

FALL/WINTER

# REAL ESTATE AND CONSTRUCTION NEWSLETTER 2016



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# REAL ESTATE AND CONSTRUCTION NEWSLETTER



## IN THIS EDITION

It's no secret that the health of Canada's construction sector is often looked upon as an indicator of the health and well-being of the national economy, as a whole. While we have to account for differences stemming from specific regions and types of construction, overall the sector seems to be moving forward at a relatively stable pace - although there always remains a degree of uncertainty about what's to come.

In our Road to Success article, featuring Paul Tennyson and his land and residential development projects, we see that conducting business internationally can be challenging, time-consuming, and fraught with uncertainty - particularly when dealing with foreign governments and labour forces. But with persistence, cultural sensitivity, and a properly executed strategy, the rewards can potentially outweigh the risks and uncertainties.

Speaking of risks, they often seem overwhelming when developing or building new properties on a domestic front, as well. There are a host of things that can go wrong when the stakes are high. Be sure to read our Advisors Point of View article with some key tips to ensure a successfully completed project, including the need to plan in advance, secure sufficient funding, and source reputable contractors.

While it's just good business practice to do everything in our power to minimize risks and uncertainties, there will always be situations that fall outside of our control - and sometimes things can go awry. In Patricia Harris' article on Construction Tender Disputes, we look at a few of the most common methods used by forensic accountants to determine the amount of lost profit, when a tender dispute goes to litigation.

In the end, your best chance of effectively mitigating any risks and uncertainties in your business is to surround yourself with experienced advisors you can trust. After all, strength can often be found in numbers.

A handwritten signature in black ink that reads "Mike Stoyan". The signature is fluid and cursive, with a long horizontal stroke at the end.

**Mike Stoyan**  
Practice Group Leader  
Real Estate and Construction



# ROAD TO SUCCESS

## CORAL DUNES AND BAHAMA LAND HOLDINGS: A SLICE OF PARADISE AND A LABOUR OF LOVE

Sipping piña coladas on your deck, overlooking the white sand beach; exploring majestic cays and coves by boat; snorkelling through world-class coral reef; reeling in the big one on a deep sea fishing excursion – just a few of the local activities in Hope Town, Bahamas that make Paul Tennyson's day job seem like a piece of cake.

Paul Tennyson is President of Coral Dunes Ltd. and Bahama Land Holdings Ltd - boutique land and residential development companies building homes in the out islands of the Bahamas. The current project consists of 14 unique single family homes in Hope Town, ranging in price from \$700,000 to \$1.5M USD. It's a little slice of paradise only 150 miles east of Florida with beautiful beaches and breathtaking sunsets, and unlike the more mainstream islands, it's free from cruise ships, huge resorts, and pushy street vendors.

But building residential properties on foreign land isn't all fun and games. "It's certainly not for the faint of heart," says Tennyson. "Dealing at the federal level in the Bahamas to obtain work permits and approvals can be time-consuming, costly, and incredibly frustrating. My experience has shown that although there appears to be a push to attract foreign investment, the government's ability to actually execute is far from perfect. But it can be very rewarding if you're willing to invest the time, build strategic alliances, and work in synergy with the local government."

### HOME AWAY FROM HOME

For almost 45 years, Tennyson has made the Bahamas his home-away-from-home, becoming intimately familiar with the surroundings and development opportunities. He works closely with the local district council who is very supportive of his development efforts and very welcoming of Canadian families and executives who are willing to settle in and respectfully enjoy the islands.

And when Tennyson is not personally available to oversee the development project, he has the comfort of a Canadian supervisor on site, along with a staff of highly-skilled local labour. The majority of construction materials, including top-grade lumber and steel, are shipped via ocean container from Canada, to ensure that best-in-class building materials are used in every home construction.

