The Land Economist

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Administrative Offices:
1235 Bay St. Suite 500
Toronto, Ontario, M5R 3K4

Phone: (416) 934-5166
Fax: (416) 934-5021
Website: www.aole.org
Email: aole@interactive-ca.com

The Kitchener-Waterloo area has climbed a long way back since the early '90s. Keith Hobcraft discusses the area's significant recovery and growth on page 4.

Hospitality Market Overview

by Brian Flood and Curtis Gallagher

The hotel market is often viewed as a leading performance indicator within the real estate industry. Since hotel room rental contracts are for one night, compared to the longer-term agreements of other forms of investment real estate, they tend to feel the impact of any downward shifts in the economy almost immediately.

After several years of strong growth, the hotel industry in Canada has recently begun facing challenges on several fronts:

- In late 1999, the market began to soften as a result of Y2K concerns.
- first quarter 2000 saw reduced business travel.
- In 4th quarter 2000, the economy began to weaken.
- 2001 brought the high-tech meltdown.

Due to the lag effect of development, certain markets are seeing new supply enter just as their markets are declining.

More recently, the terrorist attacks in New York have had a negative impact on the hotel industry as business, convention and leisure travel have all been curtailed. This factor will have a definite impact on fourth quarter 2001, but the longer term impact is still uncertain.

Chart 1

Ontario Hotel Results

Year	% Occupancy	ADR
1990	64.4	$93.25
1991	56.5	$78.29
1992	56.8	$75.61
1993	59.1	$77.41
1994	63.8	$76.95
1995	65.4	$80.91
1996	65.8	$84.54
1997	68.5	$90.60
1998	70.6	$97.38
1999	69.4	$105.69
2000	67.7	$113.70
Jan-June 2000	64.0	$110.68
Jan-June 2001	62.9	$116.33

Source: Pannell Kerr Forster

Historic Results

Market results for Ontario, outlined in Chart 1, provide some perspective on the market over the past decade. In the period just before this chart begins, strong operating results and the availability of both equity and debt financing had led to a major building boom in the hotel industry in the late 1980s. Some markets in Ontario saw a 100% increase in room supply in a 5-year span.

Then, in late 1989, the economy slipped into recession, resulting in reduced travel and spending just as many of these new rooms came on to the market. As a result, between 1989 and 1992, Ontario's hotel occupancy levels and average daily rates (ADR) decreased rapidly.

As the Canadian economy emerged from recession in 1993-94, the lodging market was revitalized and properties began to return to profitability through improved operating fundamentals. The majority of primary Canadian hotel markets have experienced consistent growth in RevPAR (Revenue Per Available Room) from that period through to 2001.

The recovery culminated in a peak occupancy level across the Province of 70.6% in 1998. The 1999 decline was modest, at less than 1.0%. In 2000, however, the drop in occupancy was more pronounced, falling almost 2.0%.

Despite declining occupancy, ADR rose by 8.5% in 1999 and 7.6% in 2000 – and continued unabated at 5.1% in the first six months of 2001. In comparison, for the period of 1991 to 1998, ADR growth was 3.2% on a compound annual basis.

Investment Market

A significant change in the Canadian hotel investment market was the arrival of U.S.-based opportunity funds in the early 1990s. Following the improvement in the U.S. market, these buyers targeted Canada seeking undervalued, non-performing assets for purposes of repositioning.

In 1997, the Canadian hotel investment market was impacted with the arrival of Real Estate Investment Trusts (REITs). The first Canadian Hotel REIT (CHIP) was launched in June 1997.

Following its success, two other hotel REITs (Legacy and Royal Host) entered the market.This gave both private and public hotel buyers access to capital — and fuelled an unprecedented amount of acquisition activity.

