1,440	-
Prepaid expenses and sundry assets	947	763
	6,903	4,619

7. Bank Loans

The Company has created demand debentures which are pledged to secure amounts owing or which may become owing to its banker from time to time. These debentures are secured by way of a floating charge on the undertaking, property and assets of the Company. The Company's banker also holds a general assignment of book debts. This security ranks ahead of the security for the sinking fund debentures.

8. Mortgages and Other Secured Payables

Amounts payable under mortgages, agreements of purchase and sale and other secured payables relate to the following real estate assets:

	1981 ($000s)	1980 ($000s)
Housing and land under development		
Mortgage draws on housing	**28,520**	12,768
Land under development	**15,139**	19,047
Land for future development	**115,905**	35,396
Rental properties	**7,997**	7,804
	167,561	75,015

Mortgage draws on housing will be converted to first mortgage financing and will be assumed by purchasers as the properties are sold. Interest rates and approximate principal repayments are as follows:

	Land under develop-ment	Land for future develop-ment	Rental properties	Total
Range of rates	7.0%–20.5%	6.75%–19.0%	9.5%–11.375%	6.75%–20.5%
Weighted average	14.3%	13.7%	10.1%	13.6%
Principal due ($000s)				
1982	9,095	16,227	26	25,348
1983	4,501	25,622	30	30,153
1984	968	19,836	33	20,837
1985	575	15,285	37	15,897
1986	–	21,424	40	21,464
Subsequent to 1986	–	17,511	7,831	25,342
	15,139	115,905	7,997	139,041

9. Debentures Payable

	1981 ($000s)	1980 ($000s)
9¾% Sinking Fund Debentures Series A maturing May 15, 1991	**3,107**	3,282
12% Sinking Fund Debentures Series B maturing February 12, 1990	**6,531**	7,007
11¼% Sinking Fund Debentures Series D maturing June 15, 1997	**13,065**	13,289
11⅞% Sinking Fund Debentures Series E maturing November 1, 1998	**23,000**	23,763
12% Sinking Fund Debentures Series F maturing October 15, 1999	**19,151**	19,161
	64,854	66,502

During 1981, in order to effect certain amendments to the trust indentures for the Series A and B debentures, the interest rate on these debentures was increased by ½ of 1%.

The debentures are secured by a floating charge on the assets of the Company (subject to the security referred to in Note 7). The holders of any Series D, E or F debentures have the right to require the Company to prepay the principal amounts on June 15, 1987, November 1, 1988 or October 15, 1989, respectively.

The Company is required to establish sinking funds sufficient to retire the following principal amounts:

Series A issue, $150,000 principal in 1981, rising to $200,000 annually on May 15 in the years 1982 through 1986 and $250,000 in the years 1987 through 1990;

Series B issue, presently $448,440 annually on February 12, changing to $523,180 in the years 1986 through 1989;

Series D issue, presently $450,000 principal amount annually on June 15, changing to 6% of the principal amount outstanding on June 15, 1987 in the years 1988 through 1996;

Series E issue, commencing in 1989, 4% annually of the principal amounts outstanding on November 1, 1988. Under a purchase fund obligation, expiring in 1988, the Company agrees to use all reasonable efforts to acquire in each 12-month period ending October 31, $500,000 principal amount of Series E debentures at a price not exceeding the principal amount thereof;

Series F issue, commencing in 1990, 4% annually of the principal amount outstanding on October 15, 1989. Under a purchase fund obligation, expiring in 1989, the Company agrees to use all reasonable efforts to acquire in each 12-month period ending October 14, $400,000 principal amount of Series F debentures at a price not exceeding the principal amount thereof.

Retirements made during 1981 as a result of sinking and purchase fund requirements amounted to $1,648,000 (1980 – $3,822,000).

10. Capital Stock

The authorized capital comprises 6,000,000 common shares without nominal or par value and an unlimited number of preferred shares issuable in series. At December 31, 1981, 4,611,946 common shares were issued and outstanding (1980 – 4,269,762). No preferred shares have been issued. For purposes of calculating basic earnings per share and cash flow per share, the weighted average number of shares outstanding during the year was 4,559,689 (1980 – 4,247,691).

During 1981, 46,884 share purchase warrants were exercised for a total cash consideration of $148,500 and the balance of 10,074 warrants expired.