"Understanding the landscape, the people, and what is necessary to attract foreign investment that fits well with the local flavour and preserves the uniqueness of the culture is key to a successful offshore development project," explains Tennyson. "I have in-depth and hands-on experience in all aspects of offshore structuring, including residency applications for home ownership or permanent residency. Bahamas offers the best structures in the world, and the requirements to pass the residency tests are still very reasonable compared with other Caribbean nations."

### SO, WHAT'S NEXT?

A second land development phase will see 4 estate-sized, ocean-to-ocean homes in the \$3M range, and negotiations are currently underway to secure over 1,000 feet of Caribbean frontage to construct a unique multiplex, only steps away from a private dock. Beyond that, he's focused on continued innovative home construction and mini-communities, and perhaps some full-service boutique resorts in partnership with local groups.

"This is a labour of love" explains Tennyson. "I work so hard on these development projects because I believe in the end product and the positive impact it will have on the Bahamian economy. Our homes are truly unique designs on prime real estate. The land is limited and once it's gone, it will demand an exponential increase in value. The Bahamian currency is pegged to the US dollar. The Bahamas is in the same time zone, is safe, easily accessible, full-featured, and offers a stable British-based government – it's really a vacation and financial paradise that's only a few hours away."



# ADVISORS POINT OF VIEW

## RISKY BUSINESS:

### CONSIDERATIONS FOR REDUCING THE RISK OF A CONSTRUCTION PROJECT

Building or developing a new property can indeed be a risky business. Managing and overseeing a range of trades, remaining on-side with your bank's lending terms, and staying on time and on budget are just a few of the concerns that might keep you up at night.

But with some careful attention to a few key areas—regardless of whether the project is for a new or substantially renovated home or commercial development—you can minimize your risks and help ensure a successfully completed project. Here are a few of the main considerations to keep in mind:

- The need for extensive upfront planning;
- Ensuring that the project has sufficient equity to enhance the likelihood of favorable construction financing terms from a lender;
- The value of working with a reputable builder and architect to ensure all aspects of the project are properly managed.

#### THE IMPORTANCE OF PLANNING

As an owner, it is important for you to manage expectations at the outset of a project and schedule regular meetings with both your builder and architect throughout the duration of the project to prevent unnecessary mistakes from being made. Planning from the outset is critical, and any work deviations from the original plan should be supported by a properly documented change order, signed off by the owner and the general contractor.

#### SECURING EQUITY AND FAVORABLE TERMS FOR CONSTRUCTION FINANCING

A construction project may require that the lender look to the land as the contribution of the owner's equity when considering construction financing. Construction financing may range up to 75- 80% of the budgeted construction costs. Lenders will advance construction funding based on stages of physical completion of the project. These draw requests are usually at various stages of project completion such as excavation and foundation work, rough framing and enclosure of the building envelope including installed windows and roofing, with further advances being drawn thereafter as construction continues.

Construction loans are generally for a one-year term with 4-6 draws scheduled as the project advances. Each draw request is inspected by an agent of the lender that verifies physical completion of the work. Quantity surveyors typically perform this role on behalf of the lender. Given that construction financing takes place as the stage of completion occurs, it would be wise for any homeowner or borrower to ensure that they have ample savings or bridge financing in the form of a line of credit to fund the time between laying out funds to the trades and the time of receiving ultimate funding from their lender. Not being able to fund trades can ultimately lead to project delays and inefficiencies resulting in potential project cost overruns.

Subcontractors and the various trades have a right to file a builder's lien on the property to protect their interests, and a lender will not advance subsequent draws until the lien has been removed. Lenders also try to protect themselves from being encumbered with a project that cannot be finished because the borrower runs out of funds or, for some reason, unanticipated delays wreak havoc on timing. For this reason, lenders rightfully pay great attention to cost of completing a



job to ensure that the owner/borrower always has sufficient equity in the project. This way, any remaining unfunded component of the construction loan has a better chance of being sufficient to complete the project. No lender wishes to be in the unenviable position of realizing on their security which is only compounded with a partially finished project.