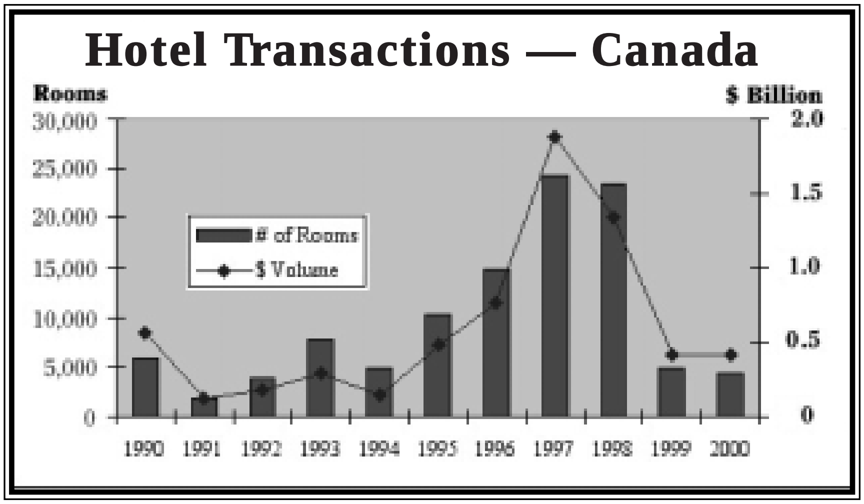
In mid 1998, however, the capital markets tightened and many buyers, particularly hotel REITs, lost their ability to fund acquisitions. Their unit prices fell significantly and investment return expectations rose.

As shown in Charts 2 and 3, the effect on the market was immediate. Since mid 1998, the level of hotel investment activity has declined markedly.

As of year-to-date June 2001, the volume of transactions has declined in excess of 50% over the comparable period the previous year. However, the total number of rooms traded was only marginally lower at 2,591 representing a decrease of 3.9%. The average price per room declined to $56,014 compared to $59,300 in year-to-date June 2000.

The majority of transactions were located in secondary markets and most involve repositioning opportunities. Some major acquisitions have taken place recently by Fairmont (CP) Hotels and Resorts and Legacy REIT, including the Empress Hotel, Chateau Frontenac, the Lombard and Crowne Plaza in Winnipeg. (The sales involving the Frontenac and Empress are not considered arms length, however, and are not included in the charts.)

Chart 2



Source: Colliers International Hotel Realty

Operating Results Outlook
In terms of operating results, we are in a period of perceived higher risk since most of the potential gains in occupancy and average rate have been realized.

Many markets are seeing new supply, particularly in the suburban limited service sector, to capture previously unsatisfied demand.

For example, there has been significant new supply in areas around Toronto, such as Whitby/Ajax, Richmond Hill/Markham and Mississauga. The impetus for this development was the rapid growth in local industry, particularly the strength in the technology sector at that time, and the expansion of Pearson International Airport. The highway 404/407 area will see five new hotels in 2001-2002. Meadowvale will see four new hotels added to the local market.

Generally speaking, downtown hotels are more immune to new supply given the high cost of construction and time required to develop a larger high-rise hotel.

In Toronto, despite a healthy economy, development in the downtown area has been limited. Two former office buildings were converted in 2000 and another completely retrofitted, adding approximately 800 rooms to the market.

We do not expect much new development given the general lack of financing available for new projects.

Given that occupancy levels in many markets have stabilized, most income growth is now achieved through rising ADR. Although we have seen strong ADR growth, many operators suggest that hotels here still lag behind U.S. levels. Hotels in major U.S. cities charge approximately 2 to 3 times the room rates of equivalent hotels in Canada.

We expect average room rates to continue to rise at above inflation levels. However, growth in income will moderate.

Hotel Investment Outlook
In today's market, acquisitions are usually by hotel owner/operators and most represent a repositioning opportunity, although these types of deals are increasingly difficult to find.

With record level earnings, the majority of hotel owners have been content to generate increasing returns on their investments through improved operating performance. With reduced income upside available to buyers, rates of return have increased significantly since mid 1998.

Provided acquisition costs remain below replacement cost, investors will be attracted to the market; however, purchasers have become more

discerning in their search for assets that will give them an adequate return on their investment.

Brian Flood, AACI, P.App, PLE, is Executive Managing Director, and Curtis Gallagher is Director, Hospitality Consulting, at Colliers International Realty Advisors Inc.

