Canadian Equity Strategy

Update to Brookfield Properties Restructuring Options

Within the Weekly Market Strategy recently published on February 8, we highlighted the possibility of Brookfield Properties (BPO) embarking on a restructuring effort aimed at driving tax efficiencies and value creation for shareholders. We were of the view that the merits of such a restructuring appear compelling and would indeed surface shareholder value.

On Friday, February 26, Brookfield Properties (BPO) and its subsidiary BPO properties (BPP) did indeed announce plans to create a new Canadian office REIT, Brookfield Office Properties Canada. We highlight the details of the transaction below (as published by Scotia Capital's REIT analyst, Mario Saric).

It is worth noting that we previously indicated a preference to position for this possibility through an investment in Brookfield Asset Management (BAM.A). While the shares of BAM.A are up 10.3% since that time, outperforming BPO by 230 basis points, our view remains unchanged on a relative basis. We continue to believe that investors of BAM.A would gain possible upside from any further BPO restructuring efforts, plus exposure to a portfolio of property, power, and infrastructure assets that generate sustainable cash flows.

Year-End North American Benchmark Information

	Recent	2010F	2011F
S&P/TSX Composite Index			
TSX Level/Target	11,629.63	12,750	
TSX Earnings	$558.85	$775.00	$850.00
TSX P/E	20.81	16.45	N/A
TSX Dividends	$318.13	N/A	N/A
TSX Yield	2.74%	N/A	N/A
S&P 500			
S&P 500 Level/Target	1,104.49	1,225	
S&P 500 Earnings	$62.54	$75.00	$82.00
S&P 500 P/E	17.66	16.33	N/A
S&P 500 Dividends	$22.62	N/A	N/A
S&P 500 Yield	2.05%	N/A	N/A
Fixed Income & Currency			
BoC Overnight Rate	0.25%	1.25%	2.25%
Canada 10-Year Bond	3.391%	4.50%	4.50%
Cdn/U.S. Dollar	$1.0517	$0.99	$0.96
U.S. Fed Funds Rate	0.25%	1.25%	2.25%
U.S. 10-Year Treasury	3.6117	4.80%	4.80%
U.S. Dollar/Euro	$1.3631	U$1.53	U$1.48
Commodities			
Gold	$1,117.60	U$1100.00	U$1250.00
Oil (WTI)	$79.66	U$90.00	U$92.00

Source: Scotia Capital, Bloomberg.

New Canadian Office REIT

- BPO Properties (BPP), a company 90% owned by Brookfield Properties (BPO), is proposing a new Canadian office REIT, Brookfield Office Properties Canada (BOPC). Upon transaction closing, BPP shareholders will receive one unit of BOPC plus a C$1.02/unit special distribution, with BOPC initially paying a C$0.80/unit distribution (yield of ~4%).
- BOPC will own BPP's Canadian office assets, except for its 25% interest in the Canadian Office Fund; BPO will also vend in its interest in Brookfield Place for new REIT units at an estimated 5.5%-6% cap rate (BPO current implied cap rate is 6.6%).
- The conversion/creation of the new REIT attempts to address its inefficient structure for tax purposes as annual cash taxes of ~$25M were previously forecast by BPP management.
- BPO (and affiliates) will retain an initial 91% interest in BOPC. We expect BPO to lower its interest should capital re-deployment opportunities surface.
- Based on a supplemental produced by BPO Properties, BOPC's enterprise value and equity capitalization are estimated at $3.7 billion and $2.0 billion, respectively, resulting in a debt/EV of ~46% (BPP's preferred shares will reside at the BPO level). We think the initial cap rate could fall in the 6.5%-7% range.
- BPP shareholder vote set for April 9. The proposed transaction has received a fairness opinion and is being unanimously recommended by an independent committee of BPP directors. The transaction now requires a simple majority of the minority, and legislative approval. An information circular is expected in mid-March, with transaction completion expected on April 14, 2010.
- Brookfield Properties will continue to provide property and asset management services on the BPOC portfolio, providing continuity and leveraging both its global real estate expertise and its vendor/tenant relationships.