By law, statutory lien holdbacks of 10% are required and released only after 45 days from the date of substantial completion. These retention holdbacks ultimately require the issuance of a certificate of occupancy and, at times, formal notification in a published newspaper allowing time for trades to come forth.

Construction financing usually requires interest-only payments, and you will want to ensure that permanent or take-out funding is lined up, upon project completion, to replace the interim financing. Permanent mortgage financing will have more favorable interest rate pricing when compared to the interim construction loan. Loan to value ratios will determine if sufficient value is available to take out the full construction loan.

### **WORKING WITH REPUTABLE AND INSURED CONTRACTORS**

As an owner, you and your builder also need to pay attention to insurance for the duration of the project. Your construction loan will require that you or your contractor carries General Liability Insurance, covering harm to people or property caused during construction. Builder's Risk Insurance, which covers damage to the unfinished building, is also necessary.

By law, make sure that your General Contractor carries Worker's Compensation Insurance for all employees. These types of coverage mitigate any potential damage that you, as an owner, may face if sued by an injured employee or by a passing neighbour should they be injured. Make sure you have this discussion with the Contractor you end up choosing to ensure that they are adequately insured.

In summary, while the rewards can be great, there are many risks when building or developing a new property. These risks can be mitigated by up-front planning, access to sufficient financial resources to ensure project cost overruns can be dealt with efficiently, and by choosing both a reputable lender and builder with experience and proven track records.



**BY MIKE STOYAN, CPA, CA**

Mike Stoyan is a partner with Fuller Landau's Audit & Assurance practice, and is also the chair of the firm's Real Estate & Construction group. He can be reached at (416) 645-6545 or [mstoyan@fullerllp.com](mailto:mstoyan@fullerllp.com).

# ADVISORS POINT OF VIEW

## CONSTRUCTION TENDER DISPUTES – SUPPORTING THE DAMAGES CALCULATION

In the construction industry, a tender process is a common way to choose a service provider. Typically, the lowest bid that meets the criteria wins, and the project gets underway without issue. However, situations may arise in which a bidder claims that they were unsuccessful due to the alleged actions of the tendering company. If litigation results, an expert forensic accountant may be needed to provide an opinion of the loss of profit resulting from the alleged actions of the tendering company.

It is important to note that a forensic accounting expert does not provide an opinion on liability. Rather, the forensic expert focuses on the quantification of lost profit. Calculations are based upon a number of factors—including a review of documentation, financial analysis, and discussions with relevant parties—with reference to accepted approaches to estimating the financial impact of an alleged wrong.

### THE TYPE OF PROFESSIONAL ENGAGED

In a tender dispute, Counsel determines the type of expert required. Because the expert may be called to testify in court, the damage quantification reports are usually prepared by a CPA, who has credentials including Chartered Business Valuator (CBV), Investigative Forensic Accountant (IFA) and/or Certified in Financial Forensics (CFF) designations. The expert's governing professional organization sets out standards for the preparation of expert reports in litigation matters.

### INFORMATION REQUESTED

Confidentiality of sensitive information is of utmost importance to all parties involved. Company owners and management are concerned about releasing financial information that will not only be provided to their expert, but will also be produced to the opposing party and their expert.

Items requested may include the Request for Proposal, cost and expense estimates (tender sheets, workups, budgets), the bid document, the contract, company financial statements, subcontractor quotes, labour expense information, and financial information related to comparable projects.

### APPROACHES TO QUANTIFYING THE LOSS

Generally, in a tender dispute there is a claim in which the plaintiff alleges that it was, or should have been, awarded the particular project. As a result, the financial expert is engaged to provide an opinion of the financial impact for something that did not happen. As such, the financial expert will utilize a variety of approaches to support the opinion provided. This may result in a range of damages that, in some cases, may be significant.