Chart 3

Hotel Transactions — Canada

Year	# transactions	# rooms	Price	Ave. $/Room
1990	29	5,849	$562,986,870	$96,253
1991	17	1,834	$123,361,700	$67,264
1992	23	3,809	$174,419,371	$45,791
1993	46	7,693	$295,583,408	$38,422
1994	47	4,843	$143,660,000	$29,663
1995	67	10,339	$481,759,442	$46,596
1996	75	14,912	$769,552,977	$51,606
1997	118	24,267	$1,881,056,386	$77,515
1998	175	23,496	$1,332,207,828	$56,700
1999	41	4,826	$418,709,400	$86,760
2000	48	5,690	$478,390,000	$84,075
Jan-June 2000	26	2,695	$159,815,000	$59,300
Jan-June 2001*	12	2,591	$145,132,000	$56,014

Source: Colliers International Hotel Realty

**The Fairmont Empress (Victoria, B.C.) and Le Chateau Frontenac (Quebec City, Q.C.) were acquired in a non-arms length transaction by Legacy REIT in February 2001 and have not been included.*

Kitchener-Waterloo has seen significant growth

by Keith Hobcraft

The Kitchener/Waterloo conurbation, once part of the "Golden Triangle" of a former industrial era, is now a key part of Canada's "Technology Triangle".

This evolution is the result of a well-educated population, civic support and, of course, a couple of excellent universities.

With a population of about 300,000, easy access to major markets and a local airport, the area has achieved much of the painful shift from older manufacturing uses to services, technology, research and cultural activity. Local experts say it is well positioned to ride out the next few quarters.

Like most municipalities in Southwestern Ontario, Kitchener and Waterloo experienced a declining real estate market from early 1991 to 1994 when the market "bottomed out". During 1995, the local real estate economy began to recover and there has been significant growth in several sectors of the market.

Downtown Kitchener

A significant part of this upturn can be witnessed in downtown Kitchener, where the usual urban fight against the "edge of Town" Big Box development has taken place.

Notable achievements include:

- New $3.7 million King Street Theatre Centre (375 seats), which opened in September
- 50,000 sf, four-storey Childrens Museum, in the former Goudies department store, scheduled for completion in 2003 - an interesting recycling of an older building.
- Manulife Financial's purchase and conversion of King Centre (now called Manulife Square) to provide 65,000 sf offices
- Remarketing of Market Square to include a Call Centre, Sears Outlet & Fitness Centre
- City proposal for new Farmers Market commercial development at King/Eby, much of the land having already been acquired
- Restoration of the Governors House and Gaol as a regional courthouse, to be completed this fall

The City is clearly committed to a vibrant downtown area, and with the support of its major business and community groups, appears to be successful.

Waterloo Downtown

While Kitchener is known for its long established traditional urban downtown, Waterloo is a more recently planned community with a typically more spacious feel. Its "newness" is reflected by the fact that 75 per cent of all companies were started after 1970.

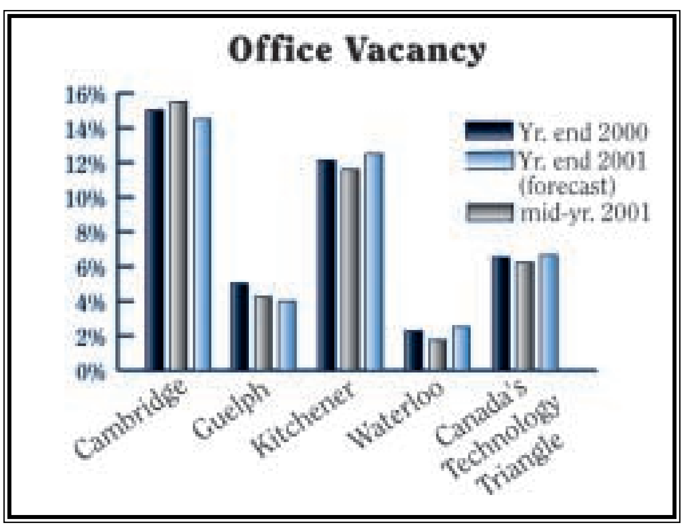
One of the biggest projects currently under way in Waterloo is Clarica's redevelopment of the Westmount Mall.

First Gulf Development Corporation's redevelopment proposal for "Uptown Waterloo" hit a major roadblock this summer. The City Council had setAugust 1 as the deadline for taking

out the first building permits on plans approved two years ago; they refused to extend to December 1. The approved plans included a multi-screen theatre, bookstore and library – all of which were dropped from the developer's most recent proposal. Galaxy Theatres has recently opened a new 10-screen cinema in north Waterloo at Conestoga Mall.

Residential Development

Single family residential development has remained strong across the Kitchener CMA (which includes Kitchener, Waterloo, Cambridge and most of the rest of Waterloo Region). Townhouse development, which surged by nearly 40 per cent last year, has stayed fairly high, and if a couple of large apartment projects get their footings completed before year end, that sector should match 2000 as well.