Under an employee stock purchase plan, 160,000 shares were issued during 1981 at a price of $9.00 per share. The shares are held by a trustee on behalf of employees as security for loans made by the Company to the employees to fund the share purchase. At December 31, 1981, 8,400 shares are reserved for future issuance under the plan.

During 1981, options covering 135,300 shares were exercised for a total cash consideration of $741,375. At December 31, 1981, options for 51,300 shares remain outstanding of which 33,750 have an exercise price of $4.67 per share and expire on November 15, 1982 and 17,550 have an exercise price of $6.50 per share and expire on April 11, 1983.

11. Interest

	1981 ($000s)	1980 ($000s)
Interest charges were incurred on:		
Mortgages	15,751	8,684
Debentures	7,518	7,803
Bank loans	15,286	3,796
	38,555	20,283
Interest was allocated to:		
Housing and land under development	2,230	1,367
Land for future development	18,350	5,291
Rental property under construction	284	69
Expense		
Rental properties	435	1,029
Housing and land	4,818	4,730
Interest	12,438	7,797
	38,555	20,283

12. Joint Venture Operations

The Company's share of real estate joint venture operations accounted for on a line-by-line basis is summarized as follows:

	1981 ($000s)	1980 ($000s)
Assets		
Cash and short term deposits	392	57
Accounts receivable	918	500
Mortgages receivable	16,919	5,395
Real estate assets		
Land under development	6,098	8,500
Land for future development	35,723	33,443
Rental properties	10,724	6,016
Total assets	70,774	53,911
Liabilities		
Bank loans	2,205	6,187
Accounts payable and accruals	4,437	3,026
Mortgages payable	12,664	13,900
Deferred income taxes	9,962	4,456
Total liabilities	29,268	27,569
Investment in real estate joint ventures	41,506	26,342
Total liabilities and investment	70,774	53,911
Revenues	23,967	6,831
Expenses	13,281	3,754
Trading profit	10,686	3,077

13. Net Increase in Capitalized Costs in Housing and Land

	1981 ($000s)	1980 ($000s)
Interest		
On housing and land under development	2,230	1,367
On land for future development	18,350	5,291
Real estate taxes	738	225
Salaries and expenses	2,225	929
	23,543	7,812
Capitalized costs previously incurred, charged to expense	1,901	3,046
Net increase in capitalized costs	21,642	4,766

14. Commitments and Contingent Liabilities

The Company has entered into various occupancy lease commitments with lease periods up to 1987. The aggregate minimum rentals payable under such leases amount to approximately $4,032,000 of which approximately $3,816,000 is payable within the next five years.

The Company is a defendant in legal actions for damages in the aggregate of approximately $7,600,000 pertaining to the development of a subdivision and the purchase of a parcel of land. The Company is defending these actions and management anticipates favourable results. Accordingly, no provision is recorded in the accounts for these matters.

Peat, Marwick, Mitchell & Co.

Auditors' Report to Shareholders

We have examined the consolidated balance sheet of Costain Limited as at December 31, 1981 and the consolidated statements of earnings, 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 December 31, 1981 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.

Peat, Marwick, Mitchell & Co.

Chartered Accountants

Toronto, Canada
February 18, 1982

Ten Year Review

Year ended December 31 In thousands of dollars unless otherwise noted	1981		1980		1979		1978	
Revenues								
Housing	**93,872**	**55.3%**	93,569	65.0%	89,729	62.9%	77,212	80.2%
Land	**64,878**	**38.2**	41,460	28.8	48,231	33.8	14,432	15.0
Rental properties	**772**	**.5**	2,717	1.9	2,746	1.9	2,584	2.7
Interest and other	**10,167**	**6.0**	6,201	4.3	1,953	1.4	2,033	2.1
Total revenues	**169,689**	**100.0**	143,947	100.0	142,659	100.0	96,261	100.0
Expenses								
Housing	**85,302**	**50.3**	86,499	60.1	82,853	58.1	64,567	67.1
Land	**42,780**	**25.2**	31,866	22.1	30,962	21.7	7,576	7.9
Rental properties	**835**	**.5**	2,684	1.9	2,842	2.0	2,749	2.8
Interest	**12,438**	**7.3**	7,797	5.4	4,801	3.3	2,685	2.8
General and administrative	**9,668**	**5.7**	8,096	5.6	7,389	5.2	5,060	5.2
Total expenses	**151,023**	**89.0**	136,942	95.1	128,847	90.3	82,637	85.8
Earnings before income taxes	**18,666**	**11.0**	7,005	4.9	13,812	9.7	13,624	14.2
Income taxes								
Current (recovery)	**3,938**	**2.3**	2,698	1.9	(1,116)	(.7)	5,274	5.5
Deferred	**4,336**	**2.6**	658	.5	7,751	5.4	1,349	1.4
Total income taxes	**8,274**	**4.9**	3,356	2.4	6,635	4.7	6,623	6.9
Net earnings	**10,392**	**6.1**	3,649	2.5	7,177	5.0	7,001	7.3