Although case-specific and a matter of the expert's professional judgment, there are typically four or five methods utilized to varying degrees for quantifying the loss of profit:

1. The plaintiff company's estimate of the profitability of the project. The expert will review and analyze the company's estimates of loss of profit. Estimates prepared during the bidding process will be reviewed and tested. The financial expert will support and test the estimates prepared by management, and may adjust them accordingly.
2. Analysis of comparable projects. Profitability on comparable projects may provide a benchmark for the expected profitability of the subject project. Actual labour costs, subcontractor expenses, and other data including overall profitability of comparable projects often provides good data to assist the expert in estimating the subject project profitability. In addition, if available, the expert may compare the plaintiff company's profitability estimates for similar projects with the actual profitability of those projects.

3. Financial statements. The profitability of the plaintiff company, as set out on its financial statements, may also be a benchmark of the profitability of the subject project. This analysis may serve as a reasonableness check.
4. Industry benchmarks. Although sometimes difficult to obtain, industry benchmarks and comparable company profitability may be a benchmark/reasonability test of the anticipated profitability of the subject project.
5. The actual results of the Project. If a company other than the plaintiff is awarded and completes the project, the actual financial results, if available, may be a good gauge of what the plaintiff's profitability may have been. Generally, this information is difficult to obtain as the "replacement" company will not volunteer this information unless compelled to do so.

The quantification of a loss of profit in a tender dispute is benefited from an examination of the anticipated project profitability, from a number of perspectives. The extent of reliance on each of the various approaches is case-specific and the financial expert will use professional judgment to support his or her findings.



**BY PATRICIA HARRIS,**  
CPA, CA-IFA, CBV, DIFA, CFF

Patricia Harris is a partner with Fuller Landau's Valuations practice. She focuses on business valuations and litigation support services, as well as investigative and forensic accounting. Patricia can be reached at (416) 645-6570 or [pharris@fullerllp.com](mailto:pharris@fullerllp.com).



# FAST FACTS, TRENDS AND RECENT NEWS

Will the threat of negative interest rates by the Bank of Canada offset the effects of falling oil prices on the real estate and construction sector of our economy? Fuller Landau is here to help you weather what may be a stormy time ahead.

## RESIDENTIAL

After the Bank of Canada cut its key overnight lending rate by a quarter of a percentage point in January 2015, interest rates remain low as we move through 2016. Lower interest rates translate into higher housing prices, which are hard to imagine given the increases the residential market has experienced over the past several years. The Toronto Real Estate Board ("TREB") reported very strong year-over-year increases in sales units and average sale prices in August 2016. Detached homes experienced an increase in average sale price between August 2015 and August 2016 of 18.6% in the City of Toronto and 21.7% for all regions reporting to the Toronto Real Estate Board.

## RESIDENTIAL HOME SALES TRENDS<sup>1</sup> YEAR-OVER YEAR SUMMARY FOR THE MONTH OF AUGUST

	AVERAGE PRICE		
	2016	2015	% CHANGE
<b>DETACHED</b>			
City of Toronto	\$1,206,637	\$1,017,652	18.6%
All TREB Regions <sup>2</sup>	\$964,002	\$792,111	21.7%
<b>SEMI-DETACHED</b>			
City of Toronto	\$774,700	\$662,968	16.9%
All TREB Regions <sup>2</sup>	\$637,780	\$541,919	17.7%
<b>ATTACHED/ROW/TOWNHOUSE</b>			
City of Toronto	\$614,638	\$524,136	17.3%
All TREB Regions <sup>2</sup>	\$554,775	\$469,721	18.1%
<b>CONDOS</b>			
City of Toronto	\$446,612	\$406,587	9.8%
All TREB Regions <sup>2</sup>	\$417,869	\$380,228	9.9%
<b>ALL HOME TYPES<sup>3</sup></b>			
City of Toronto	\$677,241	\$605,817	11.8%
All TREB Regions <sup>2</sup>	\$710,410	\$602,607	17.9%

The Toronto Real Estate Boards reports data on the number of sales by housing type and price range. Of noteworthy mention is the sharpest increases in attached/row/townhouse properties selling in the \$800,000 to \$899,999, \$1,250,000 to \$1,499,999 and \$1,750,000 to \$1,999,999 price ranges.