Source: CB Richard Ellis

An interesting shift in apartment investment has taken place. Almost 400 rental apartments were built in 2000. A further 418± downtown rental units, together with 524 rental units in the suburbs, are either under construction, or planned. These are market driven investments, by developers realizing the potential for profitable rental buildings resulting from low vacancy, rising rents and low interest rates.

Jack Carapella of the Tricar Group, a major investor in Kitchener, Guelph and London,

is confident about the upper to high end rental market. With two projects under way in Kitchener, he points to the good demand, 0.7 per cent vacancy rates, and relatively light competition from privately rented condominium units as positives for new rental building investment.

Industrial vacancies low

Despite a slowdown in some industrial sectors, development activity in Kitchener-Waterloo has remained brisk.

Industrial vacancies declined to two per cent in 2000, with significant demand for small and medium-sized spaces. Although the vacancy rate increased during the first part of 2001, this was largely a result of several large single-user facilities coming onto the market. In mid sized buildings, the vacancy rates also increased marginally – a trend which may continue as more speculative projects are completed.

Demand for smaller industrial space is spurring some speculative construction of high quality industrial multiples. With supply tight, rental rates are staying constant.

Waterloo's Economic Development Committee is investigating three key options for increasing the supply of industrial land: city purchase of additional land; servicing of land it owns in the west end; and exploring closer partnerships with the private sector.

Commercial outlook

The insurance industry is the mainstay of the economy. Four of Canada's major companies are headquartered here. Recently, however, Kitchener-Waterloo may have become even better known for its research and development, and its electronics/ computer industries.

Long a "resource" centre for Microsoft, (i.e. a source of well qualified staff), the region has established a local high-tech entrepreneurial culture with expected long term growth. It has seen the rise of internationally known hi-tech companies such as R.I.M. (Research in Motion), Open Text, and Pixstream. It is also becoming known for environmental management firms.

Office vacancies are at four to nine per cent on average, with the technology and financial services sectors absorbing much of the available space. Retail vacancy rates at the end of 2000 were in the five to 10 per cent range on average, characterized by conversion of old retail space to office uses in the downtown area, as well as construction of new suburban retail space.

In mid 2002, now that funding from all levels of the public and private sectors seems to be coming into place, the north campus of the University of Waterloo ("Wat Park") is expected to get into high gear as a high-tech development node. This could ultimately lead to several million square feet of new high-tech space.

Throughout 2000, the Kitchener CMA enjoyed one of the country's lowest unemployment rates. While rates have risen in 2001, the area's unemployment remains below the provincial and national averages.

Keith Hobcraft. AACI, FRICS, PLE, is President of Bosley Farr Associates Ltd., and serves on the AOLE Council as Journal Chair. This article was prepared with files from City Management and Appraisals Ltd., Kitchener, and the City of Kitchener Economic Development Department.

Legislative Beat

From Page 8

Graham has stated that preferred SuperBuild projects, for example, must meet Smart Growth (SG) criteria.

The following initiatives are now under the SG umbrella: five-year review of the Provincial Policy Statement (on Ontario's land use policies), Brownfields legislation, Oak Ridges Moraine, new Development Permit system and the new Municipal Act.

More targeted provincial and federal funding for infrastructure, combined with new fiscal and legal tools for cities, are emerging as key themes for future success.

The Ontario Professional Planners Institute has responded to this SG initiative with a thoughtful paper entitled *Exploring Growth Management Roles in Ontario: Learning from 'Who Does What' Elsewhere.*

Case studies from Baltimore, Portland, Calgary, Cobourg, London and Waterloo suggest that an arsenal of tools, including financial ones, are critical to implementing growth management policies.

