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Costs in the Subsidized Rental Market

This is the first article in a series

A study of rental developments in Metro Toronto that are now coming on the market under the Assisted Rental Program — which became very popular with Toronto-area developers before its termination last year — shows the following:

• Average rent for a standard 2-bedroom apartment, the major size being built under the program, is being set at around $370 in the Metro Toronto boroughs.

• Virtually all of the projects qualified for the maximum first-year assistance of $100 per month per unit loan from the federal level, and most are at or near the maximum of $50 per month provincial grant.

• It appears that "costs" for the projects as agreed between CMHC and the builders, for a 2-bedroom unit in Metro, average as follows: Land $8000 per unit; hard construction costs $27,000 per unit; and soft costs apparently $4000, for a total unit cost of $39,000, and an average mortgage amount of $35,000.

The land cost is the amount for which the land is sold, either in an arms-length or non-arms-length transaction, at about the time the ARP agreement is entered into; and the $35,000 mortgage amount is the average value of the 90% building mortgages registered on title. The Ontario Housing Ministry provided me with information on the number of units and sizes. Hard construction costs reflect a current figure of $24-25 per square foot of building area, including parking in the cost, but not in the building area.

Individual projects can vary by $2000 above or below the $39,000 total. Location and municipal parking requirements are among the key variables.

Assuming, as analysts seem to do, that operating costs are about 45% of market rents, the first-year pro-forma statement for the average 2-bedroom unit in Metro would look something like this:

Market rent	$370
1st year subsidy	147
	517
Financing (10½%)	318
Operating cost	167
10% return	32
	517

Finding the truth about residential costs is like peeling an onion to find its core. No one but the builders know what the actual costs are, as CMHC officials are the first to admit. Building costs are agreed upon in negotiations between CMHC and the builder on a project-by-project basis. CMHC bases its negotiating position on a set of what it calls "basic rates" for various types of units. Each CMHC branch has its own basic rates, which are correlated at the regional and national levels.

Also agreed upon, or negotiated, is the first-year rent level and operating costs. And space is left in the operating equation for a return of 5-10% on "equity", which is nothing more than the arithmetic 10% of the total negotiated capital cost.

In other words, the whole package is based on negotiation and agreement on the three key dollar amounts of allowable land cost, allowable building cost, and allowable operating cost. Naturally, participants in this exercise are not particularly anxious to disclose the true basis of their position. CMHC, for example, fears that the publication of their guideline figures would cause them to become minimums. And so it is that apparently simple questions like the cost to operate an apartment unit of a certain size becomes an extremely sensitive issue.

In fact, there isn't any generally-understood or generally-accepted information on the recent behaviour of any of these costs in Ontario.

• Rents. The 1978 Ontario Housing Ministry Survey said rent levels rose by 10% in Metro in the 12-month period. The Ministry has also calculated that a new 2-bedroom unit in 1977 would have had an average market rent of $307 in Metro. The $370 being asked for the new ARPs of that size currently would indicate that the market is continuing to rise at the 10% rate. The Rent Index component of the Consumer Price Index understates rent increases by one-half and more, for reasons discussed in the last issue of Bimonthly Reports.

• Land costs. Per-unit land costs for rental construction are said to have doubled to $5000-$6000 by 1975 in Metro; and they are continuing to rise in spite of the allegedly deteriorating rental economics.

• Operating costs. CMHC has full information on operating costs, which is used in monitoring projects built under Limited Dividend and ARP agreements, but they do not release this information.

• Building costs. This is the single most important cost factor, but various techniques used to measure cost increases in this area differ by a factor of 100%, just as the CPI and rental survey conclusions about rent increases differ.

How are these construction costs measured?

In commercial construction, sound cost estimates and sound historical data are obtainable from general contract awards in which a property-owner engages a general contractor to construct a project. But the normal practice in residential construction is that the property owner is his own general contractor, and he deals directly with the subtrades. So normally there is no general contract, and that measure of costs is generally not available in the private-sector residential industry. Only the owner-builder knows what his costs are.

In Canada, outside the circle of owner-builders, cost information in the residential sector arises in two ways. First, the CMHC branch offices measure price increases in a sample of the cost components both of labor and material. These are the figures that are used to up-date the CMHC "basic rates," and they are also the figures that flow through the CMHC national office and the Statistics Canada office, to appear in various publications as the Building Materials Price Index, Residential, and the Construction Wage Rate Index, as well as a Composite Index combining the two.

The second source of cost information is quantity surveyors. Acting often for builders, they obtain detailed price estimates for a particular project, and often monitor costs as the project proceeds.

In statistical jargon, the CMHC figures measure "input prices," and those of the quantity surveyors are "output prices." The difference can be illustrated this way. If union wage rates — the basis of the labor input figures — rise by 20%, then a 20% increase, weighted

Continued on page 2

Rental Costs

Continued from page 1

according to the weight of that labor component, will be reflected in the input index. On the other hand, if the wage rates rise by 20%, and productivity is improved to the extent that 20% less time is required to complete the same job, the output cost will show no increase. Or, and this is particularly significant in the residential industry, if the work is done on a piece-work basis rather than an hourly-rated basis, then the hourly wage-rates reflected in the input index will be completely irrelevant.

When the input indexes were first published in 1970, StatCan issued this proviso: "Important defects of the fixed-weighted composite indexes as indicators of price changes for the output of the industry or completed buildings in place are that the impact of changing profit margins and productivity are not reflected in the index movement. For this reason, the composite indexes of labor and materials are thought to have an upward bias as indicators of price change for building construction, and it is therefore suggested that users exercise caution in making use of the series for this purpose."

At the same time, StatCan made an attempt to remedy the upward bias. Lacking general contract prices to construct a real output index, and not wishing to go the quantity surveyor route, a system was adopted to measure the productivity of the labor component — by comparing man-hours with materials used — which together with other refinements, was published as the "Implicit Index of Residential Construction." The Implicit Index, a kind of surrogate output index, was done back to 1957, and it showed a very substantial cut in the rate of cost increases that was indicated in the input index. Side by side, the national figures were these:

	Composite Index	Implicit Index
1961	100	100
1966	124.2	119.6
1971	176.6	145.3

Most residential labor in that period was not unionized at all, so the technique of deflating the union wage-rate increases still wasn't a very good way of measuring cost increases.