Implications and current valuation of Brookfield Properties (BPO)

- BPO still trading at a discount to U.S. office peers, but the gap has narrowed. Overall, BPO has outperformed the U.S. REIT sector and its U.S. office peers by ~10% and ~9%, respectively, in February, likely due to better-than-expected 2010 guidance and prospective corporate restructuring initiatives.
- BPO is now trading at 19x and 15.8x 2010E AFFO and EV/EBITDA, respectively (assuming zero value for residential operations). On both metrics, BPO continues to trade at a modest discount to its U.S. office REIT peers, although the discount has subsided in February.
- Overall, Scotia Capital remains of the view that Brookfield Properties provides shareholders with attractive upside potential, although we acknowledge that some of the low-hanging fruit has been picked.

Geoff Ho, CFA – *Director, Portfolio Advisory Group*

Economic Outlook

Last week in the U.S. there was a significant amount of economic data released, with mixed results on the economy. On the negative side, consumer confidence came out lower then expected at 46 versus the 55.9 prior, and new home sales were released well below expectations, falling 11.2% month over month versus consensus forecasts of a 3.5% gain. Home sales have seen two consecutive months of declines with the Northeast region facing the worst, with double-digit falls in both months. Existing home sales were also weaker, falling 7.2% to 5.05 million from 5.45 million last month. Finally, initial jobless claims and continuing claims were both slightly weaker than expected. On the positive side, growth was strong in the fourth quarter, in fact stronger than originally reported, rising 5.9% - the strongest gain in over six years. Inflation also remains subdued, with the GDP price index lower by 0.2% at 0.4%, and while the Core PCE was revised up to 1.6% from 1.4% prior, this remains a low level.

Equity Indices - Weekly Performance

	Close	Weekly Change		YTD Return
Equity Index	02/26/2010	Points	%	%
S&P/TSX Composite Index	11629.63	-79.66	-0.7%	-0.99%
Dow Jones Industrial Avg.	10325.26	-77.09	-0.7%	-0.99%
S&P 500	1104.49	-4.68	-0.4%	-0.95%
Nasdaq Composite	2238.26	-5.61	-0.3%	-1.36%
FTSE-100 (London)	5354.52	-3.65	-0.1%	-1.08%
CAC-40 (Paris)	3708.8	-60.74	-1.6%	-5.78%
DAX (Frankfort)	5598.46	-123.59	-2.2%	-6.03%
Nikkei (Tokyo)	10126.03	2.45	+0.0%	-3.99%
Hang Seng (H.K.)	20608.7	714.68	+3.6%	-5.78%

Last week in Canada there was only one economic release of note, the current account, which came out at -$9.8 billion up from -$13.1 billion prior.

This week is another busy week for U.S. economic data releases. The ISM Manufacturing index and construction spending will be reported on Monday, domestic vehicle sales come out on Tuesday, ADP Employment report, and ISM Non-manufacturing composite will come out on Wednesday, and Pending home sales index, employment report, and consumer credit will come out at the end of the week.

In Canada, focus will be on the Bank of Canada rate announcement on Tuesday, with markets looking for any change in tone about potential rate hikes later this year. In terms of data, we have GDP numbers on Monday, followed by Building permits and the Ivey Purchasing Managers Index on Thursday.

Amy Billinghurst – *Associate, Portfolio Advisory Group – Fixed Income*

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Fixed Income Strategy

Investors Look for Safety after Renewed Sovereign Debt Concerns

Canadian Bond Yields - Weekly Change

	Feb 26	Jan 19	Change (bps)
Canada 2-Year Bond	1.28	1.39	-11
Canada 10-Year Bond	3.39	3.50	-11
Canada 30-Year Bond	4.02	4.08	-6
BoC Target Overnight	0.25	0.25	0
Prime	2.25	2.25	0
U.S. 2-Year Bond	0.82	0.92	-10
U.S. 10-Year Bond	3.62	3.78	-16
U.S. 30-Year Bond	4.56	4.71	-15
Federal Funds	0.25	0.25	0
Prime	3.25	3.25	0