GO Transit/GTSB

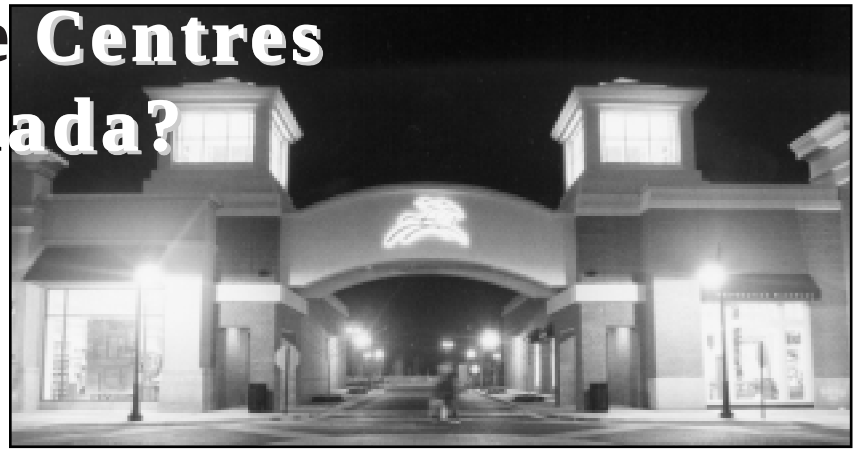
In a radical move that acknowledged that municipalitiescannot pay for public transit on their own, the Province announced that it would once again contribute a share. The Premier announced that the Province would contribute $300 million per year over 10 years, and his hope is to lever the other levels of government for a two-thirds contribution of the total $9 billion transit plan.

The Greater Toronto Services Board will be phased out and replaced with a Smart Growth Council for the Golden Horseshoe, comprised of municipal and private representatives.

Andy Manahan, PLE, is Development Promotion Representative for the Universal Workers Union, Local 183.

Will Lifestyle Centres Come to Canada?

by Frank Clayton and Sameer Patel



Deer Park, located in is one of many examples of the new Lifestyle Centres developing in the United States.

The newest and hottest retail shopping centre concept to emerge south of the border is the "lifestyle centre".

It's difficult to open a magazine or attend a conference in the States without finding more tributes to this kind of retail development. It is all a bit reminiscent of what happened around the "big box" centre a decade ago.

Given that big box centres went on to become big success stories here a few years after the U.S. hype, you might expect the same thing to happen with lifestyle centres. But be cautious. These centres have flourished south of the border because of a specific set of market factors that are not common in Canada.

Defining Lifestyle Centres
At their most basic, lifestyle centres represent a very upscale strip plaza shopping environment, usually located within a growing high-income suburban market. They offer convenient access to a selection of lifestyle/home décor retailers and regional mall tenants, such as Williams-Sonoma, The Bombay Company, and Pottery Barn, plus trendy sit-down restaurants.

Architecturally, they often use a lot of brick, and are expensively landscaped with trees, flowers, fountains and sculptures. Convenient access by car is critical; typically there are numerous smaller parking lots with strong pedestrian connections between the lots and the centre.

The first lifestyle centre to be built in the U.S. was probably Saddle Creek, which opened in 1987 in an upscale neighbourhood of Memphis, Tennessee.

This open-air centre has more than 142,000 sq. ft., tenanted by retailers such as Restoration Hardware, Banana Republic, and Ann Taylor.

The modern prototype has not changed much. Although there are a few enclosed lifestyle centres, many of their shops offer external entrances to maintain convenience.

Specific Market Niche
The U.S. has a large number of upper income suburbs, which are not located in close proximity to regional shopping malls. Lifestyle centres serve this market niche.

By creating a pleasant environment, they are able to cater to destination shoppers who view shopping as an enjoyable pastime. Alternatively, for that portion of the market that is increasingly time-starved and does not want to navigate through a regional mall to find one store, lifestyle centres provide strip plaza convenience.

Emergence of National Lifestyle
A big part of the success of lifestyle centres has been the emergence of lifestyle retailers on the national scene. Retailers such as The Bombay Company and Williams-Sonoma have developed larger format stores, and have discovered that they do not need to be located in regional malls with anchor stores, or on busy downtown streets, to be successful. Furthermore these retailers are achieving equal or better sales in lifestyle centres while not having to pay the rising common area maintenance charges in malls.

Canadian Lifestyle Centres?
Unfortunately, lifestyle centres are much less likely to flourish in this country. Canadians have lower average incomes than their neighbours to the south. The proportion of wealthy consumers is also lower in Canada, reflecting a society less polarized between rich and poor. In addition, planning policies here discourage large, new, homogeneous upper income communities.

As a result, there are not as many new affluent neighbourhoods that could support a lifestyle centre. Existing markets with these qualities already have established enclosed malls, such as northern Toronto's Bayview Village Shopping Centre. Furthermore, there are not enough specialty lifestyle retailers in Canada that can hold their own without anchors.