	1981	1980	1979	1978
Total assets	**407,736**	264,724	242,445	178,529
Shareholders' equity	**46,282**	35,446	33,315	27,650
Real estate assets				
Housing and land under development	**92,891**	80,713	72,330	56,335
Land for future development	**209,074**	91,047	94,629	75,086
Rental properties	**13,853**	17,214	18,118	15,854
Inventory of land holdings (acres)	**5,362**	4,894	4,603	4,445
Sales				
Houses closed	**868**	913	1,018	1,071
Lots (units)	**601**	447	926	468
Land (acres)	**290**	389	388	17
Average number of shares outstanding	**4,559,689**	4,247,691	4,238,400	4,234,161
Per common share				
Earnings	**$ 2.28**	.86	1.69	1.65
Fully diluted earnings	**$ 2.23**	.83	1.60	1.56
Cash flow	**$ 3.38**	1.17	3.68	2.09
Dividends	**$ .410**	.380	.357	.270
Shareholders' equity	**$10.04**	8.30	7.86	6.53
Stock price range	**$15-8¼**	11⅜-6½	11½-6½	9⅓-5
Return on				
Average shareholders' equity	**25.4%**	10.6	23.5	28.3
Revenues	**6.1%**	2.5	5.0	7.3

Per share figures are adjusted for stock splits in 1977 (2 for 1) and 1979 (3 for 2).

1977		1976		1975		1974		1973		1972	
54,183	70.2%	44,423	78.7%	28,713	74.9%	33,350	83.4%	24,127	72.7%	21,111	79.4%
18,983	24.6	8,734	15.5	6,865	17.9	4,799	12.0	8,350	25.2	4,982	18.7
2,422	3.1	2,181	3.9	2,069	5.4	1,149	2.9	24	.1	–	–
1,599	2.1	1,088	1.9	689	1.8	687	1.7	689	2.0	503	1.9
77,187	100.0	56,426	100.0	38,336	100.0	39,985	100.0	33,190	100.0	26,596	100.0
46,191	59.8	37,010	65.6	22,691	59.2	26,625	66.6	21,054	63.4	18,813	70.7
10,572	13.7	4,550	8.1	3,859	10.1	3,392	8.5	5,651	17.1	3,684	13.9
2,617	3.4	2,495	4.4	2,274	5.9	1,328	3.3	26	.1	–	–
1,911	2.5	1,101	1.9	747	2.0	583	1.4	583	1.7	440	1.6
4,032	5.2	3,079	5.5	2,434	6.3	2,148	5.4	1,621	4.9	1,140	4.3
65,323	84.6	48,235	85.5	32,005	83.5	34,076	85.2	28,935	87.2	24,077	90.5
11,864	15.4	8,191	14.5	6,331	16.5	5,909	14.8	4,255	12.8	2,519	9.5
2,252	2.9	812	1.4	1,595	4.2	1,815	4.5	441	1.3	830	3.2
3,612	4.7	3,040	5.4	1,544	4.0	1,397	3.5	1,875	5.7	404	1.5
5,864	7.6	3,852	6.8	3,139	8.2	3,212	8.0	2,316	7.0	1,234	4.7
6,000	7.8	4,339	7.7	3,192	8.3	2,697	6.8	1,939	5.8	1,285	4.8