Source: Bloomberg

Bond Index Performance (YTD)

	Feb 26	Jan 19	Change (bps)
DEX Universe Bond Index	2.00%	1.38%	0.62%
DEX All Government Bond Index	1.79%	1.17%	0.62%
DEX All Corporate Bond Index	2.54%	1.90%	0.64%

Source: PC-Bond

Ongoing concerns over European sovereign debt, weak economic data, as well as poor equity markets triggered a flight to quality in the U.S. last week. U.S. Treasuries strengthen as yields fell by 0.10% to 0.16%, led by longer maturities, as the market absorbed $118 billion in new supply of 2-year, 5-year and 7-year notes. Weak economic figures came in the form of disappointing numbers for housing data, initial & continuing jobless claims, durables goods orders and consumer confidence. Greece was crippled by nation wide strikes and Standard & Poor's (S&P) stated their worries over the country's intended measures to curb their deficit woes on the backdrop of a weak economic outlook. They noted that Greece's BBB+ rating could be subject to another downgrade within the next few weeks. On the corporate bond side, the North American credit default swap index (IG13) weakened by about 0.03% on the back of international debt concerns, as the yield pick-up on corporate bonds over Treasuries rose alongside rising foreign government bond yields.

We had no major economic releases for Canada last week and the Government of Canada yield curve followed the direction of the U.S., but to a lesser extent. Both the 2-year and 10-year benchmark yields fell by 0.11% whereas the 30 year maturity fell by 0.06%. Bank subordinated debentures and Tier-1 spreads were modestly stronger, in spite of Moody's 3-notch downgrade to all Canadian bank innovative Tier 1 notes. Supply was a factor, as CIBC issued $1.5 billion of senior deposit notes (3.1% due 03/02/2015) following the release of strong Q1 2010 results, and this did weigh on bank deposit note spreads, but overall Canadian corporate bonds spreads did end tighter. In the end, the DEX Universe Bond Index, the All Government Bond Index and the All Corporate Bond Index advanced by 0.62%, 0.61% and 0.64% respectively for the week.