Information published by a Toronto quantity surveyor indicates the rate of cost increases was even less than the Implicit Index indicated. Quantity surveyors Helyar and Associates publish rule-of-thumb construction figures in various sectors, in conjunction with the Tornto Real Estate Board, and while the figures are meant merely as guides, they are based on the substantial amount of work done by the firm, and they have been published since 1966. Taking increase rates over long periods of time, figures representing Toronto, as the Helyar figures do, and the national figures should be comparable.

But taking the Helyar figures for Toronto apartment buildings over ten storeys converted into an index, side by side with the two sets of StatCan figures, all based on 1966 and 1971, shows a remarkable degree of variation:

	Composite	"Implicit"	Helyar
1966	100	100	100
1971	142.2 (100)	122.1	113.7 (100)
1978	274.3 (192.9)	—	174.5 (153.5)

The composite index rose more than twice as fast as the Helyar figures in the whole period 1966-78, and almost twice as fast in the 1971-78 period.

(The reason for the dash under the Implicit Index after 1971 is that the index didn't continue to be calculated on the same basis. Instead, sometime in the early 1970s, the basis for that index was shifted to figures derived from municipal building permit application cost figures — probably the most unreliable set of figures in existence. And as the municipalities began to alter their fee systems from a cost basis — because costs were being understated to save on fees — to a per square foot basis, cost figures reported on the permit applications tended to rise abnormally. Naturally, so did the index. From 1971 to 1978 the implicit index, on this new Alice-in-Wonderland basis, actually rose substantially faster than the input index. In this way, these published StatCan/CMHC figures were totally cut off from any attempt to measure output prices — or the real cost of putting a building in place.)

The radically different behavior of the input index from the quantity surveyor's figures is explainable, and the major source of the difference can be identified. It is the labor component.

The labor index is based on the hourly rates contained in construction industry collective agreements. But any attempt to argue that the union hourly rates are a reliable factor in residential costs would face formidable difficulties.

- The non-unionized component. The Ontario Building and Construction Trades Council said in a 1976 brief: "Estimates of the size of the non-union labor force are hazardous because of the size of the residential construction labor force, but is suspected that some 75% of the employees in this sector are unorganized. We have some organized contractors operating in certain cities. Given the competitive aspects of the sector, the degree of union organization has important labor relations ramifications as competitive advantage in the sector may be gained at the expense of wages and working conditions . . ."
- Piece-work. Even when employees are union members, conditions in the industry have been known to make the union hourly wage rate irrelevant. A 1974 Commission of Inquiry report said: "We find, however, that (piecework) has been accepted by some locals faced with serious competition. The contractors prefer piecework: they consider that it is necessary where supervision is difficult, and it also allows for cost control. . . . A practice known as bid-pedalling grew up, particularly among developers. It involves taking the lower bidders on a project and playing them off, one against the other. The subcontractor who finally secures the job at a price lower than he had originally bid then does what he can to carry out the contract at a profit by paying low wages and neglecting working conditions."
- Parallel agreements. On the assumption that the work is unionized and paid at the hourly rate, in many cases there is the further question which union has the work. Particularly in the areas of concrete forming and interior gypsum wall-board, Ontario developers have made tremendous productivity gains by eliminating the traditional craft unions from such work, and working with more recently-formed union organizations. Parallel agreements are still a feature of the industry.

The Waisberg Commission of Inquiry on certain sectors of the Ontario building industry wound up in December 1974, and in that month another commission was set up, under the Labor Ministry's construction expert Don Franks, to make recommendations on bargaining structures "in the construction industry." Franks made recommendations, which were implemented, but which excluded the residential sector entirely. Franks didn't say in his report that the residential sector is either intractable, unorganized or disorganized — he simply said: "From the outset it should be clear that the Inquiry Commission is dealing with the organized sector of the construction industry."

The various cost indexes explain themselves to some degree in the light on the labor relations questions. The Helyar figures, in their long-term behavior, are closely related to the materials index. Lower than the materials index, the Helyar figures vary in an almost fixed relationship to it. In each period referred to in the following chart, the Helyar figures increase at a rate that is 68-69% of the rate by which the materials index rises. And the Helyar figures don't reflect the behavior of the labor index at all. In other words, the quantity surveyor's results support the thought that the labor index — hourly wage-rates — are largely irrelevant in a close analysis of actual costs of putting up a building.

The following are the average year-to-year percentage increases in the Helyar figures for Toronto apartment buildings, the CMHC national materials index, the CMHC national labor index, and the CMHC composite index.

	Helyar	Materials	Labor	Composite
1966-71	2.6	3.8	10.3	7.3
1971-78	6.3	9.1	10.9	9.8

Activity on a Downtown Bay St Block: Franciotti, Assaf, et al

The deteriorated and over-mortgaged office building at 330 Bay Street was sold in a judicial sale for $3,021,500, which is about what its sale price was in 1972. Purchaser was Imbrook Properties Ltd. Meanwhile a neighbouring building at 350 Bay Street — that had been bought along with 330 Bay in a package with 25 Adelaide West in 1975 — is the subject of a disputed Power of Sale proceeding in Supreme Court of Ontario.

Also the property sandwiched between 330 and 350 Bay, the old Savarin, is the object of a renewed effort by two members of the Assaf family to set aside its 1977 sale to a numbered Ontario company. Guarantor on a recent mortgage extension agreement by the numbered company is Toronto real estate dealer John Franciotti. One of Franciotti's companies had offered $1.9 million for the Savarin in 1975; and the Assafs say it isn't right that the Savarin was sold to this numbered company, which they say is also Franciotti's, in 1977 for $1.5 million, or $400,000 less than the 1975 offer. Vendors were the executors of the estate of the elder William Edward Assaf, who died in 1971.

The 1975 deal didn't close, apparently because Franciotti couldn't satisfy the Liquor Licence Board of Ontario about the source of his financing, something the Board likes to know about before they issue a liquor licence.