<sup>1</sup> Source: Toronto Real Estate Board Market Watch August 2015 and August 2016.

<sup>2</sup> All TREB regions include Halton, Peel, York, Durham, Dufferin, Simcoe and Toronto.

<sup>3</sup> Includes row homes, co-operatives, co-ownerships, detached condominiums and link properties.

## SALES BY PRICE RANGE AND HOUSE TYPE<sup>1</sup> - ALL TREB REGIONS<sup>2</sup> - AUGUST 31<sup>ST</sup> YEAR-TO-DATE

PRICE RANGE	DETACHED			SEMI-DETACHED			ATTACHED/ROW/TOWN			CONDO		
	2016	2015	% CHANGE	2016	2015	% CHANGE	2016	2015	% CHANGE	2016	2015	% CHANGE
\$0 to \$99,999	2	12	-83.3%	-	-	0.0%	1	11	-90.9%	60	64	-6.3%
\$100,000 to \$199,999	68	162	-58.0%	7	9	-22.2%	127	260	-51.2%	709	1,077	-34.2%
\$200,000 to \$299,999	388	774	-49.9%	77	291	-73.5%	623	1,205	-48.3%	5,072	5,384	-5.8%
\$300,000 to \$399,999	1,365	2,603	-47.6%	381	738	-48.4%	2,021	2,780	-27.3%	6,818	5,441	25.3%
\$400,000 to \$499,999	2,906	4,414	-34.2%	1,062	2,023	-47.5%	3,142	3,208	-2.1%	3,801	2,657	43.1%
\$500,000 to \$599,999	4,420	5,537	-20.2%	2,172	1,828	18.8%	2,584	1,705	51.6%	1,761	1,182	49.0%
\$600,000 to \$699,999	5,461	5,431	0.6%	1,614	1,076	50.0%	1,449	1,047	38.4%	907	530	71.1%
\$700,000 to \$799,999	5,117	4,053	26.3%	925	548	68.8%	915	580	57.8%	465	283	64.3%
\$800,000 to \$899,999	4,204	3,179	32.2%	508	307	65.5%	552	199	177.4%	226	138	63.8%
\$900,000 to \$999,999	2,805	2,122	32.2%	295	144	104.9%	226	111	103.6%	129	72	79.2%
\$1,000,000 to \$1,249,999	4,193	2,802	49.6%	270	133	103.0%	179	103	73.8%	174	118	47.5%
\$1,250,000 to \$1,499,999	3,016	1,680	79.5%	126	80	57.5%	99	31	219.4%	90	58	55.2%
\$1,500,000 to \$1,749,999	1,718	823	108.7%	58	29	100.0%	30	14	114.3%	51	35	45.7%
\$1,750,000 to \$1,999,999	898	546	64.5%	21	19	10.5%	17	5	240.0%	24	22	9.1%
\$2,000,000+	1,946	1,070	81.9%	43	23	87.0%	9	10	-10.0%	62	55	12.7%

<sup>1</sup> Source: Toronto Real Estate Board Market Watch August 2016 and August 2015.

<sup>2</sup> All TREB regions include Halton, Peel, York, Durham, Dufferin, Simcoe and Toronto.

ECONOMIC INDICATORS		
	2016	2015
<b>Q3 Real GDP Growth</b>	-1.6%	-0.5%
<b>Toronto Employment Growth</b>		
As at July 31	1.2%	4.2%
<b>Toronto Unemployment Rate</b>		
As at July 31	6.4%	6.6%
<b>Inflation (Yr/Yr CPI Growth)</b>		
As at July 31	1.3%	1.3%
<b>Bank of Canada Overnight Rate</b>		
As at August 31	0.5%	0.5%
<b>Prime Rate</b>		
As at August 31	2.7%	2.7%
<b>Chartered Bank Fixed Mortgage Rates</b>		
1 Year	3.14%	2.89%
3 Year	3.39%	3.39%
5 Year	4.74%	4.64%

Source: Toronto Real Estate Board Market Watch August 2016 and August 2015.