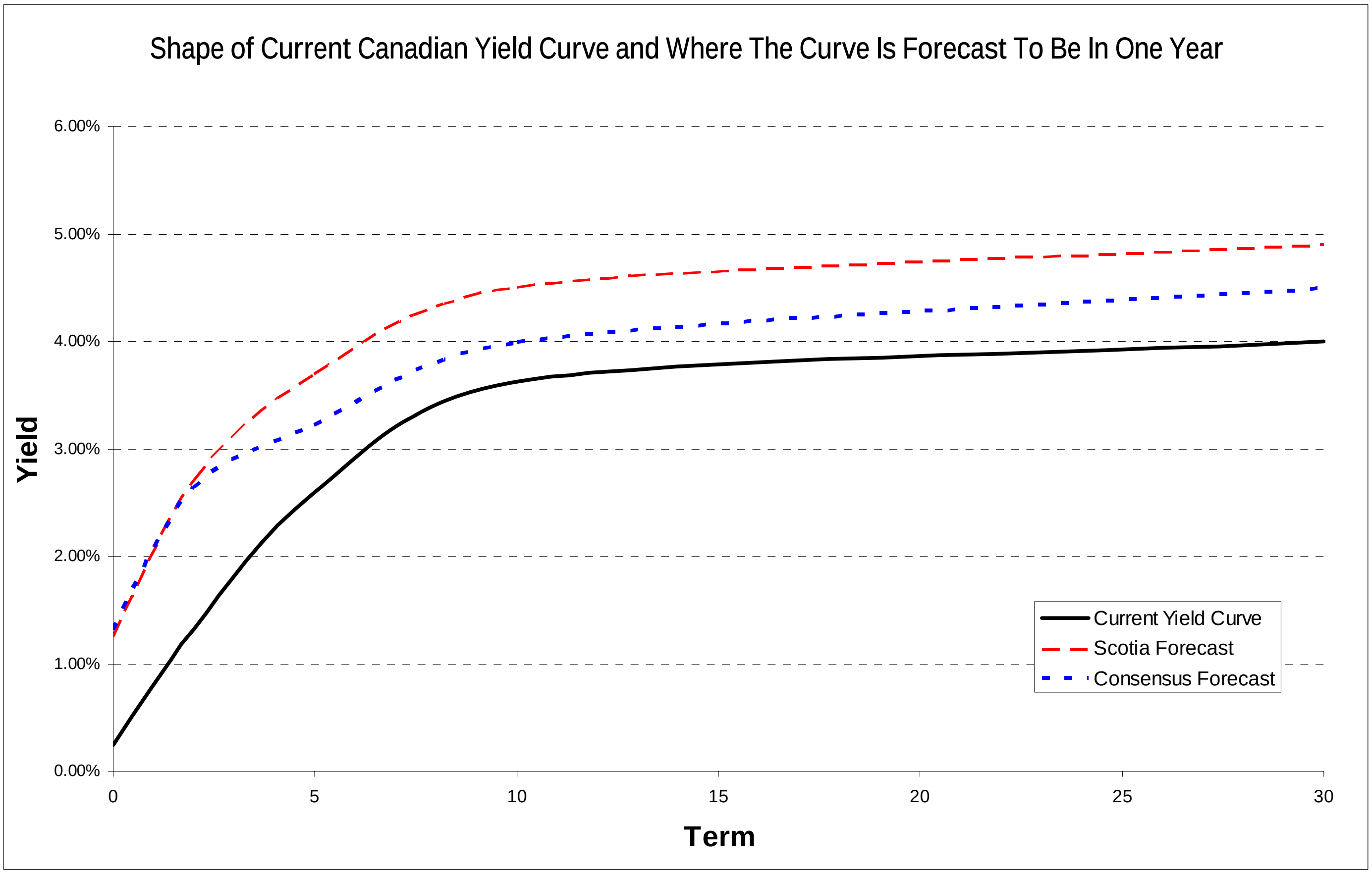
Several economic releases are scheduled to come out this week but the focus will be on the U.S.'s Nonfarm Payrolls on Friday. Also, the ISM indices and the Federal Reserve's Beige book will also be released. In Canada, our central bank has a rate announcement set for Tuesday (expected to remain on hold) while Q1 2010 bank earnings will continue and the Canadian Federal budget on Thursday should garner some attention. Wednesday's 5-year Canada bond auction will be the only supply for the week and the Bank of England along with the European Central bank are also scheduled to make a rate announcement.

Portfolio Advisory Group Fixed Income – Current Recommendations (changes in blue)

1. Term Call – below benchmark duration; overweight cash
2. Sector Call – Underweight Canadas, overweight provincials, municipals and corporates
3. Currency Call – Recent strength in the Canadian dollar means little upside to foreign currency trades
4. Alternative Strategies – overweight high yield, overweight Emerging Markets Debt, underweight inflation protected.

Portfolio Advisory Group Fixed Income – Current Recommendations (changes in blue)

1. **Term Call** – With both Scotia Economics and Bloomberg Consensus forecasts calling for bond yields to rise across the spectrum over the next 12 months, maturities beyond 5-years are expected to post negative returns over the next 12 months. We therefore recommend active investors remain in the very short end of the maturity spectrum, or in cash.