The two other properties, 330 and 350 Bay, together with the Savarin, make up the entire Bay Street west side frontage between Adelaide and Temperance Streets. The 1975 purchase of those properties was also by a group including Franciotti. It included J.V. Franciotti Realty Ltd, Consolidated Victoria Investments Ltd, and Inter Swiss Holdings Ltd, thought to be owned or controlled by Franciotti, Frank Anthony, and Bruno Arnold respectively. Another company, 350 Bay Street Holdings Ltd, took title to 350 Bay St. Then apparently controlled by the Franciotti/Anthony group, it is now represented by Toronto lawyer Joseph Sorbara, who says he is acting for three European investors. The third property the group bought was 25 Adelaide West.

All four companies issued a blanket second mortgage to the vendor, a numbered company associated with Toronto investor Norton Penturn. Penturn's company assigned the mortgage to a Miami attorney, George Sampas, for whom Penturn acts as agent.

For Sorbara and his investors in 350 Bay Street, the problem is this: Of the three properties standing as security for this mortgage, 25 Adelaide was sold in 1977 — and a portion of the mortgage discharged — then last spring the second property, 330 Bay, was foreclosed by the first mortgagee and sold. The judicial sale generated a little over $100,000 toward the $670,000 still owing to Miami attorney Sampas. So for the rest, Sampas looked to 350 Bay and issued his Power of Sale notice. He has been enjoined by Justice Carruthers from exercising it until September 4. The judge said: "I have reason to doubt the sufficiency in law of the notice of exercise of power of sale, and in any event I believe there are triable issues outstanding between the parties..."

The judicial sale of 330 Bay also wiped out all of a third mortgage to one Gerhard Kubetschek of the town of Wolfenbuttel, with over $2 million owing. Kubetschek died in 1976.

As for 25 Adelaide, it was sold in December 1977 by the Franciotti group to a representative of W.H. Bosley and Co., realtors, thought to be acting for the Bank of Nova Scotia in assembling the King/Bay/Adelaide block for Toronto's fifth bank palace.

Apart from providing for speculation whether the Franciotti group are or were doing a land-assembly between Adelaide and Temperance, or, as seems more likely, just dealing in the properties, the court cases can provide interesting market information. Although the 330-350 Bay St frontage is long — about 208 feet — the lot is extremely shallow, being cut off by the Bell Telephone exchange to the west, so it isn't a very attractive redevelopment site. Two appraisals filed in court on the 330 Bay St sale say the "highest and best use" of the property is to retain the building with some improvements. They point out that the existing building has floor-area about 13 times the lot area, while the new zoning will apparently allow only 8 times coverage. They evaluated the building on an income basis, and arrived at estimates of $2.5 million and $2.8 million.

A.E. LePage, which has been managing the building on an interim basis, netted only $60,500 in the last 12-month period, not counting any debt service. Gross receipts were $407,000 and operating costs and taxes were $347,000. However, the appraisers estimate that with some improvements and a diminished vacancy rate the building should produce net operating revenue before debt service of between $270,000 and $350,000 annually, charging rents between $8.00 and $8.70 per square foot, a slight increase from the current level of around $7.00.

They point out that the building's location is excellent, but its reputation has become extremely poor.

The best way of measuring the market in such properties is the sale price expressed in terms of the gross floor-area of the building. One of the appraisals, by A.D. MacKenzie of MacKenzie Ray Heron and Edwardh Ltd, set out a list of sale prices for similar buildings, 20 to 50 years old, in the area. The most recent ones he cites are these:

1.	1972 330 Bay	$2,968,888	$27.45/sf
2.	1973 365 Bay	4,120,000	40.60
3.	1975 365 Bay	3,287,500	32.40
4.	1975 350 Bay	1,851,716	30.00
5.	1976 220 Bay	2,000,000	31.80
6.	1978 357 Bay	4,000,000	50.75

The recent sale of 330 Bay, for $3,021,500 or $27.93 per square foot of gross floor-area. On the list, it is the lowest price since 1972, and it represents almost exactly the price paid by Penturn's numbered company for the same building in that year.

Numbers 2 and 6 on the list are abnormally high. The two transactions involving 365 Bay are a 1973 sale to public company International Mogul Mines Ltd by Romagnola Investments, and the 1975 sale by the public company, for $800,000 less, to something called QTS Developments Ltd.

Of the 357 Bay transaction, MacKenzie says this: "This is a 50 year old modernized 11-storey building on the northeast corner of Temperance St. It was always the prestigious headquarters of General Accident and Insurance Co., which over the years leased more and more space to Metropolitan Trust Co. The ground floor was completely redone a few years ago into modern trust company offices. Both companies have spent much money on this building and early this year the trust company bought with General Accident remaining as a tenant on two floors. Relatively, the price was very high as in most owner-occupant purchases and there are a great many unknowns in this purchase."

The other appraisal, by A.E. LePage, says the current vacancy rate in the area is about 13%; however, "During the next two years, absorption of the current substantial office space surplus is anticipated and rental rates should be forced sharply upwards in what will then be a strong lessor's market."

The Savarin situation is an extremely bitter one. On the death in 1971 of William Assaf Senior, administration of his estate and of The Savarin Ltd was in the hands of his executors, chartered accountant Robert Pogue and lawyer Henry Koury. Then William Assaf Junior found another will which he was later convicted of uttering as a forged document. He and his mother Vivian Assaf have repeatedly and unsuccessfully challenged the executors in court. The latest move is an application for leave to Assaf Jr's sister, Barbara Evans, to sue on behalf of The Savarin Ltd to set aside the 1977 sale to the numbered company. Besides their point about the consideration being less than was offered in 1975, the application alleges there was no shareholders' meeting held to approve the sale, and another breach of the Ontario Business Corporations Act.

The property is vacant, and the ubiquitous A.E. LePage firm, on

Continued on page 7

Sloppy Lending Down East
The Nova Scotia Savings Case

Publicly-held Nova Scotia Savings and Loan Company was defrauded of around $2 million by its own agent in New Brunswick when it advanced mortgage monies for up to 200% of the acquisition price of income properties in the 1973-5 period; and a similar allegation against its Nova Scotia agent is scheduled for trial this fall. A similar alleged scheme is under investigation in Prince Edward Island.