Opportunity for Hybrids
While Canada may not see any true lifestyle centres, we do expect to see the emergence of hybrid malls in this country. These will incorporate some aspects of lifestyle centres – creating more external entrances directly to shops for convenience, or building retail pads closer to the main mall and creating greater pedestrian links between the parking lots and the stores. Hybrid malls also offer possible redevelopment scenarios for some of the countless community/neighbourhood malls in Canada that are experiencing high vacancy rates and are looking to reposition themselves.

Frank A. Clayton,PhD, is President and Sameer Patel, MA, is Senior Research Analyst with Clayton Research, a Toronto-based firm of urban and real estate economists.

President's Message

It is an honor to serve as your new president. During the two years that I have served on council it has been a pleasure to work with and meet such a diverse group of members who bring years of expertise to our Association.

I would like to take this opportunity to thank our past president Dave Sanna for his leadership and commitment to the Association over the past year. Dave has spent countless hours computerizing our membership data and reorganizing our administrative structure so that I am starting my term as president with a 'clean slate'.

On behalf of our membership I would also like to thank retiring council members John Lang, Michael Cane, Ian Brown, and David Gibson for their support over the years as council members and presidents of our organization. Their contributions have helped build the AOLE into the respected Association that it is today. We wish them all success for the future.

Moving forward, I hope to build on the firm financial base that the Association has established over the past few years. Council has been successful in increasing revenue while at the same time reducing our operating expenses significantly. In the coming year, we look forward to continuing the current level of growth in our membership numbers.

We plan to present a strong line-up of dinner speakers, addressing a variety of topics related to the land economic issues facing our membership today. I look forward to seeing many of you at our next dinner meeting.

We also plan to continue and strengthen our successful Journal. Rowena and Keith have been involved for many years in providing our membership with updates on current provincial legislative initiatives, economic updates, as well as editorials on a variety of issues related to land economics. Please feel free to contact them if you have any suggestions with respect to the content of the Journal or if you would like to have a paper published.

Other initiatives include the continual updating of our presence on the World Wide Web. I would particularly like to thank Konrad Koenig who has been instrumental in the development of our website. The website contains information about our Association, membership application forms, back issues of the Journal and one of the most comprehensive 'links' pages relating to the real estate industry in Canada. Please tell your friends to bookmark *www.aole.org* and visit it often.

I wish to once again thank the membership and Council for their support. I welcome any comments or suggestions, and can be contacted at (416) 643-3472 or via e-mail at michael.real@colliers.com.

Michael J. Real, AIMA, PLE

2001-2002 Council

President
MICHAEL J. REAL
Realty Tax Consultant
Colliers International
Realty Advisors Inc.
416-643-3472
michael-real@colliers.com

Past President
DAVID SANNA
Principal
SannaD Property
Solutions Inc.
416-282-9155
sannad@idirect.com

Treasurer
EDWARD C. BRUCE
Vice President
Integris Real Estate
Counsellors
416-979-2023
edbruce@
integrisrealestatea.com

Secretary
W. ELGIN DOUGLAS
Real Estate Appraiser
416-214-5630
welgindouglas@on.aibn.com

Journal
KEITH HOBCRAFT
Bosley Farr Associates Ltd.
President
416-486-9997
hobcraft@ica.net

Internet
KONRAD KOENIG
Realty Services
Go Transit
416-869-3600 ext. 5340
kk@rpf.com

Membership
ALAN MOTT
Retired
416-368-6937
alanmott@istar.ca

Program
JOHN BLACKBURN
President
CRU Communications Inc.
905-508-0005
cru-communications@
sympatico.ca

Education
BONNIE BOWERMAN
Senior Mortgage
Underwriter
Sun Life Mortgages
416-979-6343
bonnie-bowerman@
home.com

Members at Large
CATHERINE HUESTIS
Senior Consultant,
Realty Tax Services
Colliers International
Realty Advisors Inc. 416-
643-3736
catherine.huestis@
colliers.com

EILEEN OSTROWSKI
Taxation Assessment
Derbyshire Consultants
Limited
905-455-5500
eostrowski@derbytax.com

EDWARD SAJECKI
Asst. Deputy Minister
Municipal Affairs &
Housing
416-585-6600
edward sajecki
@mah.gov.on.ca

ALLAN WINDREM
Dillon Consulting Ltd.
(Planning Manager)
416-229-4647
awindrem@dillon.ca

Journal editor
ROWENA MOYES
Consultant
416-466-9829
rmoyes@idirect.ca

Association services
ERIKA CZIKA
416-934-5166
aole@interactive-ca.com

The Legislative Beat

by Andy Manahan

Terrorist Hijackings
The Fall session of the Ontario Legislature began on Sept. 24 and was devoted to an all-party discussion of the tragedies that occurred in the United States on Sept. 11.