Source: Scotia Economics and Bloomberg

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	2 Year Canada	2 Year Provincial	2 Year Bank	5 Year Canada	5 Year Provincial	5 Year Bank	10 Year Canada	10 Year Provincial	10 Year Bank	30 Year Canada	30 Year Provincial	30 Year Bank
Scotia	0.78%	0.93%	1.16%	-0.26%	0.11%	0.47%	-1.68%	-0.91%	0.15%	-9.48%	-7.77%	-4.48%
Consensus	0.77%	0.92%	1.15%	0.99%	1.35%	1.71%	2.01%	2.68%	3.61%	-3.42%	-2.15%	0.36%

Source: Scotia Economics and Bloomberg

2. **Sector Call –** In conjunction with our term call (to remain in cash or very short term investments), we recommend investors look to the provincial, municipal, and corporate sectors for yield enhancement. Credit spreads (the yield pick up over Canada bonds) still remain attractive in the provincial and municipal space, and although corporate bond yields are at multi-decade lows, there is still a significant yield pick-up available in the short end of the yield curve versus T-Bills and Canada bonds.

3. **Currency Call -** Scotia Economics' and consensus forecast expectations are for the Canadian dollar to outperform most major currencies over the next year, therefore we recommend Canadian investors remain in Canadian dollars for their fixed income holdings at this time.

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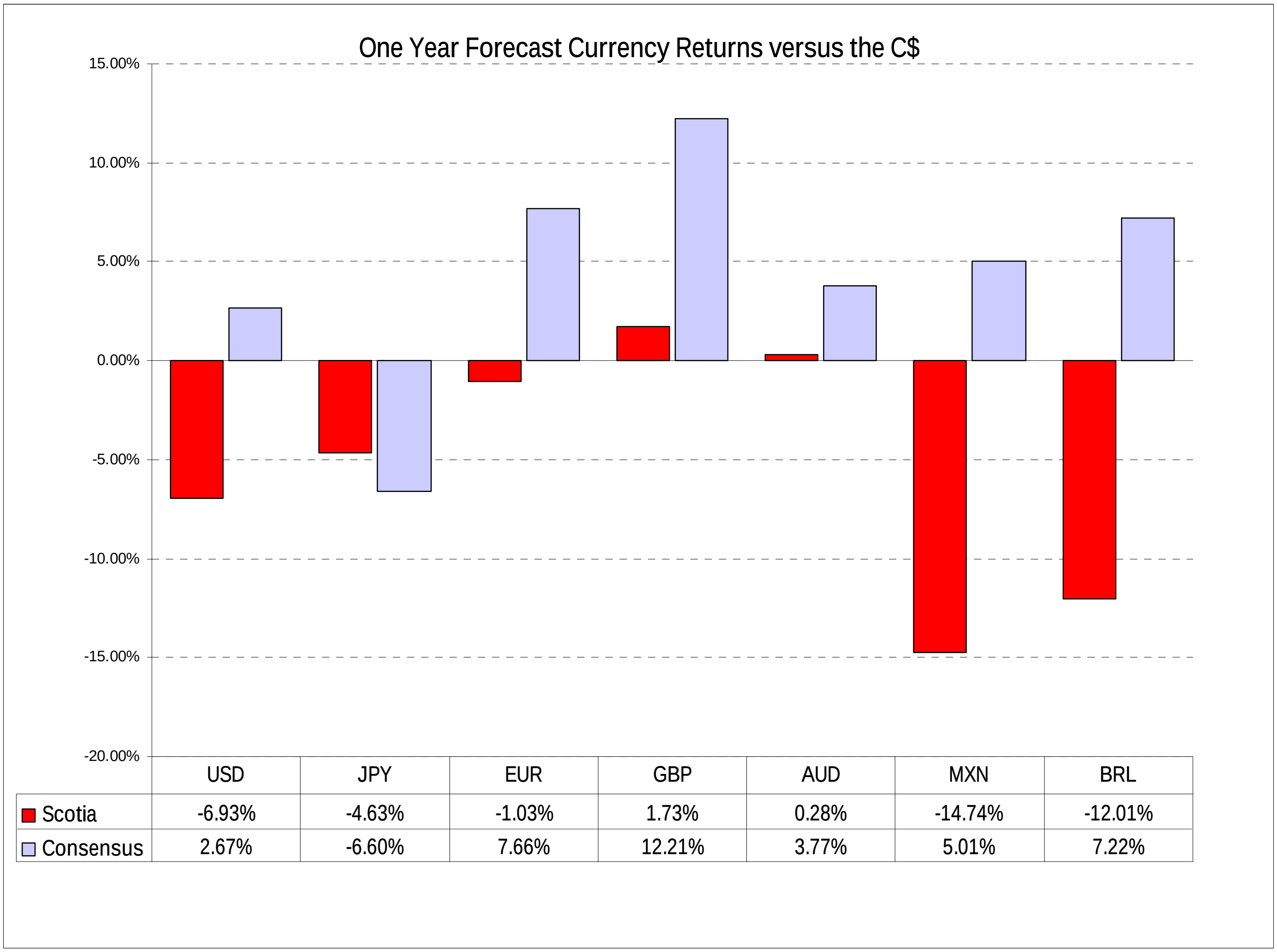