In the New Brunswick case, the company says no one above the level of mortgage manager Hugh Jones knew what was going on. The scheme involved their Fredericton agent, former meat-dealer and restaurant owner Lary Eusler, who is now serving a four-year prison term following his guilty pleas earlier this year to charges of obtaining credit by false pretenses and conspiracy. Eusler's lawyer said his client, an immigrant to Canada from Romania by way of Italy, with only a grade four education and difficulty reading and writing English, couldn't possibly have masterminded the scheme. A Fredericton jury recently acquitted five other men alleged to have been part of the Eusler scheme, and in doing so they clearly disbelieved the prosecution theory that Nova Scotia Savings' complicity stopped at the level of its mortgage manager.

The jury was told that investigating officers had found none of the corporate books of record of Eusler's companies; and Eusler's corporate lawyer, who in the past had a special relationship with the mortgage company, wasn't called to give evidence.

New Brunswick Director of Public Prosecutions Hazen Strange is expected to decide soon whether to re-try the conspiracy charge against the five men which resulted in a hung jury; whether or how to proceed with other charges arising out of Eusler's agency; whether or how to proceed against any of eleven New Brunswick lawyers found by the provincial Barristers Society to have been implicated in the scheme (not including Eusler's corporate lawyer, Richard Cochrane); and whether or how to proceed with charges involving another scheme, also in New Brunswick, allegedly perpetrated against Canada Permanent Mortgage Corp. One alternative being considered is to discontinue further prosecutions on the grounds that professional sanctions are sufficient penalty for any lawyers who may have committed criminal acts, and that the mastermind of the largest scheme, Eusler, is in jail.

In a typical case involving Eusler, an old building rented to commercial tenants — once a school-house — was acquired by a Eusler entity for $175,000, and a mortgage application was submitted to the mortgage company via mortgage manager Jones setting out a false purchase price of $356,000. Mortgage funds of $252,000 were advanced by Nova Scotia Savings, and they were used as follows: Payment for the $175,000 purchase in cash; payment of a $25,000 "finder's fee" to a Fredericton lawyer-developer; payment of the $2000 fee to another lawyer; and payment of the surplus of some $50,000 to Eusler. The mortgage application said gross rents were $4610 and expenses $816, but rents were really $3220 and expenses $2100.

Nova Scotia Savings general manager Robert T. "Mike" Hammer says the company didn't realize what was happening. However, after the scheme was investigated by police, the company did ask for the resignation of Hugh Jones, a close friend of Eusler. Jones, for his part, says money advanced for his benefit by Eusler for two cars, a trip to Las Vegas and one to Jamaica, weekends in Montreal, and a $13,000 loan to acquire a house, were all to be paid back, and none of it constituted a gift. Jones is now mortgage manager for Canadian Mortgage Corporation in Fredericton.

In the $175,000/$356,000 property, Jones personally checked the building before the loan was approved, but he says he didn't check the rents, and didn't find anything amiss in the phony application.

The building burned down in October 1975, and the insurance company, finding that the property was over-insured, checked with the original vendor and concluded that it was over-mortgaged as well. An RCMP commercial crime section investigation followed, and then a preliminary hearing that lasted from September 1976 until March 1978 before Provincial Court Judge James Harper, who committed Eusler and the five other men to trial, concluding that the scheme resulted in "a total amount of 'overloans,' for want of a better word, in excess of $2 million."

In addition to such acquisitions and borrowings for his own account — and for the benefit of any of his co-shareholders disclosed in the never-produced corporate records — Eusler, as agent for Nova Scotia Savings, provided the same opportunity for excess loans to clients. For this he charged an unauthorized fee ranging between $5000 and $25,000 per loan, something Nova Scotia Savings general manager Hammer also said he knew nothing about.

According to witnesses, the service apparently included the Eusler circle preparing the false documentation that accompanied the mortgage-loan application. Moncton real estate and second-hand furniture dealer Michael Atkinson put it this way: "I felt that if I was to bring in a purchase and sale agreement all signed up with my name on it, for whatever the, you know, exaggerated figure would be, but that would be fraudulent... And I felt that as long as he (Eusler associate Charles Harvey, who has since skipped the country) was doing it, it was all right. Maybe it's not the way to look at things, but that's the way I looked at it."

Atkinson said he "assumed that Nova Scotia Savings and Loan was well aware of what was going on," and that there was "inside assistance at Nova Scotia Savings..... from rumour, talk among the boys... you know, real estate agents."

The procedure didn't surprise him, Atkinson said, but he was astonished at what happened next. Mechanics liens and more mortgages accumulated on some of the properties; Atkinson sold the property but the sale went afoul somehow; arrears accumulated; "so Hugh Jones was putting the pressure on me to take them back over and I couldn't very well do that because the price of them had skyrocketed with all these added things on them, so they finally went to foreclosure, and he gave me the word that when the auction was over that he would sell them back to me with another 100% mortgage." The procedure wiped out the claims of the subsequent mortgagees and the mechanics lien claimants, but the 100% mortgage covered all the arrears, taxes and legal costs in addition to the original amount, and it was an amount the rents from the property were unable to cover.

"I couldn't understand," Atkinson testified, "how in the world they were doing it and I didn't want to know (what information was being put on the new mortgage application form). You know, how do you foreclose on a man and then sell him back the property for, you know, the Mounties are coming in one door telling me you're buying properties and paying too much money, and he's coming along the next month and selling them back to you for 8 or 10 thousand higher, giving you a 100% mortgage....."

All Nova Scotia Savings mortgage loans were approved by the full board of directors, those under $40,000 in groups, and those over $40,000 individually. How could experienced lenders fail to question loan approvals that were at a level up to 200% of their market value? Part of the answer is that some New Brunswick properties, like those elsewhere in Canada, were in fact appreciating rapidly in the 1973-75 period. But these properties were bought cheaply and they were primarily old, dead-beat properties that hadn't, and wouldn't appreciate at that rate. To have found this out would have required a reasonably careful appraisal, something the mortgage company, on the crown's theory, didn't obtain. For example, the property discussed by Atkinson had its roof blown off in a windstorm after he acquired it the second time, and the mortgage company had to foreclose again.