## BUILDING PERMITS

According to Statistics Canada, the overall dollar value of building permits for the City of Toronto decreased by approximately 10.53% during the period January to July 2016 compared to the same 7-month period in 2015. The most significant decrease came from the dollar value of residential building permits issued. During the period January to July 2015, approximately \$6.48 billion dollars of residential building permits were issued in the City of Toronto, compared to approximately \$6.07 billion during the period January to July 2016. This is a decrease of approximately 6.35%.

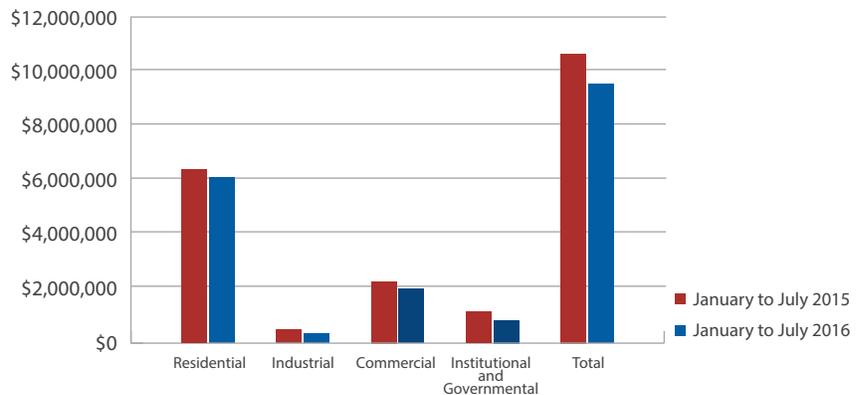
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<sup>1</sup> Source: Statistics Canada "Building Permits" July 2016 and July 2015 (Catalogue no. 64-001-X).

## BUILDING PERMITS - JULY VALUE OF CONSTRUCTION (THOUSANDS OF DOLLARS)

	RESIDENTIAL	INDUSTRIAL	COMMERCIAL	INSTITUTIONAL AND GOVERNMENTAL	TOTAL
January to July 2015	\$6,482,041	\$593,993	\$2,093,572	\$1,327,674	\$10,497,280
January to July 2016	\$6,070,690	\$469,299	\$1,889,233	\$962,299	\$9,391,521
% Change	-6.35% (411,351)	-20.99% (124,694)	-9.76% (204,339)	-27.52% (365,375)	-10.53% (1,105,759)

### VALUE OF BUILDING PERMITS<sup>1</sup> TORONTO, ONTARIO (\$000)





#### **QUESTIONS? COMMENTS?**

Please contact our Director of Growth:

#### **AIMEE MORITA**

416-645-6572

[amorita@fullerllp.com](mailto:amorita@fullerllp.com)

#### **FULLER LANDAU LLP**

[www.fullerllp.com](http://www.fullerllp.com)

151 Bloor Street West  
12th Floor  
Toronto, Ontario  
Canada M5S 1S4  
416-645-6500

45 Goderich Road  
Unit 7C  
Hamilton, Ontario  
Canada L8E 4W8  
905-561-2992

## **ABOUT FULLER LANDAU**

Fuller Landau is a leading mid-sized accounting, tax and advisory firm with offices in Toronto and Hamilton. We are committed to helping you, the entrepreneur, build value and grow your business, we know first-hand what it takes to meet those challenges and succeed in any business environment.

### **OUR REAL ESTATE AND CONSTRUCTION PRACTICE GROUP**

We know that companies within the construction and real estate sector are subject to many challenges ranging from rising material costs to cyclical demand. We have hands-on experience helping construction and real estate-related companies like yours make sense of the business landscape.



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