Source: Scotia Economics and Bloomberg

4. **Alternative Strategies:** Within a broadly diversified portfolio our recommendations are as follows:

   a) High Yield – In conjunction with our positive equity market outlook for the next 12 months (based on the outlook for economic recovery), we now recommend investors shift to an overweight position in high yield debt.

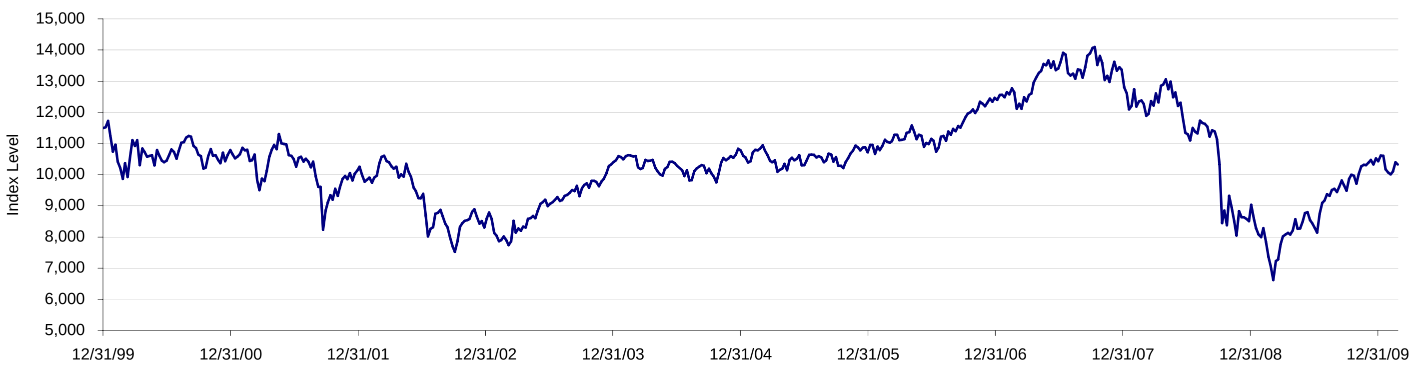
   b) Emerging Markets – Similar to our outlook for high yield and equities, we continue to see value in this sector versus both investment grade and high yield. Hence, we continue to recommend maintaining an overweight exposure.

   c) Inflation Protected Bonds – with current real yields in the area of 1.55%, and the market pricing in an effective long term inflation rate of 2.50%, we see limited value in Canadian Real Return Bonds, and hence recommend an underweight exposure to the sector.