In committing Eusler and the five others to trial, Judge Harper summarized the evidence as follows: "The methods utilized in the preparation of false documents were varied and ingenious. In some instances actual persons were persuaded to sign their names in

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Nova Scotia Savings

blank to mortgage applications, following which the same would be completed using false information. In other instances, the signatories to all documents forwarded to Nova Scotia Savings, both in the falsified agreement of purchase and sale and in the falsified application for mortgage loan, were outright forgeries. In other instances, the evidence indicates that forged documents were actually 'constructed' by using a photostat of the real and actual signatures of the actual parties to the sale as contained on the bottom part of a valid agreement of purchase and sale, and using a forged top half of these printed documents, showing a falsified down payment and false sale price, in order to make a final photostatic product that would show a reproduction of actual signatures combined with a falsified upper portion . . .

"As the body of evidence as to forgery and electrostatic manipulation of true signatures grew during the hearing, it became very evident to the court that many persons, other than those charged, were involved either directly or indirectly in this scheme and very materially profited by it. Some of these persons, either knew or ought to have known what was going on. The persons to whom I refer are, in the main, the court was shocked to discover, practicing lawyers in the Province of New Brunswick at this very time. I do not for a moment suggest that every lawyer who in any manner was associated with these transactions was acting illegally, but there is a great body of evidence in respect to some that their involvement was so extensive, so deep, that there is little doubt that their activities and participation constituted conduct at least unbecoming a barrister, if not outright fraud."

Eighteen law offices were searched in the Eusler investigation, and none of the lawyers moved in court to assert the solicitor and client privilege and quash the warrant. A typical cross-examination of a lawyer in the preliminary inquiry went like this:

—Now, on the twelfth transaction that you had with Mr Eusler and his associates, there was a surplus on $33,000 (mortgage advance) of $15,000 (over the purchase price). That's almost 100% of the purchase price is going to surplus funds. Did that not raise a question in your mind, sir?

—I don't believe it did, no.

— . . .The thirty-second property that you dealt with . . . and there the surplus was $59,250. Now, did you not question that one?

— Nope.

— Well, is the reason that you did not question this because you were well aware of what was going on?

— Nope. . . . I didn't know that much about property transactions; when I started doing them I thought everything was all right and it continued. So I never questioned them until the police came over to my office.

Judge Harper explored the question with another lawyer this way, dealing with the old schoolhouse property:

— You must have been rather intrigued by all this weren't you Mr Stevenson? . . . You're handling a transaction for the parties who are buying and selling and the price is $174,000 and the mortgage is $251,000. That's not unusual to you?

— Very unusual, Your Honour. (But) I had occasion to be in Mr Eusler's office . . . I noticed a card on his desk which described Mr Eusler as an agent for Nova Scotia Savings and Loan, so when this thing came up and I looked at it, I said, my God, this is amazing, but he's an agent and he's got some drag there that I wouldn't otherwise have and that's the reason for the larger amount. . . . But if the ordinary Joe on the street came in tomorrow and he got a $35,000 mortgage on a $30,000 house that he was purchasing, I would have questioned it immediately.

— I see.

Among the lawyers disbursing the Nova Scotia Savings mortgage funds, there was confusion whether they were acting for the lender or the borrower. Many didn't realize it was both, and consequently didn't see the difficulty in protecting the interests of both in these strange transactions.

In some cases the lawyer acted for the vendor as well, and in one case Judge Harper wanted to know if the vendor was told that the mortgage company was making more money available in first mortgage funds than the vendor was receiving for the property. Naturally, the answer was no.

Judge Harper prodded prosecutor Eugene Westhaver to call Eusler's corporate lawyer Richard Cochrane as a witness, but he was unsuccessful, and Cochrane didn't appear at the trial either. Harper did, however, get the opportunity to question Cochrane's law partner John Patterson. The judge told him another Nova Scotia Savings agent, Hazen Allen, had testified he was at one time the sole New Brunswick agent for Nova Scotia Savings. "And he obtained this . . . through the intervention of your firm, which he said was the sole law firm used by Nova Scotia Savings in Fredericton at that time. . . . I remember when I was in practice I couldn't get the Nova Scotia Savings business because your firm had it all." Patterson didn't know anything about it, and general manager Hammer, also questioned by the judge, said the same thing.

In addition to the firm's relationship to Nova Scotia Savings, the judge said he was bothered by evidence that Cochrane had his lease on a car paid for by Eusler. He told prosecutor Westhaver: "You don't want Mr Cochrane here as a witness. You're not curious about that car? . . . Nobody ever gave me a car, Mr Westhaver . . . I don't see any reason why Cochrane should have any reason not to expalin it. There may be a very simple explanation . . . This is a preliminary inquiry against the people involved, but in order that justice should be seen and seem to be done, let's find out who all had their finger in the pie."

Eusler's bookkeeper Charles Wilcox testified at trial that "the unscrambled puzzle" of the Eusler companies involved in the fraud was "on Prospect Street" where Cochrane had his office.

One element of the puzzle put in evidence was a document signed by Cochrane showing Jones, the mortgage manager, and Eusler, the agent, as co-officers of a company that owned several of the mortgaged properties. Jones denied any involvement, and the matter was left unresolved.

Cochrane was an officer, along with Eusler, of the company owning the Riverview Arms Tavern, where Eusler had his office.

For its part, Nova Scotia Savings and Loan Co. was aggressive and expanding, according to evidence. In addition to taking deposits and selling debentures, the company was buying large blocks of money in the Montreal and Toronto money-market and paying a fraction of a percent more than competitors, and charging from a half to one percent more than competitors for mortgage loans. Agents were informed on a daily basis on the availability and the interest rate, mortgage manager Jones said. "We would say we have a block of money in and we can look after some of your loans, but we had to pay a little bit high for it, the interest rate will have to be such and such. Do you have any of your applications that are waiting that you would like to be fitted in and looked after."

The rates didn't seem to bother the borrowers, as Michael Atkinson explained: "I guess my feeling was that they were charging rates much higher than anyone else and they seemed to have an abundance of money; and (Eusler associate) Charlie Harvey's philosophy was that if you went and dug into your savings or had to borrow the money to make a down payment and then you're strapped with that payment plus a first mortgage payment, and then you still had a building that needed numerous repairs and they couldn't afford to make them . . . the extra money was there to use."