1977	1976	1975	1974	1973	1972
148,136	111,646	92,625	79,852	74,313	37,118
21,776	17,076	13,143	10,486	8,115	6,480
46,534	24,170	18,826	11,394	16,700	9,029
60,399	54,157	46,985	43,701	31,772	17,693
15,925	16,031	16,134	16,128	14,118	764
3,813	3,614	3,582	3,710	3,442	2,277
784	814	498	724	674	633
837	323	358	391	651	360
41	7	–	–	66	7
4,202,669	4,053,591	4,037,988	4,035,033	4,028,991	4,009,101
1.43	1.07	.79	.67	.48	.32
1.34	.96	.71	.60	.44	.30
2.38	1.89	1.22	1.06	.97	.44
.183	.133	.133	.083	.083	.083
5.15	4.16	3.25	2.60	2.01	1.61
$5\frac{7}{8}$-$2\frac{2}{3}$	$3\frac{1}{2}$-$2\frac{1}{8}$	$3\frac{1}{4}$-$1\frac{7}{8}$	$3\frac{1}{4}$-$1\frac{2}{3}$	$3\frac{1}{8}$-$1\frac{3}{4}$	$3\frac{2}{3}$-$2\frac{3}{8}$
30.9	28.7	27.0	29.0	26.6	21.4
7.8	7.7	8.3	6.8	5.8	4.8

The Waterways
Dade County, Florida

Approved site plan includes 3,677 condominiums, a 102-room hotel and a 15-acre shopping centre. ▽

Land Development

Millrise community in southwest Calgary, Alberta

Land sales played an important role in the Company's performance during 1981. In Canada, the sale of lots and several parcels, with generally higher profit margins, contributed substantially to earnings. In the United States, land sales - residential, commercial and industrial - spared the Company losses that might otherwise have occurred in that country because of the feeble condition of its housing markets.

Typically, the Company acquires land with a view to developing it through to finished product. In addition to its own construction program, a certain number of lots have always been reserved for sale to other builders. This has had the effect not only of ensuring the individualism and variety characteristic of Costain subdivisions, but also of adding beneficially to earnings and cash flow. Under current economic conditions, with expensive land carrying costs arising from high interest rates, it can be advantageous for the Company to sell parcels of land before planning approvals have been fully achieved. This approach enables the Company to manage its assets in a prudent manner. The sale of undeveloped land in 1981 represented only a small portion of revenue, but made an important contribution to earnings.

In its Canadian operations, the Company acquired few land holdings in 1981, but effected several profitable sales. Calgary experienced a buoyant lot market which helped to offset weak housing activity. In eastern Canada, Ottawa lot sales performance was only moderate, while results in Toronto were excellent. Difficulty was experienced in producing finished lots in several of the Company's major markets, particularly Edmonton, because of delays at the municipal level.

In the United States, the Company was active both in land sales and acquisitions during 1981. The most significant sales from existing land inventory involved lots in Scottsdale Ranch, Phoenix. Several land parcels, rezoned and split off from newly acquired larger blocks, were also sold. For example, the residential portion of the Chiles Tract in suburban Washington, D.C. was sold at an advantageous price, while the larger portion was retained for commercial development. Similar transactions involving newly acquired commercial land in Denver and industrial land in Phoenix also contributed to profits. Overall land holdings for development in the United States increased by 544 acres.

Land Development Summary

	Sales		Purchases		Registrations	Inventory at Year End							
						Under Development				Future			
	Lots	Acres	Lots	Acres	Acres	Lots (Units)	Lots (Acres)	Multiple Residential	Commercial/ Industrial	Preliminary Approval or Zoned	Raw	Under Agreement or Option	Total
Canada													
Central Ontario	31	89	111	27	20	387	75	40	1	404	634	1	1,155
Ottawa	141	9	114	-	42	363	47	76	42	-	953	-	1,118
Edmonton	-	-	89	20	-	73	12	-	-	-	307	-	319
Calgary	205	15	48	106	87	299	51	-	14	60	146	-	271
United States													
Florida	110	-	-	190	-	34	13	-	-	198	14	-	225
Virginia	11	48	-	235	55	473	114	-	108	195	-	61	478
Maryland	-	36	17	209	258	1,385	286	-	-	-	-	236	522
Arizona	73	87	14	500	76	341	113	-	160	653	-	-	926
Washington	30	-	59	41	8	60	16	-	1	220	-	1	238
Colorado	-	6	-	94	-	-	-	-	9	46	34	21	110
	601	290	452	1,422	546	3,415	727	116	335	1,776	2,088	320	5,362

All figures are in acres except lots which are in units.

Model Home
Scottsdale Ranch
Phoenix, Arizona

The 1,100-acre Scottsdale Ranch
showing the recently completed lake system.