Anthony Mentor – *Associate, Portfolio Advisory Group – Fixed Income*

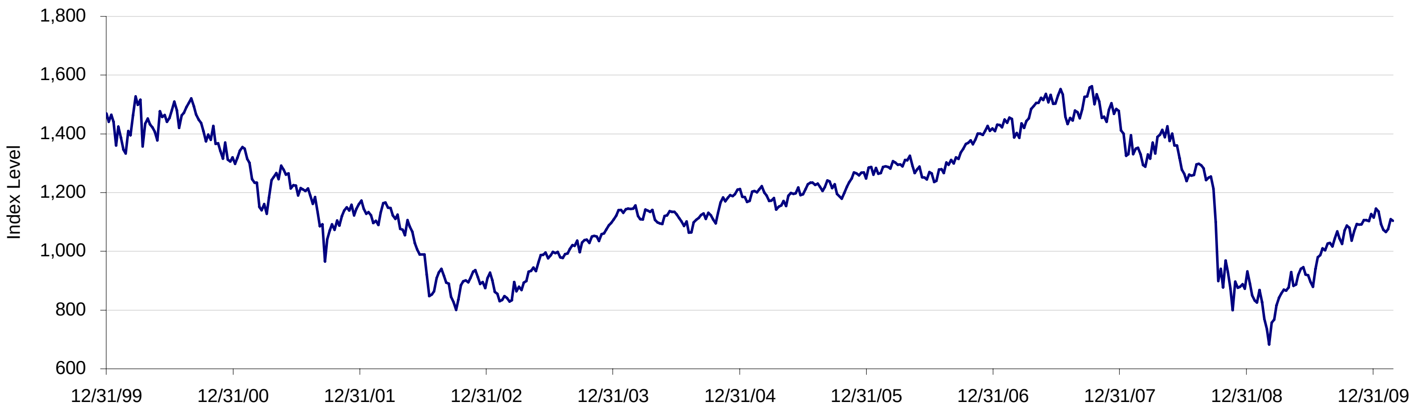
-S&P/TSX Composite Index

-Dow Jones Industrial Average



-NASDAQ

- S&P 500 Index



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Definition of Scotia Capital Equity Research Ratings & Risk Rankings

We have a three-tiered rating system, with ratings of 1-Sector Outperform, 2-Sector Perform, and 3-Sector Underperform. Each analyst assigns a rating that is relative to his or her coverage universe.

Our risk ranking system provides transparency as to the underlying financial and operational risk of each stock covered. Statistical and judgmental factors considered are: historical financial results, share price volatility, liquidity of the shares, credit ratings, analyst forecasts, consistency and predictability of earnings, EPS growth, dividends, cash flow from operations, and strength of balance sheet. The Director of Research and the Supervisory Analyst jointly make the final determination of all risk rankings.

Ratings

1-Sector Outperform
The stock is expected to outperform the average total return of the analyst's coverage universe by sector over the next 12 months.

2-Sector Perform
The stock is expected to perform approximately in line with the average total return of the analyst's coverage universe by sector over the next 12 months.

3-Sector Underperform
The stock is expected to underperform the average total return of the analyst's coverage universe by sector over the next 12 months.

Other Ratings
Tender - Investors are guided to tender to the terms of the takeover offer.

Under Review - The rating has been temporarily placed under review, until sufficient information has been received and assessed by the analyst.

Risk Rankings

Low
Low financial and operational risk, high predictability of financial results, low stock volatility.

Medium
Moderate financial and operational risk, moderate predictability of financial results, moderate stock volatility.

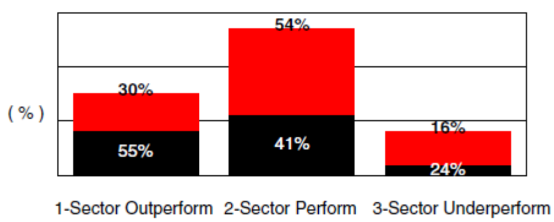
High
High financial and/or operational risk, low predictability of financial results, high stock volatility.

Caution Warranted
Exceptionally high financial and/or operational risk, exceptionally low predictability of financial results, exceptionally high stock volatility. For risk tolerant investors only.

Venture
Risk and return consistent with Venture Capital. For risk-tolerant investors only.

Scotia Capital Equity Research Ratings Distribution*

Distribution by Ratings and Equity and Equity-Related Financings*



Percentage of companies covered by Scotia Capital Equity Research within each rating category.

Percentage of companies within each rating category for which Scotia Capital has undertaken an underwriting liability or has provided advice for a fee within the last 12 months.

** As at February 28, 2010.*
Source: Scotia Capital.

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None.

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