The Nova Scotia case is scheduled for trial the week of September 17. The mortgage company's agent, John Marcus, faces five counts of fraud and an associate faces four counts.□

Meridian

One of Toronto's largest residential landlords, the Meridian group controlled by Morton Merkur and Philip Roth, is the subject of nine court applications by their former associate Leonard Blatt, for partition and sale of residential properties in which Blatt has an interest. Blatt says since 1969 Meridian Property Management Ltd has been making excessive charges for management and maintenance of the buildings. He says in 1970, he found Maintenance and wage charges were being paid to a company called Azteck Technical Services Ltd. "Maintenance and wage costs soared," Blatt says in his court affidavit. "I subsequently learned that Azteck Technical Services Ltd was a sub-contractor hired and controlled by the Merkur and Roth families, and that these additional excessive management charges were being made for their own services." At that time, Blatt says, discussions began for valuation of the properties, "in order to partition the ownership and come to some equitable arrangement."

An earlier Blatt/Roth/Merkur agreement had named lawyers James McCallum and Elmore Houser as arbitrators, but Blatt says discussions held in 1970 were fruitless.

Later, in 1977, says Blatt, Meridian Property Management Ltd was replaced by 308182 Ontario Ltd, and Blatt adds, "I was subsequently informed in the summer of 1977 that the percentage by which the submanagement company Azteck Technical Services Ltd multiplied its costs when charging for services rendered, had been increased."

In addition to the partition and sale of the properties, Blatt asks for "a full accounting as to the management of the property, from January 1 1969 to date."

Last June the case in Supreme Court of Ontario was adjourned indefinitely, "in view of settlement proposal being carried on." □

Mayzel

Another major apartment group, owners and operators of an estimated 17,500 rental units in Ontario, is a consortium whose principals are developers Sam Bojman, Irving Naiberg, and Michael Finkelstein. Through their companies, they allege that the partner in one of their apartment complexes, Louis Mayzel, owes that particular partnership money as a result of overdrawing funds while managing the buildings. This dispute too has been going on for several years, and as Naiberg swears in a court affidavit, the group is ageing. "The applicants herein," he says, "wish to have the partnership wound up and an accounting taken by (the court). I feel that I have endured enough, and we are all aging in that I am 72 years of age, Mr. Bojman, a principal of Damis Holdings, is 57 years of age, Mr. Finkelstein, a principal of Sabel Holdings, is 68 years of age, and because we are not getting any younger, we wish to no longer have to deal with the reoccurring constant problems with respect to the partnership."

The dispute is over Briarcrest Manor in Etobicoke, a 350-unit pair of apartment buildings that was recently the subject of unflattering television publicity.

The applicants filed in court a copy of a 1962 agreement in which Mayzel's company, which held the land, was to be a 50% partner with the Bojman group, which was to do the building. Naiberg says the partnership's auditor finds some $115,000 in excess drawings by Mayzel.

Last January, Jerry Friedman of Laventhol and Horwath Ltd was appointed interim receiver of Briarcrest Manor by the court. The final disposition of the Briarcrest partnership and its assets is still pending.□

MICC Looks at the Default Problem

Mortgage Insurance Company of Canada, the largest private mortgage insurer, is conducting a review of the default and loss picture in its portfolio of some 237,000 insured high-ratio house mortgages. At 1978 year-end 1.00% of these loans were three months or more in arrears. In normal times, the company says, the default ratio should be in the .25% to .50% range.

A company analysis of high ratio house claims paid last year indicates 98% of them were on mortgages insured between 1973 and 1976. The analysis also indicates some of the problem areas:

- Refinancing cases. 5-10% of the portfolio involves cases of refinancing and not sale. But 20% of the losses involved refinancing cases.
- Gross debt service: 6-7% of the portfolio involves cases of borrowers who commit more than 30% of their salary to mortgage payments. But 20% of the claim cases were in this category.
- Loan to Value ratio: 20-25% of the portfolio involves loans greater than 90% of the property's value. But this category accounted for 35% of last year's claims.

Commenting on the figures in a recent talk, MICC president Reg Ryan said the situation is serious, "not desperate or disastrous, but serious."

"Unfortunately," he said, "in addition to a mortgage collection operation grown rusty through virtual disuse in the so-called "golden years of real estate" in the early 1970s, these golden years also saw some poor underwriting practices creep into our business. Values were increasing so quickly and regulary that we saw sloppy valuation practices and lax underwriting criteria applied to borrowers. Although lenders began to tighten up their total underwriting in 1977, we are still seeing some of these badly underwritten loans making their way through the default and loss process. Futhermore, even at this date, some in the business still seem to be prepared to make a loan on almost any kind of real estate or to any kind of borrower, if they can get it insured. While I appreciate the problem that an oversupply of funds for investment can cause a lender, I cannot understand how any lender can rationalize that insurance will turn a bad loan into a good investment."

Ryan said: "There are quite a number of things that might occur in the mortgage field if a high level of default and losses persisted for some time . . .

1. Lenders could introduce tougher underwriting criteria — e.g., reduced maximum Gross Debt Service and Total Debt Service ratios, lower loan to value ratios, lower percentage of a working spouse's income accepted, etc. There is not much evidence at this time that such action is being taken.
2. Lenders could more actively seek other forms of investment — i.e., they would divert funds away from the mortgage sector. Some lenders are now involved in this process.
3. Lenders could direct more of their mortgage investments into those areas of the country where the default levels and losses are low. At this time, funds would be directed toward Alberta.
4. Lenders could direct more of their funds into classes of mortgage investment that are the least troublesome and direct less funds to troublesome types of real estate. This is already happening with respect to mortgage financing for condominium projects.
5. Lenders could review the list of agents and brokers with whom they are doing business. Any who seem to be involved in a higher than average percentage of bad loans might find their relationship with the lender terminated.
6. Depending on the extent of defaults and losses, and the impact on the lender's margins and profits, there could be an attempt to offset poor results with an increase in interest rates and/or processing fee.
7. There could be tendency to obtain mortgage insurance for a higher percentage of loans placed. Last year, MICC's losses were the highest in our history and our new business volume was also at a record level."

"However," Ryan added, "in the light of today's oversupply of mortgage funds, in relation to demand, it is possible that some of these actions may never be taken, others may be delayed for some time, and others could be taken soon or may have already been taken by some lenders."