Premier Mike Harris indicated that a number of counter-terrorist measures would be taken (the Ontario Provincial Police was directed to report back with recommendations). A special fund has been established to help Ontario families of the victims.

Economic Statement
Provincial representatives have stressed that the Province's fiscal situation is in good shape to weather any economic downturn that may have been exacerbated by the terrorist activities. Finance Minister Jim Flaherty delivered an economic statement on Nov. 6 in which he assured Ontarians that a balanced budget would be maintained for 2001-02 by dipping into a $1 billion reserve.

Premier Harris to Step Down
In a surprise mid-term announcement, Mike Harris, advised on October 16th that he would resign as leader of the Ontario P.C. party. This will provide ample opportunity for a leadership convention to be held in the spring of 2002, prior to the next general election likely in 2003. Early candidates include Deputy Premier and Finance Minister Jim Flaherty; Minister of Health Tony Clement; Education Minister Janet Ecker; Environment Minister Elizabeth Witmer; Minister of Municipal Affairs & Housing Chris Hodgson and Labour Minister Chris Stockwell.

Municipal Act
Now that the 'who does what' exercise has somewhat clarified the responsibilities of municipalities and the Province, Hon. Chris Hodgson will grant local governments broader powers under a new Municipal Act that was introduced on Oct. 18. Innovative municipal service delivery would be achieved, for example, by providing municipalities with enhanced taxation, regulatory and licensing authority. User fees, however, would be subject to new accountability and process measures so that there is a relationship to cost recovery. There would also be updated rules for municipal debt and investment. If the bill is passed as is, 'sale of land' is an item that could be discussed by Council in a closed meeting. The proposed new Act contains 10 municipal "spheres of influence".

The government intends to enter into a memorandum of understanding with the Association of Municipalities of Ontario and the municipal sector.

Red Tape News
The 13th Red Tape Reduction bill was passed on June 29. Containing more than 120 legislative amendments identified by 15 Ministries, the *Government Efficiency Act, 2001* is intended to help remove barriers to jobs, investment and growth, while improving service to the public. One amendment makes it an offence to give false information to the Ministry of the Environment or its agent under several environmental statutes.

Between August and the end of October, the Red Tape Commission consulted with small businesses in more than 20 communities, primarily through local Chambers of Commerce, to obtain first-hand information about government barriers. Recurring proposals include: reduce the paper burden for business, simplify and streamline administration of the retail sales tax system and alleviate traffic congestion and delays affecting the smooth delivery of goods and services.

Oak Ridges Moraine
In a move hailed by environmentalists as "stunning", the Province announced on Nov. 1 that over 90 per cent of the Moraine would remain essentially undeveloped. Landowners who had hoped to proceed with development in Richmond Hill and Uxbridge will have the opportunity to develop provincially-owned lands in the Seaton area of Pickering.

Based on inter-ministry public meetings to develop a strategy to protect the moraine, four broad land use designations have been created:

- natural core area
- natural linkage
- countryside and
- settlement.

Rural municipalities east of Toronto such as the Peterborough area will be given greater flexibility to develop in the countryside category because they are relatively less economically well off.

Smart Growth
The Ministry of Municipal Affairs and Housing has released *Listening to Ontario: A Summary of Smart Growth Consultations,* based on feedback from 17 regional meetings. An important distinction has emerged: in major centres in southern Ontario there is an emphasis on managing growth, whereas in northern communities growth cannot be taken for granted and must be fostered for a strong economy.

This underlines an earlier statement by Brad Graham, executive coordinator of the Smart Growth Secretariat, that a "one size fits all" approach will not work in Ontario. In all cases, however, more integrated decision-making is the key to ensuring that a range of objectives are met — from preserving farmland to providing affordable housing.

See Legislative Beat page 5