Housing

Across North America, the housing industry in 1981 suffered through its second consecutive year of serious depression. It was a slump caused generally by weak overall economic conditions and specifically by the steep rise in interest rates. During 1981, record high mortgage rates were the greatest single factor retarding what was expected to have been the start of a widespread recovery in the housebuilding sector. Instead, starts were depressed both in Canada and the United States. The Canadian level of 178,000 showed a slight improvement over the year before - probably influenced by a year end surge to meet the deadline for expiry of the federal MURB program. In the United States, the abysmal record of 1,101,000 starts made 1981 the worst year for housing since World War II.

Model Home
Seattle, Washington

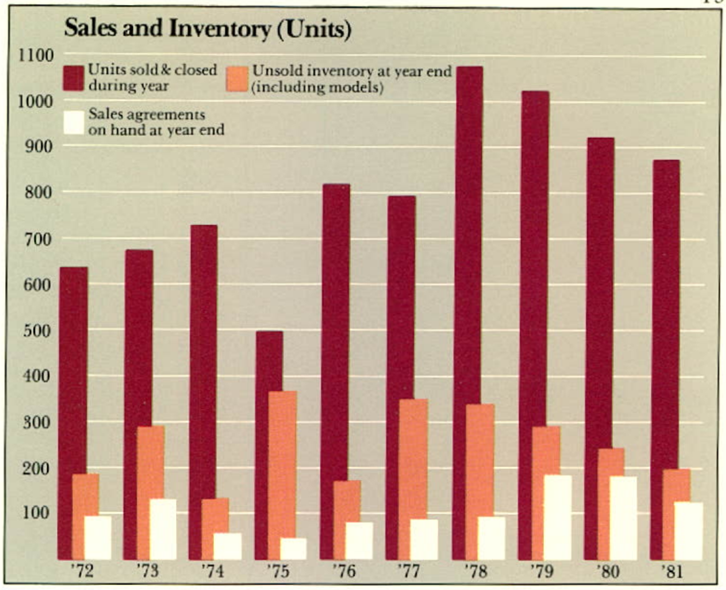
Much of the blame for the massive consumer resistance to house purchases in the United States can be attributed to that country's traditional structure of mortgage lending. In Canada, the concept of shorter mortgages with a five-year renewable term was introduced a number of years ago (and in recent years, terms of even shorter duration) - an innovation that provided crucial flexibility in periods of volatile interest rates. In the United States, on the other hand, both lenders and borrowers have been reluctant to vary from the more rigid tradition of 30-year term mortgages. In early periods of stable low-cost mortgages, this formula worked to the advantage of both. Later, as inflation gathered momentum, the borrower became the chief beneficiary, often to the detriment of the lender. More recently, during the current bout of even higher rates, this system has had the effect of choking off both the supply and demand for mortgage funds. For their part, lending institutions have been experiencing a severe shortage of deposit monies, and in many cases, this has resulted in periods during which the flow of funds has been negative. Among potential borrowers, the majority of existing United States homeowners are safely locked into long-term low-cost mortgages which they do not want to give up, while prospective new homeowners are shying away from long-term mortgage commitments when costs appear so prohibitive. The combined effect created a severe shortage in the demand for new housing in 1981.

Model Home
Anne Arundel County, Maryland

These prevailing North American trends were clearly reflected in the Company's activities during the year. Housing operations provided 55 percent of the Company's overall revenues - down nearly 13 percent from expectations. In Canada, where consumers have access to more flexible financing alternatives, and where a significant proportion of existing households face renewals at current rates annually, the Company's performance was close to the level targeted. In the United States, however, where financing structures are more rigid, housing sales trickled in at barely one-quarter of the level anticipated before last year's disastrous peaking of rates.

Even within the somewhat more stable Canadian environment, changing trends and demographics produced uneven results. The surprising surge in employment in Ottawa and Toronto during 1981 was a major contributor to the Company's strong Ontario performance. These two Ontario markets recorded both higher unit sales and increased margins - making a substantial contribution to earnings. Elsewhere in Canada, housebuilding activity, though generally depressed, was close to anticipated levels. In Alberta, the province is in urgent need of an improvement in consumer confidence before the Company's performance can regain full potential. Edmonton in particular has been harmed by the uncertainty hanging over the future of energy mega-projects.