Ryan said the results of the company's default and arrears review will be published when it has been completed. □

Press Law

Winnipeg is becoming a center of attraction for Canadian press-law issues that don't often get contested at the appellate level. The issues in two current cases involve an appeal from a judge's contempt finding in the "tendency to prejudice"/*sub judice* area, and a superior court challenge to a Provincial Court Judge's order barring a particular newspaper from attending portions of a trial.

The first case has raised again, at least in Winnipeg press circles, the unanswered question of Canadian contempt law: How remote, how hypothetical, and how subjective can the "tendency to prejudice" be, and still activate the fair-trial/suppression of publication rule?

Two newspapers, the *Tribune* and the *Free Press*, owned by Southam and FP Publications respectively, have said they will appeal a recent Manitoba Court of Queens Bench decision finding them in contempt of court over publication of eyewitness accounts of a fatal shooting on October 19, 1978. Although the shooting trial hasn't been scheduled yet, and probably won't be held before next spring (about 18 months after the publication), Judge John Hunt last July agreed with a crown attorney's submission that the accounts had a "tendency to prejudice" the conduct of the eventual trial. The newspaper accounts didn't name the accused, a juvenile, and he apparently hadn't been charged at the time of the articles. (A radio station did name the accused, contrary to the Juvenile Delinquents Act, and it too was found in contempt.)

Judge Hunt said: "I am of the opinion that while freedom of speech is of great importance to our society, the right to a fair, just and unprejudiced trial must be maintained and must be paramount."

The accuracy of the newspaper accounts was not in question, and they lacked the Toronto Star type of crime sensationalism. So if the standard of the recent case was applied on a consistent basis, there would have been many such contempt findings in Winnipeg and elsewhere. The *Free Press* asked Deputy Attorney General Gordon Pilkey why there weren't prosecutions in numerous other similar instances, and they received this reply: "Well, perhaps we should go more frequently to the courts on these cases."

Murray Burt, former *Globe and Mail* city editor and now managing editor of the *Free Press*, said the implications of the case "could leave the public in the unenviable position of having all its information on such topics filtered through the Crown or police."

Some consider that the rule is something of a skeleton in the closet of Anglo-Canadian jurisprudence. The British government is reportedly drafting legislation to define the sub judice rule following severe criticism of a recent English decision by the European Court of Human Rights.

And the Canadian Law Reform Commission recommended in 1977 that the *sub judice* rule be defined as follows: "Anyone who, wilfully or through recklessness, publishes or allows to be published anything that constitutes a serious risk of obstructing or influencing the impartial development of a judicial proceeding is guilty of an offence." The present rule, contained in the judge-made case law, sets out the rule as a "tendency" to affect, rather than the proposed, "serious risk."

Not everyone agrees, Canadian publishers haven't reacted to the recommendations, nor apparently have any of the Canadian bar associations.

For his part, Judge Hunt observed: "Let me clear up one thing at once, gentlemen. It has been said in some cases that the law in relation to contempt is not too satisfactory. That may be the view of those who express that opinion; it is not a view shared by me. If the law relating to contempt were to be strictly codified I think it would be much more difficult for everybody concerned. I find very little difficulty with it."

The newspapers say it should be necessary to prove that the impugned publication caused some prejudice.

The second current Winnipeg case involves a Provincial Court trial hearing evidence about "extras" received by customers in a local massage parlor. The *Free Press* published the name and a summary of the evidence of one customer; the crown then asked for, and the judge made, an order barring the *Free Press* and its reporters from hearing the evidence of another witness. The Criminal Code gives a Provincial Court Judge authority to bar the public "or any part thereof" from otherwise public proceedings, in the interest of public morals or in the interest of the administration of justice.

The *Free Press* applied to the Court of Queens Bench for an order quashing the Provincial Court Judge's order, and barring him from making similar orders. The newspaper says the "administration of justice" reason doesn't include simply making the crown's job easier, and historically cases on exclusion from court have not considered that embarrassment to a witness is sufficient reason. □

Franciotti

Continued from page 3

behalf of the numbered company, has been advertising it for sale.

The forged will has plagued the younger Assaf in his battles with Koury and Pogue. It was originally found to be forged by the late Justice Fraser in 1973 after Vivian Assaf put it forward as the real will. Fraser noted that those propounding it didn't testify. Of Koury, who had been Assaf Sr's close advisor, Fraser observed: "Koury, the lawyer who drew the earlier will, (the real one) had at one time been convicted of conspiracy in connection with some mining venture. He had served a sentence, he was disbarred but subsequently reinstated.... I am satisfied as to the honesty of Koury..." The criminal prosecution of Assaf Jr arose out of Fraser's finding that the document was forged.

An earlier attempt by Assaf Jr to have the sale set aside was dismissed by Justice Garrett with these words: "This application is entirely without merit, completely without merit, and absolutely without merit.... (The sale) has all the earmarks of being a reasonable deal, although I pass no judgement on the adequacy of the consideration because I have not got the faintest idea what this hotel is worth but no doubt the executors have got some information on it." He severely criticized the younger Assaf's conduct.

In the current application being brought by Assaf Jr via a power of attorney from his sister Assaf says it came to his attention this year that Koury, in cross-examination on another matter admitted there had been no Savarin shareholders' meeting to confirm the sale. The Franciotti guarantee for the numbered company was also registered this year.

Also named as proposed defendants in the application are the law firm of Fasken and Calvin, who act for the executors, and Terrence O'Neill, who acted for Franciotti in the 1975 offer and for the numbered company that bought in 1977.

In another trial last June, Victoria Queen Investments Ltd, the Francotti company, tried to recover a $100,000 despoit it paid The Savarin Ltd in the abortive 1975 deal. The Francotti company claimed the sale agreement was nullified when it couldn't get a liquor licence from the Liquor Licence Board of Ontario. Defendants Koury and The Savarin Ltd said Franciotti refused to make arrangements that would have satisfied the Board. Victoria Queen, said the defendants, "sought and obtained a loan from a New York mortgage broker. As a term of this loan, the broker was to retain an interest in the realty and business operations contemplated (for the Savarin).... Contrary to (the Board's) requirements, and in violation and contravention thereof, the Plaintiff wrongfully failed and refused to provide the LLB with the necessary personal information and resume relating to the New York mortgage broker as required by the LLB... or to make alternative financial arrangements in order that all necessary information could be disclosed."