70 Rosehill Presentation Centre ▷
Model ▽



Conditions in Canada are not likely to change dramatically in 1982. Although a slight improvement may occur in housing markets overall, the Company is not expecting a substantial upturn in its operations. The continued weak performance of the Canadian economy and, in particular, the persistence of double-digit inflation, reduces the likelihood of any meaningful decline in interest rates, at least in the short term. This factor alone makes the prospect of improvement somewhat remote. In the meantime, the Company will continue to provide alternative financing programs - for example, by pre-paying amounts on mortgages in return for lower rates. This "buying down" technique may reduce margins but often provides the key incentive necessary to induce consumer purchases.

The Company entered the high rise condominium business in 1980 when it purchased a site in the fashionable Yonge and St. Clair district of Toronto. The location, across from the David A. Balfour Park at 70 Rosehill Avenue, affords an uninterrupted view of the Toronto skyline. The plan incorporates 68 units in two luxurious nine-storey buildings. Every unit has a southerly exposure overlooking both the park and the city and is served directly by elevator, thereby eliminating common corridors. Construction commenced in late 1981 and, when completed, 70 Rosehill will become recognized as the premier condominium address in Toronto.

Another park setting for a similarly prestigious condominium was acquired this year with the purchase of the Muir Park Hotel property. This location, on Yonge Street across from Muir Park, is currently under design and it is expected that construction will commence during the winter of 1982/83.

Looking to the United States, the Company sees reason for somewhat increased optimism. With its greater success in reducing inflation levels, there is a possibility that the United States will be able to bring about a lowering of interest rates as the year proceeds. In addition, there is evidence that traditional resistance to shorter term mortgages described earlier may be giving way as lenders and borrowers continue to seek means of breaking the current financing logjam. Even if rates do begin to moderate this year, as expected, they will still be high by historical standards, and thus it is almost inevitable that more flexible and effective ways of dealing with them will evolve. The underlying demand for housing in the United States, severely cramped by the recent sustained period of reduced housebuilding, is also a positive factor which cannot be ignored. Demographics show a need for about two million starts annually through to the mid-1980s. The Company's strategic land inventories in key United States growth areas assure it a strong performance as conditions continue to improve.

Throughout its housing operations both in Canada and the United States, the Company continues to monitor and respond to the imperatives of consumer demand. The many factors affected by changing demographics, energy costs and financing restraints, continue to guide the Company in its technical and marketing decisions - from house designs and lot sizes to methods of alternative financing. And in all its markets, the Company remains committed to producing high quality housing to meet consumer needs.

Housing Summary

	Closed	Inventory At Year End				Sales Carried Forward		
		Models	Unsold*	Sold	Total	Started	Not Started	Total
Canada								
Central Ontario	233	19	23	13	55	13	9	22
Ottawa	279	16	9	14	39	14	3	17
Edmonton	143	6	14	10	30	10	1	11
Calgary	77	4	15	7	26	7	1	8
United States								
Florida	23	-	30	4	34	4	-	4
Virginia	62	15	25	8	48	8	4	12
Maryland	26	2	7	2	11	2	4	6
Arizona	22	4	4	2	10	2	28	30
Washington	3	-	6	2	8	2	2	4
Total	868	66	133	62	261	62	52	114

Commercial Operations

The Commercial Division took several positive steps in 1981 toward its long-term goal of developing a strong portfolio of income-producing properties. More than $20 million was spent in acquiring land for future commercial development both in Canada and the United States.

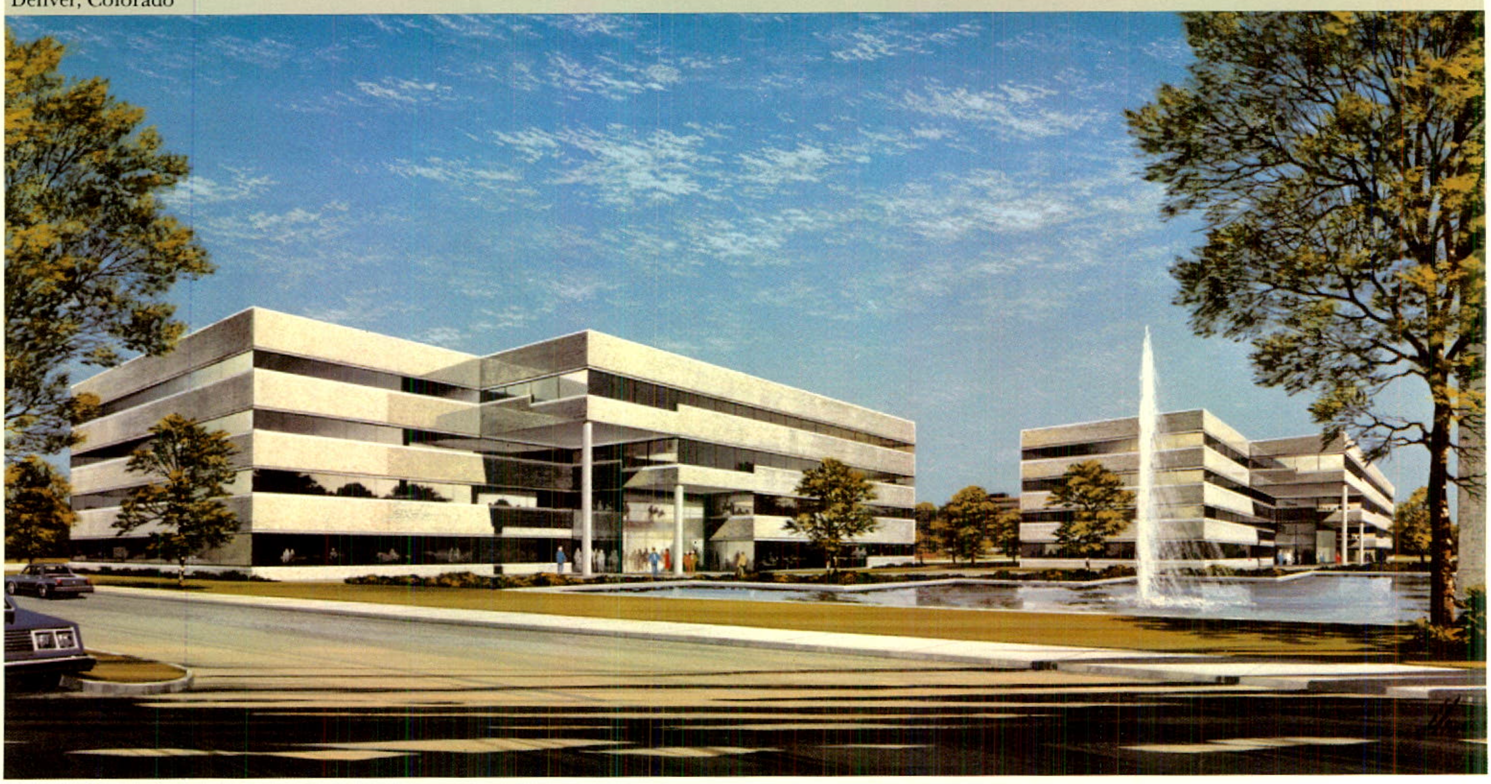
In the same way that housing operations were hampered by high interest rates during 1981, commercial development was also slowed by negative economic factors. The difficulty in obtaining viable financing was further compounded by delays in zoning changes and other municipal approvals necessary for building. Indeed, owing to the sale of an apartment building in Ottawa, the Company's last remaining residential income property, rental revenues from the Commercial Division were down from earlier years.

In spite of the disappointingly slow progress of construction, several advantageous land sales were negotiated in 1981. Earnings from these profitable transactions are recorded under general land sales in the Company's 1981 earnings statement. But, looking ahead, it is expected that construction of more than 600,000 square feet of space will commence in 1982.

Further commercial development is a key component of the Company's strategy for continued growth. A strong portfolio of income-producing properties will provide a reliable flow of income, as well as a tax shelter to be applied against earnings achieved in other trading operations.

Tysons International Office Building, Virginia, completed during year, has 163,700 square feet of leaseable space.

Academy Place
Denver, Colorado



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Chief Executive Officer
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M.A. Pittana, B.A., M.A., MBA

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Costain Arizona Inc.
Costain Colorado Inc.
Costain Florida Inc.
Costain Maryland Inc.
Costain Seattle Inc.
Costain Washington Inc.
Costain Waterways Inc.

Associated Companies 50% Owned

Torva Holdings Limited
Woburn Gate Limited

Transfer Agent and Registrar

Canada Permanent Trust
Company

Trustee for Debentures

National Trust Company,
Limited

Banker

The Toronto-Dominion Bank

Incorporation

Under the Canada Business
Corporations Act

Stock Exchange Listings

Toronto and Montreal
(Symbol COT)

Annual Meeting

April 20, 1982
Royal York Hotel
Toronto, Ontario

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