Justice Eberle ruled Victoria Queen had forfeited its $100,000 deposit and must pay the Savarin a further $367,000 and its costs.□

"A Startlingly Bold Initiative" Part of the Untold Brascan Saga

A letter filed in US District Court in New York in last June's Edper/Brascan litigation indicates former Brascan chairman J.H. (Jake) Moore approached the Canadian Imperial Bank of Commerce — of which he is a director — with a proposal to finance a private takeover of Brascan by a group of carefully selected people in Brascan management. The scheme, as outlined by its chief proponent, Brascan director of taxation Robert Simon, was for a select management group to form a private company; borrow over $600 million and bid $25 to $27 for Brascan stock; sell off Brascan assets to repay the loan; and thus wind up with absolute control of the remainder of Brascan. Simon wrote in company memos in late 1978 that the proposed bid of $25 to $27 would represent a premium over the expected market level of $20-22, and that others would be unlikely to enter a bidding war with a group composed of Brascan management — Americans, because of FIRA; and "Canadians, even if they can lay their hands on the initial funding, would think twice before taking on the management. They would, I think, conclude that if they win, they have paid too much by definition since no one would know better than management how much the assets are worth. In these circumstances, it is hard to gamble at the $650 million level from the outside."

Simon cautioned that Moore had to be sold on the scheme, "I believe (Moore) to be vital and pivotal to the entire proposition, and (he) alone is able to line up the temporary very large credit required."

In a letter to the judge opposing Brascan's claim of confidentiality for all the documents it had produced, Edper lawyer Donald Strauber referred to the examination of Simon in the case — Strauber had already used some of the Simon memos to illustrate his argument. Strauber wrote: "Mr Simon admitted that he consulted Robert Dunford, chief legal officer of Brascan, with respect to Project Navel (the private takeover scheme), and had his advice and help with respect to aspects of the scheme. More significantly, Simon admitted that the chairman of Brascan, J.H. Moore, whose participation was vital to the scheme's success, met personally with the Canadian Imperial Bank of Commerce, asked the bank to finance Project Navel, and received a response which was 'in principle, positive.' The required loan was in excess of $600 million."

Nothing in the court files indicates why the project which predated the Woolworth attempt, wasn't carried through; but it was clearly a serious proposal, contrary to the *Globe and Mail's* rather nebulous and misleading reference to it. The *Globe* said it was a scheme for "the company," that is, Brascan, to borrow the money to "go private" and "diminish" its vulnerability to a takeover. It reported, "Mr Simon said his flights of whimsy are 'tolerated' around Brascan head office. 'But I love it here — this is a marvelous group of people to work with.'"

Some flight of whimsy.

Simon outlined the scheme's advantages this way in an undated memo apparently prepared in November 1978:

"We eliminate Brascan's vulnerability forever, or for as long as we choose.

"Make the Brascan shareholders very happy by giving them more cash than they ever realistically hoped to get in one lump sum.

"Make a bank very happy.

"Create a post GM (apparently referring to the sale of the Brazilian assets) Brascan which can grow faster and better, because it can invest aggressively in opportunities for growth rather than for defence.

"Create a management climate which no longer requires a constant 'looking over the shoulder,' and is conducive to risk taking at a time when opportunities abound.

"Make a carefully selected group of individuals very rich.

"Allow for unique (and potentially very large) management equity incentives where we now need them most and cannot now compete on this score.

"Remove restrictions under which there is an increasing tendency to invest, manage and account for operations in order to meet the narrowing dictates of the Clarkson Grodon syndrome.

"Demonstrate that Canadian entrepreneurs do exist, and exist with a startlingly bold capacity for initiative and discernment for value. There is no doubt in my mind that, when the dust settles, this would be the perception in PR terms.

"Last but not least, create a situation which could easily be seen as stronger and more effective than Argus, for example, with an ongoing investment capacity which would exceed current Brascan's by some $30 million per year."

This demonstration project of Canadian entrepreneurship and discernment for value is only one of the areas whose documentation Brascan fought to keep secret. Only the abrupt termination of active litigation in June prevented a final court determination on the confidentiality of documents and examinations filed in the suit. The Navel documents only came to light because they were attached to an affidavit by Edper counsel on the very issue of confidentiality. And the followthrough with the Bank is referred to in a further letter to the judge on the same subject. Edper lawyer Strauber wrote: "We agreed temporarily to treat as confidential all documents which (Brascan) designate as confidential, pending a court resolution of this question. We have now reviewed the documents and find that defendants have designated *all* of their many thousands of documents as confidential, although we find none which could properly be regarded as containing 'a trade secret or other confidential research, development or commercial information.'... Included in the documents designated by defendants as 'confidential' are, for example, mailings from Brascan Ltd to its shareholders, a Brascan press release, and even a letter from Edper Investments Ltd to Brascan Ltd.... Brascan's obsession with secrecy appears to flow from the fact that at least certain of their documents reveal a less than proud period in their management history. That regrettable fact, which is at the heart of this action, is not a proper basis for shrouding pre-trial discovery in secrecy..... The secrecy demanded by defendants would deprive the public, including Brascan's shareholders, from access to highly significant documents."

The court case isn't active, but it hasn't been terminated either. Presumably, Edper could still press for the release of the material filed.

In the Woolworth suit against Brascan, both sides entered into an agreement for a "protective order" to keep pre-trial discovery secret, but in spite of that I found in the court's file depositions of two Canadian Imperial Bank of Commerce directors, J. Page R. Wadsworth and Edmund C. Bovey. Wadsworth said he was in the Virgin Islands when the CIBC board met to approve the $700 million loan to Brascan to acquire Woolworth, but Bovey was present.

CIBC approval was voted April 5, and it wasn't a very informative meeting. The bank directors weren't told the identity of the company to be acquired by Brascan, Bovey said. They were told the loan was for Brascan, that it was for $700 million toward a total acquisition that would cost about $1.15 billion, and they approved the loan, without knowing, Bovey said, what the proceeds were going to be used to acquire. In answer to their questions, the directors were told they would recognize the company if they heard the name, that it was a multinational, and that there could be legal problems with the loan, Bovey said.

According to his recollection, there was discussion about the size and stability of Brascan, but little or no detail about such things as Brascan's ability to repay, or the value of the security to be lodged with the bank. □